THE STATE OF NEW HAMPSHIRE

SUPREME COURT

1998 TERM

DOCKET No. 97-779

CATERPILLAR, INC., ET AL.

V.

NEW HAMPSHIRE DEPARTMENT OF REVENUE
ADMINISTRATION, ET AL.

APPEAL FROM MERRIMACK COUNTY SUPERIOR COURT
DECISION THE MERITS

AMICUS CURIAE BRIEF

OF PETER S. GARRE

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Summary of Argument

New Hampshire's Water's Edge method of taxation is discriminatory, violates the Commerce Clause of the U.S. Constitution and fails the test set forth by the U.S. Supreme Court in Complete Auto Transit, Inc. v. Brady. The Water's Edge method punishes multinational corporations based within the United States and favors multinational corporations based outside the United States. The Water's Edge method does not discriminate against foreign commerce. To the contrary, it discriminates against domestic interstate commerce. Caterpillar's remedy goes in the wrong direction at the wrong time. New Hampshire must go back to the future for the remedy, to the linchpin of apportionability, the unitary business principal on a worldwide combination basis.

Indeed, should the Court find that New Hampshire's Water's Edge method is discriminatory and unconstitutional, the Court may not have any other option for remedy save worldwide combination. In 1986, when RSA 77-A was amended, restricting application of the unitary business principal to water's edge, the New Hampshire Legislature also provided for the severability and repeal of the water's edge language - "If RSA 77-

A:1, XV as inserted by section 3 of this act or the application thereof to any person or circumstance is found invalid, then RSA 77-A:1, XV shall read as follows and RSA 77-A:1, XIX shall be deemed repealed" (1986 Chapter 153:7, I). That provision simply adds U.S. possessions or territories to the water's edge combined group.

However, as provided in Chapter 153:7, II, if that provision/definition of a water's edge combined group is "also found invalid, then it is the intent of the legislature that sections 2-6 of this act [which added RSA 77-A:1,III(f) and XV-XIX, RSA 77-A:2-b, and RSA 77-A:3, IV, and amended RSA 77-A:3, II and III and RSA 77-A:6, IV] be considered as a unit and that the provision of sections 2-6 of this act be inseparable." Furthermore, "If any provision of sections 2-6 of this act is declared unconstitutional, all of the provisions of sections 2-6 of this act, shall be invalid, and the provisions of RSA 77-A as they existed prior to the enactment of this act shall apply."

We know from the U.S. Supreme Court's 1994 decisions in Colgate-Palmolive Company v Franchise Tax Board and Barclays Bank International Ltd. v. Franchise Tax Board that the worldwide combination of a unitary group of companies is permissible. By artificially restricting a worldwide unitary group to water's edge to just those companies that operate in the United States, U.S. based multinational corporations are taxed on their domestic AND foreign income while the U.S. subsidiaries of foreign based multinational corporations are taxed only on the income that is reported by them to the IRS on the separate entity/arm's length method - a method that is inherently flawed and the raison d'être for the States' unitary method of taxation. The playing field is not level in the taxation of multinational and smaller, inter-state and intra-state corporations. The Commerce Clause is the bulldozer that can and should make the playing field level. It is up to this Court to decide whether or not that bulldozer will be fired up and operated to flatten down this terribly uneven, unlevel, and unjust playing field of taxation in the global economy.

ARGUMENT

I am grateful to the Court for allowing me the opportunity to file an amicus curiae brief in this case. I do not believe that a former field examiner has ever filed or requested to file an amicus curiae brief in the 29 year history of the New Hampshire Business Profits Tax - until now. Furthermore, in the history of state taxation of corporate income, since the U.S. Supreme Court sanctioned multistate apportionment in 1924 in a Connecticut case, Underwood Typewriter Co. v. Chamberlain, I do not believe that a former field examiner has ever filed an amicus curiae brief in a state's highest court.

I was fortunate to work closely with John Mahon, the Director of the Audit Division, before his untimely and unfortunate death in 1985. Together, we worked on, what I believe was the first unitary/combination case in the history of the Department. Ironically, it was the decision in Caterpillar Tractor Co. v. Lenkos, an Illinois case, where Caterpillar won the right to file a combined report (in order to receive a sizable refund), that John found the support he needed to force combination on a company that I was auditing. He was respected and well liked by those who worked with him and by those who

worked for industry. I wish that John was alive today and submitting this brief instead of me.

My motivation for filing this brief is simple. I am interested in equality and equal treatment of taxpayers no matter what their size or state or country of commercial domicile and fair taxation. The issues in this case are not that far removed from the issues in the Claremont education lawsuit – parents and children want equality and equal treatment in their school system. We seek a level playing field and a fair game and we expect our government to enact fair laws and act as impartial referees and umpires on that level playing field.

When I started work as a field examiner for the Business Profits Tax in 1980, apportionment audits of separate legal entities were the norm. New Hampshire had rejected the method of taxation known as separate accounting/geographical accounting soon after the inception of the Business Profits Tax in 1970. The majority of the separate entities that I audited were wholly owned subsidiaries of parent companies based in the United States. After a while, I realized that no matter how diligent or thorough my examinations were of the apportionment factors – sales, payroll, and property - the end result was next to meaningless because whatever apportionment adjustments I proposed were applied to a meaningless tax base.

Here, it is essential that the Court know and understand the ways of corporate accounting and just how easy it is for the tax/accounting department of a parent corporation to assign or charge its subsidiaries bona fide and less than bona fide expenses for a whole host of identifiable items such as: corporate management, corporate administration, corporate development, corporate legal expenses, corporate accounting, corporate information services, corporate financing, etc., etc., etc.

Some parent corporations or related subsidiaries make all or most of the purchases for the entire group of related companies. Within a group of related companies, one company could procure raw materials, another manufactures products, another transports the product, and another related company could sell the product. There are many, many possible variations but they all have a common thread – they are all wholly owned companies that are controlled by the parent that owns them. They may be legal separate entities but they anything but independent separate entities.

All this gives a group of related companies many avenues to assign profit and expenses. Sometimes the inter-company expenses are identified in a subsidiary's separate entity tax return. Sometimes they are not. For example,

the income or profit shift from a subsidiary to a subsidiary or up to a parent company is not seen or identified because it is a component of an inter-company sale. Say Parent Company A based in the U.S. makes a product, marks it up 100%, and sells it at a profit to its related marketing subsidiary, Company B. Company A is able to report a profit on its separate entity tax return.

Company B has no choice in the matter, it is Company A's marketing arm and it can only sell what it must buy from Company A at a price set by Company A. If Company B cannot then mark-up the product that it must buy from Company A to a competitive, marketable price to, at least, cover its expenses, it will never, ever be able to report a profit. And, just why would this happen? Why would Company A take so much profit for itself? After all, for financial reporting purposes, the income and expenses of Company A and Company B are usually combined and treated as if they were just one company.

More than likely, Parent Company A and Company B file a consolidated federal tax return and the separate entity profits that Company A has are netted against Company B's separate entity losses and the net amount is taxed by the IRS. So for federal tax purposes, Parent Company A and Company B are

treated as if they were just one company. The federal government gets to tax something whereas the state or states where Company B operated gets nothing.

Or, if Parent Company A was based in another country, Company A's profits would, (presumably) be taxed in that foreign country and Company B would never, ever pay a corporate income tax to the federal government or to the state or states with which it had a taxable presence or nexus.

This whole business of companies reporting losses year after year after year seems kind of silly when you consider that companies simply just cannot exist without making a profit sometime, somewhere. Why would a parent company allow any of its subsidiaries to operate at a loss year after year after year? Why would a parent company based outside the United States, sell its goods and services in the U.S. at a loss year after year after year? And, how is it, that, at the same time, many of these loss companies are owned by very profitable companies that report great profits to its shareholders year after year after year. If a subsidiary's losses are dragging down a group's profits every year, why wouldn't the parent company sell that subsidiary or simply close it down?

The answer, of course, is that by having so many subsidiaries, a parent company can manipulate its profits, shift its profits around to states and/or countries that have low taxes or no taxes. The name is transfer pricing and the game is a high stake version of the old shell game. Only here, the hidden objects are profits – where're the profits? Now, I am sure that Caterpillar and any other big multinational company can and will say that they have valid, bona fide business reasons for all their subsidiaries. If tax planning is not one of those business reasons, I suppose one could say that it is just a happy, unintended, coincidence that some of these subsidiaries just happen to be located in low tax or no tax jurisdictions. Serendipity for multinational corporations.

Or, it could be said that multinational corporations employ tax specialists, tax attorneys, and the like to form corporations all over the world for the sole purpose of shifting profits away from high tax jurisdictions to low tax or no tax jurisdictions. Of course, corporations are in business to make profits for their owners/shareholders and they can use whatever legal means and sums of money they can to shield those profits from taxation. They can and they do. And, even if a given multinational wanted to just let the chips (profits) fall where they

may, they wouldn't or couldn't do it because their competitors are shifting profits.

It is also essential that the Court know and understand how easy it is to form legal separate entities and incorporate them in a given state or country of choice. There are companies that specialize in providing incorporation services (see Exhibits # 1 thru #6). One of these service companies states in its Internet website (see Exhibit #2) that "A Delaware Corporation can be formed quickly and easily by phone in as little as 5 minutes." Apparently, a Nevada Corporation can also be formed quickly and easily by phone is as little as 5 minutes.

Another (see Exhibit #4) lists 40 plus jurisdictions/countries, from Anguilla to Vanuatu, and one state, Delaware, where it can incorporate companies in as little as 2 hours (the Seychelles), 1 day (Anguilla, Belize, Isle of Man, and Mauritius), or as long as 60 days (Madeira). The list reads like a Who's Who of the world's smallest countries with the possible exception of Cyprus, Hungary, Ireland, Liberia, Luxembourg, Panama, and Switzerland. This service company informs us that "Most offshore jurisdictions are free from foreign exchange controls and have introduced company legislation to cater for a diverse range of

international business requirements" and that "Some jurisdictions have introduced new and modern suites of corporate legislation, specifically designed for international business whilst others have amended existing domestic legislation to cater for offshore requirements."

This same service company also informs us that "Clients seeking to take advantage of double taxation treaty relief would normally wish to establish a company situated in a treaty jurisdiction." "This is essential for the minimisation of withholding taxes on the payment of dividends and royalties from contracting states." "Treaty jurisdictions also portray a non-offshore image and thus provide cosmetic appeal." ""Non-treaty jurisdictions are mainly used because of the absence of corporate taxes on the profits of the company and usually only require companies to pay a fixed annual license fee." "It is, therefore, important to assess the taxation implications of the business that is to be conducted, and decide whether or not a treaty jurisdiction is required."

In its segment on the uses of offshore companies (see Exhibit # 3), the service company explains that "One of the most popular uses of a company incorporated in a low tax area is for international trading." "Significant tax saving opportunities can arise by interposing an offshore company into an

international trading transaction." If an offshore company were to procure products from one country, and then sell them to another country the profits arising out of the transaction may be accumulated in the offshore company, free from taxation in the offshore centre."

It seems as if the world and its geopolitical divisions are one giant game board. And indeed it is. It is made possible by forms, forms with little substance - legal entities with paper assets, subsidiaries that are controlled by their creator, the parent company (or in some cases, individuals). Why go through all this trouble? Because it is worth it, because it pays off.

Of course, I am not suggesting that Caterpillar is shifting its profits around the world although it should be noted that Caterpillar owns some companies in low tax or no tax jurisdictions such as the Netherlands Antilles, Bermuda, Ireland, and the Channel Islands (see Exhibit # 7). Indeed, I know of not a single company that says in its annual reports that it is dealing with its subsidiaries at anything less (or more) than arm's length pricing. Nor, have I ever seen or heard of a company that conceded that it was dealing with its subsidiaries at anything less than arm's length (for example, see Exhibit # 8).

What I am suggesting is that this whole business of profit shifting has gone on far too long by far too many multinational corporations for far too much money. Yet, our own federal government/Internal Revenue Service insists that worldwide combination is not the solution. They insist that separate entity/arm's length pricing must be the international norm (see Exhibit # 9). Why the IRS continues on this path is truly a mystery (although Exhibit # 10 may provide a clue). Indeed, the IRS made a quid pro quo promise in 1986 to those unitary/combination states that switched to water's edge - that the IRS would step-up its transfer pricing audits. Maybe they have but their success has been less than stellar (see Exhibits # 11 and # 12).

In their brief, on page 22, Caterpillar states that "The irony to this story is that the victims of this discrimination are not the foreign nations and their foreign-based businesses whose political tactics forced the water's edge compromise, but rather the victims are U.S.-based businesses, like Caterpillar, who operate overseas only to suffer an 'apportionment mugging' when they seek to repatriate their foreign earnings to their home jurisdictions." I agree with Caterpillar that they are victims because they are U.S. based. But I am not too sure who the mugger and muggee really are.

Six pages later in their brief, Caterpillar seems to do an about face on the water's edge method. "The 1986 water's edge compromise resulted in a state taxation statute that differentiates on its face between domestic members of a unitary business and foreign members of a unitary business." "This express legislative distinction achieves an important public purpose with which Appellants agree – respect for international relationships among sovereign nations and the harmonization of the unitary business/formula apportionment method with the separate accounting method employed by national income tax systems." Caterpillar seems to be saying that in the interest of world peace, the states must continue to utilize the water's edge method.

However, it is not clear what Caterpillar means by harmonization since unitary formulary apportionment and separate accounting are like apples and oranges. The goal is the same but the means are not. What the states seek is fair taxation, a return on the state's investments in its infrastructure, the infrastructure that allows intra-state, inter-state, and inter-national businesses, to function. Isn't that an important public purpose? "The simple but controlling question is whether the State has given anything for which it can ask return" (Justice Frankfurter).

The answer is yes for those companies who have a taxable nexus or connection in a state. The problem then for a state is how to get a return from a company that enjoys its infrastructure but never makes any money, any taxable profits. A Company such as this gets a free ride and, worse, the building and maintenance of a state's infrastructure is shifted to others, to that fellow or company behind the tree. "Don't tax you, don't tax me, tax that fellow behind the tree."

I am by no means an expert or scholar on constitutional law, but it seems that the writers of the U.S. Constitution wrote the Commerce Clause into the Constitution to protect all commerce from discrimination. At the time, they were concerned that the in-state businesses would have greater influence with that state's lawmakers than the out-of-state businesses. Caterpillar, in their brief, cites a number of court decisions that addresses such in-state favoritism. "The fundamental principle underlying the commerce clause as it relates to taxation is that no state may impose a tax which discriminates against interstate commerce … by providing a direct advantage to local business." "Differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter."

More than likely, it never crossed the minds of the writers of the U.S. Constitution that in-state businesses would need protection from discrimination, that out-of-state businesses would be favored in-state over in-state businesses. Unthinkable. What state in their collective right mind would pass a law that discriminated against their own in-state businesses? Unthinkable, which is no doubt why there is no express or explicit language in the Commerce Clause that protects intra-state businesses.

It is unthinkable that the New Hampshire Legislature would tax the interest and dividends that residents received from in-state banks or businesses and exempt from tax the interest and dividends that residents received from out-of-state bank and businesses (the inverse of Smith v. New Hampshire Department of Revenue Administration). It is unthinkable that the North Carolina Legislature would pass a law that taxed its residents on 100% of the dividends that they received from companies that conducted 100% of their business within the State of North Carolina and tax less than 100% of the dividends that residents received from companies that did not conduct 100% of their business within North Carolina (the inverse of Fulton Corp v. Faulkner). Unthinkable.

It is unthinkable that the New Hampshire Legislature would prohibit a New Hampshire company, that owned other unitary companies (e.g., a parent company and two subsidiaries) that conducted 100 % of their business within New Hampshire, from filing a combined return. Yet, RSA 77-A:1, XIV defines a unitary business as "one or more related business organizations engaged in business activity both within and without this state, among which there exists a unity of ownership, operation, and use; or an interdependence in their functions" (emphasis added).

Therefore, related unitary businesses that conduct 100% of their business within New Hampshire don't meet the State's threshold filing requirement for a water's edge combined group. They cannot file a combined return with the New Hampshire Department of Revenue. If one of the members of a 100% in-state group has a loss, they are out of luck and cannot net that loss against the other members' profits. The federal government would allow a 100% in-state group to file a federal consolidated return and they would get the benefit of netting any separate entity losses with related separate entity profits. Nope, not in New Hampshire. 100% in-state unitary groups are discriminated against and punished for conducting 100% of their business in-state. Unthinkable.

It is also unthinkable when one considers the consequences. If a unitary group that conducts 100% of its business wants to file a combined return, they have only one alternative, go west or south or north and start conducting business in another state or country. Get smart, get nexus outside New Hampshire. RSA 77-A:1, XIV invites you to leave the state and conduct less business within New Hampshire. "We have met the enemy, and it is us" is an old line that seems appropriate here. I do not believe that this discrimination will be remedied by the 1986 provisions in Chapter 153:7,I or II.

If the U.S. Constitution was being written today in this global economy, I suggest that the writers' concerns would be pretty much the same as they were in the 1787 with one possible exception. They would want to make sure that in addition to protecting inter-state commerce/out-of-state companies from intra-state favoritism and discrimination, the writers' would also want to protect inter-national commerce and out-of-country companies from inter-state commerce/U.S. based companies and the favoritism and discrimination that the states and possibly even the federal government would be tempted to enact to protect "their own." This concern over inter-national commerce was addressed by the U.S. Supreme Court in Japan Line, Ltd. v. County of Los Angeles and Kraft Gen. Foods, Inc. v. Iowa Dep't of Revenue.

In the Kraft case, Iowa taxed the foreign dividends that Kraft received from its foreign subsidiaries but did not tax domestic dividends received its U.S. subsidiaries. The Court found this to be discriminatory, favoring domestic over foreign commerce. Iowa taxed corporations on a separate entity basis and, by using line 30 of Kraft's federal tax return as a starting point, domestic dividends are (for the most part) deducted on line 29 of a federal tax return. The Kraft case is interesting because it concerns a single company with foreign and domestic subsidiaries. It was not a case of discrimination against an out-of-state, unrelated company in favor of an in-state, unrelated company. I don't believe that Iowa's intent was to favor an in-state company over an out-of-state company. In other words, I don't believe that the Kraft case was your typical Commerce Clause discrimination where a state designs their tax laws in such a fashion as to favor the in-state companies over the out-of-state companies.

However, because Kraft received domestic dividends from domestic subsidiaries engaged in inter-state commerce, it does raise an interesting question. What if Iowa did the opposite and didn't tax the foreign dividends that it received from its foreign subsidiaries but did tax the domestic dividends that it received from its U.S. subsidiaries? Would this constitute discrimination against inter-state commerce in favor of foreign commerce? The answer, I suggest, would have to be in the affirmative.

Of course, what state would want to discriminate against inter-state commerce in favor of foreign commerce? What state would discriminate against a U.S. based company in favor of a foreign based company? To the writers' of the Commerce Clause this discrimination, like discrimination against intra-state commerce that favors inter-state commerce, is unthinkable. Caterpillar is a U.S. company, based in Peoria, Illinois. Per their 1997 10K report, Caterpillar employees 39,722 persons in the United States. What state or states would do the unthinkable and discriminate against Caterpillar in favor of Caterpillar's foreign based competitors?

The State of New Hampshire does. New Hampshire water's edge statute by its definition discriminates against Caterpillar, a U.S. based company and favors its foreign based competitors. Don't tax Komatsu, don't tax me, tax Caterpillar

behind the tree. New Hampshire doesn't combine unitary overseas companies. And, worse, New Hampshire is telling Caterpillar, in so many words, that if Caterpillar wants better treatment by New Hampshire (or the other states), it had better move its headquarters to a foreign country (I wonder how that would play in Peoria). We have met the enemy, and it is us.

Where did we go wrong? How did this happen? The states won the big battle in 1994 in Colgate-Palmolive Company v. Franchise Tax Board and Barclays Bank International Ltd. v. Franchise Tax Board but lost the war eight years earlier in 1986 when unitary combination was restricted to water's edge. The vote in both of these cases, it should be noted and remembered, was not close. Colgate lost 9 to 0 and Barclays Bank lost 7 to 2. It should also be noted that the Clinton Administration directed the Solicitor General to urge the Supreme Court to deny certiorari in the Barclays Bank case. The U.S. Chamber of Commerce also weighed in on this case (see Exhibit #13).

