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Deloitte Tax Challenge 2008

Team Category – Finals

Your team of tax consultants has been invited by Mike Caceras, the new Chief Financial Officer of a Malaysian oil and gas contractor, Oilpipes International Sdn Bhd ("OISB"), which was acquired on 1 January 2008 by Oilpipes International Incorporated ("OII"), a US multinational corporation listed on the New York Stock Exchange, to participate in two top confidential projects code named Project Beaver and Project Falcon.

In **Project Beaver**, Mike Caceras, who is new to Malaysia, but knows OII well, having worked with them for 10 years, is concerned over certain comments in the high-level tax due diligence report received in connection with OII's acquisition of OISB, which suggest that OISB may not have fully reported the remuneration of its US expatriates to the Malaysian Inland Revenue Board ("MIRB"). Your team of tax consultants was asked to undertake a preliminary limited review of this matter for only one pre-acquisition year i.e. 2007, using a sample of 4 US expatriates out of 100 expatriates employed and your findings are:

1. The portion of their salaries credited by an offshore payroll company into Malaysian bank accounts of the expatriates were charged to OISB and were reported to the MIRB as described in (4) below.
2. The portion of their salaries paid into overseas bank accounts in respect of their employment exercised in Malaysia was not charged to OISB and was not reported to the MIRB.
3. Accommodation provided (and paid by OISB) in serviced apartments operated as a condotel in Kertih, their employment base in Malaysia, where OISB operated a project office, was not reported as employment income.
4. The expatriates worked a 2-week on and 2-week off schedule ie they worked for 2 weeks on an oil rig in Malaysian waters offshore Trengganu and then enjoyed 2 weeks leave and so on. Only salaries paid in respect of the 2 weeks on were reported to the MIRB (and scheduler tax deduction was applied thereon) as the expatriates spent the 2 weeks off outside Malaysia, generally in Thailand or Philippines.
5. Food and accommodation provided at the oil rig were not reported as income of the expatriates.
6. When the expatriates were first mobilized from their homes to Kertih and when they were demobilized at the end of their contracts, the transport costs were not reported as their income.
7. Tax clearance was obtained for 2 expatriates when they ceased employment in Malaysia.

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Mike has asked your team to make a high level presentation (executive summary presentation) to the Board of Directors of OISB and his boss, Tim Contrary, the CFO of OII. Mike specifically requested that you cover the ethical, reputational, legal and financial aspects of your findings and recommend the next steps noting that OII has under its sale and purchase agreement of OISB shares till 31 March 2009 to submit claims in respect of pre-acquisition liabilities to the vendors of the OISB shares it acquired. In this connection, OII and OISB are required to cooperate with the vendors in the absence of which, claims may not be met by the vendors.

In line with Petronas licence conditions, 30% of the shares of OISB are held by a Bumiputra individual who was previously in joint venture with the foreign vendor of OISB shares to OII. This Bumiputra individual is very well connected to politicians and of royal lineage, is very skeptical of your team's findings and has the ability to influence projects which your firm may obtain. He owns many companies and appoints consultants he chooses. He may stand to lose several million Ringgit as he previously owned 51% of OISB but sold part of his stake to OII and now owns 30% of OISB.

It should be noted that the Malaysian tax of the expatriate employees of OISB is borne by OISB itself. Some of the expatriates have had grouses with the company for three years and one of them has filed a claim against OISB in a Malaysian court of law.

In **Project Falcon**, OISB plans to bid for a project to supply the services of 5 remote operated vehicles (ROV) for 1 year from 1 January 2009 to an oil exploration company to be used in Malaysian waters offshore Sabah. The ROV are to be supplied with 15 specialist ROV operators and would be used for underwater inspection purposes. As mentioned earlier, OISB will bear the Malaysian income tax of expatriates it employs.

The OII Group has owned and used these ROV for some time through its Cayman100%-held company which is tax resident there. The normal day rate of the ROV is high and the Cayman company has therefore been most profitable in that tax free country.

Mike Caceras has asked your team to present to the board of directors a high level summary of your tax plans for this project with a view to minimizing the Malaysian taxes otherwise chargeable. You are to include in your presentation (with PowerPoint slides) potential areas of exposure – areas which the MIRB may challenge. It is thought that this project will be highly competitive and OISB intends to pass to the oil exploration company the tax savings you identify through your tax planning such that it will have a better chance of winning the project. Questions like whether OISB should buy or rent the ROV, subcontract the project to the Cayman company which owns the ROV or employ the expatriates plus other tax saving plans should all be covered briefly as the board has a time constraint.

Your team is in competition with 4 others to win this tax planning engagement which will be awarded to those who present the best tax plan acceptable to OISB. A handsome fee is guaranteed for this engagement and OISB has undertaken not to use any plan disclosed unless a fee is paid to the service provider.

In connection with your planning, please note that ROV operators typically work 4 weeks on and 4 weeks off; customs duties apply to the import of ROV into Malaysia; and the ROV identified for the project in Malaysia are valued at RM36 million and after a years' usage, the ROV would have a market value of RM31 million; the revenue from the one year project is expected to be RM10 million; and the cost of the ROV operators is expected to be RM5 million. The Cayman Island company is prepared to rent the 5 ROV to OISB at RM4 million for the one-year project.

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