

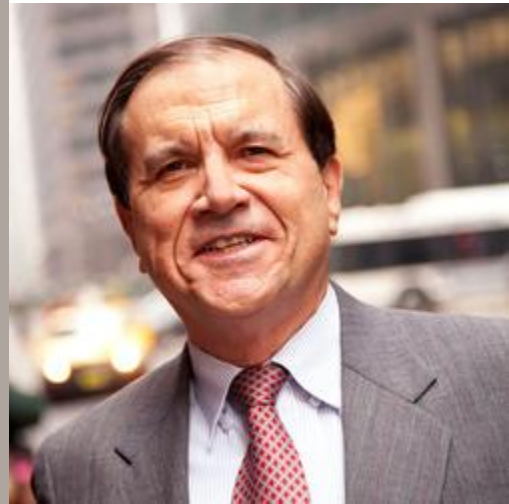
Bright Future for ICCs

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Now that protected cell companies (PCCs) are firmly established in numerous offshore and onshore domiciles, the next generation – incorporated cell companies (ICCs) – are emerging as an enticing variant in a rapidly expanding number of jurisdictions. Leading the way offshore has been Jersey, with Malta, Guernsey and soon the Cayman Islands following. Similarly, the District of Columbia together with Delaware pioneered the concept onshore with Vermont and Montana, among others, enacting facilitating legislation last year.

So what is the difference between a PCC and an ICC?

Generally, the structural framework is the same with a single core (called the 'general account' offshore) and any number of cells attached. The critical distinction is that an incorporated cell (IC), unlike a protected cell (PC), is a separate juridical person with all the legal attributes of any other corporation formed in the relevant domicile.



Advantages of using ICCs and ICs

Several key benefits, characterised largely as greater certainty of outcome, are inherent in IC structures.

Segregation: First, regarding segregation of a cell's assets and liabilities, it is often stated the IC walls are higher and thicker than those of a PC. What that means legally is that to break IC segregation, 'piercing the corporate veil' must be accomplished by applying traditional legal principles. This 'piercing' test is quite stringent – generally merely respecting corporate formalities (holding requisite board meetings, paying annual government fees, for example) and keeping track of corporate assets and liabilities is all that's required to uphold corporate limitation of liability (i.e., segregation). The judicial test of upholding segregation in the PC world is not yet well defined (although a Bermuda court recently indicated it would honour PC segregation in the absence of fraud).

Which leads to another advantage – the corporate piercing test applies in most legal jurisdictions around the world. In contrast, most commentators properly observe that PC segregation is assured only if the segregation challenge occurs in the jurisdiction that has enacted the cell legislation under scrutiny.

Contracts between cells: Second, in some jurisdictions the IC structure solves the limitation regarding cells' inability to contract with one another. The legal dilemma is how can a single entity contract with itself to create a valid and binding agreement? Bermuda's statute went to great lengths to address this concern using trust principles, the District of Columbia's statute simply states that inter-cellular contracts are valid and binding without addressing the conceptual dilemma and Cayman lawyers refuse to opine that this type of contract is enforceable. Using ICs, of course, eliminates the issue entirely.

Federal taxes: Third, ICs clarify the US federal tax status of offshore cell structures. Treasury regulations proposed in September of 2010 drew a sharp distinction between the proper tax characterisation of domestic and foreign cells. Specifically, for domestic cell companies and series LLCs, each cell or series will be treated as a separate taxpayer and thus will file its own returns and make its own tax elections. In contrast, for foreign cells the regulations are very narrow. Only if the cell, considering just the activity occurring in that cell, constitutes an insurance company under applicable tax principles will it be treated as a separate taxpayer. The regulations refuse to characterise foreign cells not qualifying as insurance companies on a standalone basis due to, for example, lack of risk shifting or insufficient risk distribution. Worse, in many cases it's not completely clear whether a PC will pass all the insurance offshore PC is in limbo, in contrast to that same PC clearly being a separate taxpayer had it been formed onshore as part of a domestic cell company. Again, ICs come to the rescue. Because foreign ICs are indistinguishable in

legal format to foreign corporations, it would seem axiomatic that they will be respected by tax authorities as separate taxpayers notwithstanding their being part of an ICC structure. This is a benefit for federal tax clarity and seems to be a significant motivator for offshore domiciles to enact an ICC/IC option.