Our trading partners, it seems, considered the states' use of worldwide combination an "irritant to international trade" (especially when it meant that one of "their" companies was being taxed via worldwide combination). Of course, it could be said that any tax is irritating (unless, of course, one was a tax

attorney). Frankly, I always been puzzled by that term "trading partners." I don't think that Caterpillar would consider, say, Komatsu, a trading partner. A competitor, yes, but trading partner? I don't know who said it, but I believe that it is more accurate to say, "Countries don't trade, companies trade." It may have been a Cold War term but that war is over. Furthermore, nationalized/state owned companies in Europe are becoming a thing of the past with the trend towards privatization/sale of those state owned companies to private shareholders.

Nonetheless, foreign based companies and the countries that they are based in, dislike worldwide combination intensely as evidenced by the number of amicus curiae briefs that were filed on Barclays Bank's behalf. I seem to recall Justice Ginsberg's observation of "the din" coming from the opponents of worldwide combination of foreign based multinational corporations. What is it about worldwide combination that so distresses our trading partners? Some foreign countries (not companies) have even threatened to retaliate, if the states combine "their" companies. Why?

Could it be that our trading partners/foreign countries/foreign companies have already crunched the numbers and know that the U.S. subsidiaries of "their"

companies will pay more or, in many cases, pay corporate income taxes to a state for the first time ever (see Exhibit # 10). Could it be that "their" companies just don't like paying taxes to "our" states (and federal government)? Could it be that our trading partners want to play in our marketplace but don't want to pay to play? Could it be that our trading partners have a different kind of capitalism? Could it be that our trading partners consider themselves partners and the Unites States a competitor? Don't tax the U.S. subsidiary of your French company, don't tax the U.S. subsidiary of my German company, tax that U.S. company behind the tree.

Or, could it be that nationalistic, self-interest is the force behind our trading partners objections to worldwide combination? Could it be that these foreign countries are acting like some states in this country and favor their in-country/home based companies over their out-of-country companies/ competitors? Could it be that countries, like states, are tempted to treat their own home based/in-country companies better than those without? Could it be that our own federal government and state governments are aiding and abetting our foreign trading partners/foreign competitors by embracing separate entity/arm's length at the national/international level and water's edge at the state level? Could it be that our trading partners fear application of the Commerce Clause to them?

The term itself, multinational corporation, is puzzling. How can a multinational corporation have a "nationality"? Caterpillar, a Delaware chartered company with headquarters in Peoria, Illinois, and many subsidiaries (see Exhibit #7), sold more products outside the United States in 1997, 1996, and 1995 than inside the United States (see Exhibit # 14). Is it fair to say that Caterpillar is an American company? If all the executive officers of Caterpillar moved to the Bahamas would Caterpillar then be a Bahamian company? Is Chrysler no longer an American company now that Daimler-Benz, a German company, has taken them over? Does it matter?

We are often bombarded with advertisements in this country by companies, many foreign based multinational corporations, that seem to be saying "We're not one of them, we're one of you." Think globally, act locally (see Exhibit # 15). The U.S. subsidiaries of foreign companies tell us that they pay property taxes in the U.S., employment taxes in the U.S., sales taxes in the U.S., etc., etc. Corporate income taxes? Well, that's another matter. "Think globally, act locally, shift profits, and minimize corporate income taxes" seems to be what they are really saying.

This profiting shifting is not just in the domain of multinational corporations either. Hollywood accountants have been known to be the masters of the game. Ever heard of a movie that actually made money? At the last Academy Awards show, Arnold Schwarzenegger said in a telling moment that "The Titanic movie made so much money that no accountant could hide it." The smart actors and actresses ask for a percentage off the top, a percentage of gross revenues because those that get a percentage of the profits usually end up with nothing, zip, nada.

Perhaps governments should do likewise. As I have hopefully demonstrated by now, the way that this state and others states, and this country and other countries tax corporate income is a mess. Of course, accountants and tax attorneys thrive in this environment and they would hate to see any kind of simplification and a level playing field. Corporate spokespersons often tell us that they hate uncertainty and big legal bills. But, they apparently hate the unitary business principal even more. I guess they hate taxes more than they hate uncertainty and big legal bills.

This mess, this whole mess is become of form and form over substance. If there was a law that any company, no matter how big and no matter how many states

or countries it operated in, was restricted to one legal entity, we would not be here today. A company could play games with their apportionment factors but they could not shift profits all over God's creation. A good example of this is Reuters, Ltd. v. Tax Appeals Tribunal, a New York corporate income tax case.

Reuters, Ltd., an English based news organization, chartered in the U.K. did business in approximately eighty countries. During the years in question, Reuters apparently filed a branch return, an 1120F federal tax return with the IRS and with the State of New York. A branch return is unusual in that it is supposed to represent the income and expenses of a division of a separate legal entity. They are generally filed by foreign corporations that choose to operate in the U.S. via an unincorporated branch or division. The 1120F returns filed by Reuters showed the income and expenses of Reuters' New York office. Those returns also showed an absence of profits. Reuters other branches around the world were profitable.

The accounting for a branch return is much like the separate accounting/ geographical accounting that was rejected by the U.S. Supreme Court in 1980 in Exxon Corp. v. Wisconsin Dept. of Revenue. "The idea of separate functional accounting seems to be incompatible with the 'very essence of

formulary apportionment, namely, that where there are integrated, interdependent steps in the economic process carried on by a business enterprise, there is no logical or viable method for accurately separating out the profit attributable to one step in the economic process from the other steps."

The difference here is that Reuters was operating across international borders instead of state lines. In both cases, both companies were found to be operating unitary businesses. And, in both cases, the courts allowed the taxing jurisdictions to combine all the divisions within their respective separate legal entities. The interesting point here is that if Reuters had incorporated its U.S. division and operated it as a U.S. subsidiary instead of a branch, there probably would not have been a court fight and Reuters would not have paid any corporate income tax to the City of New York. Indeed, Reuters' contention was that the New York office should be treated as if it were a separate entity. This case is a rare instance where form did not work in the taxpayer's favor. I suspect that Reuters has, by now, incorporated its New York operations.

In a footnote in Barclays Bank PLC Ltd. v. Franchise Tax Board, it was disclosed that England's Inland Revenue (the UK's IRS) had just six employees working on transfer pricing abuses. I suspect that that number has since grown considerably. Indeed, the Organization for Economic Co-operation and

Development (the "OECD"), a Paris based intergovernmental organization, is now, finally, very concerned with transfer pricing/profit shifting abuses (see Exhibits #16 and # 17). The OECD, which was formed in 1961 by European countries and the United States and Canada, can trace its origins back to the Marshall Plan (which recently celebrated its 50th anniversary).

In the OECD report "Harmful Tax Competition: An Emerging Global Issue" that was recently released in April 1988, there is concern that globalisation "has widened opportunities for tax evasion and avoidance." "In this new environment, tax havens have thrived and some governments have adopted preferential tax regimes specifically targeted at attracting mobile activities." "If nothing is done, governments may increasing be forced to engage in competitive tax bidding to attract or retain mobile activities." "That 'race to the bottom,' where location and financing decisions become primarily tax driven, will mean that capital and financial flows will be distorted and it will become more difficult to achieve fair competition for real economic activities." "There is no reason why taxpayers that do not or cannot take advantage of harmful tax practices should have to pay the taxes avoided by those who have easy access to tax havens and harmful preferential tax regimes."

"The potential impact of these developments is significant. It is estimated, for example, that foreign direct investment by G7 countries in a number of jurisdictions in the Caribbean and in the South Pacific island states, which are generally considered to be low-tax jurisdictions, increased more than five-fold over the period 1985-1994 to more than US$200 billion, a rate of increase well in excess of the growth of total investment outbound foreign direct investment."

I am certain that separate entity/arm's length accounting is not and never will be the remedy for this tax abuse – profit shifting. As long as corporations have unfettered use of form – incorporated entities – profit shifting will persist and worsen. The beauty of the unitary approach on a worldwide basis is that it ignores form. It pierces the corporate veil and treats a parent company and all of its unitary subsidiaries (or branches) AS IF THEY WERE ONE COMPANY. It denies companies the ability to play the transfer pricing – profit shifting game (see Exhibit #18 and # 19). It also denies companies the ability to shift taxes to "that fellow behind the tree."

CONCLUSION

I agree with Caterpillar that New Hampshire's water's edge method is discriminatory. I do not agree with Caterpillar's remedy. The State of New Hampshire's brief demonstrates that Caterpillar's remedy is a step backwards and makes a bad situation worse. Worldwide combination is a step forwards. I encourage the Court to fire up the Commerce Clause bulldozer and make the playing field level.

Respectfully submitted,

Peter S. Garre

CERTIFICATE OF SERVICE

September 30, 1998

I certify that a copy of the foregoing was served as follows:

Martin Honigberg, Esquire (by first class mail)
Senior Assistant Attorney General
Office of the Attorney General
33 Capital Street
Concord, NH 03301

William Ardinger, Esquire (by first class mail)
Rath, Young, & Pignatelli
One Capital Plaza
P.O. Box 1500
Concord, NH 03301-1500

Peter S. Garre

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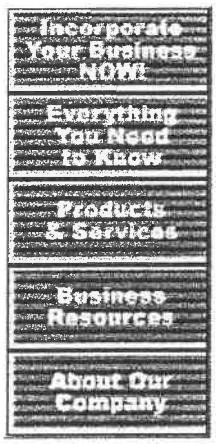
EXHIBIT #1



F.A.Q.

(Frequently Asked Questions)

Who is The Company Corporation?

The Company Corporation (TCC) and its affiliated companies have been providing incorporatio and entrepreneurial communities since 1899. Forming well over 100,000 new business entities e services including:

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- Free name search and reservation
- Preparation and filing of Articles of Incorporation in all 50 states
- Formation of Limited Liability Companies in all 50 states
- Registered Agent office and address
- Receive and forward service of process
- Forward official federal and state mail
- Corporate organizers, which include: Corporate minute book, seal and stock ce
- IRS form 2553 for S Corporation status
- IRS form SS-4 for your Tax ID number
- File qualification documents in all 50 states
- Entrepreneurs Advantage Resource Network™(E.A.R.N™), a small business
- U.S. trademark and patent searches
- Internet Domain Name Reservations (worldwide)

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Do I need an attorney to form my corporation?

While we recommend a discussion with your attorney and/or tax advisor to determine the value it is not necessary to employ the services of an attorney to form your corporation. The Company service company and can assist you in forming a new corporation or LLC in any state. TCC does

Where should I incorporate?

It is not the purpose of this guide to provide legal or tax advice. Before deciding to form a co attorney or an accountant to determine if a corporate structure is best for your business, and in wl

Some accountants and lawyers recommend forming a Delaware corporation in all cases. It is true Delaware corporations did have significant tax and other advantages. This is no longer as true as advantageous to form a corporation in Nevada, Wyoming or any other state in America if you do advice may be to form a corporation in the state where you plan to conduct business. It will be fa cost-effective in the long run.
Listed below are some of the reasons why Delaware attracts both large and small businesses:

What are the advantages of a Delaware or Nevada corporation?

Anyone may form a corporation in Delaware without ever having to visit the state. Delaware has friendliest states to corporations. Indeed, over 50% of all companies listed on the New York Stoc

- Names and addresses of initial directors need not be listed in public records.
- The cost to form a Delaware corporation is among the lowest in the nation. The annual $ favorably with that of most other states.
- Delaware maintains a separate court system for business, called the "Court of Chancery." involving a trial in Delaware, there is an established record of business decisions.
- No minimum capital is required to organize the corporation and there is no need to have
- Just one person can hold all the offices of the corporation: President, Vice President, Sec
- There is no state corporate income tax on Delaware corporations that do not operate with
- Shares of stock owned by persons outside of Delaware are not subject to Delaware perso
- There is no Delaware inheritance tax levied on stock held by non-residents.
- A Delaware corporation can be formed quickly and easily by phone in as little as 5 minu

Nevada is becoming increasingly friendly to corporations with its privacy and liability protection business entities to Nevada in order to receive the numerous tax benefits. Listed below are some each day:

- No state corporate tax on profits
- No state annual franchise tax
- No personal income tax
- Stockholders are not public record which permits complete anonymity
- Just one person can hold all the offices of the corporation: President, Vice President, Sec
- Stockholders, directors and officers need not be residents of Nevada
- A Nevada corporation can be formed quickly and easily by phone in as little as 5 minute

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Can my Delaware corporation do business in my home state and other sta

Yes. In fact, nearly half of the corporations listed on the New York Stock Exchange are Delawa conduct business throughout the U.S. and abroad. They must, of course, conform to the laws of a that any foreign (out of state) corporation qualify to do business in their state. The Company Cor corporation or LLC in any state you choose.

Are there any special requirements for selecting a corporate name?

Yes. The corporate name you choose must contain a valid corporate indicator for the state in accept one of the following identifiers or a suitable abbreviation: Incorporated, Corporation, Con corporations do vary from state to state. In addition, your corporate name must not match or be t registered in your desired state. The Company Corporation can assist you in determining an acce

How do I find out if my preferred corporate name is available?

This service is provided by The Company Corporation as part of your order. Corporate names reserved within only a few moments and at no additional cost. Name availability checks in other states. Please note, many states require that your corporate name be unique and not deceptively s state. For this and to ensure your filing is completed as quickly as possible, it is a good idea to su

Is there a minimum capital requirement to start a corporation?

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In most states, the only capital required to start your corporation or LLC is the state filing fee need to pay the filing fees of $74 and TCC service fees.

How many people do I need to incorporate?

Most states require there be at least one director for a corporation and two for an LLC, althoug

How long will it take before my business is officially incorporated?

If you form a Delaware corporation with The Company Corporation, your new corporation w your order. Due to our nationwide network of offices, your corporate documents in most other sta just 2-3 days. As soon as the official documents are released by the state, we forward them to you

When will I receive my corporate kit?

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Your corporate kit will be shipped to you via express courier after official verification of filin varies from state to state, but in most cases, you will receive your corporate kit within 5-7 busine: filed Articles of Incorporation arrive separately.

When will I receive my Articles of Incorporation?

Your copy of the filed Articles of Incorporation will arrive separately from the corporate kit. (have them in your hands in as little as 10 business days. Foreign business formations require a so Express service, within just 24 hours of receiving documentation from your state of incorporatior your selected Corporate Kit by overnight delivery.

What is a Registered Agent?

Most states require that corporations maintain a designated person or entity (a resident of the stat vital legal and tax documents on behalf of the corporation. An "agent" of the corporation "registe this service - thus the term "Registered Agent." Service performed by the Registered Agent inclu

- Provide a local address for service of process in the state of incorporation.
- Forward official state and federal mail.
- Forward state franchise tax or annual reports when required.
- Provide additional buffer between the state and your business allowing you greater perso
- All service of process is sent to you promptly for your immediate attention.
- The Company Corporation serves as a full time Registered Agent in all 50 states and the
- Our fees for serving as Registered Agent vary with the state or international jurisdiction.
- You will find The Company Corporation the most cost effective and comprehensive reso

The Company Corporation can serve as your Registered Agent in any state you require. Our ann all states.

With our nationwide network of offices, we can provide a full-range of corporate services for ev

What is a Corporate Organizer^{tm} and do I need one?

When you form your new corporation, it is essential to keep accurate records. Our Corporate Kit corporate procedures an easy task. Take your choice of our standard, Deluxe or Attaché Corporat Here is what's included in the kit:

- Corporate seal
- Minute book and slipcase
- 20 stock certificates imprinted with corporate name

- Stock transfer ledger
- Sample forms for minutes and bylaws

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Can I keep the same bank account or do I need to open a new one once I'r

It is necessary to open a new bank account for your new entity. Do not commingle cash. Always from yourself in every respect. By using the same bank account for personal and corporate purpo challenge the validity of your corporation and attack your personal assets.

Can I keep or transfer my current tax ID number?

No. Your Employer Identification Number is like a social security number. Just as you would ob people, you must have a different EIN for each new company.

What is E.A.R.N.™ ?

The E.A.R.N. program was created to help small businesses save time and money. Small busine are starting a new venture. Most have not focused on services such as health and dental insurance check guarantee, venture capital or any of our other 40 discounted services. Each E.A.R.N. vend so that you can rely on the program for all your business needs. Many E.A.R.N. members discov their business. With such a low annual fee, most members renew their annual membership to tak businesses grow.

Visit the E.A.R.N. web site

What can The Company Corporation do to help me file an international c

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The Company Corporation has developed strategic alliances with specialized international inco international company in almost any jurisdiction. Our international network offers you the most c the availability of ready-made shelf companies in major worldwide jurisdictions.

We also provide other special international services including notarization, apostilles and transla international company, TCC can assist you. (Click here to see more information on international requests will take longer than 24 hours to complete and may require additional information to reg

The Company Corporation is a service company and does not offer legal or financial advice.

OCRA World Wide

Uses of Offshore Companies

Tax Minimisation v Risk Management v Cost Reduction

"No man in the country is under the smallest obligation, moral or other, so to arrange his legal relations to his business or property as to enable the Inland Revenue to put the largest possible shovel in his stores. The Inland Revenue is not slow - and quite rightly - to take every advantage which is open to it under the Taxing Statutes for the purposes of depleting the taxpayer's pocket. And the taxpayer is in like manner entitled to be astute to prevent, so far as he honestly can, the depletion of his means by the Inland Revenue."

- UK Law Lord Clyde -

"There is nothing sinister in so arranging one's affairs as to keep taxes as low as possible. Everybody does so, rich or poor; all do right. Nobody owes any public duty to pay more than the law demands; taxes are enforced exactions not voluntary contributions!"

- US Judge Learned Hand -

Some examples of the areas in which OCRA World Wide helps its clients follow. Apply the principles to yourself or your company to appreciate how we can help you. Further information can be found under each Location.

INTERNATIONAL TRADING AND PURCHASING COMPANIES

One of the most popular uses of a company incorporated in a low tax area is for international trading. Significant tax saving opportunities can arise by interposing an offshore company into an international trading transaction. If an offshore company were to procure products from one country, and then sell them on to another country the profits arising out of the transaction may be accumulated in the offshore company, free from taxation in the offshore centre.

For European Union transactions, the Isle of Man and Madeira have become very popular locations for conducting cross border trading activities. Both the Isle of Man and Madeira are able to obtain VAT registration, which is imperative for triangular transactions within the 15 Member States of the European Union. As an example, if an Isle of Man company wished to source products from France for sale to Germany, the Isle of Man company would inform the French company of its VAT number so that it could zero rate its sales invoice, i.e. the French company would not have to charge VAT to

EXHIBIT #3

the Isle of Man company. The Isle of Man company would then obtain the German company's VAT number so that it could zero rate its sales invoice.

This type of transaction would not normally be possible through other jurisdictions without the requirement of either establishing a branch office or appointing a tax agent within the European Union which can be a complicated exercise and may give rise to taxation implications.

Factoring trading debts of a company resident in a high tax jurisdiction through a company established in low tax jurisdiction may assist in transferring funds to the low tax jurisdiction.

Another common use of an offshore entity is for bulk purchasing. Such a structure is typically established by a group of associated or un-associated companies to benefit from economies of scale and reduced administrative costs. Moreover, such a structure may be more tax efficient than an onshore arrangement.

Timber

The Group assists clients in buying timber from Canada for sale in the European Union by buying the timber through a company established in the Channel Islands, which sells the timber on to the company's head office in Belgium for onward distribution throughout the European Union. The timber is shipped directly from Canada to Belgium.

Fashion

The Group established a company in Hong Kong for a client who buys clothing from various manufacturing centres in the Far East. The clothing is sold by the Hong Kong company to distributors in North America and Western Europe and the profits of the Hong Kong company are completely free of taxation in Hong Kong.

Electronics

The Group established an offshore company in the Isle of Man for an international client who exports sophisticated electronics equipment for the computer industry world-wide. By firstly selling the products to the Isle of Man company, large profits were accumulated completely free of tax on the Isle of Man company's onward sales to customers in Japan, the United States of America and Germany.

