

## Exhibit 1

### Domestic Double Tax Problems and Mitigation Thereof

**Total D.T. Regime**  
(E.g. the United States, Sweden, and Netherlands)

X Company	
Tax Base (Net income)	\$1000
Tax	<u>500**</u>
Amt. left for Dist. to s/h	\$ 500



Distribute all to individual shareholders

Tax Base (Amt. Dist.)	\$500
Tax	<u>250**</u>
Remainder	\$250

Thus total tax on the \$1000 of income will be \$750 (\$500 at corporate level and \$250 at S/H level) for an effective rate of 75% on this income.

**Integrated system\*** (imputation of tax paid at corporate level to s/h as a credit)

X Company	
Tax Base (Net income)	\$1000
Tax	<u>500</u>
Amt. left for Dist. to s/h	\$ 500



Distribute all to individual shareholders

Tax Base Amt. Dist.	\$500
Gross up for corporate level tax	<u>500</u>
Total Tax Base	\$1000
Tax Liability	500
Less credit for corp. taxes paid	<u>500</u>
Tax Due	0

\*\* Assume a 50% tax but it may be much less (e.g. U.S. highest ind. rate is 39.6% and highest corporate rate is 35%)

\* With integrated system, individual s/hs receive full credit for taxes at corp. level. Thus a single level of tax (Australia, France and Germany); in the past partial imputation UK and Ireland but it has been phased out.

Assumptions: A flat corporate Tax Rate of 50% and an individual rate of 50%.

**EXHIBIT 2**  
 Reproduced from Ault on  
 Comparative Income Taxation: A Structural Analysis

The following Table III summarizes some of the features of the corporate tax systems discussed in Part III. The notations "Partial imputation" or "Full imputation" refer to the degree to which the tax imposed at the corporate level is relieved in the hands of the shareholder when profits are distributed. The amount of unrelieved corporate tax on distributed profits is shown in the column headed "Residual corporate tax."

Some basic aspects of corporate taxation

	Basic approach	Corporate rate on retentions	Residual corporate tax on distributed profits	Total tax burden (corp tax + max. shareholder tax) on div. distr.	Profits requirement for taxable distr.	Intercorp. dividend relief	Corp. level tax on distr. of apprec. property	Consol. taxation possible
Australia	full imputation	36%	0%	47%	yes	yes via rebate 100%	yes	no (some equiv. techniques)
Canada	partial imputation	30-46% (depending on province and type of income); lower for Can. small corps.	ca. 24% (depending on province and type of income); 0% in some cases for Can. small corps	51-67% depending on province; lower for Can. small corp.	no	yes (100% relief)	yes	no (some equiv. techniques)
France	full imputation	33%	0%	56.6% (60.7% with surcharge + additional levies)	yes	yes (100% relief)	yes	yes
Germany	imputation/ split rate (full relief)	45%	0%	53% (plus surcharges; higher if local trade tax included)	no	yes (through general rules)	yes	yes
Japan	very limited imputation (10% credit)	37.5%	31.25%	62.25%	no	limited (80-100%)	yes	no
The Netherlands	Classical	35%	35%	74%	no	yes (5%+ share holding)	yes	yes
Sweden	classical	28%	28%	49%	no	yes (25%+ share holding)	yes	no (some equivalent techniques)
United Kingdom	partial imputation	33% (or lower)	18.25%	49.75%	no	yes	yes	no (some equivalent techniques)
United States	classical	34/35%	34/35%	60.74%	yes	limited (70-80-100%)	yes	yes

EXHIBIT 3  
Taken From  
Taxation of International Taxation  
Gustafson, Peroni & Pugh

The chart below illustrates the consequences of full double taxation by Countries A and B, and the exemption, foreign tax credit and deduction approaches to eliminating or mitigating international double taxation. The assumptions are that a Country A corporation has a branch in Country B earning income from sources in Country B. The taxable income (TI) of the branch is \$100, which, absent any mechanism to prevent or reduce double taxation, would be subject to a 30-percent Country B income tax and to a 35-percent Country A tax. (The numbers in parentheses indicate the results if the Country B tax is 40 percent, none of which is refunded by Country A.)

