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The Extended Use of Protected Cell Companies in International Tax Structures

Protected cell companies ('PCC') were first introduced by Guernsey in 1997 and have, for several years, been widely used in international tax structures. Initially developed for insurance arrangements they are now popular investment fund vehicles and are available in most of the offshore financial centres. The PCC concept was broadened (and some would say enhanced) through the introduction by Jersey in 2006 of the Incorporated Cell Company – now replicated in other jurisdictions.

Milestone has advised on the use of PCCs in various structures, some of which are summarized below.

To Counter Controlled Foreign Company Rules

The UK has anti-avoidance legislation that attributes the gains of a non-UK close company to UK resident participators. A close company is defined as being one that is under the control of 5 or fewer people. As an example, a UK resident may want to hold investment assets via a BVI company. When the BVI company sells the underlying investments any gains will be taxed on an arising basis in the hands of the individual – the BVI company is essentially "looked through".

If structured correctly a PCC can blunt the application of these anti-avoidance provisions. The individual is then able to contribute capital to his cell to fund the investment objective. Any gains realised by the cell will only be taxed once distributed to the individual allowing gross re-investment.

Similar deferral benefits can be achieved for individuals resident in other high tax jurisdictions with similar CFC-type laws (e.g. South Africa).

Life Assurance / PPB Holding Structure

A PCC can also be used in conjunction with a Personal Portfolio Bond ('PPB') to mitigate adverse consequences on exit. Despite their punitive tax treatment in the UK, there are occasions when a PPB works well for UK residents, particularly domiciled individuals.

For example, a UK resident and domiciled individual could structure their PPB as follows – the policyholder elects to pay a nominal premium into the bond and accept that it is a PPB for UK tax purposes. The primary investment made by the PPB would usually be shares in a private company that would, in turn, invest in real estate, subsidiary company shares, hedge fund investments and other esoteric investments such as fine art and wine. However, in many cases the policyholder will not want nor be able to leave the UK at a time when it is desirable to liquidate the investment structure.

In these circumstances, a 40% tax rate would apply to any encashment proceeds. This is extremely inefficient as the underlying assets may well have suffered 18% capital gains tax had they been held directly. In order to structure a less punitive exit, the PPB could be held via an offshore PCC, potentially resulting in an effective tax rate of 18%.

As a Holding vehicle for Swiss Companies

Many Russian and Eastern European clients have begun to shy away from Cyprus as the traditional "bolt-hole" for offshore investment structures. The 'kudos' of Switzerland and its perceived flexible and beneficial tax regime have led to a significant number of Russian individuals establishing Swiss holding companies for investment and trading activities. The ability to negotiate beneficial tax rulings and the absence of CFC legislation make Switzerland an ideal location.

Yet, one issue often overlooked is the draconian 35% withholding tax on distributions out of Switzerland. This can be reduced if the shareholder of the Swiss company is an EU company or resident in a jurisdiction that has concluded a favourable double tax agreement with Switzerland. However, for the treaty benefits to apply, it is vital that the shareholding entity has real substance, infrastructure and a business activity connected with the activities of the Swiss company. Without this it is very unlikely that the dividend withholding tax will be reduced.

For many clients, achieving the substance required by the Swiss authorities is impossible. By structuring the ownership of the Swiss company via an EU resident PCC that has the requisite substance, the ability to extract profits from Switzerland without 35% withholding tax is achievable.

The Private PCC

Traditional offshore trust structures for private clients can often develop into myriad different entities in numerous jurisdictions. A PCC owned by an offshore trust can help simplify and consolidate a typical structure that might otherwise include wholly-owned special purpose vehicles for cash deposits, property portfolios and other investments such as private equity.

If you would like to discuss how a PCC structure might assit your business, please contact us on info@milestonetax.com

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