Diamonds

The Group saves its clients substantial sums of tax in a more complex transaction by use of an offshore structure for the purchase, by a Swiss company, of rough diamonds in Antwerp, which are then sent to India where they are cut and polished prior to export to a Netherlands company which subsequently sells them to distributors in the United States of America.

Confirming House

The Group saves many international clients large sums of money on import and export transactions by routing such transactions through a confirming house which is set up in a low tax jurisdiction.

For example, for one such international client, the Group arranged the incorporation of a

confirming house in Cyprus which purchases construction equipment and raw materials for a multi-million dollar construction project in Eastern Europe. The confirming house purchases from suppliers in Eastern and Western European countries, as well as from the United States of America, and the supplies are shipped direct from the country of origin to Eastern Europe. This enables the client to take advantage of Cyprus' double taxation treaty with these territories, and profits are accumulated in the Cyprus company, suffering only nominal taxation.

Factoring Company

The Group administers several offshore factoring companies for overseas clients engaged in both the manufacturing and service industries. Factoring trading debts of a company resident in a high tax jurisdiction through a factoring company established in a low tax jurisdiction can achieve the transfer of funds from a high tax jurisdiction to a low tax jurisdiction. It should be possible to ensure that the factoring charge is treated as a deductible expense in the high tax jurisdiction concerned.

INTERNATIONAL INVESTMENT

Both corporations and individuals regularly make use of offshore companies as vehicles to hold investment portfolios. Such portfolios may consist of stock, bonds, cash and a broad range of other investment products. Cash assets held by offshore companies may earn deposit interest free of tax.

High net worth individuals often use offshore companies as personal holding companies to hold investments made in a number of different markets and countries. Personal holding companies can provide privacy and may save the professional and other fees associated with setting up and maintaining entities in a number of different structures. In this connection offshore companies are regularly used for inheritance planning and to reduce the costs and time delays associated with probate.

The selection of a politically and economically stable corporate domicile may reduce risks that both corporations and individuals may face in either their home or third party countries.

Many large corporations and companies wishing to invest into countries where a Double Taxation Agreement does not exist between the investor's country and the country where the investment is to be made will establish an intermediary company in a jurisdiction where there is a suitable treaty. The Madeiran SGPS Company, for example, has been used extensively for inward investment into European Union corporate entities to make use of the EU Parent Subsidiary Directive.

Cyprus has an extensive double taxation treaty network with many Eastern European and CIS countries, and the use of Cypriot companies for inward investment into these countries provides a tax efficient conduit.

Offshore corporations and trusts are often used to hold investments in subsidiary and/or associated companies, publicly quoted and private companies and joint venture projects. In many cases capital gains, arising from the disposal of particular investments, can be made without the encumbrance of taxation. In the case of dividend payments, reduced levels of withholding taxes can be achieved by the utilisation of a company incorporated in a zero or low tax jurisdiction that has double taxation agreements with the contracting state. An example of this is a Mauritian Offshore Company which can invest into Indian companies and benefit from the double taxation treaty that exists between the

two countries, whereby withholding taxes on dividend payments are reduced from 25% to 15%. Moreover, there is no capital gains tax upon the disposal of the investment in India.

Triangular Structures

The Group assists clients from third countries to take advantage of Portuguese treaties in their dealings with Portugal's treaty partners where the third country does not itself have a treaty with Portugal's treaty partner.

The Brazilian example is a very useful and illustrative one: A country that does not have a treaty with Brazil may use a Madeira company to reduce the withholding tax on interest or royalty income emanating from Brazil. For example, a company that is a resident of the US is normally subject to a 25% withholding tax in Brazil on interest and royalties.

If payment of such income are directed to a subsidiary of the American company located in Madeira, the withholding tax payable in Brazil will be reduced to 15%, or even 10% for royalties in certain cases, due to the double tax treaty existing between Portugal and Brazil. Subsequently, the income received by the Madeira company will be exempt and the profits distributed to the parent company (US) will not be subject to withholding tax in Madeira.

The "SGPS" Structure - The Gateway to Europe

Of all corporations allowed to be established within the International Business Centre of Madeira, the so-called SGPS "Sociedade Gestora de Participações Sociais" is of particular importance in view of its specific advantages for some international tax planning structures.

In order to allow Madeira companies to become a useful alternative for structuring investments in Europe via holding companies, in early 1993 the Portuguese Government reviewed and clarified the regime of tax incentives granted to companies operating in the International Business Centre of Madeira under article 41 of Portugal's general tax incentives statute.

One of the major improvements contemplated in the new regime is the possibility of incorporating the Portuguese type of companies called Sociedades Gestoras de Participações Sociais (SGPS), which are exclusively holding companies.

In accordance with the Portuguese SGPS legislation, which was enacted by Decree Law No. 495/88 of December 1988, these companies are entitled to a deduction of 95% of their taxable income derived from dividends received, in order to reduce the double taxation of such income, which means that the dividends emanating from the shareholdings of these companies are effectively taxed at 1,8%, namely 36% of 5%.

This regime only applies to dividends received by the SGPS. Eventual capital gains derived from the sale of the shareholding would be taxed at the regular 36% rate, unless the gain is totally or partially reinvested in the acquisition of other shareholdings by the end of the second fiscal year, following the sale which created the capital gain.

According to the amended tax system applicable to the Madeira Free Zone, an SGPS

incorporated in Madeira is subject to corporate tax on the profits emanating from their shareholdings located in Portugal and other EC countries. Dividends paid by companies located in other countries are still fully exempt. Thus, Madeira SGPS holding companies comply with the three basic requirements to qualify for the exemption from withholding tax on dividends received from EC subsidiaries, in accordance with the EC parent/subsidiary directive, particularly the subject-to-tax rule.

Double Tax Treaties

The Group assists its clients to make substantial tax savings on their investments in the recently liberalised Indian market.

The Group has structured a Mauritian offshore company for a UK based client so that it obtained a Certificate of Tax Residence from the Mauritian tax authorities, which certified that the company was entitled to the benefits of the Indo-Mauritian Double Taxation Agreement.

The client then used his Mauritian company to purchase shares in Indian companies. By using a Mauritian vehicle, instead of investing directly, the client achieved the following benefits:

Dividends

The Indian withholding tax of 25 per cent on dividend payment was reduced to 15 per cent where the dividends were paid to the Mauritian company. (The withholding tax is reduced to 5 per cent in the case of those investments where the Mauritian company owns more than 10 per cent of the Indian company).

Capital Gains

Complete exemption from Indian capital gains tax when the client's Mauritian company sold it's Indian shares. The dividends, capital gain or interest payment received by the client's Mauritian company were not subject to tax in Mauritius and could be freely repatriated abroad.

The Mauritian route for investment into India is now being extensively used. The group registered the first Mauritian fund for investment in the Indian markets, and works in conjunction with clients' professional advisers in India to structure vehicles which qualify for Foreign Institutional Investor status and for Non-Resident Indian concessions.

PERSONAL SERVICE COMPANIES

Many individuals engaged in the provision of professional services in the professions and in the construction, engineering, aviation, finance, computer, film and entertainment industries can achieve considerable tax saving benefits through the establishment of a personal service company, based offshore. The offshore company can contract to supply the services of the individual outside the country in which he/she is normally resident and the fees earned can accumulate offshore, free from taxation in the offshore centre. Payments to the individual can then be structured in such a way to minimise income tax. The Group has advised famous stars, actresses, pop groups, sportsmen, oil

engineers and financial consultants, on entering into contracts with independent employment companies, incorporated in appropriate jurisdictions, which sell their services outside the individual's country of residence.

PROPERTY AND LAND OWNERSHIP

The ownership of real property and land by an offshore company can often create many tax advantages, including the legal avoidance of capital gains, inheritance and property transfer taxes.

If, for example, an offshore company owned a property in the United Kingdom for investment purposes and the property was then later sold on to a third party, the capital gain arising from the transaction would not be subject to United Kingdom capital gains taxation. Also, by structuring the financing correctly through a back-to-back loan facility, the offshore company can reduce the effective level of any withholding taxes on rental income that may apply.

The Group appreciates there are often great advantages in using an offshore property holding company for the purchase of overseas property. The costs of doing this are not significant in relation to the benefits that arise. Using a trust to own the shares in the offshore company can give rise to additional tax advantages in the client's country of residence and simplifies procedures in the event of the client's death.

The BVI, Isle of Man, Mauritius and Madeira are amongst the safe and stable jurisdictions for property owning companies and trusts and the Group administers many such companies and trusts.

The Group has made special arrangements with a major British Clearing Bank to provide finance on favourable terms for the financing of property purchases in amongst others France, Spain and Portugal by offshore companies. Loans are available to qualified buyers in any major currency, for up to twenty years with no penalty for early repayment.

EMPLOYMENT COMPANIES

Many companies utilise offshore companies for the employment of staff working on overseas assignments. This helps to reduce the costs associated with payroll and travel expense administration, and may provide a tax and social security saving benefit for the employees.

INTELLECTUAL PROPERTY, LICENSING AND FRANCHISING

Intellectual property, including computer software, technical know-how, patents, trademarks and copyrights can be owned by or assigned to an offshore company. Upon the acquisition of the rights, the offshore company can then enter into licence or franchise agreements with companies interested in the exploitation of such rights around the world. The income arising from such arrangements can be accumulated offshore and by the careful selection of an appropriate jurisdiction, withholding taxes on royalty payments can be reduced by the commercial application of double taxation treaties. The UK, Netherlands, Madeira, Cyprus and Mauritius are good examples of jurisdictions used for holding intellectual property.

MIXING VEHICLES

Several of the major multinational operations have established their own offshore Mixing Companies to mix dividends from their subsidiaries, to take maximum advantage of tax credits.

The Group assists clients in high tax credit jurisdictions, including, for example, the UK which treats overseas dividend income on a source by source basis. This may give rise to situations where a dividend from one source has an underlying foreign tax credit which exceeds the domestic tax payable, there being no facility in domestic law to set the excessive tax credit on the first dividend against the domestic tax liability on the second dividend. The solution is for the domestic company to form a subsidiary normally located in a territory which has favourable double tax treaty arrangements and use that, effectively mixing the foreign underlying tax credits allowing "set off" for excess tax credits against dividends from low tax sources. The "mixed" dividend is then paid on to the domestic parent with the underlying rate averaged out.

The Group's tax specialists have considerable experience in assisting clients with multinational subsidiaries and can give clients the benefit of experience gained in structuring such operations.

STOCK MARKET LISTINGS AND CAPITAL RAISING EXERCISES

With political and economic uncertainty in some countries, many large corporations have sought to mitigate risk by moving ownership of assets and bases of operations offshore. Luxembourg and Bermuda have been host to many companies wishing to re-domicile their operations.

Offshore companies are regularly employed to raise money through loan or bond issues. Such a structure may reduce withholding tax on interest payments as, for example, countries such as the UK raise a withholding tax on interest paid on non-quoted bonds to non-residents. Double taxation avoidance planning is vital in cases such as these.

FINANCE

Offshore finance companies can be established to fulfil an inter-group treasury management function. Interest payments from group companies may be subject to withholding taxes, but often these taxes are different to the normal rates of corporation taxes that are levied. The interest paid would be a deductible charge, for taxation purposes, and so consolidating interest payments in an offshore finance company may provide a tax saving benefit. In many countries foreign exchange losses are not deductible for tax purposes. If an offshore finance subsidiary was formed, then made a foreign exchange loss, and was then liquidated, the investment could be a tax deductible item for the parent company.

Offshore companies are often utilised as part of mechanisms and structures for acquiring foreign entities, international restructuring of corporations, real estate and other investments and other corporate finance related projects.

The Group has identified a number of high tax jurisdiction that grant fairly high capital allowances or give investment grants to companies within their jurisdiction which purchase capital equipment and the popular concept is that it is usually not advantageous to use a low tax area centre from which to lease capital assets.

There are, however, a number of circumstances under which there are advantages to using a low tax area as a leasing base. Essentially, these concern situations where there is a wish to move international

group funds into a high tax area. Their movement in the normal course of events would lead to their treatment as taxable income, either as a real or deemed dividend receipt.

In these circumstances the use of a low tax company as a conduit for funds can achieve the two fold benefit of meeting the need for capital expenditure in a high tax jurisdiction in a form which does not give rise to tax as the funds cross frontiers and then enables the further extraction of subsequent profits from a high tax area in the form of lease payment at arms length rates. There can also be exchange control benefits.

SHIPPING COMPANIES

Since the early part of the 20th Century, the use of offshore companies to own merchant ships and pleasure craft has been an important function of certain offshore jurisdictions, such as Panama and Liberia.

Many other important offshore jurisdictions have modern ship and pleasure craft registration facilities that provide low cost registration fees and tax exemption on income derived from shipping and chartering activities. These jurisdictions include the Isle of Man, Madeira, Jersey, Gibraltar, Cyprus, Bahamas, Belize and Mauritius.

It should be noted that pleasure vessels being operated within European Union waters for extended periods of time require specialised advice in relation to Value Added Tax.

The Group uses low tax jurisdictions for basing shipping companies to eliminate taxation on profits earned from chartering and other ancillary activities. The Group believes that there are advantages in flying the British Flag, and these advantages can be obtained, together with substantial tax benefits by registering ships at low tax jurisdiction British ports of registry such as Gibraltar and the Isle of Man.

The Group has realised the need for specialist skills in this field and provides expert advice on the Isle of Man shipping Register in particular and international ship management generally. The Isle of Man can offer may advantages to existing or potential ship owners and managers. Vessels registered in the Isle of Man sail under the British Flag with all the prestige of a Class A register while still enjoying many of the advantages associated with offshore operation, including tax exemption.

The Group undertakes the registration of private yachts in a variety of jurisdictions and assists clients chartering such yachts to choose the most tax efficient structure. The Group has substantial experience of dealing effectively with the difficulties of the potential V.A.T. liability on yachts operating within the European Community.

EMIGRATION

The Group respects the fact that the anti-avoidance legislation of most high tax jurisdictions is primarily aimed at long term residents of that jurisdiction or alternatively at countering action taken while a resident of that jurisdiction. This leaves an enormous amount of scope for planning when an individual is physically moving between high tax countries, whether for business purposes or retirement, for periods of anything between one year and the indefinite future.

No Frames navigation

Please go to our Home Page where you will find interesting information on the benefits of using offshore companies and trusts for business and personal use, links to information on other locations and details of our products and services.

OCRA World Wide

Location Comparison

Part 1	Type of company	Common or Civil Law	Shelf Company Availability	OCRA's time to Incorporate	Minimum annual licence, duty or franchise fee
Part 2	Annual return filing fee	Taxation	Disclosure of beneficial ownership	Bearer shares permitted	Minimum paid up capital
Part 3	Standard authorised share capital	Permitted currencies of capital	Minimum number of shareholders or equity participants	Minimum number of directors	Corporate directors permitted
Part 4	Local directors required	Company secretary required	Company seal required	Public register of directors	Public register of shareholders
Part 5	Location of directors meetings	Location of shareholders meetings	Telephone board meetings permitted	Double taxation treaty access	Requirement to submit accounts
Part 6	Requirement to file annual return	Change in domicile permitted	Time Zone GMT +/-		

Jurisdiction	Type of company	Common or Civil Law	Shelf Company Availability	OCRA's time to Incorporate	Minimum annual licence, duty or franchise fee
Anguilla	IBC	Common	Yes	1 day	None
Bahamas	IBC	Common	Yes	2 days	$ 100
Belize	IBC	Common	Yes	1 day	$ 100
Bermuda	Exempt	Common	No	15 days	$ 1695
British Virgin Islands	IBC	Common	Yes	2 days	$ 300
Cayman Islands	Exempt	Common	Yes	2 days	$ 500
Cook Islands	IBC	Common	Yes	3 days	$ 700
Cyprus	Offshore	Common	Yes	5 days	Not applicable
Delaware - USA	LLC	Common	Yes	2 days	Not applicable
Delaware - USA	C Corporation	Common	Yes	2 days	Minimum $ 30
Gibraltar	Exempt	Common	Yes	5 days	£ 225
Gibraltar	Non resident	Common	Yes	5 days	Not applicable
Hong Kong	Private limited	Common	Yes	10 days	$ 300
Hungary	Offshore KFT	Civil	Yes	5-10 days	HUF 800
Hungary	Offshore RT	Civil	No	5-10 days	HUF 800
Ireland	Non resident	Common	Yes	10 days	Not applicable
Isle of Man	Exempt	Common	Yes	1 day	£ 400
Isle of Man	Non resident	Common	Yes	1 day	£ 750
Jersey	Exempt	Common	No	5 days	£ 600
Labuan	Offshore - Non Trading	Common	No	5 days	RM 2k
Labuan	Offshore - Trading	Common	No	5 days	RM 2k
Liberia	Non resident	Common	Yes	2 days	$ 150
Liechtenstein	AG	Civil	No	15 days	CHF 1000
Liechtenstein	Anstalt	Civil	No	15 days	CHF 1000
Luxembourg	1929 Holding	Civil	No	15 days	0.2% of capital
Luxembourg	1990 SOPARFI Holding	Civil	No	15 days	Not applicable

EXHIBIT #4

Madeira	Limitada	Civil	Yes	60 days	$ 1000
Madeira	SA	Civil	Yes	60 days	$ 1000
Malta	ITC/IHC	Civil	No	5 days	Not applicable
Mauritius	International	Hybrid	Yes	1 day	$ 100
Mauritius	Offshore	Hybrid	No	15 days	$ 1500
Netherlands Antilles	Offshore Trading	Civil	No	10 days	$ 60
Netherlands Antilles	Offshore Investment	Civil	No	10 days	$ 60
Nevis	NBCO	Common	Yes	2 days	$ 200
Niue	IBC	Common	Yes	2 days	$ 150
Panama	Non resident	Civil	Yes	2 days	$ 150
Samoa	International	Common	Yes	2 days	$ 300
Seychelles	IBC	Common	Yes	2 hours	$ 100
Switzerland	AG	Civil	No	8 - 10 days	Varies
Switzerland	GmbH	Civil	No	8 - 10 days	Varies
Turks & Caicos	Exempt	Common	Yes	2 days	$ 300
UK Ltd	Resident	Common	Yes	1-8 days	Not applicable
UK PLC	Resident	Common	Yes	1-8 days	Not applicable
Uruguay	SAFI	Civil	Yes	30 days	0.3% of capital
Vanuatu	International	Hybrid	Yes	2 days	$ 300
Note: For detailed information and clarification of taxation liabilities see jurisdiction information					

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Jurisdiction	Annual return filing fee	Taxation	Disclosure of beneficial ownership	Bearer shares permitted	Minimum paid up capital
Anguilla	US$230	Nil	No	Yes	$ 1
Bahamas	Not applicable	Nil	No	Yes	$ 1
Belize	Not applicable	Nil	No	Yes	$ 1
Bermuda	Not applicable	Nil	Yes	No	$ 1
British Virgin Islands	Not applicable	Nil	No	Yes	$ 1
Cayman Islands	Not applicable	Nil	No	Yes	$ 1
Cook Islands	Nil	Nil	No	Yes	$ 1
Cyprus	Nil	4.25%	Yes	No	CY£ 1000
Delaware - USA	$ 100	Fiscally transparent	No	No	Not applicable
Delaware - USA	$ 20	Yes	No	No	$ 1
Gibraltar	£ 26	Nil	Yes	No	£ 100
Gibraltar	£ 26	Nil	No	Yes	£ 1
Hong Kong	$ 13	Nil on Foreign Profits	No	No	HK$ 2
Hungary	Not applicable	3%	No	No	$ 7500
Hungary	Not applicable	3%	No	Yes	$ 50k
Ireland	£ 30	Nil	Yes	No	£ 2
Isle of Man	£ 45	Nil	No	No (Bearer warrants possible)	£ 1
Isle of Man	£ 120	Nil	No	No (Bearer warrants possible)	£ 1