**Mechanisms for Eliminating or Reducing  
International Double Taxation**

		<i>Double Tax</i>	<i>Exemption</i>	<i>Credit</i>		<i>Deduction</i>
(1) B Branch TI	=	100	100	100		
(2) B Tax	=					100
[30% of (1)]		30	30	30(40)		
(3) TI to A Corp.	=	100	0	100	Less B Tax	30
(4) Tentative A Tax	=					70
[35% of (1)]		35	0	35		
(5) Less tax credit	=	<u>0</u>		<u>30(40)</u>		
(6) Final A Tax	=	<u>35</u>	<u>0</u>	<u>5(0)</u>	[35% of (3)]	<u>24.5</u>
(7) Total A and B Tax	=	65	30	35(40)		<u>54.5</u>

The three foregoing mechanisms—the exemption, the foreign tax credit and the deduction—are *unilateral* devices for mitigating double taxation because they are formulated by Country A, the country of residence, without reaching agreement with Country B or any other country. There is a fourth mechanism—the income tax treaty—that is a *bilateral* device for mitigating double taxation. This approach involves Country A, the country of residence, reaching agreement with Country B, the country of source, regarding the allocation of taxing jurisdiction over income realized by residents of one country from sources within the other country. A tax treaty can be entered into by Country A and Country B that will preclude one state from exercising the taxing jurisdiction it could otherwise exercise under international law. Alternatively, a treaty may permit both countries to tax the income, but limit the amount of the tax that the source country will be permitted to impose. The latter mechanism in effect divides the tax revenues between Country A and Country B.

The premise of mechanisms to eliminate or mitigate double taxation, and of the hundreds of bilateral tax treaties in force throughout the world that are directed toward that end, is that the source country in which the income arises or is earned has initial and primary jurisdiction to tax such income. This basic principle of international taxation reflects the reality that the source country normally has the power to impose its tax on income arising in its territory before that income leaves the country.

Exhibit 4

The Deferral Principle

Assume: U.S. company operating a manufacturing branch in Ireland for sales in Europe. The results of a branch operation are compared with a foreign sub. in which distributions are not made to parent.

I. Irish Branch  
Irish Tax Consequence

Branch Income	\$1000
Irish Corp. Tax	<u>100</u>
Remainder	\$ 900

U.S. Tax Consequences

Branch Income	\$1000
U.S. Tax liability	350
less FTC for Irish tax	<u>100</u>
Net tax to U.S.	\$ 250

Total tax transaction costs for year would be \$350 (\$100 Irish and \$250 in the U.S.)

I. Irish Subsidiary Company  
Irish Tax Consequence

Net Income of Irish Company	\$1000
Tax to Ireland	<u>100</u>
Remainder	\$ 900

U.S. Tax Consequences

None until dist. to US parent.  
Current tax trans. cost is \$100 with \$250 deferred.

Note: Deferral is an important tax principle since the money not given to the taxing authorities can be invested in the business to make additional profit for the subsidiary Time Value of Money issue.

## Exhibit 5

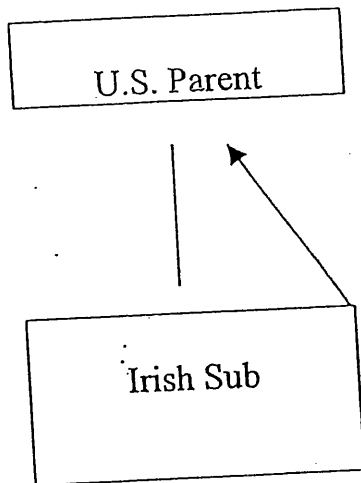
### Transfer Pricing Issues

Irish sub sells product to American parent for \$1000 (which is \$300 over FMV)

Effect is to subject \$300 properly attributable to U.S. source income to Irish Tax. Tax would be at 10% so that the improperly allocated amount incurs a \$30 tax and \$100 would be deferred.

If fully effective transfer pricing rule in effect, the deemed sales price will be \$700 rather than \$1000 and \$300 would be deemed to come to Irish sub as a contribution to capital. When deemed price is \$700, the \$300 amount will then become income of U.S. parent, as its cost in product will be \$700 rather than \$1000.

• U.S. has very tough transfer-price rules. Ireland, by contrast, does not have such detailed rules but does have rules.



Sell at \$300 above FMV.  
If no transfer pricing rules,  
\$100 of tax would be  
deferred.

## Exhibit 6

### Deemed Foreign Tax Credit

#### When Foreign Sub. Makes Distribution to Domestic Point

Facts: --Same facts as Exhibit 4 but only with respect to Irish sub. Assume Irish sub pays \$900 Div to U.S. parent.

Tax Base	
Cash Div	\$ 900
Gross up Div for deemed credit	<u>100</u>
Total tax base	\$ 1000
US Tax	350
Less deemed FTC	<u>100</u>
Net Tax	\$ 250

Note: Purpose of Deemed Credit is to approximate the result that would occur if the Irish operation had been a branch (rather than sub).