“All arrows point in the direction of an exponential future use of incorporated cells in a growing number of domiciles enacting enabling ICC statutes” – Tom Jones

Governance: Fourth, ICs as separate corporations have their own boards of directors. While some jurisdictions like Jersey have required that each IC board be comprised of the same individuals as the core board, most jurisdictions do not. Thus, in the District of Columbia, for example, different cells can have different persons acting as directors who also can differ from the core’s directors. In fact, in DC a cell company can create a hybrid structure in which some of the cells are PCs and others are ICs. This flexibility can support structures unavailable to a PC only format.

Two illustrations follow:

- A global construction company engages in numerous mega-projects with large joint venture partners. It proposes an OCIP or CCIP programme to roll up each project’s risks into a separate risk pool. But the JV partner requires direct governance input as a condition of agreeing to participation in the insurance programme. Only an ICC structure will address this factual scenario. As is typical, each project will be placed in a separate cell. But a ‘regular’ cell company doesn’t work because the construction company won’t allow the JV partner to have a representative on the cell captive core board. (That board oversees many projects in which the JV partner is not involved.) Using an IC solves the problem. The JV representative is placed on the relevant IC board and the insurance program proceeds. In this case, other cells not requiring outside board representation can be formed as PCs because this ICC is domestic (and thus escapes the offshore PC tax ambiguity).

- A healthcare system maintains two offshore captives in the same domicile, originally not combining them due to the distinct differences in their parent hospital affiliates. One is a specialized childrens’ hospital and the other a general all-specialty community hospital. Each captive has a separate board of directors expert in the medical professional liability exposures inherent in operating that particular type of hospital. Once ICCs become available in the domicile, however, the two captives plan to convert to two ICs and continue the same separate board structure as previously, but attached in a single ICC.

Portability: Finally, although both PCs and ICs legally can “hive off” from the core and become a standalone captive, with a pre-existing corporation having its own articles of incorporation, bylaws, board of directors, etc. an IC could do so with less disruption than would occur in a PC separation.

Disadvantages of using ICCs and ICs

The list of drawbacks is quite short, compared with the list of benefits. The drawbacks include:

Increased regulatory formalities: Some domiciles issue an umbrella licence to the ICC which covers all its affiliated cells while others require a separate licence for each IC. The latter generally means greater licence application and subsequent annual fees. Either way, a more critical element is whether a PC is regulated with a ‘lighter touch’ than an IC. At this point no clear answer seems to have emerged, although a strong argument exists for regulating PCs and ICs to the same degree and standards.

Domicile taxes: Some domiciles in effect favour PCs by treating them collectively as a part of a single cell company whereas those same domiciles treat each IC as a separate taxpayer. Thus, for purposes of applying the minimum or maximum domicile premium tax amounts or the downward sliding scale of tax rate percentages an IC structure will end up paying more domicile tax than a PC structure. Those domiciles’ justification usually is that the increase in fees is warranted given the issuance of multiple insurance licences. The District of Columbia is in this category. The good news is that the rate of tax is just a fraction of a per cent. Vermont, on the other hand, treats the ICC and any number of its connected ICs as a single entity for purposes of its premium tax.

Detrimental effect on PC segregation: Concern has been expressed that creating an alternate IC regime may negatively impact the outcome of a court determination of the efficacy of a PC structure under creditor attack. Inserting legislative history to the effect that creation of an IC structure in no way should be misinterpreted to weaken the strength of PC cell 'walls' would seem to address that concern. In closing, weighing the foregoing factors, plus comparing the familiarity of the corporate form with the unfamiliarity of a cell appended to a corporation, all arrows point in the direction of an exponential future use of incorporated cells in a growing number of domiciles enacting enabling ICC statutes.

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