Jersey	£ 120	Nil	Yes	No	£ 2
Labuan	RM 100	Nil	No	No	$ 1
Labuan	RM 100	3% or RM 20k	No	No	$ 1
Liberia	Not applicable	Nil	No	Yes	$ 1
Liechtenstein	Not applicable	4% coupon tax on dividends and an annual capital tax of 0.1%	No	Yes	CHF 50k
Liechtenstein	Not applicable	Annual capital tax of 0.1%	No	No	CHF 30k
Luxembourg	Nil	Nil	No	Yes	FLUX 1.25M
Luxembourg	Nil	Normal rates	No	Yes	FLUX 1.25M
Madeira	Not applicable	Nil	No	No	ESC 400k
Madeira	Not applicable	Nil	No	Yes	ESC 5M
Malta	From Lm 50	Credits/Refunds	No	No	Lm 500, 20% paid up
Mauritius	Not applicable	Nil	No	Yes	$ 1
Mauritius	Nil	15% or 0-35%	Yes	No	$ 2
Netherlands Antilles	Not applicable	4.8% on $ 56k 6% on balance	No	Yes	$ 6000
Netherlands Antilles	Not applicable	2.4% on $ 56k 3% on balance	No	Yes	$ 6000
Nevis	Not applicable	Nil	No	Yes	$ 1
Niue	Not applicable	Nil	No	Yes	$ 1
Panama	Not applicable	Nil	No	Yes	$ 1
Samoa	Not applicable	Nil	No	Yes	Nil
Seychelles	Not applicable	Nil	No	Yes	$ 1
Switzerland	Not applicable	Nil on foreign profits	No	Yes	Normally CHF 100k
Switzerland	Not applicable	Nil on foreign profits	No	No	Normally CHF 100k
Turks & Caicos	Not applicable	Nil	No	Yes	$ 1
UK Ltd	£ 15	24% to 33%	No	No (Bearer warrants possible)	£ 1
UK PLC	£ 15	24% to 33%	No	No	£ 12.5k
Uruguay	Not applicable	Nil	No	Yes	$ 2500
Vanuatu	Not applicable	Nil	No	Yes	One unit of currency of capital
Note: For detailed information and clarification of taxation liabilities see jurisdiction information					

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Jurisdiction	Standard authorised	Permitted currencies of	Minimum number of shareholders or	Minimum number	Corporate directors

	share capital	capital	equity participants	of directors	permitted
Anguilla	$ 50k	Any	1	1	Yes
Bahamas	$ 5000	Any	1	1	Yes
Belize	$ 50k	Any	1	1	Yes
Bermuda	$ 12k	Bermuda $	1	2	No
British Virgin Islands	$ 50k	Any	1	1	Yes
Cayman Islands	$ 50k	Any	1	1	Yes
Cook Islands	Not applicable	Any	1	1	Yes
Cyprus	$ 50k	Cyprus Pound	2	1	Yes
Delaware - USA	Not applicable	US Dollar	Normally 2	1 manager	Not applicable
Delaware - USA	$ 150k	Not applicable	1	1	No
Gibraltar	£ 2,000	Any	1	1	Yes
Gibraltar	£ 2,000	Any	1	1	Yes
Hong Kong	HK$ 1000	Any	2	2	Yes
Hungary	$ 15,000	Forint	1	1	No
Hungary	$ 100k	Forint	1	3	No
Ireland	£ 1M	Any	2	2	No
Isle of Man	£ 2,000	Any	1	2	No
Isle of Man	£ 2,000	Any	1	2	No
Jersey	£ 10k	Any	2	1	No
Labuan	$ 10k	Any except RM	1	1	Yes
Labuan	$ 10k	Any except RM	1	1	Yes
Liberia	$ 50k	Any	1	1	Yes
Liechtenstein	CHF 50k	Swiss Franc	1	1	Yes
Liechtenstein	CHF 30k	Swiss Franc	1	1	Yes
Luxembourg	FLUX 1.25M	Any	2	3	Yes
Luxembourg	FLUX 1.25M	Any	2	3	Yes
Madeira	ESC 400k	Escudo	Normally 2 (1 is possible)	1	No
Madeira	ESC 5M	Escudo	Normally 5 (1 is possible)	1	No
Malta	Lm 500	Any	ITC - one, IHC - two	1	Yes
Mauritius	$ 100k	Any	1	1	Yes
Mauritius	$ 100k	Any	Normally 2	2	No
Netherlands Antilles	$ 30k	Any	1	1	Yes
Netherlands Antilles	$ 30k	Any	1	1	Yes
Nevis	$ 100k	0	1	1	Yes
Niue	$ 50k	Any	1	1	Yes
Panama	$ 10k	Any	1	3	Yes
Samoa	$ 1M	Any	Nil	1	Yes
Seychelles	$ 5000	Any	1	1	Yes
Switzerland	Not applicable	CHF	1	1	No
Switzerland	Not applicable	CHF	1	1	No
Turks & Caicos	$ 5000	Any	1	1	Yes
UK Ltd	£ 1,000	Any	1	1	Yes
UK PLC	£ 50k minimum	Any	2	2	Yes
Uruguay	$ 50k	Any	1	1	Yes
Vanuatu	None	Any	1	1	Yes
Note: For detailed information and clarification of taxation liabilities see jurisdiction information					

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Jurisdiction	Local directors required	Company secretary required	Company seal required	Public register of directors	Public register of shareholders
Anguilla	No	No	Yes	No	No
Bahamas	No	No	Yes	Optional	No
Belize	No	No	Yes	No	No
Bermuda	No	Yes- local	Optional	No	Yes
British Virgin Islands	No	No	Yes	No	Optional
Cayman Islands	No	No	No	No	No
Cook Islands	No	Yes	Optional	No	No
Cyprus	No	Yes	Yes	Yes	Yes
Delaware - USA	Not applicable	Not applicable	Yes	Not applicable	No
Delaware - USA	No	Yes	Optional	No	No
Gibraltar	No	Yes	Optional	Yes	Yes
Gibraltar	No	No	Optional	Yes	Yes
Hong Kong	No	Yes - local	Yes	Yes	Yes
Hungary	Yes - majority	No	No	Yes	Yes
Hungary	Yes - majority	No	No	Yes	Yes
Ireland	No	Yes	Yes	Yes	Yes
Isle of Man	Yes - one	Yes - local	Optional	Yes	Yes
Isle of Man	No	Yes	Optional	Yes	Yes
Jersey	No	Yes	Yes	Yes	No
Labuan	No	Yes - local	Yes	No	No
Labuan	No	Yes - local	Yes	No	No
Liberia	No	Yes	Optional	Optional	No
Liechtenstein	Yes - one	No	Optional	Yes	Yes
Liechtenstein	Yes - one	No	Optional	Yes	Yes
Luxembourg	No	No	Optional	Yes	No
Luxembourg	No	No	Optional	Yes	No
Madeira	No	No	Yes	Yes	Yes
Madeira	No	No	Yes	Yes	Yes
Malta	No	Yes - local	No	Yes	Yes
Mauritius	No	No	No	Optional	Optional
Mauritius	Yes - two	Yes - local	Yes	No	No
Netherlands Antilles	Yes - one	No	No	Yes	Yes
Netherlands Antilles	Yes - one	No	No	Yes	Yes
Nevis	No	Yes	Optional	No	No
Niue	No	No	Optional	No	Optional
Panama	No	Yes	Optional	Yes	Optional
Samoa	No	Yes	Optional	No	No
Seychelles	No	No	Optional	No	No
Switzerland	Yes - majority	No	No	Yes	No
Switzerland	Yes - one	No	No	Yes	Yes
Turks & Caicos	No	Yes	Optional	No	No
UK Ltd	No	Yes	Optional	Yes	Yes
UK PLC	No	Yes	Optional	Yes	Yes
Uruguay	No	No	Optional	Yes	No
Vanuatu	No	No	Optional	No	No
Note: For detailed information and clarification of taxation liabilities see jurisdiction information					

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Jurisdiction	Location of directors meetings	Location of shareholders meetings	Telephone board meetings permitted	Double taxation treaty access	Requirement to submit accounts
Anguilla	Anywhere	Anywhere	Yes	No	No
Bahamas	Anywhere	Anywhere	Yes	No	No
Belize	Anywhere	Anywhere	Yes	No	No
Bermuda	Anywhere	Anywhere	Yes	No	No
British Virgin Islands	Anywhere	Anywhere	Yes	No	No
Cayman Islands	Anywhere	Anywhere	No	No	No
Cook Islands	Anywhere	Anywhere	Yes	No	No (by resolution)
Cyprus	Anywhere	Anywhere	No	Yes	Yes
Delaware - USA	Anywhere	Anywhere	Not applicable	Yes	Yes
Delaware - USA	Anywhere	Anywhere	Yes	Yes	Yes
Gibraltar	Anywhere	Anywhere	Yes	No	No
Gibraltar	Anywhere	Anywhere	Yes	No	No
Hong Kong	Anywhere	Anywhere	Yes	No	Yes
Hungary	Anywhere	Anywhere	Yes	Yes	Yes
Hungary	Anywhere	Anywhere	Yes	Yes	Yes
Ireland	Anywhere	Anywhere	Yes	No	Yes
Isle of Man	Anywhere	Anywhere	Yes	No	No
Isle of Man	Anywhere	Anywhere	Yes	No	No
Jersey	Anywhere	Anywhere	Yes	No	No
Labuan	Anywhere	Anywhere	Yes	Yes	No
Labuan	Anywhere	Anywhere	Yes	Yes	Depends on tax regime elected
Liberia	Anywhere	Anywhere	Yes	No	No
Liechtenstein	Anywhere	Anywhere	Yes	No	Yes
Liechtenstein	Anywhere	Anywhere	Yes	No	Only Commercial Anstalt
Luxembourg	Anywhere	Anywhere	Yes	Varies	Yes
Luxembourg	Anywhere	Anywhere	Yes	Yes	Yes
Madeira	Anywhere	Madeira (by proxy)	Yes	Yes	Yes
Madeira	Madeira (by proxy)	Madeira (by proxy)	Yes	Yes	Yes
Malta	Anywhere	Anywhere	Yes	Yes	Yes
Mauritius	Anywhere	Anywhere	Yes	No	No
Mauritius	Mauritius	Mauritius	Yes	Yes	Yes
Netherlands Antilles	Anywhere	Netherlands Antilles (by proxy)	Yes	Yes	Yes
Netherlands Antilles	Anywhere	Netherlands Antilles (by proxy)	Yes	Yes	Yes
Nevis	Anywhere	Anywhere	Yes	No	No
Niue	Anywhere	Anywhere	Yes	No	No
Panama	Anywhere	Anywhere	Yes	No	No
Samoa	Anywhere	Anywhere	Yes	No	No
Seychelles	Anywhere	Anywhere	Yes	No	No
Switzerland	Anywhere	Anywhere	Yes	Varies	Yes
Switzerland	Anywhere	Anywhere	Yes	Varies	Yes

Turks & Caicos	Anywhere	Anywhere	Yes	No	No
UK Ltd	Anywhere	Anywhere	Yes	Yes	Yes
UK PLC	Anywhere	Anywhere	Yes	Yes	Yes
Uruguay	Anywhere	1 AGM p.a. in Uruguay (by proxy)	Yes	No	Yes
Vanuatu	Anywhere	Anywhere	Yes	No	No
Note: For detailed information and clarification of taxation liabilities see jurisdiction information					

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Jurisdiction	Requirement to file annual return	Change in domicile permitted	Time Zone GMT +/-
Anguilla	Yes	Yes	-5
Bahamas	No	Yes	-5
Belize	No	Yes	-6
Bermuda	No	No	-4
British Virgin Islands	No	Yes	-5
Cayman Islands	Yes	Yes	-5
Cook Islands	Yes	Yes	-10
Cyprus	Yes	No	2
Delaware - USA	Yes	No	-5
Delaware - USA	Yes	No	-5
Gibraltar	Yes	Yes	1
Gibraltar	Yes	Yes	1
Hong Kong	Yes	No	8
Hungary	No	No	1
Hungary	No	No	1
Ireland	Yes	No	GMT
Isle of Man	Yes	No	GMT
Isle of Man	Yes	No	GMT
Jersey	Yes	No	GMT
Labuan	Yes	Yes	8
Labuan	Yes	Yes	8
Liberia	No	No	GMT
Liechtenstein	Yes	No	1
Liechtenstein	Yes	No	1
Luxembourg	Yes	Yes	1
Luxembourg	Yes	Yes	1
Madeira	Yes	Yes	GMT
Madeira	Yes	Yes	GMT
Malta	Yes	No	1
Mauritius	No	Yes	4
Mauritius	Yes	No	4
Netherlands Antilles	Yes	Yes	-4
Netherlands Antilles	Yes	Yes	-4
Nevis	No	Yes	-4
Niue	No	Yes	-11
Panama	No	Yes	-5
Samoa	No	Yes	-11
Seychelles	No	Yes	4
Switzerland	No	No	1
Switzerland	No	No	1

Turks & Caicos	Yes	Yes	-5
UK Ltd	Yes	No	GMT
UK PLC	Yes	No	GMT
Uruguay	Yes	No	-3
Vanuatu	No	Yes	11
Note: For detailed information and clarification of taxation liabilities see jurisdiction information			

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OCRA World Wide

SELECTING A JURISDICTION

INTRODUCTION	The selection of the most suitable jurisdiction for either international trade or investment can often be difficult and requires very careful consideration. Most offshore jurisdictions are free from foreign exchange controls and have introduced company legislation to cater for a diverse range of international business requirements. It is important to select a jurisdiction that is well suited to specific corporate and personal needs and it should meet the following criteria.
LEGISLATION	There are now in excess of 50 jurisdictions world wide providing offshore company legislation. Some jurisdictions have introduced new and modern suites of corporate legislation, specifically designed for international business whilst others have amended existing domestic legislation to cater for offshore requirements. The most essential criteria, however, is that the legislation be modern, flexible and should include provisions on issues such as low capital requirements, minimal or optional statutory filing obligations, the ability to hold directors and/or shareholders meetings anywhere in the world, the facility to appoint professional directors, officers and nominee shareholders, the issuance of bearer shares and the absence of or the optional requirement for the audit of accounting records. Furthermore, the legislation should preferably provide confidentiality and complete privacy regarding the client's business dealings.
DOUBLE TAXATION AVOIDANCE TREATIES	The jurisdictions around the world can be categorised as follows: • Treaty jurisdictions • Non-Treaty jurisdictions Clients seeking to take advantage of double taxation treaty relief would normally wish to establish a company situated in a treaty jurisdiction. This is essential for the minimisation of withholding taxes on the payment of dividends and royalties from contracting states. Treaty jurisdictions also portray a non-offshore image and thus provide cosmetic appeal. Non-treaty jurisdictions are mainly used because of the absence of corporate taxes on the profits of the company and usually only require companies to pay a fixed annual licence fee. It is, therefore, important to assess the taxation implications of the business that is to be conducted,

EXHIBIT # 5

	and decide whether or not a treaty jurisdiction is required. Under normal circumstances, a treaty jurisdiction would not be required for the international movement of goods and most services. Inward investment into certain countries, however, may require a treaty jurisdiction to minimise the impact of taxation.
POLITICAL AND ECONOMIC STABILITY	The pre-requisite requirement for anyone wishing to establish their business or private interests offshore is to select a jurisdiction that provides political and economic stability so that business can be conducted with certainty, confidence and corporate security. (For background details on individual countries select Background from the FinDat Menus.)
PROFESSIONAL INFRASTRUCTURE	The ongoing administration of all offshore entities demands both legal and accounting services. It is, therefore, essential that a jurisdiction provides a comprehensive selection of legal and accounting firms who can provide services to an international standard at competitive prices.
COMMUNICATIONS	It is important for a jurisdiction to have state of the art communication facilities, to include air travel, mail services and telecommunication systems in order that business can be conducted an expeditious manner.
LANGUAGE	Whilst the residents of most offshore jurisdictions are able to provide multi-lingual services, it is imperative that they be fluent in English, this being the international business language. This will ensure that client requirements are fully understood and performed without the risk of mistakes.
BANKING	Whilst most offshore companies are able to bank anywhere in the world, and most do, many people prefer to open corporate accounts in the jurisdiction where the company was incorporated. It is, therefore, important that a jurisdiction has a comprehensive range of banking services and access to international banking facilities.
TIME ZONES	Whilst most international business correspondence can be transmitted at any time through facsimile and e-mail it is important that both parties are able to communicate by telephone within the same working day. Therefore, a time zone which offers convenient access by telephone becomes an added advantage when considering any offshore jurisdiction as a business location. OCRA World Wide has offices located within most of the world's time zones enabling clients the flexibility of being able to arrange transactions during office hours between compatible time zones. (For details of the Time Zones applying to individual countries select Background from the FinDat Menus.)

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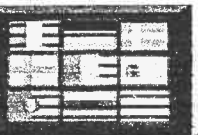
DISCLAIMER & WARNING | Site Contents |  | Ordering Companies On-Line | Offshore Corporation | Price List

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OCRA WORLD WIDE

US Jurisdictions
Company Incorporation Details

OCRA World Wide is able to form corporate and non-corporate entities in all 50 states.

US corporate law is governed by Federal and State Law and there are considerable differences between the states. On this web site we provide a detailed guide to Delaware Companies and United States Limited Liability Companies.

This information was compiled in September 1996. Whilst every effort has been taken to ensure the accuracy of this information, it is for guidance purposes only and OCRA World Wide cannot be held responsible for any loss occasioned. Specific advice should be obtained from AICS in Newport Beach, California.

Preincorporated US companies are available from stock from many of our offices worldwide. Pre-incorporated Delaware companies can be ordered from online services maintained by our office in the Isle of Man - see Purchasing a company for details. These offices also provide a range of business and professional services.

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Company Incorporations
Delaware

OCRA Worldwide is one of the world's leading independent company formation specialists, operating from 20 offices world-wide. We are pleased to provide a summary of the salient features of companies incorporated in Delaware which has been prepared by our US affiliate American and International Corporate Services Ltd.

General

There are three main types of corporations that can be formed under state law in the United States:

- **Close Corporation**

  This type of corporation is often suited to the individual who wants to start a company alone or with a small group of people, most of whom will participate in management, as well as stock ownership. Although the laws governing Close Corporations vary from state to state, stockholders under a Close Corporation can work effectively like a partnership, without many of the formalities that are required of General Corporations.

- **General Corporations**

  This type of corporation is designed for the business person entering into a corporate venture with plans to have more than thirty stockholders or have large public stock offerings.

- **S Corporation**

  After the Tax Reform Act of 1986, the S Corporation became a highly desirable entity for tax purposes. Under the various requirements to qualify as an S Corporation and to obtain S Corporation status, an election must be made on IRS Form 2553. Essentially the S Corporation treats income as though the owners are 'Partners'. Corporate losses are also passed through the corporation to its shareholders.

An international company that wants to acquire a United States company or operate a United States subsidiary typically forms a corporation in the United States to act as its vehicle. Corporation law, that is, the body of law that governs the creation and internal governance of corporations, is for the most part, established by the individual states. While a small operating company of wholly inter-state operation tends to incorporate in the state of its principal place of business.

Delaware has long been viewed as the most popular jurisdiction of incorporation for holding companies and multi-state corporations. Over 200,000 companies are now incorporated in Delaware, including more that half of the 500 largest United States industrial corporations. In fact, more large companies have incorporated in Delaware than in all other states combined. Delaware is the chartering state for over 40 per cent of the companies listed on the New York Stock Exchange and

for 37 per cent of the Companies listed on the American Stock Exchange. Since 1965 over 80 per cent of the companies changing their states of incorporation have moved to Delaware.

Incorporated entities, both domestic and international, form Delaware subsidiaries to accomplish acquisition transactions. Delaware's continued success may be attributed to three essential factors: its flexible and current corporate statute; its expert judiciary whose many considered interpretations of the Delaware General Corporation Law (DGCL) over the years have imbued the statue with certain and predictable meaning; and the commitment on the part of the Secretary of State to promote Delaware incorporations and service to its corporate citizens.

Delaware General Corporation Law

The Delaware General Corporation Law reflects a philosophy that corporations may best flourish in an atmosphere of minimum regulation of internal corporate governance. A corporation's founders, directors and management are granted flexibility in structuring and managing the affairs of the corporation. A company may be formed to engage in virtually any lawful activity. Few requirements are imposed for the basic corporate documents, the articles of incorporation, and the by-laws. The articles of incorporation may include 'any provisions creating, defining, limiting and regulating the powers of the corporation, the directors and the stockholders ... if such provisions are not contrary to the laws of this State'. The bylaws may contain 'any provision, not inconsistent with the law or the articles of Incorporation, relating to the business of the corporation, the conduct of its affairs, and its rights or powers, or the rights or powers of its stockholders, directors, officers or employees'.

