The Aver Advisory

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Life Insurance

Incontestability clauses in US versus fraudulent representations

Fondation Dixhuit v. PRUCO, 2014 WL 4230586, (U.S.D.C. , S.D. NY. No. 14–CV–2165, 2014)

Yaron Bruckner was a resident of Monaco and a citizen of both Belgium and Israel. Bruckner acquired a portfolio of life insurance policies totaling about $100 million. The portfolio was brokered by a New York agent and the policies were solicited and negotiated in New York.

One of the policies, issued by Pruco Life Insurance Company of New Jersey and delivered in New York, had a death benefit of $20 million. Fondation Dixhuit, a private foundation formed under Liechtenstein laws to benefit Bruckner's family, was the policy beneficiary. Bruckner bought the policy in question from Pruco in March 2008. Bruckner died from a brain tumor in August 2013 and Dixhuit subsequently filed a claim for the policy benefits.

After investigating, Pruco discovered that Bruckner misrepresented his medical history in his application. Specifically, Pruco learned he had undergone surgery to remove a brain tumor in 2006 and had received chemo and radiation therapy. However, on the application, Bruckner denied that he had ever been treated for or diagnosed with cancer, tumors, or any disorder of the brain or nervous system.

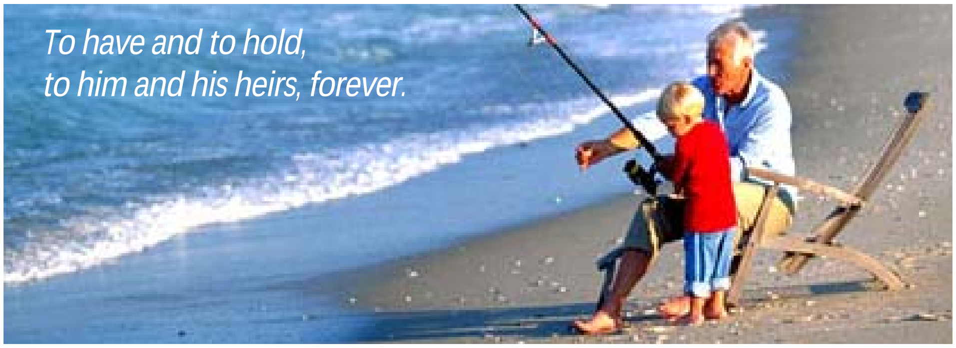
Pruco initiated proceedings in Liechtenstein, seeking a judgment that the policy was invalid due to fraud. Days later, Dixhuit filed a complaint in New York for breach of the insurance contract, claiming Pruco must pay the insurance proceeds because the policy's contestability period had lapsed by the time the misrepresentation was uncovered. The policy contains the standard incontestability clause—consistent with New York law—that reads: "we will not contest this contract after it has been in force during the Insured's lifetime for two years from the issue date."

The issue was whether an insurer can deny a beneficiary's claim to the policy proceeds if the insured applicant intentionally made material misrepresentations in the application, but that fraud is not discovered until after the incontestability period had lapsed? The outcome depends almost entirely on the law of the jurisdiction that decides the case. If it is decided that New York's law governs, an insurer win is almost impossible.

Decision. The court determined that New York had the most significant relationship to the insurance policy, and that New York law should therefore govern the dispute.

New York's public policy reasons behind the incontestability clause were to create an absolute assurance of the benefit. That interest cannot be overcome merely because the insured was a resident of a foreign country.

Commentary. This case will make history for its remarkable facts. The court's findings however are no surprise. Incontestability clauses have been used by the insurance industry in the US for over 100 years to encourage persons to purchase life insurance. Today, these clauses are required by law in most states in the US. The result of US court interpretation is that the beneficiary is protected by the incontestable clause even if an error in the application is based on a fraudulent or material misrepresentation by the applicant. The client thus gets assurance that at death the beneficiary will be the "recipient of a check and not of a lawsuit." The incontestable clause provides that assurance. ■



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Corporate Tax Planning

French Court of Appeal provides guidance on overcoming presumption of tax evasion

In Re BNP Paribas, Versailles Admin. Court of Appeal, July 18, 2013, No. 12VE04203/12VE04358

In two decisions involving French bank BNP Paribas, the Versailles Administrative Court of Appeal adopted a flexible interpretation of the evidence produced by taxpayers to prove that the principal purpose for its subsidiaries' operations was not to avoid French taxes.

