T h e S w i s s G u a r d S o l u t i o n ™

Asset protection through Swiss life insurance policies

This analysis is applicable to all life insurance policies that have been recognized by the supervisory authority, the Federal Office for Private Insurance Matters (Bundesamt für Privatversicherung), as well as to life insurance policies linked to mutual funds and derivatives. Annuities, fixed or variable, are treated as life insurance policies under Swiss law and are exempt from Swiss taxes. It should be noted at the outset that both legal entities and natural persons may be designated as beneficiaries under Swiss law. With respect to certain annuities and insurance companies, the policyholder may be a legal entity. The person insured, however, must in all cases be a natural person.

OVERVIEW OF ASSET PROTECTION IN SWITZERLAND

Beneficiaries Are All-Important

When a person residing outside of Switzerland (hereinafter referred to as the "policy owner") purchases a life insurance policy from a Swiss insurance company and designates his or her spouse and/or descendants as beneficiaries of the policy, or irrevocably designates any other third party as beneficiary (e.g., a legal entity such as a trust), the insurance policy is protected by Swiss law against any debt collection procedures instituted by the creditors of the policy owner and also is not included in any Swiss bankruptcy procedure in this regard. Even when a foreign judgment or court order expressly decrees the seizure of the policy or its inclusion in the estate in bankruptcy, the policy may not be seized in Switzerland or included in the estate in bankruptcy.

Beware Fraudulent Conveyance

Creditors may only seize the policy or have it included in the estate in bankruptcy when the purchase of the policy or the designation of the beneficiaries is considered to be a fraudulent conveyance under Swiss law. This condition is fulfilled when the policy owner has designated the beneficiaries not more than one year before the initiation of debt collection proceedings that eventually lead to a bankruptcy decree against the policy owner or to the seizure of the policy owner‘s assets.

This condition is also met when the beneficiary has been designated with the clear intent to damage creditors or to treat some creditors more favorably than others and the designation was made within five years from the date debt collection proceedings resulting in a bankruptcy decree or in the seizure of assets were initiated against the policyholder. The creditors concerned, however, need to prove not only the policy owner’s intent—and here we can see where the law stands—but also that the beneficiary had knowledge of the intent to defraud. Clearly such an intent to defraud cannot be proved when the beneficiaries were designated at a time the policy owner was solvent and no creditors had yet asserted any claims against him or her that could have rendered him or her insolvent. When the policy owner has designated his or her spouse and/or descendants as beneficiaries, the insurance policy will be protected from claims made by his or her creditors irrespective of whether the designation is revocable or irrevocable. The policy owner may therefore designate his or her spouse and/or descendants as beneficiaries on a revocable basis and later revoke this designation prior to the expiration of the policy if at such time there are no threats from any creditors. At the expiration of the insurance policy the policyholder will be able to collect the proceeds pursuant to the policy, extend the existing policy, or roll the proceeds over into a new policy. It should be noted that if, at the time of expiration, a creditor appears or the owner becomes insolvent, a new policy would not be protected whereas an extended policy would.

Protection Even Under Duress

When an insurer receives a letter from the policy owner revoking the beneficiary designation (in connection with a foreign court order to revoke a past beneficiary designation in order to include the respective assets in a foreign bankruptcy estate), the insurer may come to the conclusion that the instruction received from the policy owner does not express the policy owner‘s true intent and was forced upon him or her by the foreign judge or court. The Swiss insurance company can only act upon orders of the owner if his or her actions are deemed not to have been made under duress. If there is any evidence that an order has been forced upon the owner, the insurance company cannot follow the instructions so issued. In such a case, the beneficiaries should inform the insurance company.

Automatic Protection in Case of Bankruptcy

In case of bankruptcy of the policy owner, protection is also guaranteed because ownership is transferred to the beneficiaries automatically. Any instructions from the original policy owner that are forced upon him or her can no longer be acted upon; only his or her beneficiaries, as the new owners, can give instructions to the insurance company.

ANALYSIS OF SWISS ASSET PROTECTION LAWS

Conditions for the Protection of Life

Insurance Policies in Swiss Debt

Collection and Bankruptcy Proceedings

According to the Swiss Insurance Act, a life insurance policy is protected from the policy owner's creditors under the following conditions.