The directors of a Delaware corporation manage all of its business and affairs unless otherwise provided by the articles of Incorporation. The board possesses broad powers, including the power to adopt, amend or repeal the corporation's by-laws. Without first seeking stockholder approval, the board may, by resolution, specify the number of directors, the dividend rate, and issue authorised shares at such times and for such consideration as it deems appropriate. The board may also be empowered to specify convertibility, preferences, qualifications and other forms of classes of stock. There are no requirements for US citizens to be the incorporators of a Delaware corporation nor are there any restrictions as to the minimum or maximum number of shares that must be authorised or issued, the type of stock, or the rights of the stockholders.

The Delaware Corporation Law permits directors' meetings to be held over the telephone rather than requiring the directors to be present for a formal meeting.

Delaware law also allows the directors to be non-resident aliens, and there is no requirement that the directors need to be US citizens or resident in the US Neither does Delaware impose the requirement for independent audit of their accounts or require the minute book, stock transfer ledger, and other corporate books to be kept within the state of incorporation.

For administrative convenience, Delaware also allows the board to delegate certain aspects of the managerial function to committees consisting of one or more directors. Such committees may be authorised to exercise full powers of the formal board of directors, with certain exceptions, in matters of corporate responsibility. The boards of many large companies use the committee system to delegate review of such matters as adults or executive compensation. Generally, the board of directors appoint officers to operate the business on a day-day business. These officers are usually a President, Vice-President, Treasurer and Secretary. In Delaware a director can be an officer, and a sole director can be all of the above named officers.

Other specific provisions of the DGCL aimed at flexibility include the following:

- The board of directors may consist of only one director or, of course, more if the stockholders wish.
- The board may conduct meetings by telephone conference or take action by unanimous written consent without a meeting
- No minimum capital requirements are imposed
- The articles of incorporation may include a provision eliminating or limiting the personal liability of directors of monetary damages for certain breaches of fiduciary duty
- Written consent for actions to be taken by stockholders is allowed in lieu of a stockholders' meeting
- Corporations may purchase shares of their own stock and hold, sell or transfer those shares
- There is no limit to the amount of stock that may be held by the corporation, either inside or outside of the state

Delaware corporations also enjoy a favourable state tax policy. The State assesses moderate filing and organisational fees, as well as annual franchise taxes. More significantly, the Delaware State Constitution prohibits the state from imposing corporate income taxes on those corporations which do not conduct business in the State.

Efforts have been made in other states to copy the DGCL and, in fact, many of the statutory provisions discussed above are available in other states. Indeed, Nevada has adopted the DGCL outright, changing only its name. What other states have not successfully duplicated, however, and what remains perhaps the most significant factor distinguishing the Delaware corporate law is its expert judiciary, which has been called upon to interpret virtually every provision of the DGCL and has done so in a careful and consistent fashion. In a common law system, the existence of consistent reliable precedent is of great importance, and most litigants in corporate cases want sound, impartial and predictable results.

Unlike the judiciary of larger or more populous states with more crowded dockets, Delaware courts routinely provide prompt judicial resolution of corporate disputes. The courts permit expected treatment of many corporate cases and have developed a facility for dealing with complex corporate matters in a very short period of time.

Delaware Corporations and Taxation

Delaware has no sales tax. For companies which are incorporated in Delaware, but are located and operating elsewhere, there is no State of Delaware corporate income tax. ***However, federal corporate income tax will be imposed, at progressive rates depending on the amount of net income.*** Corporations do pay a minimum annual franchise tax of $30, plus a filing fee of $20, which is based upon the authorised shares of the corporation. Shares of up to 3,000 at no par value, or par value shares up to $150,000 in capital would qualify for the minimum franchise tax.

Delaware and Currency

The United States Dollar is the accepted currency in Delaware. (United States banks do not allow multi-currency accounts).

Delaware and Secrecy of Information

Delaware does not require more than a minimum of information. The annual franchise tax report requests the names and addresses of officers and directors. This information is not computerised and is not readily available to the public at this time. There is no reporting of shareholders by the Secretary of State. There is no need to report assets (unless the corporation chooses to do so to reduce the franchise tax). Information contained in the Certificate of Incorporation (or other filings) or on the franchise tax report is public record and may be given to anyone who requests it. The Secretary of State will disclose the name(s) of the director(s) of a corporation. ***The federal tax return for a Delaware corporation requires a year end balance sheet and income statement.***

The Delaware Limited Liability Company

The Limited Liability Company combines the corporate advantage of limited liability with flow-through tax advantages of partnership classification and provides a distinct alternative to the partnership, C corporation and S corporation. In 1977 Wyoming became the first state to enact a limited liability company act: The Wyoming Limited Liability Act. This Act was modelled after the 1892 German company law known as The German GmbH Code of 1892. The State of Florida in 1982 followed Wyoming with a similar act in order to lure capital to the state to add to the economic base of Florida. Since 1990 all US States have enacted similar limited liability company acts to that of Wyoming.

A limited liability company (LLC) is quite a different entity from that of its alternatives, the C corporation, S corporation, and partnership. To illustrate the differences, an examination of the other entities is necessary. The C corporation provides limited liability and allows full management of the entity in a Board of Directors who may also be the shareholders. From a foreign investment perspective, the problem with the C corporation is that it must either pay the corporate tax or withhold tax on dividend or royalty income to its foreign parent or foreign shareholders.

The S corporation also provides limited liability but has restrictions as to the number of shareholders, maximum of 75, and restricts non-residents as shareholders. On 20 August 1996 President Clinton signed into law the Small Business Job Protection Act of 1996 which amended the tax code by allowing S corporations to have a maximum of 75 shareholders instead of 35. The limited partnership provides limited liability only to those designated as limited partners and only to the extent of their investment. The limited partners are not allowed to have any management and control of the limited partnership, otherwise their investment will be subject to creditors' claims. The management and control of the limited partnership is vested only in the general partner. The general partnership provides no limited liability to its partners, since each partner is jointly and severally liable to all other partners for the partnership liabilities. There is no restriction to the number of partners.

The LLC has:

- No citizenship requirement
- No limitations on one class of shares
- No limitation on the size and number of members
- No tax penalties on liquidation
- No limitation on ownership of other corporations
- It can avail itself of Section 754 Code Elections

- Allows limited liability to all members including those who participate in management

The owners or shareholders of a LLC can be individuals, trusts, partnerships, corporations, and non resident aliens and are allowed to be active in the management of the business regardless of their share in the company.

A LLC is a non-corporate entity receiving flow-through tax treatment like a partnership since it only has limited liability and centralisation of management but not the free transferability of interests or continuity of life.

On 14 July 1992, Delaware enacted legislation that created a new business entity - the Limited Liability Company ('LLC'). The LLC is the latest advance in the evolution of business formation. The concept has its historical origins in Europe and was accepted by the Internal Revenue Service in 1988. It offers entrepreneurs a clear and, in many instances, superior alternative to corporations and partnerships by COMBINING the corporate advantage of limited personal liability and the taxation advantage of all ventures, and the S Corporation. Also, it has definite advantages over regular or close corporations with closely held stock.

The LLC is Delaware's statutory answer to three of the most pursued objectives of today's emerging entrepreneurs:

- An LLC offers limited personal liability to all of its owners (termed 'Members')
- This business form is treated like a partnership or S corporation for tax purposes allowing income (or losses) to be reported on the Member's individual income tax returns, thereby avoiding the double taxation of general corporations
- The LLC provides great flexibility in organisation and management of the business. It is expected that many of these entities will operate informally with little paperwork beyond a brief 'Operating Agreement'. 'Managers' may be elected by the Members to run the business.

In summary, a Delaware Limited Liability Company is similar to:

- A general partnership where all the partners are free to participate in management
- A limited partnership where all the limited partners have limited liability
- An S Corporation without the ownership restrictions.

An LLC is not a corporation, and it is not a partnership. A Delaware Limited Liability Company is a new alternative business entity created under the laws of the State of Delaware in response to the demand for a better alternative to the traditional forms of business.

*** SPECIAL DISCLAIMER ***

The information contained in this report should not be relied upon without first obtaining appropriate and timely legal and tax advice from a qualified professional licensed to render such professional advice. It is advised to seek such advice from a professional before establishing any structure or entity mentioned in this report.

RETURN TO US JURISDICTION LISTING

No Frames Navigation

Please go to our Home Page where you will find interesting information on the benefits of using offshore companies and trusts for business and personal use, links to information on other locations and details of our products and services.

<S>
Profit.....
Add:
  Provision for income taxes.....

Profit before taxes.....
Fixed charges:
  Interest and other costs related to borrowed funds/(1)/.....
  Rentals at computed interest factors/(2)/.....

Total fixed charges.....

Profit before provision for income taxes and fixed charges.....

Ratio of profit to fixed charges.....

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/(1)/Interest expense as reported in the Consolidated Results of Operations plus the Company's proportionate share of 50 percent-owned affiliated companies' interest expense.

/(2)/Amounts represent those portions of rent expense that are reasonable approximations of interest costs.
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Exhibit 21

SUBSIDIARIES AND AFFILIATES OF THE REGISTRANT

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Name of Company	Jurisdiction in which Organized
<S>	<C>
Caterpillar Inc. (Registrant)	Delaware
Affiliates of the Registrant:	
Advanced Filtration Systems Inc.	Delaware
AO Novotruck	Russia
Caterpillar Elphinstone Pty. Ltd.	Australia
Subsidiary:	
Elphinstone Commercial Services Ltd.	Canada
Caterpillar Hungary Component Manufacturing Company Ltd.	Hungary
Cyclean, Inc.	Delaware
Peoria Medical Research Corporation	Illinois

Rapisarda Industries S.r.L.	Italy
UNOC Equipment and Supply, L.L.C.	Delaware
Subsidiary:	
AO UNOC Equipment and Supply	Russia
Subsidiaries of the Registrant:	
Advanced Fuels, L.L.C.	Delaware
Advanced Technology Services, Inc.	Illinois
Anchor Coupling Inc.	Delaware
AO Caterpillar Commercial	Russia
AO Nevamash	Russia
Balderson Inc.	Kansas
Carter Machinery Company, Incorporated	Delaware
Caterpillar Americas Co.	Delaware
Caterpillar Asia Pacific Holding Inc.	Delaware
Subsidiaries:	
Caterpillar Shanghai Engine Company Ltd.	China
Caterpillar Xuzhou Ltd.	China
Caterpillar Asia Pte. Ltd.	Singapore
Caterpillar of Australia Ltd.	Australia
Affiliates:	
Energy Power Systems Australia Pty Limited	Australia
Affiliate:	
Mine Power Australia Pty. Ltd.	Australia
Subsidiary:	
Energy Power Systems PNG Pty Limited	New Guinea
EPSA Superannuation Nominees Pty. Ltd.	Australia
Caterpillar Brasil Ltda.	Brazil
Subsidiary:	
Caterpillar Administracao e Participacoes S/C Ltda.	Brazil
Caterpillar Building Construction Products AG	Switzerland
Caterpillar of Canada Ltd.	Canada
Caterpillar Capital Company, Inc.	Delaware

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Caterpillar Commercial N.V.	Belgium
Affiliate:	
Hindustan Powerplus Limited	India
Subsidiary:	
Caterpillar Group Services N.V.	Belgium
Caterpillar Commercial Services Ltd.	Canada
Caterpillar of Delaware, Inc.	Delaware
Subsidiary:	
Caterpillar Industrial Products, Inc.	Delaware
Subsidiary:	
Nexus International Inc.	Delaware
Caterpillar Export Limited	U.S. Virgin Islands
Caterpillar Financial Services Corporation	Delaware
Affiliate:	
Bio-energy Partners	Illinois
Subsidiaries:	
Caterpillar Finance France S.A.	France
Caterpillar Financial Asset Sales L.L.C.	Tennessee
Caterpillar Financial Australia Limited	Australia
Caterpillar Financial Funding Corporation	Nevada
Caterpillar Financial Leasing, S.A.	Spain
Caterpillar Financial Corporacion Financiera S.A.	Spain

Caterpillar Financial Member Company	Delaware
Caterpillar Financial Nordic Services A.B.	Sweden
Subsidiary:	
Caterpillar Financial Services Norway AS	Norway
Caterpillar Financial Receivables Inc.	Delaware
Caterpillar Financial Renting S.A.	Spain
Caterpillar Financial Services Holding GmbH	Germany
Affiliates:	
EDC European Excavator Design Center GmbH & Co. KG	Germany
EDC European Excavator Design Center Verwaltungs GmbH	Germany
Subsidiaries:	
Caterpillar Leasing GmbH (Ismaning)	Germany
Caterpillar Leasing GmbH (Leipzig)	Germany
Caterpillar Financial Services Limited	Canada
Caterpillar Financial Services (U.K.) Limited	England
Grupo Financiero Caterpillar Mexico, S.A. de C.V.	Mexico
Subsidiaries:	
Caterpillar Credito, S.A. de C.V. Soc. Fin. de Obj. Lim.	Mexico
Caterpillar Arrendadora Financiera, S.A. de C.V.	Mexico
Caterpillar Factoraje Financiero, S.A. de C.V.	Mexico
GFCM Servicios, S.A. de C.V.	Mexico
MICA Energy Systems	Michigan
Caterpillar Financial Services N.V.	Netherlands Antilles
Caterpillar Industrial Inc.	Ohio
Affiliates:	
Mitsubishi Caterpillar Forklift America Inc.	Delaware
Mitsubishi Caterpillar Forklift Asia Pte. Ltd.	Singapore
Mistubishi Caterpillar Forklift Europe B.V.	Netherlands
Rapidparts Inc.	Michigan
Subsidiary:	
Matchparts N.V.	Belgium
Caterpillar Insurance Co. Ltd.	Bermuda
Caterpillar Insurance Services Corporation	Tennessee
Caterpillar International Finance Plc.	Ireland

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Caterpillar International Leasing L.L.C.	Delaware
Caterpillar Investment Management Ltd.	Delaware
Subsidiary:	
Caterpillar Securities Inc.	Delaware
Caterpillar Logistics Services, Inc.	Delaware
Subsidiary:	
Caterpillar Logistics Services Belgium N.V.	Belgium
Caterpillar Logistics Services Spain, S.A.	Spain
Caterpillar Marketing Services Inc.	Illinois
Caterpillar Mexico S.A. de C.V.	Mexico
Subsidiary:	
Inmobiliaria Conek, S.A.	Mexico
Caterpillar Overseas Credit Corporation S.A.	Switzerland
Caterpillar Overseas S.A.	Switzerland
Affiliates:	
Caterpillar MHI Marketing Ltd.	Japan
Shin Caterpillar Mitsubishi Ltd.	Japan
Affiliates:	

Aishin Co.	Japan
D.O.M. Ltd.	Japan
G. M. Kenki Lease Co.	Japan
Hama-rental Co.	Japan
Hokken Service Co.	Japan
Itoh Tekkosho Co., Ltd.	Japan
K-Lea Co., Ltd.	Japan
Kyoei Co.	Japan
Rentec Co.	Japan
Sowa System Co.	Japan
Sagakiko-shokai Co., Ltd.	Japan
Tokyo Rental Co.	Japan
Tokuden Co.	Japan
Tunnel Rental Co., Ltd.	Japan
Subsidiaries:	
Akashi GS Co., Ltd.	Japan
Chubu Caterpillar Mitsubishi Construction Equipment Sales, Ltd.	Japan
CMEC Co., Ltd.	Japan
CM Human Services Co., Ltd.	Japan
CM Logistics Services Co., Ltd.	Japan
East Chugoku Caterpillar Mitsubishi Construction Equipment Sales, Ltd.	Japan
East Kanto Caterpillar Mitsubishi Construction Equipment Sales, Ltd.	Japan
Affiliate:	
Clean World Co.	Japan
Tone Lease Co.	Japan
Hokkaido Caterpillar Mitsubishi Construction Equipment Sales, Ltd.	Japan
Affiliate:	
Ryosey Kenpan Co., Ltd.	Japan
Subsidiary:	
Shin Hokken Ltd.	Japan
Hokuetsu Caterpillar Mitsubishi Construction Equipment Sales, Ltd.	Japan
Affiliates:	
Akira Shoji Co., Ltd.	Japan
F. M. K. Co., Ltd.	Japan
Hokuriku Caterpillar Mitsubishi Construction Equipment Sales, Ltd.	Japan
Affiliate:	
Dia Rental Hokuriku Co., Ltd.	Japan
Kanagawa Caterpillar Mitsubishi Construction Equipment Sales, Ltd.	Japan

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Kansai Caterpillar Mitsubishi Construction Equipment Sales, Ltd.	Japan
Kinki Caterpillar Mitsubishi Construction Equipment Sales, Ltd.	Japan
Affiliate:	
Rental Sanwa Co., Ltd.	Japan
Koshin Caterpillar Mitsubishi Construction Equipment Sales, Ltd.	Japan
Affiliate:	
Sanko Rental Co.	Japan
North Kanto Caterpillar Mitsubishi Construction Equipment Sales, Ltd.	Japan

Affiliate:	
Takuma Co.	Japan
Sagami GS Co., Ltd.	Japan
SCM Operator Training Co., Ltd.	Japan
SCM Shoji Co., Ltd.	Japan
SCM System Service Co., Ltd.	Japan
Shizuoka Caterpillar Mitsubishi Construction Equipment Sales, Ltd.	Japan
Subsidiary:	
Seiryo Co., Ltd.	Japan
Tokyo Caterpillar Mitsubishi Construction Equipment Sales, Ltd.	Japan
Subsidiary:	
Aiwa Co., Ltd.	Japan
West Chugoku Caterpillar Mitsubishi Construction Equipment Sales, Ltd.	Japan
Affiliate:	
Yeep Co.	Japan
Tractor Engineers Limited	India
Subsidiaries:	
Caterpillar (Africa) (Proprietary) Limited	South Africa
Caterpillar Asia Limited	Hong Kong
Caterpillar Belgium S. A.	Belgium
Caterpillar China Limited	Hong Kong
Caterpillar Commercial APS	Denmark
Caterpillar Commercial S.A.R.L.	France
Caterpillar Commerciale S.r.L.	Italy
Caterpillar France S.A.	France
Caterpillar Logistics Services Limited	England
Mec-Track S.r.L.	Italy
Caterpillar (U.K.) Limited	England
P.T. Natra Raya	Indonesia
Solar Turbines Canada Ltd.	Canada
Solar Turbines S.A.	Belgium
Caterpillar Paving Products Inc.	Oklahoma
Subsidiary:	
Caterpillar Materiels Routiers S.A.	France
Caterpillar Power Systems Inc.	Delaware
Caterpillar Redistribution Services Inc.	Delaware
Subsidiary:	
Duecosa Limited	Channel Islands
Caterpillar Rental Services Network Inc.	Delaware
Caterpillar Risk Management Services Ltd.	Delaware
Caterpillar Services Limited	Delaware
Caterpillar World Trading Corporation	Delaware
Depositary (Bermuda) Limited	Bermuda
Engine Service Specialists, Inc.	Delaware
Subsidiaries:	
Road Ready Inc.	Delaware
RR-1 Limited Partnership	Illinois

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Solar Turbines Incorporated	Delaware
Subsidiaries:	
Compsolven Corporation	California
OTSG, Inc.	Delaware
Affiliate:	
Innovative Steam Technologies	California
Solar Turbines International Company	Delaware

Affiliate:	
Turboservices SDN BHD	Malaysia
Subsidiaries:	
Energy Services International Group, Ltd.	Delaware
Energy Services International Limited	Bermuda
Servtech Limited	Ireland
Turbinas Solar S.A. de C.V.	Mexico
Turbinas Solar de Venezuela, C.A.	Venezuela
Turbo Tecnologia de Reparaciones S.A. de C.V.	Mexico
Tecnologia Modificada S.A. de C.V.	Mexico

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* Qualifying shares have been ignored in giving ownership percentage figures.

For further information see Notes to Consolidated Financial Statements incorporated by reference from the 1996 Annual Meeting Proxy Statement.

