THE LAW FIRM OF ALEXANDER A. BOVE, JR., P.C.

Firms with big insurance bills are finding a place in the sun.

Few readers of John Gresham's "The Firm" were surprised to find that Bendini Lambert & Locke chose the Cayman as a hiding place for its clients' funds. In fact, the Cayman Islands seems to have built a reputation second only to Swiss bank accounts when it comes to hiding money from the tax authorities.

Its true the Cayman Islands is regarded as a tax haven, but just what does that mean? Generally it means that for residents of the Caymans and for most transactions local to the island, there are no taxes. No income tax, no capital gains tax, no sales tax, no inheritance tax or estate tax.

But if a US taxpayer does not report the interest earned by a Cayman Islands bank account, he could go to jail for tax fraud (wasn't that one of the reasons the FBI was chasing Bendini Lambert & Locke?). So what is the attraction of the Caymans? It is certainly not its asset protection laws. Of all the foreign jurisdictions (now referred to as offshore financial centers) that offer laws favorable to protection against creditors, the Cayman Islands is far from the No. 1 choice, according to Colorado lawyer Barry Engel, an expert in asset-protection planning. For one things, he says, the Cayman Islands has a six-year statue of limitations, within which a creditor can sue after a transfer of assets, while the Cook Islands, for example, limits the period to two years.

In short, for the individual US taxpayer, the Cayman Islands has little attraction, except, perhaps, as a nice place to vacation. For the business person, however, jurisdictions like the Cayman Islands often allow the formation of corporations with nominee shareholders or bearer shares. Such shares are unregistered and can be instantly transferred simply by delivering the shares to someone. Theoretically, at least, if no US taxpayer owned these shares, neither the taxpayer nor the corporation would have to pay tax on corporate earnings that remained in the corporation. If you're thinking this smacks of a risky scheme, you're absolutely right. If your money or assets are placed in such a corporation, it is likely the stock will be treated as yours for tax purposes, with the attendant US reporting requirements, regardless of the local secrecy feature.

Nevertheless, one of the most common, rapidly growing and totally legitimate uses of the Cayman Islands is for offshore insurance companies. Although the details are complicated, the basic concept is that a business that has huge insurance costs for health, malpractice, workers' compensation or other coverage may find it profitable to form its own insurance company (often called a captive) and pay those huge premiums, in a sense, to itself.

To provide for protection against large losses or payouts, the captive will reinsure portions of the risk, so its loss is limited. In fact, many large Boston medical groups and institutions, whose names we would instantly recognize, have formed captives to provide their own malpractice insurance coverage. Similarly, many large businesses have formed captives to provide workers' compensation or other coverage. Although there are few tax benefits (the IRS has ruled that payments to your own captive that has the parent as its only customer are not deductible), the longer-term savings and investment benefits can be quite substantial.

According to John Schroeder, a vice president of Johnson & Higgins in Boston, a firm that helps organize and manage captives, "insurance companies make their money not from the premiums, but from the use of those funds until they are eventually paid out. Just having the investment proceeds of, say, $3 million of premiums over four to five years can easily produce a $1 million profit for the captive, after operating expenses." John Covelli, president of Andrew-Anthony Companies in Framingham, also specializing in design of insurance captives, agrees, And, he says, "a well-designed captive can also produce underwriting profits."

While Bermuda was once the most common choice for offshore insurance captives, the Cayman Islands is rapidly catching up, perhaps because its laws and government are, according to Schroeder and Covelli, a little more flexible. In both, capitalization and regulatory requirements are far less stringent than those of most US states, although still carefully designed to protect the insured and the public. And besides, Covelli says, the officers and directors get to take one or more tax-deductible, all-expense-paid trips there each year to "take care of business."

This article by Alexander A. Bove Jr. appeared in the Boston Globe, December 15th, 1994.