The Protecting Proper Life Insurance from Abuse Act

Background: Private Placement Life Insurance (PPLI) policies are a type of shelter used by the ultra-wealthy to avoid taxes on investment income. PPLI policies are related in name only to the typical life insurance policies commonly held by middle class families. They are exclusively available to ultra-wealthy individuals, and they make up just 0.003 percent of all outstanding life insurance policies. PPLI contracts allow the ultra-wealthy to hide behind the longstanding preferential tax treatment of life insurance, behave as sophisticated investors, and avoid paying a fair share in taxes.

This draft legislation was prepared in connection with the report, "Private Placement Life Insurance: A Tax Shelter for the Ultra-Wealthy masquerading as Insurance," issued by the Finance Committee on February 21, 2024, which found that the PPLI industry has helped ultra-wealthy policy holders shelter at least $40 billion.

Solution: In order to protect the tax treatment of traditional life insurance from further abuse, the draft *Protecting Proper Life Insurance from Abuse Act* (*PPLI Abuse Act*) would separate PPLI policies from traditional life insurance and deem them "Private Placement Contracts" (PPCs). Under the legislation, a policy taken out by a wealthy investor would be considered a PPC if it is backed by an insurance company asset account that supports fewer than 25 contracts held by other individual investors. The definition would apply not only to PPLI but also to private placement annuities. The discussion draft includes rules providing that contracts owned by related parties would be aggregated to determine whether the arrangement meets or fails the 25-investor requirement, and the Treasury Department would be granted authority to prevent other circumvention. The proposal would also define contracts issued by foreign insurers to US purchasers.

The *PPLI Abuse Act* stipulates that a PPC would not be treated as a life insurance or annuity contract under the Internal Revenue Code. This means that the earnings and losses of the separate account that supports the PPC would be taxed to the contract holder as they are earned each year. The proposal would disqualify PPCs from enjoying the protected inside build-up that is a tax benefit of traditional life insurance and annuity contracts. Since the PPC is not a life insurance or annuity contract, the proposal includes a rule that the issuing insurance company would not be permitted to include the reserves related to the PPC in their life insurance reserves, it would receive no deduction for the reserve held to support the PPC, and reserves would not count as life insurance reserves for purposes of testing whether the issuing company qualifies as a life insurance company. Rather the reserves would be subject to general accrual tax principles. The death benefit paid under a PPC would be taxed. The rules for PPCs would apply to existing contracts as well as new PPCs, with a 180-day transition rule for policies existing on the date of enactment to allow holders of PPCs to convert them to traditional insurance policies before they are subject to the new PPC rules.

In addition to defining PPC and setting forth the tax consequences of owning and issuing such a contract, the draft legislation would create badly-needed reporting requirements. An information return would be required when a contract becomes a PPC, either upon issue or conversion to a PPC. Failure to file this return would result in a $1 million fine for each 30 days that the report goes unfiled. Moreover, the appropriate insurance commissioner and the SEC would be informed about the failure to report. Annual reporting would be required each subsequent year, although there will be no enhanced penalties. The proposal would also make necessary modifications related to reporting requirements under the Foreign Account Tax Compliance Act to prevent the growth of foreign PPLI tax shelters.

The proposal would be effective on the date of enactment and apply to PPC's issued before, on or after that date.