Irrevocable Designation of Third Party as Beneficiary. According to Article 79 paragraph 2 of the Swiss Insurance Act, if the policy owner has irrevocably designated a third party as beneficiary of a life insurance policy, the policy may not be seized by the policy owner's creditors. In the cited decision, the Federal Supreme Court held the following with regard to the effects of an irrevocable designation of a third-party beneficiary:

In case of enforcement measures against the policy owner, if the designation of the beneficiary is irrevocable, there is in the estate of the policy owner no insurance claim and the policy owner has no right to revoke the beneficiary's right as normally would be the case. The creditors of the policy owner may, therefore, not seize, have listed or auction off [an insurance policy]. This principle is expressed in Art. 79 para. 2 Swiss Insurance Act according to which, if the policy owner has waived his or her right to revoke the designation, then the insurance policy may not be seized by the policy owner's creditors.

According to Article 77 paragraph 2 of the Swiss Insurance Act, the designation of a third party as beneficiary will only be considered to be irrevocable if the policy owner has waived his or her right to revoke the designation in writing and the policy is physically handed over to the beneficiary. By signing the relevant declaration and handing the insurance policy over to the beneficiary, the policy owner will meet these requirements.

Designation of Spouse and/or Descendants as Beneficiaries. If the policy owner has designated his or her spouse and/or descendants as beneficiaries of the insurance policy in question, according to Article 80 of the Swiss Insurance Act the policy may not be seized by his or her creditors unless the policy owner has explicitly granted a security interest in the policy to a creditor. The designation of the spouse and/or descendants as beneficiaries is not subject to specific formal requirements.6 Regarding Articles 80 and 81 of the Swiss Insurance Act, the Federal Supreme Court held the following:

Art. 80 and 81 of the Swiss Insurance Act provide for a special rule where the spouse and the descendants of the policy owner are beneficiaries of an insurance policy. The designation as beneficiary may no longer be revoked when the policy owner is declared bankrupt as would normally be the case in accordance with Art. 79 para. 1 of the Swiss Insurance Act. Pursuant to Art. 80 of the Swiss Insurance Act the claim against the insurer may not be subject to enforcement measures and the beneficiaries at the time when bankruptcy is declared will enter into the rights and obligations of the insurance agreement replacing the policy owner (pursuant to Art. 81 of the Act), unless they expressly decline such transfer of the agreement. Naturally, eventual liens of third parties relating to the insurance policy will not be concerned thereby (Art. 80 of the Swiss Insurance Act).

In contrast to the designation of another third party as beneficiary; it is irrelevant in the case of the designation of a spouse and/or descendants whether the designation is irrevocable or revocable. The insurance policy will also be protected from the policy owner's creditors if the designation of the spouse and/or descendants is revocable. 8 If the policy owner falls into bankruptcy or if the debt collection office certifies to his or her creditors after a seizure that the assets seized do not cover the policy owner's debts, any spouse and/or descendants who are beneficiaries of the policy will, according to Article 81 of the Swiss Insurance Act, be assigned all the rights and duties of the policy owner under the relevant insurance policy.

Rules on Fraudulent Conveyance

According to Article 82 of the Swiss Insurance Act, however, creditors of a policy owner may seize the policy even in the above cases if they can prove that the irrevocable designation of a third party or the designation of the spouse and/or descendants as beneficiaries is to be viewed as a fraudulent conveyance within the meaning of Article 285 et seq. of the Swiss Debt Collection and Bankruptcy Act. The purchase of an insurance policy and the designation of beneficiaries are considered a voidable preference under the Swiss fraudulent conveyance rules in the following cases.

Designation Made Within One Year Before Bankruptcy or Seizure. According to Article 286 of the Swiss Debt Collection and Bankruptcy Act, gifts or gratuitous settlements made by a debtor are a voidable preference when the debtor is declared bankrupt or the debtor's assets are seized within one year after the initial transaction was made. In calculating the one-year period, the duration of certain specific time periods will be added (the duration of preceding composition proceedings; the duration of a stay of opening a bankruptcy; in proceedings to liquidate an estate, the period between the date of decease and the liquidation order and the duration of preceding enforcement proceedings). Because the gratuitous designation of a third party as beneficiary under an insurance policy can be regarded as a gratuitous transfer to that third party, such a designation may be voided by the creditors if it was effected within this one-year period.