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EXHIBIT 23

CONSENT OF INDEPENDENT ACCOUNTANTS

We hereby consent to the incorporation by reference in the Registration Statement on Forms S-8 (No. 2-90123, as amended, 2-97450, as amended, 33-3718, as amended, 33-8003, 33-14116, 33-37353, 33-39280 and 33-40598) of Caterpillar Inc. of our report dated January 18, 1996 related to the financial statements of Caterpillar Inc., appearing on page A-3 of the Appendix to the Company's 1996 Annual Meeting Proxy Statement which is incorporated in this Annual Report on Form 10-K. We also consent to the incorporation by reference of our report on the Financial Statement Schedule listed in Item 14(a) of such Annual Report on Form 10-K.

We hereby consent to the incorporation by reference in the Prospectus constituting part of the Registration Statement on Form S-3 (No. 33-46194) of Caterpillar Inc. of our report dated January 18, 1996 related to the financial statements of Caterpillar Inc., appearing on page A-3 of the Appendix to the Company's 1996 Annual Meeting Proxy Statement which is incorporated in this Annual Report on Form 10-K. We also consent to the incorporation by reference of our report on the Financial Statement Schedule listed in Item 14(a) of this Form 10-K.

/s/Price Waterhouse LLP

PRICE WATERHOUSE LLP

LAIDLAW Press Releases

Laidlaw U.S. Tax Case

BURLINGTON, Ont.,
July 2 /CNW/

Judge John O. Colvin of the United States Tax Court has issued his opinion in the reassessment of the Laidlaw Inc. (NYSE:LDW; TSE and ME:LDM) 1986, 1987 and 1988 tax returns by the U.S. Internal Revenue Service.

The opinion is contained in a Memorandum Findings of Fact and Opinion in which Judge Colvin concludes that advances from Laidlaw's related foreign entity, based in Holland, during the tax years in question were equity rather than debt and interest deductions claimed are to be disallowed. As a result, tax of approximately $49.6 million together with interest of approximately $91.4 million to May 31, 1998 would be payable.

Laidlaw is currently studying Judge Colvin's opinion with its tax counsel to determine an appropriate response and course of action.

While not part of the proceedings before Judge Colvin, the Internal Revenue Service has asserted similar claims against Laidlaw for the tax years 1989, 1990 and 1991 amounting to approximately $143.5 million in taxes as well as interest of approximately $145.3 million to May 31, 1998. The Company also anticipates the Internal Revenue Service will propose adjustments to the tax years 1992, 1993 and 1994. Subsequent to 1994, Laidlaw established an entity in Ireland which provided some financing to its U.S. operations. While distinct and separate from the Dutch entity, nevertheless it is possible the Internal Revenue Service may in due course, endeavor to raise similar issues with respect to Ireland.

Commenting on Judge Colvin's opinion, James R. Bullock, Laidlaw's President and Chief Executive Officer said,

> "Frankly, we felt our evidence before Judge Colvin was compelling and we believe his opinion is wrong. We are genuinely surprised and obviously disappointed.
>
> Our tax returns for 1986, 1987 and 1988 properly reflected our operating results for that period. This is the view of management then and today and is fully endorsed by both the Company's auditors and tax counsel.
>
> Without in any way mitigating the importance of Judge Colvin's opinion, everyone must recognize there are many steps in this process and we will continue to vigorously defend our Company in this matter.

Exhibit #8

If all amounts, both claimed and potentially claimed by the IRS, for the tax years 1986 through 1994 were ultimately deemed to be owing by Laidlaw, the cash cost to the Company would be in the order of $500 million. The Company currently has available tax reserves of more than $200 million for these purposes.

Based in Burlington, Ontario, Laidlaw Inc. is North America's largest provider of patient transportation, emergency department management, school busing and municipal transit services.

For further information: Contact: 1-800-563-6072; T.A.G. Watson, Vice President, Communications, Laidlaw Inc., ext 309; Les Haworth, Senior Vice President, Chief Financial Officer, Laidlaw Inc., ext. 208

COMPANY NEWS

LAIDLAW STOCK DOWN 12% ON NEWS OF TAX RULING

The stock of **Laidlaw Inc.** fell more than 12 percent yesterday after the company said it had lost a United States tax ruling. A United States Tax Court judge ruled that the company, the largest provider of ambulance and school bus service in North America, owed taxes from 1986 to 1988 of about $49.6 million, plus interest of $91.4 million. The taxes are related to a Dutch subsidiary, which was used to finance United States operations. Laidlaw said it might also owe taxes from 1989 to 1994, bringing the total amount to about $500 million. The company has $200 million of available tax reserves. The company, based in Burlington, Ontario, had 1997 revenues of $3.03 billion. On the New York Stock Exchange, Laidlaw stock fell $1.5625, to $10.6875, below the previous one-year low of $11.125 set on June 24. (Dow Jones)

CRESCENT TO PAY $548 MILLION FOR 4 OFFICE BUILDINGS

Crescent Real Estate Equities Inc., led by the billionaire investor Richard Rainwater, said yesterday that it had agreed to buy four office buildings for $548 million, extending its position as one of the largest United States office owners. The properties contain 3.16 million square feet and consist of the BP Plaza in suburban Houston, Woodfield Corporate Center in suburban Chicago, Two Town Center in Costa Mesa, Calif., and the 6701 Tower in West Los Angeles. Separately, Crescent sold $225 million of convertible preferred stock to the **Prudential Insurance Company of America** and the seller of three of the buildings. Crescent, based in Fort Worth, owns a concentration of properties around Houston, Dallas and other Southwestern cities. (Bloomberg News)

LEUCADIA TO SELL A 25% INTEREST IN ARGENTINE INSURER

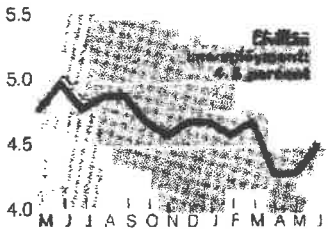
The **Leucadia National Corporation**, an investment holding company, agreed yesterday to sell a 25 percent interest in the privately held Argentine insurance company Caja de Ahorro y Seguro S.A. for $140 million. Leucadia, which said in May that it might liquidate because it could not find any more businesses to buy at inexpensive prices, owns businesses as diverse as insurance companies and wineries. It said it expected to record a pretax gain of about $100 million on the Argentine sale. Leucadia, which is based in New York, said it was selling the stake in the Argentine insurer to a private Argentine company that is also an investor in Caja. Leucadia will still have a 5 percent stake in the company. Its stock rose $1.25 yesterday, to $34.25. (Bloomberg News)

INTEL TO SUSPEND OPERATIONS AT 2 PLANTS FOR 10 DAYS

intel

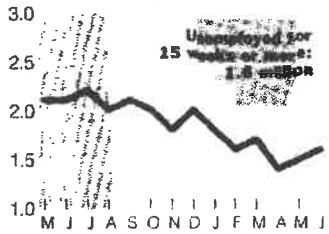
The Intel Corporation, the world's largest semiconductor company, will cut back on its manufacturing for about 10

The Labor Picture in June



DEMOGRAPHICS

White	4.0%
Black	8.2
Hispanic*	7.6
Men 20 and over	3.7%
Women 20 and over	4.1
Teen-agers (16-19)	14.6



OUT OF WORK (millions)

Total	6.2
Lost job	2.8
Left job	0.8
Returning to labor market	2.1
New to labor market	0.5

'HIDDEN' UNEMPLOYMENT (millions)

Working part time because full-time work is unavailable	3.8
'Discouraged' workers (no longer looking for work)†	0.3

TYPE OF WORK (millions)

	May	June
Nonfarm	125.5	125.7
Goods	25.3	25.3
Services	100.2	100.5
Agriculture	3.3	3.3

SHARE OF POPULATION

personal income in 1992 to 12.8% last year, western Germany's savings ratio will shrink further to an estimated 12.5% this year, two points below 1991's rate.

Few economists think consumers can keep eating into their seed corn, despite scattered signs of higher spending. First-quarter retail-sales volumes did buck up 0.6% from the final quarter last year. But the gain, says Commerzbank economist Jürgen Pfister, is "a bit of a miracle. It's not a lasting change in [consumers'] behavior." The quarter, indeed, was flat compared with the same quarter a year ago. Another encouraging sign—a rise in auto registrations early this year—was reversed in April with a 12.4% slump.

FEW FRILLS. Meanwhile in east Germany, the easy gains in spending have evaporated. Thanks to wage-leveling with the west for those with jobs and bigger doles for the rest, disposable incomes in the east rose at a fast 7.3% clip last year. But when adjusted for faster inflation of 8.8% there, says Federation of German Industry economist Siegfried Utzig, "real incomes probably [showed] a slight decrease." Just like their western cousins, the *Ossis* had to save less to keep spending. Besides, the east Germans' shop-'til-you-drop hunger for consumer goods is now well and truly sated. By early last year, according to the Bundesbank, eastern households already owned as many television sets as westerners and had all the fridges, freezers, and washers they needed.

German retailers and marketers are discovering that customers are getting a lot pickier. At west Berlin's tony KaDeWe department store sales of apparel, a key part of the store's offerings, are on the decline. A local version of the Kmart culture has rapidly taken hold: German consumers are going down-market and avoiding the frilly stuff that just costs too much. Obi and Hornbach, two do-it-yourself home repair chains, are doing a brisk business. Aldi, a $20 billion discounter, is thriving. At cataloger Otto Versand "customers are moving away from high fashion," says spokeswoman Annette Busse. "They don't buy so many trendy articles—it's back to basics like T-shirts, jeans, blazers, and sweaters."

Analysts also see consumers delaying replacement purchases of everyday articles from clothing to shoes. "Consumers are at last realizing how badly their incomes are being hit," says Jörg Laser, economist at Hamburg-based M. M. Warburg Bank. As Germany stumbles through a recovery like no other, Otto Normalverbraucher is counting every pfennig.

By John Templeman in Bonn, with Deborah Wise in Berlin and bureau reports

JAPAN

HERE COMES THE GREAT GLOBAL TAX WAR

The U.S. struck first on transfer pricing. Now, Japan is retaliating

On the campaign trail in 1992, Bill Clinton vowed to make multinationals pay $45 billion more in taxes. Following the President's cue, the Internal Revenue Service has hit such Japanese companies as Hitachi, Yamaha, and Nissan with hefty claims.

Now, Japan is striking back. The Japanese National Tax Administration Agency (NTAA) has socked Coca-Cola Co. with a $145 million tax deficiency for 1990-92. They also hit AIU Insurance Co., the Japanese subsidiary of giant American International Group Inc., with an $87 million bill that was later reduced to $37 million in a settlement. "There is clearly a war going on," says a Tokyo lawyer who advises foreign companies on Japanese tax laws.

All of these cases involve disagreements over what is called transfer pricing, the accounting system by which companies report cross-border transactions among subsidiaries. Governments believe that multinationals manipulate these figures so as to underreport profits and lower their taxes. For example, the IRS said Nissan's U. S. subsidiary inflated the prices it paid to its parent for finished cars it was importing.

LITTLE BITE. In the U. S., the IRS has been moving aggressively to pierce the transfer-pricing veil. It's putting in penalties of up to 40% for underreporting, and it's tightening up rules. Companies are particularly upset by new requirements for enormous amounts of expensive documentation. The burden is on them to prove that the transfer prices they report are "arms length," or the same as those that would have been reached by unrelated parties. "It doesn't say you have to hire an outside economist or lawyer, but the fact is any sizable company will have to do that," says William C. Gifford, a tax partner at the New York law firm of Davis Polk & Wardwell in New York.

American multinationals are also feeling the IRS's bite. PepsiCo Inc. is now battling the IRS over an $880 million bill for 1985-89 that was levied after an extensive audit of such subsidiaries as Taco Bell, Pizza Hut, and Kentucky Fried Chicken. PepsiCo is asking for a $213 million refund.

But the Japanese think they are being made special targets. They are also annoyed at what many lawyers say is a shoot-from-the-hip approach by the IRS. Indeed, many of these cases end up being settled for much less than the IRS initially sought. For example, in reaching a $160 million settlement with Nissan, the IRS backed down more than $600 million from its initial calculation of the U. S. subsidiary's profits, reports *BNA International Business & Finance Daily.*

Still, the stepped-up enforcement has certainly caught the attention of the Japanese authorities. Once considered unsophisticated on transfer pricing, they have come up the learning curve rapidly. The AIG case, for instance, involves fi-

JAPAN HANDED COKE A BILL FOR $145 MILLION ON BACK TAXES INVOLVING ROYALTY INCOME

PAM VAN RIET/BLACK STAR

75

EXH. 3 - 7 # 9

nancial services, a far tougher business to audit than manufacturing. The NTAA said that American International Group was inflating reinsurance fees paid to subsidiaries in Bermuda and elsewhere. The Japanese "are trying to get on the dance floor, too," says David Rosenbloom, a transfer pricing specialist at Caplin & Drysdale in Washington.

PEACE EFFORT. Rosenbloom adds that other countries are also trying to tap into what they see as a potentially lucrative revenue stream. The German tax agency is "heightening audit activity beyond what they ordinarily do," he says.

Fear is widespread that an all-out tax war is about to erupt. To head that off, the Organization for Economic Cooperation & Development has been trying to update its 1979 guidelines for transfer pricing that most countries use.

The big issue is whether there will be a move away from "arms length", which some lawyers say is an unworkable standard for companies in other than commodities businesses. Experts and some members of Congress are pushing for a possibly simpler system that allocates profits by a formula such as the state of California's that factors in percentages of world sales, assets, and other indicators.

The OECD, lobbied hard by the IRS, is likely to stump for keeping the arms-length concept. But it may recommend use of a formula system in some cases such as global financial trading, where even the IRS seems to be agreeable. Whatever the outcome, the confusion is unlikely to end anytime soon.

By Stanley Reed in New York, Larry Holyoke in Tokyo, and Douglas Harbrecht in Washington

MEXICO

WILL A *YANQUI* PARTNER MAKE TV AZTECA A PLAYER?

An NBC deal would help the TV network take on giant Televisa

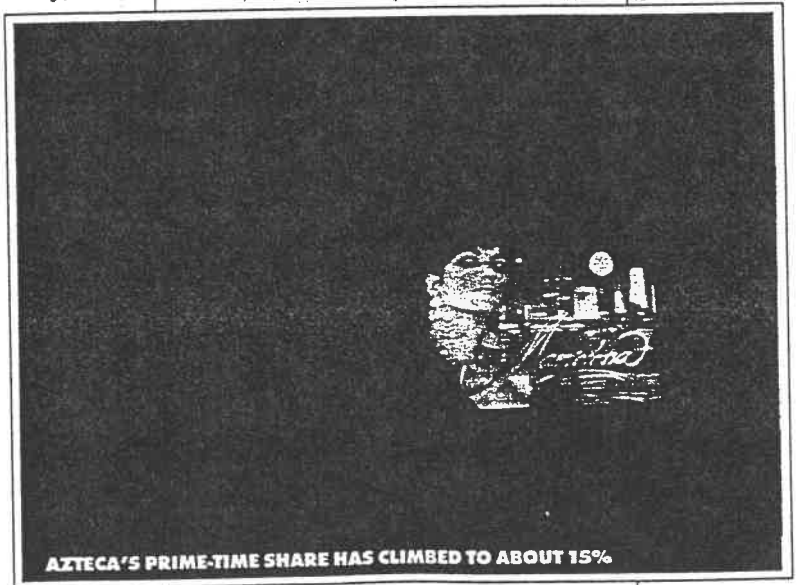
When Ricardo Salinas Pliego bought two television networks from the Mexican government for $640 million last year, one of the assets he acquired was the stylized eagle that is the logo for TV Azteca. Now, Salinas has added another bird to his collection: the NBC Inc. peacock.

The Azteca alliance with the U. S. TV network, announced in mid-May, could feather both nests nicely. Salinas' highly leveraged media company will get access to reams of programming and expert technical assistance. It could also get a sorely needed cash infusion. And Azteca will provide a platform for NBC's expansion into Latin America.

"TRULY EXPLOSIVE." With the Azteca deal, NBC becomes the first U. S. company to brave the broadcast market south of the border. The network says it is attracted by Mexico's TV audience of 80 million viewers and what it sees as huge opportunities in the wake of NAFTA's passage. "We put Mexico up there with China and India as one of the truly explosive growth markets," says Tom Rogers, president of NBC Cable & Business Development.

While no money has yet changed hands, the deal gives NBC the right to acquire 10% of Azteca's stock for $120 million by yearend and increase that investment to 20% over three years. But executives close to the network say it may wait a few years before deciding to purchase an equity stake.

It will take more than the famous peacock to impress Azteca's competitor, Grupo Televisa, Mexico's own behemoth. With three national networks and a 90% share of the Mexican ad market, it has a virtual lock on Mexican television. Its more than 42,000 hours of programming and its interests in publishing, radio, and recording make it the largest Spanish-language entertainment conglomerate in the world.



AZTECA'S PRIME-TIME SHARE HAS CLIMBED TO ABOUT 15%

KEITH DANNEMILLER/SABA

Faced with a mature broadcast market in the U. S., NBC and its rivals are seeking growth overseas. But the surge southward so far has been mostly in pay TV. MTV, the Discovery Channel, TNT, and Fox are all broadcasting in Spanish to Latin America's wealthy subscribers. NBC climbed aboard last year with its 24-hour news service, Canal de Noticias. The network also paid $23 million for a 56% stake in Europe's Super Channel. And NBC's Rogers says the network plans to expand its cable business-news service, CNBC, to Latin America and Asia.

LOSING TIMIDITY? For Salinas, the alliance means valuable knowhow from NBC. Before he bid for Azteca, the closest Salinas had come to the TV business was selling sets in his family's national chain of Elektra electronics stores. The deal could also help cure Azteca's problem luring advertisers, as NBC adds Mexico to the global and regional packages it offers prospective buyers. Until now, Salinas has had trouble overcoming advertisers' skepticism that he would ever reach his goal of 25% audience share. While Azteca's average prime-time share on its two channels is up to about 15%, it's not enough. The big advertisers "have a relationship with Televisa, and they're worried about losing it," says Joel Angeles, media director at DMB&B advertising agency in Mexico City.

But if NBC can help Azteca boost its ratings, advertisers may lose their timidity. TV accounts for about 65% of the total $18 billion in Mexican ad spending last year, compared with 35% in the U. S., and real spending is expected to grow about 15% this year. With advertisers competing to win the hearts and minds of the 60% of Mexicans under 25, there's plenty of room for another player in Mexican TV. With Azteca, NBC wants to be sure it's there first.

By Elisabeth Malkin in Mexico City, with Mark Landler in New York

Assault Weapon Ban Is Rejected By the House

ote, Coming in the Wake Of Mass Killing in Texas, Is Victory for Gun Lobby

By JEFFREY H. BIRNBAUM
f Reporter of THE WALL STREET JOURNAL

WASHINGTON—The House rejected a posed ban on assault weapons that was tained in an anti-crime bill, one day af- 22 people were slain by a gunman in een, Texas.

The 247-177 vote was a major victory for gun lobby, which had complained that proposed ban was an unfair infringe- nt on the right to bear arms. Gun-con- advocates, on the other hand, had ght the measure as what they said was ommon-sense way of reducing the kind carnage that resulted in Killeen.

The gun lobby prevailed, however, on strength of votes drawn largely from al districts and the West, which are tra- onal strongholds of the National Rifle ociation. The win came despite the ex- ssion of high hopes by mostly urban makers that the Texas tragedy might h some votes toward favoring of the .

The gun-control supporters even got a convert at the start of the vote: Demo- tic Rep. Chet Edwards, whose district udes Killeen. "Suddenly, the old argu- nts ring hollow," he said. " 'Guns don't people do.' Explain that to the fami- of victims mowed down eye-to-eye in l blood with 17-bullet clips."

Advocates of the ban pushed this notion d. "Too many people are dying; there e been too many killings," said Rep. n Lewis (D., Ga.). The provision would e made illegal to own or sell 13 de-

Ex-Tax Collectors Help Foreign Firms Fight U.S. Efforts to Get More Funds

By JILL ABRAMSON
Staff Reporter of THE WALL STREET JOURNAL

The big winners in Washington's revolving-door sweepstakes these days are former tax collectors.

Foreign corporations, including a virtual who's who of Japanese industry, are snapping up former Internal Revenue Service and Treasury Department officials to help fight the government's efforts to collect billions of dollars in additional taxes from them.

