

MODULE 1
SAUL LARNER, Ph.D.
INTERNATIONAL TAX PLANNING
MALAYSIA COMPARATIVE ASSIGNMENT

Dear Valued Client's Financial Advisor

This letter of recommendation will first summarize your objectives as I understand them as well as propose a capital structure to address tax and non tax issues as follows:

FACTS AS I UNDERSTAND THEM:

You have made a decision to invest in Malaysia to set up a manufacturing plant for the entire Asian market. Therefore, I assume that the bulk of the production will be sold outside Malaysia.

I assume that you have forecasted the sales volume to be \$2,000,000 for the first year with an increase of 20 percent each year for the additional 4 years. We assume that the gross profit before expenses will be a 20 percent loss during each of the first two years with an estimate of expenses of 20 percent leaving a 40 percent net loss before taxes during each of the first two years and then a 40 percent gross profit before expenses less 20 percent in expenses which will net a 20 percent proposed profit in each of the following three years.. However, I assume that these net profits before taxes will not have to be repatriated to the parent company after an initial period of loss during the first two years.

It is my understanding that the nature of your computer manufacturing is one with low-level assembly operations from components sourced from third parties either directly or through the parent company. In speaking with your production and human resource managers, it is my understanding that the key considerations in the labor market are (1)procurement skills, (2)Marketing and brand management and (3)sales and after-sales service organization.

Further, I have been advised by your research and development department that new patents will need to be filed and that they will rapidly increase in value. I further have been advised that you will be coming out with ancillary products which have great potential and that you will probably wish to sell these presently owned patents within a five year period as well as selling off the entire division to an Asian company who plans to use your readable display film to make monitors which will go with the computers they plan to market. I understand that their optimism and budgets are planned because there is no PDA device in the market which has good color in sunlight and they wish to be the first to get into and corner this market, and thus must have your patents to do this with.

Further and of utmost importance, we must take careful consideration to the case that while the parent company is a \$50 million company, it is (1)Privately held, (2)The owner,

Mr. Willy Saki Tumi owns the patents all personally (3) He wishes to leave \$20 million offshore in an entity where his children, grandchildren and greatchildren will have monies for a college education. He wishes to give his daughter a \$50,000 bonus if she marries someone other than an attorney. He wishes to have an income of \$100,000 a year from the patents to support a young lady who he met in South Beach in Miami and spends a lot of time with. Mr. Tumi doesn't understand that when a 75 year old man has a 23 year girlfriend, with the Miami culture it is possible that she might find it difficult to stay in a relationship with an element of permanence so he wishes to be able to recapture the white Ferrari he is going to make available to her. He wants to protect his assets from his wife as he has heard stories that there are a few cases on record whereby a girlfriend has told her boy friend's wife about their escapades together. He wants to leave no stone unturned in protecting his assets.

He has two sons, 15 and 12 who are planning to go to MIT and study computer sciences and he wants an element of business continuation from an estate planning perspective so they will take over his company. His girl friend suggests that she be the trustee of his estate, but I understand that your attorneys have advised him against it. Their answer is that although he has implicit trust in her, that they feel that a 23 year girl friend who hasn't had a day of work experience or college lacks the experience to manage an estate. Because he feels that she has "street smarts", he wants her to have some input, therefore, you as a team of advisors wish that our recommendations take asset protection planning as an area to which there must be strict adherence and the strategies taken to the highest heights.

Next, we will discuss both tax and non tax issues as well as offshore asset protection planning in various sequences as they all interplay together and all are of the greatest importance in this plan—especially because of estate planning avoidance potentials in this interesting plan, although in Miami where these circumstances are so common.

1. First, we are going to get the patents out of his estate. They are worth only \$5,000 now and later will be worth \$25 million, hopefully, so we must get it out of the estate now so they will grow outside of it. With a worth of only \$5,000 now, Mr. Tumi can use part of his annual gift tax exemption now without any consequences.
2. We will form an IBC in Belize to hold the copyright. This IBC will be owned by a trust. Therefore, if his lovely young lady ever becomes scornful and calls him in for a deposition and her new boy friend, an attorney, decides to ask who owns the IBC, Mr. Tumi can rightfully say without perjuring himself that he is only an employee of the trust and doesn't have to add any further information.
3. This trust now gives Mr. Tumi a private annuity which states that in future years he will get \$100,000 a year for life using the proceeds from the sale of the patent. He wishes to assign this to his girl friend as she has indicated that she wants financial security. Mr. Tumi explains to her that the way the law works, he cannot do this as there would be incident of ownership. When she wants money,

she has to write a letter of wishes to the trustee requesting this. Her reply is that she can't feel secure with this arrangement and has asked Mr. Tumi to find a way to come up with money some other way to give her a sense of security. We will deal with this later.