Background. French corporate tax rules provide that only profits generated in France are liable to tax. Article 209 B of the *French Tax Code* introduces an exception to the territoriality principle; namely that if a French corporate taxpayer owns more than 50% of the share capital of a non-French entity (Controlled Foreign Corporation or CFC), and such non-French entity benefits from a privileged tax regime, then the French corporate taxpayer would be deemed to receive fully taxable dividends from the non-French entity.

A safe harbor rule creates an exemption from article 209 B if the French taxpayer can prove that the principal purpose and effect of the CFC structure is not to transfer profits to a tax-privileged jurisdiction. Furthermore, such evidence is deemed to be provided when the non-French entity has an effective industrial or commercial activity in the jurisdiction where it is located.

Facts. In the first case, the CFC subsidiary was based in Guernsey where it carried on private banking activity. The local effective tax rate was about 4%. Article 209 B would have been applicable unless the safe harbor rule could be invoked to protect the French bank.

BNP Paribas argued that its subsidiaries conducted a commercial business and made profits that could not have been made in France because the individual clients were attracted by Guernsey's banking and tax legislation and wished to make fiduciary deposits in Guernsey.

In the second case, the CFC subsidiary was based in Hong Kong where it was active in the currency markets of the region. The effective tax rate in Hong Kong was *de minimis*. BNP Paribas argued that the subsidiary was needed because there were constraints given the need to intervene in real time in the markets and, given their reliance on local staff which had better knowledge of the markets and intermediaries.

The position of the French tax authorities was that only the "effect" should be taken into consideration; that is, if the presence in the non-French jurisdiction enabled a reduction in tax liability, then any question about the motivation or "purpose" of such presence would be irrelevant.

Decision. Ruling in favor of BNP Paribas, the court noted that although French tax residents could have been included in the subsidiary's clients, and that funds could have been collected in France, these facts were irrelevant as article 209 B targets the motivation of the bank and not the motivation of its clients. ■

Tax Agreements

Malta-Russia Tax Treaty now in force

The *Malta-Russia Income Tax Treaty*, which was signed on April 24, 2013 in Moscow, entered into force on May 22, 2014. Its provisions will apply from January 1, 2015.

The treaty provides that if dividends are paid by a Russian resident company to a beneficial owner of a Maltese resident company, then the tax charged in Russia may not exceed 5% provided that the beneficial owner is a company (other than a partnership) that directly holds at least 25% of the capital of the payer company, and the value of the capital held is at least €100,000. In all other cases, the applicable rate is 10%.

Interest and royalties are taxable at a maximum rate of 5%. Both Malta and Russia use credits to eliminate double taxation.

Exchange of Information

Qualifying insurance products exempt from automatic reporting and information exchange

On March 28, 2014, the governments of Luxembourg and the United States signed an intergovernmental agreement (IGA) to implement the US *Foreign Account Tax Compliance Act*. The IGA provides for the exchange of information on an annual basis between the respective tax authorities, and encompasses data about account holders in each country's financial institutions who are residents of the other country.

Under the agreement, financial institutions which are subject to reporting include any specified insurance company that issues or is obligated to make payments regarding a cash value insurance contract or an annuity contract. The term "cash value insurance contract" is defined as an insurance contract that has a cash value greater than $50,000.

The agreement includes a list of products that are exempt from FATCA reporting because they represent a low tax evasion risk for US persons, including qualifying term life insurance contracts. Such term life insurance contracts refer to policies with a coverage period that will end before the insured individual attains age 90. These contracts must also satisfy the following:

• the contract must have no contract value that any person can access without terminating the contract;

• the amount (other than a death benefit) payable on cancellation or termination of the contract cannot exceed the aggregate premiums paid for the contract, less the sum of mortality expense charges for the term of the contract and any amounts paid before the termination of the contract.