The hiring spree has outraged some members of Congress, who say the IRS is now outgunned by some of its most skilled and experienced former employees. "This has an odor about it," says Republican Sen. Jesse Helms of North Carolina, who has been a loud critic of government officials who leave office to represent foreign—and particularly Japanese—clients. The former tax collectors, he says, ought to be "embarrassed."

They aren't. "These are difficult cases and the dollars are huge," says former IRS Commissioner Lawrence Gibbs, who represents foreign as well as domestic clients with an interest in the dispute before the IRS. "Your more experienced lawyers will be representing taxpayers."

Among other cases, the IRS is scheduled to go to trial next July against Yamaha Motor Corp., which has assembled a team from Chicago's Baker & McKenzie that includes several recently retired former government officials, including Leonard Terr, formerly international tax counsel at the Treasury Department. In cases filed against subsidiaries of Hitachi Ltd. and several other Japanese electronics companies, the agency is battling still more former Treasury officials, such as Henry Zapruder, formerly with the department's tax legislation office.

At issue are a series of so-called "transfer-pricing" cases in which the government is trying to collect more than $12 billion in additional taxes from more than

& Chevalier, a prominent Washington law and lobbying firm.

Congressional concern about the companies' lobby is serious enough that Republican Rep. Frank Wolf of Virginia is seeking more money for the IRS to hire additional outside experts to counter the revolving-door onslaught of former employees. "It's a special trust to have a political appointment like that," Rep. Wolf says of the former government officials now on the other side. "Then to go out and do this is inappropriate and deeply troubling."

But John Nolan, deputy assistant Treasury secretary for tax policy in the Nixon administration and now a partner at Miller & Chevalier, disputes the notion that the government is outgunned in the transfer-pricing cases. "I haven't noticed any shortage of people at the IRS," says Mr. Nolan, who represented Toyota Motor Corp. in a dispute with the IRS that was settled in 1987. According to press reports in Japan, the Japanese government paid the U.S. more than $600 million to settle transfer-pricing claims against Toyota and Nissan Motor Co.

Current IRS officials, for their part, say they are unfazed by having agency alumni arrayed against them. Robert Culbertson, acting associate chief counsel for international matters, says that new reporting and record-keeping regulations, less onerous procurement rules for hiring outside experts and other recent changes have "helped level the playing field" between the agency and corpor dition, he says, the ec helped the IRS recru attorneys.

Taxing Matters

Some of the former Treasury and IRS officials who are representing foreign companies in transfer-pricing matters:

NAME	FIRM	FORMER POSITION
Donald Alexander	Cadwalader, Wickersham & Taft	IRS commissioner
Linda Carlisle	Cadwalader, Wickersham & Taft	Treasury attorney
Lawrence Gibbs	Gibbs & Johnson	IRS commissioner
Joseph Goeke	Mayer, Brown & Platt	IRS attorney
Alan Granwell	Cadwalader, Wickersham & Taft	Director, Treasury Office of International Tax Affairs
Kenneth Klein	Cadwalader, Wickersham & Taft	IRS associate chief counsel
John Nolan	Miller & Chevalier	Deputy assistant Treasury secretary
Leonard Terr	Baker & McKenzie	International tax counsel, Treasury
Joel Williamson	Mayer, Brown & Platt	IRS attorney
Henry Zapruder	Zapruder & Odell	Treasury attorney

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broad-scaled gun con-
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vision "will not stop
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. "Why don't we out-
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asserted Rep. Ron
, would send the Con-
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priority of President
anti-crime and anti-
House is scheduled to
bill next week. The
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il Issues an Scheme vance Fees

RNAL *Staff Reporter*

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He never saw his
council discovered

them is trying to collect more than $12 bil-
lion in additional taxes from more than 30 companies, a substantial number of which are Japanese. (It is hard to ascertain an exact number, because the IRS doesn't disclose the names of companies it is auditing.)

The government claims these companies underpaid taxes on the profits of their U.S. subsidiaries by inflating the prices they pay to their foreign parents for goods and services. IRS Commissioner Fred Goldberg has told Congress that a 1987 IRS study found that foreign firms paid taxes on less than 1% of their gross receipts—well below the tax levels of domestic companies. More explosive were figures showing that while Japanese-owned companies' U.S. sales rose nearly 50% in 1987, the reported income they paid taxes on dropped by two-thirds.

Those findings spurred the IRS to step up its audits of foreign companies—which in turn spurred the companies' rush to hire the former government officials to negotiate settlements with the IRS or to litigate against the agency.

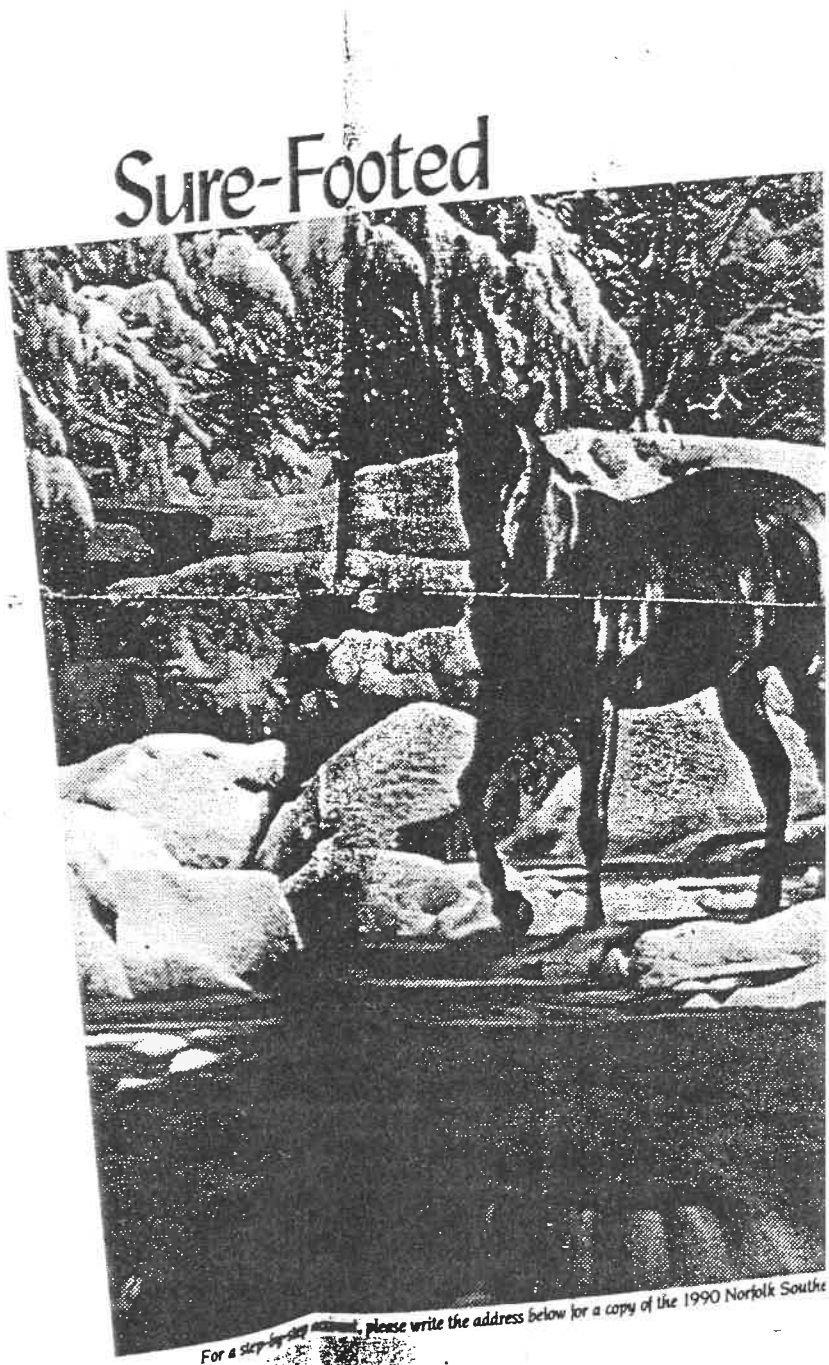
There is a long history of former IRS officials who have gone on to represent taxpayers in high-profile disputes with the agency. But these transfer-pricing cases are particularly complex—they often involve the decoding of records that are kept in Japanese and follow foreign accounting rules—and the IRS is extremely hard-pressed to match the show of force on the taxpayers' side.

"The taxpayer has an advantage in these cases," says Paul Oosterhuis, a partner in the Washington office of **Skadden, Arps, Slate, Meagher & Flom**, who represented Korea's **Daewoo** Corp. in a transfer-pricing case that was settled before trial for an undisclosed sum. Mr. Oosterhuis came to Skadden from the congressional Joint Committee on Taxation.

In one of the first cases the IRS has litigated against a foreign company, the government's experts appear to have been trounced by a legal and accounting team assembled by Westreco Inc., a subsidiary of the Swiss-based **Nestle** S.A. Although a decision in the case is still pending, several lawyers who watched the proceedings say the IRS was very badly outgunned.

The lawyers representing Westreco were Joel Williamson and Joseph Goeke of Chicago's **Mayer, Brown & Platt**, who had been two of the IRS's most experienced trial attorneys and who handled some of the agency's most important transfer-pricing litigation during the 1980s.

"We're probably handling more of these cases than anyone," says Mr. Goeke, who followed Mr. Williamson to Mayer Brown in 1988. Mr. Goeke declines to identify other clients he is representing against the IRS, although they are known to include other foreign-owned and Japanese firms



managing the selection of nongovernmental facilities for such activities. IRS has encouraged the use of modern technology to cut travel costs and estimates that it saved nearly $3 million in travel expenses from January to July 1993 by using videoconferencing. IRS officials said that IRS continues to assess its strategies to take advantage of emerging telecommunications technology.

Tax Administration:
Information on IRS' International Tax Compliance Activities

GAO/GGD-94-96FS, June 27 (19 pages).

In 1993 there were about 52,000 foreign-controlled corporations in the United States, 19,000 foreign corporations with business activities in the United States, and an estimated 80,000 U.S.-controlled foreign corporations. GAO has previously reported on problems with international tax compliance and the fact that proportionately more foreign-controlled corporations pay no U.S. income taxes versus U.S.-controlled corporations. Congress and others have raised questions about the complexity of the international tax laws and about the Internal Revenue Service's (IRS) ability to ensure that corporations are accurately calculating their tax liabilities. Therefore, Congress authorized IRS more international resources for fiscal year 1994. This fact sheet provides information on (1) how IRS has used additional resources allocated to international compliance activities and (2) how IRS measures the effectiveness of these activities.

Internal Revenue Service:
Changes Needed in the Role of Regional Offices

GAO/GGD-94-160, July 26 (60 pages).

Past studies of the Internal Revenue Service (IRS) have concluded that the agency needs regional offices. GAO reached the same conclusion after surveying the internal customers of regional offices—executives in IRS' National Office and field offices—and after reviewing regional office involvement in IRS' new initiative aimed at bringing nonfilers back into the tax system. IRS has about 96,000 field office workers spread over about 700 locations. Evidence suggests that regional offices are needed for effective management of such a large and far-flung organization. However, GAO found that these offices are not functioning in a way that yields the greatest returns to internal customers. Many customers, although

GAO

United States
General Accounting Office
Washington, D.C. 20548

General Government Division

B-260157

April 13, 1995

The Honorable Byron L. Dorgan
United States Senate

The Honorable Paul E. Kanjorski
House of Representatives

This report responds to your requests to provide recent data on transfer pricing issues and on tax compliance of foreign- and U.S.-controlled corporations.[1] Specifically, we are providing information and analysis to update our 1993 work on (1) IRS' recent experience in dealing with transfer pricing issues through its examinations, appeals, and litigation functions and (2) IRS' use of available regulatory and procedural tools. We have also used 1990 and 1991 tax data to update our analyses of how many U.S.-controlled corporations (USCC) and foreign-controlled corporations (FCC)[2], did not pay U.S. income taxes. Our 1993 work in some instances provided information for tax years dating back to 1987.

Background

A transfer price is the price charged by one company for a product or service supplied to a related company, such as the price a parent corporation charges its wholly-owned subsidiary. Any company that has a related company with which it transacts business establishes transfer prices for those intercompany transactions. Although often associated with the pricing of tangible goods, transfer pricing occurs whenever income and expenses are allocated among interrelated companies. For example, the payment of royalties, interest payments for debts, leasing expenses, and fees for other services between interrelated companies are transactions requiring transfer prices.

Pricing of intercompany transactions affects the distribution of profits and, therefore, taxable income among the related companies and, sometimes, across tax jurisdictions. Abusive transfer pricing occurs when income and expenses are improperly allocated among interrelated companies for the purpose of reducing taxable income in a high-tax

[1]We previously testified on these issues in International Taxation: Updated Information on Transfer Pricing (GAO/T-GGD-93-16, Mar. 25, 1993) and provided tax information in International Taxation: Taxes of Foreign- and U.S.-Controlled Corporations (GAO/GGD-93-112FS, June 11, 1993).

[2]Foreign-controlled corporations are U.S. corporations of which at least a specified percentage of the voting stock is owned by a foreign individual, partnership, corporation, estate, or trust. U.S.-controlled corporations are other corporations, although certain entities such as subchapter S corporations, which are corporations that are treated for federal income tax purposes like partnerships, are not included in either category.

80

Exh. 3, T #12

jurisdiction. Underpayment of U.S. income taxes can result from inappropriate transfer pricing between interrelated companies with operations in both the United States and in a country with a lower tax burden. Even when the U.S. corporate tax rate is lower than that of some other country, transfer pricing abuses can occur by shifting income through another related company that operates in a tax haven, that is, a country with low or no taxes.

The following is an example of abusive cross-border transfer pricing. A foreign parent corporation with a subsidiary operating in the United States charges the subsidiary excessive prices for goods and services rendered (for example, $1,000 instead of the going rate of $600). This raises the subsidiary's expenses (by $400), lowers its profits (by $400), and effectively shifts that income ($400) outside of the United States. At a 35-percent U.S. corporate income tax rate, the subsidiary will pay $140 less in U.S. taxes than it would if the $400 in profits were attributed to it.

Section 482 of the Internal Revenue Code provides IRS authority to allocate income among related parties if IRS determines that the transfer prices used by the taxpayer are inappropriate. To evaluate transfer pricing, the IRS examiner considers what the price would have been if the parties had not been related to each other. Such a price between unrelated parties is called the "arm's length" price. Finding a section 482 violation, that is, a difference between the price a related party charged and the arm's length price, the IRS examiner can propose an adjustment to the taxpayer's income. If the taxpayer does not agree with the proposed adjustment, it can appeal the dispute through IRS' appeals process or take the case to court.

In July 1994, IRS issued new regulations under section 482 that differed significantly from previous section 482 regulations. Under the new regulations, taxpayers have great latitude in establishing transfer prices. However, under 1993 legislation, taxpayers are subject to new requirements for documenting their transfer prices, and they face stiff penalties for substantially misstating them.

Results in Brief

IRS' recent experiences with examinations, appeals, and litigation relating to section 482 issues have been mixed. For instance, in 1993 and 1994, IRS examiners found, as they had in previous years, large section 482 violations. However, the total dollar value of the adjustments in the 2 years differed by $1.3 billion. Examiners also noted that, in a large proportion of

cases, transfer pricing activity involved pricing methods other than the three—uncontrolled price, cost plus, and resale price—that were specifically described in section 482 regulations over the years. The outcomes of the appeals and legal processes in 1993 and 1994 were similar to those in 1987 and 1988, with IRS sustaining less than 30 percent of the proposed section 482 adjustment amounts. In 1993 and the first part of 1994, IRS had somewhat better success litigating large transfer pricing cases than in 1990 through 1992.

According to IRS officials, certain enforcement tools available to IRS, such as measures to obtain information and stronger penalties, have served mostly as deterrents that altered taxpayer behavior. Alternatives to traditional examinations, appeals, and litigation, such as simultaneous examinations, arbitration, and advance pricing agreements, either have been used infrequently or are expected to grow in number in the future. Similar to examiners' experience, advance pricing agreements have prominently featured pricing methods other than the three specifically described in earlier regulations.

How successful the new transfer pricing regulatory regime will be remains to be seen. The flexibility that new regulations allow taxpayers in applying the arm's length standard must be weighed against the flexibility given IRS and the increased documentation required of taxpayers under threat of penalty.

A majority of all FCCs and USCCs paid no U.S. income tax in each year from 1987 through 1991, and the percentages of each—nearly three-quarters of FCCs and about 60 percent of USCCs—remained largely unchanged over the 5-year period.[3] Although taxpaying corporations were a minority of all FCCs and USCCs, they owned the majority of corporate assets and generated most of the receipts. Furthermore, the largest nontaxpaying corporations—those with assets of $100 million or more—were relatively few in number but accounted for relatively large proportions of all FCCs' and all USCCs' total assets and receipts. While the differences in tax payment rates between FCCs and USCCs are not convincing evidence of transfer pricing abuse, transfer pricing abuse cannot be ruled out as at least a possible cause for part of the observed differences. Other factors, such as the different types of industries for the nontaxpaying FCCs and USCCs, may also account for some of the observed differences.

[3]The confidence intervals are plus or minus 4 percent for the FCC data and plus or minus 0.9 percent for the USCC data. (See app. V.)

IRS' Examination, Appeals, and Litigation Experiences With Section 482 Were Mixed

IRS' international examiners continued to propose substantial adjustments to the taxable income of FCCs and USCCs in fiscal years 1993 and 1994, although the total dollar value of the adjustments in 1993 was $1.3 billion less than in 1994. In examinations finished in fiscal year 1993, international examiners proposed adjustments to taxable income of $2.2 billion for 369 corporations—$900 million for 247 FCCs and $1.3 billion for 122 USCCs. For 1994, IRS data showed $3.5 billion in proposed adjustments.

Most of the dollar value of these proposed section 482 adjustments was for large cases, those that had total proposed adjustments of $20 million or more. For example, in 1993 examiners proposed $1.8 billion in adjustments for 51 of these large cases—$700 million for 18 FCCs and $1.1 billion for 33 USCCs. Although the 18 large FCCs subject to proposed income adjustments in 1993 represented an increase in number over the previous 4 years, when 11 to 13 FCCs were subject to proposed income adjustments for transfer pricing, they also represented a decrease in dollars. The number of USCCs subject to income adjustments for transfer pricing in 1993, in contrast, was about the same as in previous years, although this group also involved fewer dollars.[4] According to IRS, the 1993 adjustments for transfer pricing might be understated due to data that were lost in implementing a new management information system.

Transfer pricing issues for which IRS examiners proposed income adjustments in 1993 occurred about equally in four categories, while pricing of tangible goods represented the largest share of the adjustment dollars proposed. As shown in figure 1, the categories with the most frequent section 482 issues were interest, royalties, pricing of tangible goods, and a nonspecific category of income allocations and deductions, each accounting for between 11 and 14 percent of occurrences found by IRS examiners. Yet, adjustments for pricing of goods accounted for 49 percent of all the section 482 adjustment dollars proposed.

[4]A few large adjustments significantly affect comparisons of adjustments for FCCs and USCCs and across years because they comprise large percentages of the totals.

Dkt 91-8103

U.S. Chamber of Commerce

TAX POLICY CENTER

1615 H Street, N.W. Washington, D.C. 20062 202/463-5620 Fax 202/463-3174

Benson S. Goldstein
Manager

September 17, 1991

The Honorable Kenneth W. Starr
Office of the Solicitor General
Department of Justice
10th and Constitution Avenue, N.W.
Room 5143
Washington, D.C. 20530

Dear Mr. Starr:

The U.S. Chamber of Commerce is writing this letter to seek your assistance in preventing the federal government from discriminating against American companies in favor of foreign companies. The federal government has vigorously assisted foreign companies in upholding the federal policy against worldwide unitary taxation by the states, but has failed to provide the same assistance to American companies. To avoid putting our nation at a severe disadvantage in the highly competitive world of foreign trade, it is critical for the Department of Justice to go on record that this policy equally protects American companies.

United States litigants deserve the same degree of support, such as the filing of amicus briefs, as foreign litigants. Therefore, we urge you to reiterate that the Executive Branch policy against worldwide unitary taxation applies to U.S.-based multinationals.

