

This newsletter is based on an article published in Worldwide Tax Daily¹

Background

The Bahrain-based support vessel company Adams Offshore W.L.L. is currently being litigated in the U.S. for allegedly not reporting \$45.57 million of U.S.-source income.

The case is connected to a newly issued directive by the U.S. revenue service IRS in relation to activities on the Outer Continental Shelf (OCS) and is the first one of its kind. The IRS has assessed deficiencies and penalties totaling \$23.9 million for the company's failure to file U.S. income tax returns. Adams Offshore is challenging the decision.

Using private third-party databases, monitoring and vessel tracking systems to monitor the daily movement of vessels operating on the OCS, the IRS found that Adams Offshore Services Ltd. operated several multipurpose support vessels on the OCS in connection with the exploration for, and exploitation of, subsea natural resources, thereby generating taxable U.S.-source income.

This case is seen by many as a potential precedent for other cases, since the IRS is expected to pursue the enforcement of similar taxes, since according to the IRS, an increasing number of foreign vessels have received permits to operate in the OCS (in the present case the Gulf of Mexico), and that a significant number of those vessels have not complied with U.S. tax filing requirements.

Key Issues

- Currently there are more than 4,000 oil rigs operating on the OCS and foreign companies provide a wide range of services related to their operations;
- Besides Adams Offshore, another 100 companies have already been contacted by the IRS;
- There is no statute of limitations when a foreign company fails to file a U.S. income tax return(!);
- Under the U.S. revenue code, the activity must relate to the exploration or exploitation of natural resources and the IRS takes the (very broad) view that any work directly or indirectly connected to that activity is subject to tax;
- If the IRS is successful in its assertions against a foreign company that has not filed a return, the company would likely be denied deductions, credits, or the carryover of operating losses. Due to the fact that in the shipping industry the initial investments are very high, this would seriously impact any company's financials. The day rate for chartering a vessel or rig can be quite high, but vessel owners generally do not earn a large return on rental income. Vessel owners also need to account for depreciation, possible financing charges, and operating losses on fixed-price arrangements that are subject to market shifts;
- Transfer pricing rules may apply to transactions between related vessel owners and operators, so the IRS could make adjustments to the profits and losses of a foreign company if a transaction was not at arm's length;

¹ Margaret Burow, "IRS moves to dismiss first Outer Continental Shelf Assessment Case, 6 August 2014, 2014 WTD 151-3

- Treaty protection can be obtained for companies engaged in international transport, and in cases where double tax treaties expressly address the issue of exploration and exploitation activity;
- Many countries maintaining popular flag of convenience registries do, however, not have double tax treaties with the U.S.
- Even though the outcome of this case is uncertain, it seems to be clear that the IRS will focus not only U.S. citizens at home or abroad but also on foreigners with U.S. tax liabilities, including so-called “non-filers” of tax returns;
- GCC companies (as well as individuals) should carefully review their tax positions, not just in the U.S. but also elsewhere in Europe and Asia as tax enforcement has picked up significantly and will continue in the next few years. Filing tax returns for unreported taxes and restructuring operations seem to be feasible strategies for past and future periods, respectively.

We update our clients and business partners on a regular basis about tax, legal, regulatory and other developments in the Middle East and Asia.

We are an independent advisory firm with the focus on helping clients to “de-offshorize” their international structures and to implement substance in various jurisdictions around the globe where we provide significant know-how when it comes to the implementation of onshore solutions.

We are proud to say that the background of our associates is very diverse, ranging from legal, tax, banking, economists and to even medical which allows us to cover various industries. Hence, we are comfortable to say that we can work with our clients in a number of different industries, ensuring that not only the tax and legal structure is put in place in compliance with the rapidly changing regulatory environment but also the various industry specific functions are carried out appropriately.

Furthermore, through our presence in the Middle East (Bahrain) and Asia (Hong Kong) we gained significant insight in the current developments in these striving markets. We also serve as an intermediary for investors from both parts of the world to establish them and also identify investment opportunities.



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