As a result, such policiess are not treated as reportable. Luxembourg insurers will not need to report those policies. Nor will information regarding such US policies need to be exchanged with the Luxembourg tax authorities. ■

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CELEBRITY ESTATES

Robin Williams: Lessons in estate planning

An Oscar, two Emmys and four Golden Globe awards are proof that Robin Williams was a comic genius. He was also fairly astute with his finances having taken advantage of trusts in his estate planning. Williams' 1990 trust, which was funded by two insurance policies, contains the following provisions:

• Upon reaching age 25, Williams' eldest son Zachary receives all of the income of the trust, and the trustee shall pay or apply out of principal the amounts necessary for his health, support, maintenance and education, taking into account any other income or resources available.

• Before age 30, Zachary has a testamentary special power of appointment, exercisable in favor of his issue and their spouses, and his spouse if living with him at his death. After age 30, he has a power of appointment, exercisable both during lifetime and at death, in favor of anyone other than himself or his estate or creditors.

Williams' 2009 insurance trust includes the following provisions:

• Upon Williams' death, Zelda and Cody, the youngest children from his second marriage, each get (in trust) an amount equal to the value of Zachary's 1990 trust. The balance is then divided among the children equally, in separate trusts for their benefit.

• Until the child reaches age 21, the trustee shall provide for the child's health, education, support and maintenance. After age 21, the child receives all of the income of the trust. The children receive the principal of the trust at ages 21, 25 and 30.

Lessons. While Williams' use of the trust vehicle in his estate planning is noteworthy, some lessons can be learned.

First, Williams could have done better in foreseeing the need for additional and successor trustees. Trusts often last for a long time. Trustees die or retire, and new trustees need to be appointed. Without specific provisions, the parties will need court intervention to add a co-trustee.

Second, Williams could have done better in foreseeing the need for extended asset protection for his heirs. By distributing the income of the 1990 trust beginning at age 25, and the principal of the 2009 trust at age 30 (or upon Williams' death, if later), the trust assets will be included in the children's estates for estate tax purposes, and will be subject to the children's creditors. ■

PRIVACY

European Court of Justice declares Data Retention Directive invalid

European Court of Justice (Grand Chamber), Digital Rights Ireland, C-293/12 and C-594/12, April 8, 2014

The *Data Retention Directive* aimed to harmonize legislation of EU members regarding the retention of certain data processed by telecommunications companies. The Directive sought to ensure that the data were available for a limited time to prevent, investigate, detect and prosecute serious crimes.

The Court found that the data gathered allowed for very precise conclusions to be drawn concerning the private lives of the persons whose data has been retained.

Consequently, the Court held that the Directive interferes in a particularly serious manner with the fundamental rights to respect for private life and communications and to the protection of personal data, as enshrined in Articles 7 and 8 of the Charter.

The Court also held that the EU legislature exceeded the limits permitted by the principle of proportionality. ■

INCOME TAXATION

Guidance on writing off prestige assets used to impress prospective clients

Rockall & Anor v Revenue & Customs, 2014 UKFTT 643 TC

Facts. Gillian and Michael Rockall, who operated a high-prestige management training business, sought to write off against income tax the cost of various prestige assets used to impress their clients.

Included among such assets was a US$12 million ocean-going yacht, called the Masquerade of Sole, used for business networking meetings and for customer training. The yacht was also chartered out for profit and used to explore business opportunities in the Mediterranean.

Other prestige assets were jewelry, including diamond necklaces, worn by Mrs Rockall during need-to-impress occasions such as formal dinners fund-raising events; and some antique clocks that were kept in the firm's offices.

The Rockalls claimed the cost of these and other items against tax during the period 2000 to 2009, on the basis that they were used wholly and exclusively for business purposes. However, the UK tax authorities did not agree, and issued assessments asserting that the Rockalls' personal use of the assets made them benefits in kind, and that tax relief was not available on these benefits.

The Rockalls appealed to the First-Tier Tax Tribunal, on the grounds that the use of the assets was tax-deductible under s365 of the *Income Tax (Earnings and Pensions) Act 2003* (ITEPA).

This section requires that the item comprising the benefit in kind was used wholly, exclusively and necessarily in the performance of the duties of the employment.

Decision. The tribunal ruled that the yacht was bought and operated purely for business purposes and thus was fully tax-deductible for both the Rockalls.

However, the expenditure on jewelry and clocks was not "necessarily' incurred in the performance of the duties of employment, but rather to enable those duties to be better performed. Thus there was no entitlement to a tax deduction for these items. ■