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IN199: Use of a Protected Cell Company to Fund an Employee Benefit Trust

The island of Guernsey pioneered the cell company concept by introducing the Protected Cell Company (PCC) in 1997. This enhanced the cost effectiveness of self insurance for a number of companies. It effectively extended the "captive concept," which had previously only been a realistic option for large multi-nationals, to small and medium sized enterprises (SMEs).

The success of this innovation is illustrated by the fact that the cell company is now used widely across the financial service world as an alternative approach for the structuring of products.

Guernsey's Innovative Approach

Guernsey is the jurisdiction with the greatest experience in utilising the PCC concept and during the past decade has established a wealth of expertise relating to cell companies.

As well as adopting the innovative Incorporated Cell Company (ICC), Guernsey has also, through legislative advancements, developed a regulatory infrastructure that enables a particularly wide application of the cellular company concept.

PCCs and ICCs can be formed in Guernsey, to conduct any type of business that would otherwise be undertaken through a conventional company.

Protected Cell Companies in More Detail

A PCC is a single legal entity made up of individual "cells" that can be used to undertake the business activities of many different clients.

A cell(s) within a PCC may be owned solely by the PCC owner(s) or individual cells can be owned by third parties.

Each cell has its own capital and the assets and liabilities of each cell are ring-fenced by law from the liabilities attributable to any other cell.

A PCC has two classes of shares: core and cellular. The core capital is issued to the PCC's owners and attracts voting and distribution rights, but only over the core capital. Cellular shares, in the form of redeemable preference shares, are issued to each cell owner. Cellular shares have limited status, no voting rights, and distribution rights only applying in respect of the specific cell's activities.

A PCC is a third party company, and the control of activities in a PCC cell is divested by management contract. In practice, the directors of the PCC would not take action against the wishes of the owner(s) of any of the individual cells. This divestment of control can help to increase tax efficiencies.

Advantages of Protected Cell Companies in Relation to Insurance Activities

Cells within a captive insurance PCC offer similar advantages to the benefits enjoyed by a captive insurance company. A cell behaves in the same way as a wholly owned captive insurance company with respect to its underwriting activities and, as with a captive insurance company a cell remains exposed to potential losses for the risks retained.

Additional advantages are available through the use of a cell within a PCC compared to a wholly owned captive:

- There is no minimum capital requirement of £100,000
- Operating expenses and start up costs are lower
- There is the potential to segregate profits from the parent company's accounts
- Possible Controlled Foreign Company advantages (25% rule, see below)

Additional Potential Advantages of Protected Cell Companies

• Deductibility for Tax Purposes

Insurance premiums paid to external insurance companies, are normally regarded as a standard business expense and, as such, are allowable as a deduction for tax purposes. This applies to the insurance premium tax (IPT) as well as to the premiums themselves.

Similarly, premiums paid to a captive insurance company are deductible for tax purposes, provided that the amounts

in question are not excessive (that is the premium would be in line with or lower than the comparable market rate) and there is a genuine transfer of risk.

Premiums paid to insurers attract IPT. The rate currently chargeable in the UK is 6% although certain classes, including travel, are exceptions to this general rule. Self-insurance premiums paid to a captive would attract IPT. This would not however apply if the premiums were the reinsurance of an authorised insurer in the UK, reinsurance premiums attract zero IPT.

• **Controlled Foreign Company Regulations: UK Example**

For many years UK Controlled Foreign Company (CFC) regulations required that 90% of the profit of a non-UK company, controlled by a UK entity, and which is subject to a lower rate of tax, must be repatriated to the UK parent within an 18-month period following the end of each financial year. Such profits were then subject to UK taxation.

In addition, the profits of the non-UK company would be computed in the same manner as if the company were UK domiciled and subject to UK accounting practices. Many captive insurance companies and PCCs are subject to this regulation.

The 2009 Budget and subsequent Finance Bill have created changes to these rules. New legislation treats foreign and UK dividend distributions in the same manner. The previous 90% distribution increases to 100% and the 18 month deferral period is removed. These changes came into effect from 1st July 2009.

A cell (established within a third party owned PCC) may fall outside the onerous CFC rules. This is provided that the cell owner(s) enjoys less than a '25%' interest limit in the total profits generated by the PCC as a whole.

Use of a Protected Cell to Fund an Employee Benefit Trust

A PCC (or cell) can be used for self-insurance and for the funding of a company's Employee Benefit Trust (EBT).

The company forms an EBT which in turn takes entitlement to the profits of a cell in an existing PCC. This cell is used to self-insure the company. Premiums are paid into the cell and the cell then re-insures in the wholesale market. Profits that accumulate in the cell are then available to be paid as distributions to the EBT and may then be paid out in accordance with the terms of the EBT or held for future distributions (for example when an employee retires outside of the UK).

This has the effect of converting corporate profits into individual employee benefits in a tax efficient manner. In this way, legitimate business expenses (the company's insurance premiums) can be used to fund an EBT.



Additional Information

If you would like further information regarding Protected Cell Companies and the benefits that they can provide, please contact John Nelson at Dixcart in Guernsey on 01481 723996 or email john.nelson@dixcart.co.gg

□ Filed under [Type](#), [Information Note](#), [Topic](#), [Captive Insurance](#), [Jurisdiction](#), [Channel Islands](#)

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