Designation Made with the Intent to Damage Creditors. According to Article 288 of the Swiss Debt Collection and Bankruptcy Act, all transactions are voidable that the debtor carried out during the five years prior to the seizure of assets or the opening of bankruptcy proceedings with the intention, apparent to the other party of putting his or her creditors at a disadvantage or of favoring certain of his or her creditors to the disadvantage of others. The five-year period may be extended by the periods of Article 288a mentioned above. If the designation of the spouse and/or the descendants or of a third party was made with the specific intent of the debtor to damage creditors and the beneficiaries knew of this intent, the designation is also voidable. To void the transfer, the creditors concerned need to prove the intent as well as the beneficiary's knowledge. It is, however, not sufficient for the proof of such intent to demonstrate that the designation took place at a time at which the policy owner was—due to his or her professional activities or investments— aware of certain risks as long as the policy owner's assets still covered all his or her debts and he or she could not foresee an insolvency.

Protection of Foreigners Who Purchase Swiss Life Insurance Policies

The following rules regarding debt collection and bankruptcy procedures against foreigners in Switzerland apply only to assets located in Switzerland. It is important to note that the rights under an insurance contract between a foreigner and a Swiss insurance company are, according to Swiss law, deemed to be located at the domicile of the Swiss insurance company. If the policy owner's and the beneficiaries' rights are embodied in a policy that must be considered as a security, however, a creditor could claim that the security could be seized in accordance with the debt collection and bankruptcy rules of the country in which the security is deposited, because securities normally are subject to the debt collection and bankruptcy law of the country in which they are deposited. This problem, however, can be avoided if the insurance policy is deposited in Switzerland.

Debt Collection and Bankruptcy Procedures Against Foreign Debtors. According to Article 275 of the Swiss Debt Collection and Bankruptcy Act, only assets that a creditor can seize in a debt collection procedure can be attached. Because this principle also applies to foreign debtors, a Swiss insurance policy purchased by a foreigner is protected under the conditions set forth above. Therefore, if creditors do not file for an attachment but rather for the recognition of a foreign bankruptcy decree, the insurance policy is nevertheless protected. According to Article 170 IPRG, the debtor's assets in Switzerland will be auctioned off for the benefit of his or her creditors in accordance with Swiss bankruptcy rules. The rules in Article 79 Section 2 and Article 80 VVG described previously are part of these rules.

Because debt collection and bankruptcy procedures in Switzerland are always based on Swiss bankruptcy rules alone, and these rules include Article 79 Section 2 and Article 80 VVG, life insurance policies are protected in accordance with Swiss law in such procedures, even when the debt collection or bankruptcy law in the debtor's domicile would not afford him or her such protection. In particular, according to Article 171 IPRG, only the Swiss rules on fraudulent conveyance apply, so the designation of beneficiaries cannot be avoided by creditors unless they prove that the conditions for fraudulent conveyance described previously are met, even if the purchase or designation was a voidable preference under the fraudulent conveyance rules applicable in the debtor's domicile.

The creditors of a person residing outside of Switzerland, therefore, may not in Switzerland seize or include in the estate in bankruptcy any life insurance policies that are protected under Swiss law even if they have a judgment or a bankruptcy decree that is enforceable in Switzerland, unless they can prove that the designation of the beneficiaries of the insurance policy is a voidable preference under Swiss fraudulent conveyance rules.

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Revocation of Beneficiary Designation by Order of Foreign Judge. A foreign judge or court may order a policy owner to revoke a past beneficiary designation in order to include the respective assets in the foreign bankruptcy estate. To comply with such an order or judgment, the policy owner may inform the insurer that he or she revokes the prior beneficiary designation. The question arises whether under Swiss law the insurer has to comply with such an instruction by the policy owner, which was forced upon him or her by a foreign judge or court.

In the event of an irrevocable designation of a third party under Article 79 Section 2 VVG, an insurer will not comply with the instruction by the policy owner because this would contradict the irrevocability of the beneficiary designation.

In the event of a revocable designation of the spouse or descendants, the spouse and descendants of a policy owner automatically succeed into the rights and obligations arising from the insurance contract at the moment when the policy owner is declared bankrupt, unless they expressly object to such succession. The spouse or descendants have to inform the insurer accordingly. Therefore, if the foreign policy owner has been declared bankrupt previously and later instructs the insurer that the beneficiary designation is revoked, the insurer will refuse to comply with such an instruction because at this time the rights and obligations arising from the insurance policy were already assigned to the beneficiary. In this context, it is important to make sure that the insurer in fact knows about the foreign bankruptcy decree and that the beneficiaries inform the insurer of their succession under Article 81 Section 2 VVG. Moreover, if an insurer receives a letter from the policy owner revoking the beneficiary designation, the insurer may come to the conclusion that the instruction received does not express the policy owner‘s true intent and was forced upon him or her by the foreign judge or court.