4. Now, let's look at this annuity from a tax perspective. First, in everything we wish to do herewith, we wish to use all of our strategies to keep everything out of sections 672 to 679A which deal with controlled foreign corporations, foreign personal holding companies, etc. As we explained to Mr. Tumi, the IRS here has given us all three ways to pay taxes—now, later and never. His girlfriend was present and very excited about the “never” part and as a result, he concurred. This is not the first time we have seen this re-action from future recipients of money.
5. As you know as advisors, the annuity will grow tax deferred and there will be a small percentage tax when the money is withdrawn. However, because the annuity will eventually be bought out by the IBC which will then be owned by an offshore life insurance policy, the annuity will hopefully collapse within 5 years. The monies will be in an offshore, captive and self directed variable life insurance policy and monies will be borrowed without taxes. The girl friend has volunteered to borrow money for her future spending if it will be helpful to the total mechanism. She further stated that she discussed this with a personal friend who is an attorney and he asked her to mention if there could be what he calls an “escape clause”. In that if there is borrowing and not a payback, there will be a reduction in the face value of the policy upon death and future generations will suffer. Unfortunately, this has turned into one of those rare, real life episodes where girl friend and boy friend have a monetary dispute, but we have advised Mr. Tumi that business continuation and dynasty provisions are of paramount importance to him and advised him to leave all decisions to you as his advisors who aren't so emotionally involved.
6. When the patents get sold, there will be borrowing opportunities out of the policy using these funds as well as for annuity payments. In order to keep this Section 7702 and 7702A compliant per the U.S. Tax Code as it pertains to life insurance, there must be five investments. One of these investments will be a factoring company to loan money to both the branch and the parent company with the receivables as collateral as well as putting profits offshore and complying and superceding the economic substance laws.
7. A second company owned by the offshore policy company will be a leasing company. Not only will it lease all hardware, machinery and computers to the parent and subsidiary companies, but it will lease the girl friend's Ferrari to the parent company. She will drive it and although she is a very honest lady, we advised Mr. Tumi that it is never a bad idea to keep people honest.

8. Next, all profits in excess of what is needed for the business and living expenses for Mr. Tumi and his loved ones will be in the offshore life insurance policy. The businesses will also be owned by the policy for asset protection as well as future tax avoidance. This will co-ordinate with all of the business succession procedures to be followed in preparation for Mr. Tumi's sons taking over the business. While his girl friend has consulted the lawfirm Dewey, Takem and Howe, we recommended that the three of you as his advisors and myself meet with Roy L. Gold who is a highly respected estate planner and that we work out the details together.
9. Now that we have the basic structure which we will herewith summarize as the estate and business continuation plan, the tax sheltered patents, the leasing companies, the private annuities, and the offshore IBC and Trust all working together as a mechanism to curtail any taxes due and to give all present and future generations of Mr. Tumi the estate with the incentive planning he wishes, we will shift this discussion to the capital structures of the offshore entities which will hopefully generate profits in a tax advantaged way to put into the mechanism we have created.
10. You asked about the tax treaties between Malaysia and the United States. It is a moot issue here because all of the profits will be going to Belize and then accessed tax free in the United States. Our concern is regarding the taxes that must be paid on profits earned in Malaysia and it is appropriate that our discussion addresses them herewith. Malaysia doesn't have a tax treaty with the United States. However, with our structure for royalties charged to the company in Malaysia payable in Belize, the factoring company and all other components of the mechanism, the taxes will be minimal.
11. First, Malaysia doesn't tax on world income, but rather only that income that is earned there whether the firm is resident or non resident.
12. The company tax rate is 28 percent and the top personal tax rate is 28 percent and that is for income over RM 250,000. Thus, this is an appealing jurisdiction to send competent personnel to.
13. Dividends are tax-exempt on distribution and receipt. This makes equity financing perhaps more appealing than debt financing.
14. There is a withholding of 15% on interest which makes debt financing (bonds) less appealing.
15. Royalties have a 10 percent tax withholding. However, all royalties will be earned by an IBC in Belize so this is a mute issue here.

