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TEN TREMONT STREET, SUITE 600 – BOSTON, MASSACHUSETTS 02108
Telephone: 617.720.6040 – Facsimile: 617.720.1919
www.bovelanga.com

Firms With Big Insurance Bills Are Finding A Place In The Sun

By Alexander A. Bove, Jr.

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When Mitch McDeere accepted a position as a tax lawyer with the firm of Bendini, Lambert and Locke he had no idea what was in store for him. He did know it was an offer he couldn't refuse, and his eagerness was further fortified by the fact that “most of the partners retired in their late forties or early fifties with money to burn --- and a guaranteed six figure income for life.” To his dismay, Mitch later found out, as author John Gresham relates in his gripping novel, “The Firm”, that the firm's money was obtained illegally and stashed in The Cayman Islands.

Few of “The Firm's” readers were surprised to find that Bendini, Lambert and Locke chose the Caymans as a hiding place for the tens of millions of dollars of their client's funds. In fact, the Cayman Islands seem to have built a reputation that is second only to Swiss bank accounts when it comes to hiding money from the tax authorities. Is this reputation deserved? Do the Caymans really offer such secrecy and tax benefits that more of us should think about moving our money there?

It's true that the Caymans is regarded as a “tax haven”, but just what does that mean? Generally it means that for Caymanian citizens and permanent residents, and for most transactions local to the island, there are no taxes. No income tax, no capital gains tax, no sales tax, no inheritance or

estate tax, - no tax! But only as to the Caymans. For instance, a US taxpayer could deposit, say, a million dollars in one of those famous Cayman bank accounts, receive \$50,000 interest and pay no tax on the interest.

No Cayman tax, that is. If that taxpayer does not report the “foreign” bank account on his US tax return and pay a US tax on the interest, he could go to jail for tax fraud (wasn’t that one of the reasons the FBI was chasing Bendini, Lambert and 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 number one choice, according to Colorado attorney Barry Engle, a recognized expert in asset protection planning. “For one thing”, he says, “the Caymans has a six year statute of limitations (the period within which a creditor can sue after a transfer of assets), while the Cook Islands, for example, limits the period to only two years.”

In short, for the individual US taxpayer the Cayman Islands have little attraction, except, perhaps, as a nice place to vacation. For the business person, however, it may be a different story - even Bendini, Lambert and Locke recognized this. That firm had established numerous Cayman Islands corporations among which they would shuffle client’s funds. 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 Caymans is for offshore insurance companies. Though the details are far more complicated than

can be explained here, the basic concept is that a US (or other) 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 re-insure 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 comp or other coverage. Although there are few tax benefits (the IRS has ruled that payments to your own captive which 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 and 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, three million dollars of premiums over four to five years can easily produce a million dollar profit for the captive, after operating expenses.” And John Covelli, president of Andrew-Anthony Companies in Framingham, also specializing in design of insurance captives, agrees, adding that “in addition to the investment benefits, a well-designed captive can also produce underwriting profits.”

While at one time Bermuda was the most common choice for offshore insurance captives, the Caymans is rapidly catching up, perhaps because its laws and its government are, according to both Schroeder and Covelli, “a little more flexible”. In both jurisdictions, 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 board of directors get to take one or more tax-deductible, all-expense paid trips there each year to “take care of business.

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