



By Edward J. Finley II & Michael Liebeskind

Private Placement Variable Annuities

A powerful tool to address income tax planning uses for high-net-worth individuals

I ncreasing taxes on the wealthy is very much part of the national dialogue. Most believe it's inevitable that marginal income tax rates will go up, especially for the clients we typically advise. At a minimum, there will likely be higher taxes on dividend income and, perhaps, all investment income. And, things like the charitable income tax deduction seem perilously at risk.

The federal government is very focused on raising revenue, especially from Americans living abroad (evidenced by the Foreign Account Tax Compliance Act (FATCA) and other new reporting requirements). Sophisticated investment vehicles tend to generate investment gains that are subject to the highest effective tax rates. And, especially relevant for foundations, many sophisticated investment vehicles generate unrelated business taxable income (UBTI). Most high-net-worth individuals can shelter a paltry amount of their retirement savings from income tax, making it all the more difficult to achieve their retirement objectives. Taken together, these trends create significant income tax planning challenges for high-net-worth clients.

Advisors should consider using private placement variable annuities (PPVAs) to address these issues. A powerful yet simple tool compared to other planning alternatives, PPVAs are often overlooked. We'll explore the opportunities for using PPVAs, as well as the mechanics for implementing them.

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What It Is

A PPVA is an annuity that's been stripped down to its most basic element: gains are deferred from current period taxation (PPVA investment accounts).

What It's Not

- 1. It's not a retail annuity.** PPVA isn't a traditional annuity product. Most advisors are familiar with the high cost and limited investment choices of these products. PPVAs don't have the often expensive bells and whistles of retail annuity products, such as income guarantees or protection of principal in the event of premature death (which generally add an incremental fee of 100 basis points (bps) to 200 bps annually). Instead, PPVA investment accounts generally have no upfront commission loads or premium tax charges, and assets can remain invested until a client chooses to take a one-time distribution or systematic payments over a specified period of time (often referred to as annuitization). The client isn't required to begin taking distributions until he reaches age 95 or 100, at which time most insurance companies require the account to be liquidated over a period no longer than 30 years.
- 2. It's not a contrivance.** PPVAs are specifically authorized under Internal Revenue Code Section 72. The Internal Revenue Service has repeatedly considered and ruled favorably on PPVAs, and, in 2008, issued clear safe-harbor guidelines for how investment funds offered within PPVA investment accounts (which are referred to as "insurance-dedicated funds" or IDFs) must be structured and administered to qualify for favorable tax treatment.¹ The client may make deposits into the PPVA investment account in any amount and at any time.