16. Technical and management fees are 10 percent. This is not unreasonable and in light of all of the other tax advantages, this fee doesn't deter my enthusiasm for this jurisdiction.
17. There is a real property tax on the disposal of real property over the short term. This is not an issue here for the following reasons. First, the premises are expected to be occupied for the entire five years and then sold to the new firm wishing to take it over. Second, the property will be owned by the Belizian trust and leased to the Malaysian entity. When the property gets sold, there will be rental income which will flow to the dynasty trust in Belize for future generations as well as for the annual income needed by Mr. Tumi to maintain his quality of life.
18. There are minimal anti-avoidance rules and the way we will structure our mechanism, there will be none that apply. There are no thin capitalization or formal transfer pricing rules. There are no Controlled Foreign Corporation rules which apply in Malaysia, in Belize and equally importantly, our structure clearly avoids legally all CFC rules in the United States and everything, even with Malaysia is totally taken out of Sections 672-679.
19. The tax incentives through tax holidays, investment allowances and various double expense deductions are of interest to us in that they offset the 10% technical and management fee taxes. This should come close to an even offset.
20. Losses can be carried forward indefinitely for offset against the same source. This is a very important reason to consider Malaysia because our mechanism will probably show losses and the ability to carry forward these losses will enhance the value of the proposed sale within five years.
21. You mentioned that your CPA asked you to inquire about the United Kingdom, Japan, Australia and India. We have eliminated these jurisdictions for the following reasons. First, none of them offer the tax shelters we wish for offshore planning. The treaties between the U.S. and Ireland have been abolished, the exempt limited companies between England and the Isle of Man are no longer a viable option. Moreover, we don't have an issue of double taxation as we have legally avoided taxation through our mechanism.
21. The salient issues here are that the tax incentives of Malaysia are superb. The tax structure is such that employees will be happy to move there. Third, there is a more than abundant labor supply there to meet your needs. Fourth, the tax laws are appropriate to float a public issue based on the taxation of dividends. Fifth, it will be easier to find the proper technical staff there.
22. The ownership will be the IBC as we discussed. The financing will be done by the sale of offshore stocks to non U.S. residents in the subsidiary company. The

securities laws in the U.S. are much too difficult, complicated and expensive to form and raise the \$1,000,000 in capital to get this company up and running. Plus, consumer confidence is too low in the United States.

23. However, we will discuss the issues with these countries. In India, a resident company is taxed on its world income. The corporate tax rate is 35% plus a surcharge of 2.5% on income and short-term capital gains. The corresponding rate for a foreign country is 40%. What makes it virtually impossible is that nonresident companies are taxed on income received or deemed received or accrued or arising in India, capital gains on assets in India and income such as royalties and technical service fees for services rendered in India. Moreover, in case of "business connection" in India, any income attributable to that connection is also taxable.
24. There are a few specific anti-avoidance rules in India with strict compliance and stringent penalties.
25. Their royalties tax incentives are being phased out and they seem to have little or nothing more than one can get in Malaysia.
26. It is easier to sell stock in the firm to an offshore mutual fund or to a private placement to an offshore entity investor. This gives one economic substance. In other words, for a U.S. citizen to put money offshore, he must have a reason to do so. One reason is that he wishes to invest in a certain company and he is not allowed to do so if he is a U.S. citizen as it is unregistered stock. Thus, he has an economic benefit to put his money into an offshore IBC which will then use the money to buy the stock. Not only does he feel that the company will take off and he has the right to take advantage of it, but he wishes to invest in a company in Malaysia because of their tax advantages and incentives.
27. We have totally eliminated Japan as the cost of production is too high, although they have a high tech labor pool. Most of the Japanese companies who compete have opened manufacturing facilities in Mexico because of the tax incentives there as well as the much lower cost of labor.