Under Article 18 of the Swiss Code of Obligations (CO), in case of a discrepancy between the real intent and the intent expressed in writing, a person who receives such a writing and knows that it does not express the real intent normally has to follow the real intent and ignore the writing. Although there is no court precedent dealing specifically with this situation, it is a general principle of Swiss law that a person who receives a written declaration of another person has to give the declaration the meaning that complies with the real intent of that person, if he or she knows the real intent. In other words, if an insurer receives a writing from a policy owner that he or she knows does not reflect the real intent, it can and has to ignore the writing.

TREATMENT OF FOREIGN ANNUITIES
UNDER U.S. TAX LAW

No Excise Tax

Unlike many other foreign annuities, Swiss annuities are not subject to the 1 percent U.S. excise tax on the purchase of foreign annuity and insurance premiums. This is a by-product of the adoption in 1998 of a new Swiss-U.S. Double Tax Treaty and applies to premiums paid by a U.S. citizen to an insurance company domiciled in Switzerland.

Income on Foreign Fixed Annuities Can Be Taxable

Most foreign fixed annuities are no longer tax deferred in the United States (see Internal Revenue Service regulations, “Tax Treatment of Certain Annuity Contracts," Internal Revenue Code (Code) Sections 163(e) and 1271 through 1275). Under the rules of Code Section 1275, a Swiss fixed annuity is a debt instrument, that is, a ,,promise to pay a sum certain,“ in addition to being an insurance contract. Accordingly, the owner of a Swiss fixed annuity (as well as other foreign annuities that are seen as debt instruments) pays tax on the income that accrues, including currency gains if the annuity is denominated in a foreign currency.

Most tax experts agree that as a result of the loss of tax deferral, distributions prior to age 59 1/2, including loans against the policy, are not subject to the 10 percent penalty for early withdrawals. Thus it is possible to take tax-free withdrawals from a Swiss fixed annuity whenever the policyholder chooses.

Income on Foreign Variable Annuities Can Be Tax Deferred

Death Benefits in Policy Do Not Make It a Debt Instrument. The inside buildup of a foreign variable annuity continues to be tax free. The death benefits included in the policies do not make the annuities ,,debt instruments“ (promises to pay a sum certain) and, therefore, are not tax deferred under Code Section 1275. They do not constitute debt instruments because they promise to pay a designated sum only if the owner dies. There is no guarantee of a particular sum if the owner cashes in the policy while he or she is alive.

In addition to the above criteria for determining whether a variable annuity is a debt instrument, two further conditions need to be met for tax deferral.

1. The Variable Annuity Must Not Be Self-Directed. The income from a variable annuity is tax free if the owner (or his or her adviser) is not managing the investments himself or herself (a so-called "self-directed" annuity). Owners are permitted to choose investment categories, but under the self-directed annuity rules they may not choose the actual investments. If they do, they are treated as the owners of the underlying assets and the income generated by those assets is taxable.

2. The Variable Annuity Must Be Adequately Diversified. Finally, the inside buildup of variable annuities is tax free if the underlying portfolio is adequately diversified as defined in the U.S. tax code. An account meets the "diversification rule" if

a. No more than 55 percent of the value of the total assets of the account is represented by any one fund;

b. No more than 70 percent of the value of the total assets of the account is represented by any two funds;

c. No more than 80 percent of the value of the total assets of the account is represented by any three funds; and

d. No more than 90 percent of the value of the total assets of the account is represented by any four funds.

To make certain that variable annuities comply with the diversification rule at all times, portfolio rebalancing is required on at least a quarterly basis.

The tax-deferred status of Swiss variable annuities has consequences for early withdrawal just as do U.S. contracts. Swiss variable annuities, however, offer a combination of asset protection, a choice of asset allocation strategies based on an investor's risk profile and other needs, and tax deferral for U.S. investors. This makes them ideal long-term investments that can harness the power of compound growth for a retirement portfolio.

One of the concerns many practitioners have had concerning the use of Swiss annuities was that in cases of large annuities and/or annuities purchased by large estates, the designation of the spouse and/or children as beneficiaries of the annuity usually would not be consistent with a sound estate plan. Therefore, although the asset protection aspect of the annuity was attractive, the estate planning limitations were a hindrance. Now that it is clear that an „entity“ can be named as irrevocable beneficiary of a Swiss annuity on the annuitant's death the estate planning concerns could be eliminated by naming the individual's estate planning trust as the beneficiary. Note, however, that if a nongrantor trust is named as the lifetime owner, the tax deferral (for variable annuities) will be lost because of the application of Code Section 72(u).

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