The U.S. Chamber of Commerce is concerned about recent and pending California case law which may result in the imposition of worldwide unitary taxation on U.S.-based multinationals, coupled with the exemption from worldwide unitary taxation for foreign-based multinationals. We are specifically concerned with the California Court of Appeals decisions in Barclays Bank International Ltd. v. Franchise Tax Board and Colgate-Palmolive Company v. Franchise Tax Board.

In Barclays the California Court of Appeals correctly held that the imposition of worldwide unitary taxation on foreign-based multinational corporations violated the Commerce Clause and was unconstitutional. The court based this holding on the long-standing federal policy against worldwide unitary taxation.

91-8103

However, recently the same court ruled against Colgate. In upholding the constitutionality of the worldwide unitary method, the decision in Colgate stresses that in contrast to Barclays, the Department of Justice neither filed an amicus brief nor made an appearance in the case. The opinion states, "This case could not have provided a more appropriate context for the Executive Branch to express its views regarding the application of the worldwide unitary method of domestic-parent groups with foreign subsidiaries...Nevertheless, the Executive Branch has done nothing here to make its position known."

The Executive Branch has spoken out numerous times against worldwide unitary taxation, including President Reagan's November 8, 1985 statement instructing the Attorney General to pursue, through appropriate cases in litigation, the federal policy against worldwide unitary taxation. In not one of these manifestations of federal policy against worldwide unitary taxation has the Executive Branch ever drawn a distinction between foreign-based and U.S.-based multinationals. Indeed, it is preposterous to believe that the Executive Branch would intend to discriminate against U.S.-based multinationals based solely upon the fact that the parent corporation is American. Yet the California Court of Appeals reached precisely this conclusion in Colgate.

As a consequence, the Department of Justice's lack of active support in voicing the Executive Branch's opposition to all forms of worldwide unitary taxation may result in California's continued imposition of this tax on U.S.-based multinationals. Coupled with the Barclays exemption of foreign-based multinationals from this tax, this decision will mean that U.S. parent groups will pay significantly higher state taxes than their foreign counterparts.

We cannot allow this arbitrary discrimination against U.S. companies to occur. Accordingly the Department of Justice must provide support in the Colgate case if American companies are to compete with their foreign counterparts on an even playing field.

The time frame for action on this issue is short. Colgate has informed us it plans to appeal to the California Supreme Court for review of the Court of Appeals decision. We urge the Department to file a letter in support of this petition by October 31 to insure that it is considered by the California Supreme Court.

Thank you for your careful consideration of this matter.

Sincerely,

Benson S. Goldstein

these amounts, $528 million in 1997, $410 million in 1996, and $375 million in 1995 were attributable to new prime products and major component development and major improvements to existing products. The remainders were attributable to engineering costs incurred during the early production phase as well as ongoing efforts to improve existing products. During 1997 we announced several new products as well as improvements to existing products, including our anticipated entry into the compact construction machine market in 1998. We expect to continue the development of new products and improvements to existing products in the future, with a focus in the areas of power generation equipment, smaller machines, and agricultural products.

Employment

At December 31, 1997, we employed 59,863 persons of whom 20,141 were located outside the United States.

Sales

Sales outside the United States were 51% of consolidated sales for 1997 and 1996, and 52% for 1995.

<PAGE>

Environmental Matters

The company is regulated by federal, state, and international environmental laws governing our use of substances and control of emissions. Compliance with these existing laws has not had a material impact on our capital expenditures, earnings, or competitive position.

We are cleaning up hazardous waste at a number of locations, often with other companies, pursuant to federal and state laws. When it is likely we will pay clean-up costs at a site and those costs can be estimated, the costs are charged against our earnings. In doing that estimate, we do not consider amounts expected to be recovered from insurance companies and others.

The amount set aside for environmental clean-up is not material and is included in "Accounts payable and accrued expenses" in Statement 3 of the Appendix. If a range of liability estimates is available on a particular site, we accrue the lower end of that range.

We cannot estimate costs on sites in the very early stages of clean-up. Currently, we have five of these sites and there is no more than a remote chance that a material amount for clean-up will be required.

A specific matter involving the United States Enviromental Protection Agency is discussed under Item 7 to this Form 10-K.

Item 1a. Executive Officers of the Registrant as of December 31, 1997

<TABLE>
<CAPTION>

Name and Age	Present Caterpillar Inc. position and date of initial election	Principal position past five year Caterpillar Inc. posi
<S>	<C>	<C>
Donald V. Fites (64)	Chairman and Chief Executive Officer (1990)	

EXHIBIT #14

MANAGEMENT

A Small World After All

Wanted: a 'globoboss' who's at home anywhere and sings the same tune—profits—everywhere

By Michael Hirsh

Bet on it. Any time there's a big international merger—and 1996 has had a record number—you're going to get all sorts of fretting about "culture clash." Since British Telecom announced it was buying MCI a few weeks ago, we've been hearing about whether the stodgy Brits can work with those sock-it-to-'em Americans. Same thing when any "foreigner" gets the top slot at a company far from home. When Marjorie Scardino, a tall, wisecracking Texan, was named to head Britain's blue-blooded Pearson publishing firm in November, the company's stock plunged for a day in London. Earlier this year Ford Motor named Henry Wallace, a Scottish executive, to take over its Mazda unit. As the first *gaijin* in memory to head a major Japanese company, he faces a nation of skeptics. "Ford sends people who don't speak Japanese at all," grumbles Goro Matsui, a business leader in Hiroshima, Mazda's hometown.

But Wallace's bad Japanese—he gets tutoring once a week—hardly matters these days. Nor does Scardino's Texarkana drawl grate much on British ears. With surprising speed, the big multinationals—and many small ones—have come to speak the same language and inhabit a common culture. The corporate equivalent of McWorld has bred a new kind of executive—call him, or her, globoboss—who is breaking down cultural barriers. They are also helping to drive cross-border M&A to new levels: $250 billion so far this year.

How does one qualify as a topnotch globoboss? First, learn *their* language. Global managers speak a patois of straight-shooting American pragmatism, Japanese-inspired management ideas (like *kaizen*, or continuous improvement) and M.B.A. jargon ("strategic resource allocation"). They're tough, smart and flexible enough to surf the slipstream of the global economy. Guys like Ernie Drew, a former air force captain. Drew was running Celanese, a mid-size U.S. chemical company, when it was bought by the $37 billion German giant Hoechst. Last year, impressed by Celanese's profits, Hoechst chairman Jürgen Dormann asked Drew to join the board in Frankfurt. He proceeded to remake the Teutonic parent in Celanese's image. It was only a matter of time before board members with names like Günter and Horst were jawing away in English about "vision" and "TQM" (that's "total quality management"). Then in November, Hoechst announced it was splitting into six independent units—a bit of U.S.-style financial engineering meant to boost shareholder value, a novel concept in Germany. Score one for Drew—and globobosses all over.

A new breed of globalist CEOs: *'I think the whole world is becoming more homogenized,' says Scardino*

ASHLEY ASHWOOD—FINANCIAL TIMES

Another must: "benchmarking." This buzzword means measuring your company against the best practices of other companies worldwide. Smart globobosses personally benchmark themselves against beau ideals like Coca-Cola's Roberto Goizueta and GE's Jack Welch—two of the world's most successful multinational managers. British Telecom and MCI have actually been checking each other out for years. At this point, says MCI chairman Bert Roberts, "there's no culture clash."

Clearly, globobossing is here to stay. Big companies *must* go global to be near the billions of new consumers and to find the best deal worldwide on wages, taxes and local talent. That takes a savvy globoboss. Paul Ray Jr., a New York headhunter, describes a search he did for a semiconductor company. "They were looking for someone [who understands why] the chips were designed in India, water-etched in Japan, diced and mounted in Korea, assembled in Thailand, encapsulated in Singapore and distributed" everywhere, he says. "About one in a million fits that description."

Indeed, there aren't enough globobosses to go around—even if many companies haven't yet figured out that they need them. (Few large U.S. companies, for instance, have foreigners on their boards.) The coming of the globoboss is less a revolution than culture creep, the kind that makes you sit up one day and say, "Hey, whatever happened to ..." Why, for example, don't we hear much about the Japanese way of doing business, as we did ad nauseam in the '80s? Mostly because everyone has adopted it. Today American execs chant "TQM" in their sleep and the Japanese idolize Bill Gates.

For globobosses, even time zones are a competitive edge. George Everhart, the American president of Fujitsu PC in Milpitas, Calif., tells how his team worked nonstop for months to develop software for Fujitsu's brand-new Lifebook notebook computers, the kind of cutting-edge product that just has to beat the competition to market. "When the work had been done in Japan, they would ship it here in the morning, our time. We did validation testing, wrote it up and shipped the results back to them in the evening."

That sense of cross-border trust is a big step for a Japanese firm, says Everhart. So was Fujitsu's decision to put him, a former Apple exec, in charge. His Tokyo bosses, he says, "no longer think in terms of local control of worldwide enterprise." Like globobosses everywhere, they can't afford to. ■

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Exhibit 75

Tax avoidance and evasion

Globalisation and the removal of exchange controls and other barriers to the free movement of capital have promoted economic development. But they have also increased the scope for tax avoidance and evasion, and the loss of tax revenues is significant.

Tax avoidance and evasion cause many problems. Governments lose revenues and so taxes on those who do not escape the tax net must rise to plug the gap. Countries where tax compliance is highest lose out, as trade flows are diverted elsewhere. The Committee on Fiscal Affairs has taken a number of steps to combat international tax avoidance and evasion.

International co-operation

Tax authorities have responded to concerns about avoidance and evasion by taking on new powers to collect information from taxpayers. Delegates to the working party on tax avoidance and evasion systematically inform other countries about the means at there disposal for countering avoidance, covering legislation, court decisions and audit techniques. The Committee has promoted the exchange of this information between tax authorities as the best way of fighting non-compliance in transactions across borders. The Model Convention contains an article on exchange of information. Current work includes looking at how better use of the latest information technology can help. A standard format for automatic, electronic delivery of information was established in 1992, and recently a manual aimed at tax officials was issued to explain how these procedures work in practice.

Tax Inspectors Meetings

With identities concealed, practical cases are examined in regular meetings of tax inspectors. The aim is to share practical experience and information among people working in the fields of tax auditing and detection of fraud.

New international legal instruments

Backing up increased co-operation, new legal instruments have been developed. In 1995, a multilateral convention on administrative assistance in the tax area was established in co-operation with the Council of Europe. This built on the earlier convention on administrative assistance in the recovery of tax claims.

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Harmful Tax Competition: An Emerging Global Issue

EXTRACT FROM THE COMMUNIQUE OECD COUNCIL MEETING AT MINISTERIAL LEVEL

Paris, 27-28 April 1998

"Ministers welcomed the Report "Harmful Tax Competition: an Emerging Global Issue" and recognised that it represents a step forward towards curbing harmful tax practices. Ministers underlined the commitment to intensify efforts in this area at the national, bilateral, and multilateral levels. They welcomed the establishment of Guidelines on Harmful Preferential Tax Regimes, the commitment to draw up a list of tax havens and the creation of a Forum on Harmful Tax Practices. Ministers look forward to receiving periodic reports on the progress in implementing the recommendations set out in the Report.

Ministers encouraged the OECD to pursue further, and to broaden, its work in order to carry out fully the mandate given by Ministers in 1996 to develop measures to counter the distorting effect of harmful tax competition on investment and financial decisions, including real economic activities, and to associate non-member countries with this work."

EXHIBIT #17

Synthesis and Summary of Recommendations

A. THE REPORT

Published under the title "Harmful Tax competition: An Emerging Global Issue"

In May 1996 Ministers called upon the OECD to:

"develop measures to counter the distorting effects of harmful tax competition on investment and financing decisions and the consequences for national tax bases, and report back in 1998".

The G7 Heads of State endorsed this request at their 1996 Lyon summit, urging the OECD "to vigorously pursue its work in this field, aimed at establishing a multilateral approach under which countries could operate individually and collectively to limit the extent of these practices."

In response to the Ministers' request, the OECD's Committee on Fiscal Affairs launched its project on harmful tax competition. The results of this project were presented to Ministers on the 27/28 April 1998.

In approving the Report on the 9 April 1998, the OECD Council adopted a Recommendation to the Governments of Member countries and instructed the Committee to pursue its work in this area and to develop a dialogue with non-member countries. Luxembourg and Switzerland abstained in Council on the approval of the Report and the adoption of the Recommendation (see Appendix).

The Report addresses harmful tax practices in the form of tax havens and harmful preferential tax regimes in OECD countries and non-member countries and their dependencies. It focuses on geographically mobile activities, such as financial and other service activities.

The Report defines the factors to be used in identifying these harmful tax practices and goes on to make 19 wide-ranging Recommendations to counteract such practices.

Some of the Recommendations build on and reinforce existing national and bilateral measures designed to counteract harmful tax practices. But an important new focus is on intensifying international co-operation. As well as advocating the co-ordinated application of defensive measures, a set of Guidelines is proposed to deal with harmful preferential tax regimes in Member countries. The framework for implementation of the Guidelines will be provided by a new, ongoing OECD Forum on Harmful Tax Practices. The Forum will also oversee the implementation and development of the other Recommendations and engage in a dialogue with non-member countries which share the concerns of OECD Members.

B. GLOBALISATION: BENEFITS AND CHALLENGES FOR GOVERNMENTS

Globalisation is one of the great economic events of the 20th century. It is the process which breaks down economic barriers between nations and leads firms to develop global strategies. Liberalisation of national economies opened the way for globalisation and the new technologies made that globalisation happen. This, in turn, has translated into greater prosperity for many citizens around the world.

But globalisation has also raised challenges for governments: how to distribute the cost of structural adjustments required to reap the benefit of globalisation; how to provide the necessary shelter to the weaker segments of society; how to ensure that governments maintain sufficient sovereignty to determine the revenue and expenditure structure that is best suited to their political, institutional and social conditions.

Liberalisation is at the core of the Organisation's work and is aimed at facilitating cross-border flows of trade and investment. The OECD has spent considerable efforts to eliminate double taxation, which is an obstacle to cross-border activities, and is prepared to undertake similar efforts to curb harmful tax practices which can have detrimental effects on world economic growth.

Globalisation has had a positive effect on the development of tax systems, being, for instance, the driving force behind tax reforms that have focused on base broadening and rate reductions, thereby minimising tax-induced distortions.

OECD Member countries are committed to maintaining the efficiency gains of these reforms while recognising that there are no particular reasons why any two countries should have the same level and structure of taxation.

Similarly, increased liberalisation of financial markets has improved the international allocation of savings and capital and reduced the cost of capital to enterprises. But it has also widened opportunities for tax evasion and avoidance. In this new environment, tax havens have thrived and some governments have adopted preferential tax regimes specifically targeted at attracting mobile activities.

If nothing is done, governments may increasingly be forced to engage in competitive tax bidding to attract or retain mobile activities. That "race to the bottom", where location and financing decisions become primarily tax driven, will mean that capital and financial flows will be distorted and it will become more difficult to achieve fair competition for real economic activities.

Furthermore, it will become more difficult to collect taxes on income from mobile activities. If spending is not reduced to make up for this revenue loss there is a real risk that taxes on labour, consumption and non-mobile activities will need to be increased. This shift will make tax systems less equitable and, by narrowing the tax base, will introduce further distortions. By increasing non-wage labour costs, it may also have a negative impact on employment.

There is no reason why taxpayers that do not or cannot take advantage of harmful tax practices should have to pay the taxes avoided by those who have easy access to tax havens and harmful preferential tax regimes.

The potential impact of these developments is significant. It is estimated, for example, that foreign direct investment by G7 countries in a number of jurisdictions in the Caribbean and in the South Pacific island states, which are generally considered to be low-tax jurisdictions, increased more than five-fold over the period 1985-1994, to more than US$200 billion, a rate of increase well in excess of the growth of total outbound foreign direct investment.

Governments have not remained idle in face of these challenges but, until now, most governments have generally acted independently, or at best bilaterally, to protect their tax bases and fiscal policies. In this new global environment, such actions need to be reinforced but also complemented by intensified multilateral co-operation.

Developments within the G7, the EU, the OECD and beyond suggest that the political climate is now ripe for a common approach against harmful tax practices.

The concerns identified above are not limited to OECD countries

The concerns identified above are not limited to OECD countries. Countries in the Asian-Pacific region, Latin America, Africa and in the former Soviet Bloc share many of these concerns. In some ways these countries are more exposed to tax havens and competitive bidding for financial and service activities since many of them lack the administrative capacity to implement sophisticated counteracting measures. This is why the Committee on Fiscal Affairs has already engaged in a dialogue with these countries. Ministers have asked the OECD to explore further how contacts with non-member countries can be intensified in the context of the proposed Forum.

C. IDENTIFYING HARMFUL TAX PRACTICES

The Report makes a distinction between three situations in which the tax levied in one country on income from geographically mobile financial and other service activities is lower than the tax that would be levied on the same income in another country:

i) the first country is a tax haven and, as such, generally imposes no or only nominal tax on that income;

ii) the first country collects significant revenues from tax imposed on income at the individual or corporate level but its tax system has preferential features that allow the relevant income to be subject to low or no taxation;

iii) the first country collects significant revenues from tax imposed on income at the individual or corporate level but the effective tax rate that is generally applicable at that level is lower than that levied in the other country.

Each of these situations may have undesirable effects when seen from the perspective of the other country. However, insofar as the other

factors referred to in the Report and set forth below are not present, the issues arising in situation *iii)* are outside the scope of the Report. Thus, the Report is careful not to suggest that there is some general minimum effective tax rate on income below which a country would be considered to be engaging in harmful tax practices. The focus of this Report is instead on tax havens and harmful preferential tax regimes.

The necessary starting point to identify a tax haven is to ask whether a jurisdiction imposes no or only nominal taxes and offers itself, or is perceived to offer itself, as a place to be used by non-residents to escape tax in their country of residence. Other key factors which can confirm the existence of a tax haven are: practices which prevent the effective exchange of relevant information with other governments on taxpayers benefiting from the low or no tax jurisdiction; lack of transparency; and the absence of a requirement that the activity be substantial, since this would suggest that a jurisdiction may be attempting to attract investment or transactions that are purely tax driven. No or only nominal taxation is a necessary condition for the identification of a tax haven and, if combined with a situation where the jurisdiction offers itself as a place where non-residents can escape tax in their country of residence, it may be sufficient to identify a tax haven.

Similarly, four key factors assist in identifying harmful preferential tax regimes: *i)* the regime imposes a low or zero effective tax rate on the relevant income; *ii)* the regime is "ring-fenced"; *iii)* the operation of the regime is non-transparent; and *iv)* the jurisdiction operating the regime does not effectively exchange information with other countries. Although a low or zero effective tax rate is the necessary starting point for an examination of a preferential tax regime, any evaluation should be based upon an overall assessment of each of the factors identified in the Report. In this evaluation process, harmful preferential tax regimes will be characterised by a combination of a low or zero

effective tax rate and one or more other factors.

The Report elaborates on these key characteristics and also identifies a series of other factors and considerations which can be useful in identifying harmful tax practices.

D. RECOMMENDATIONS FOR ACTION

The Recommendations recognise that greater international co-operation is required in this area. It is increasingly difficult for individual countries to combat effectively the spread of harmful tax practices without the risk of putting their taxpayers and economies at a competitive disadvantage.

There is, therefore, a strong case to reinforce existing measures and to intensify international co-operation when formulating a response to the problem of harmful tax practices.

The Recommendations set out in the Report and the accompanying Guidelines (see Annex) address the problem of harmful tax practices from different angles. Taken together, they represent a comprehensive approach by Member countries for dealing with the problems of harmful tax competition created by tax havens and harmful preferential tax regimes. Some of the Recommendations encourage countries to refrain from adopting or to eliminate measures constituting harmful tax competition. Others are aimed at offsetting the benefits for taxpayers of certain forms of harmful tax practices. Still others address the issue indirectly by focusing on tax evasion and avoidance, because many forms of harmful tax competition are aimed at taxpayers willing to engage in tax evasion and avoidance.

The effectiveness of many of the Recommendations concerning domestic legislation and tax treaties depends in part upon whether

domestic legislation and tax treaties depends in part upon whether they can be implemented in a co-ordinated way. This is why one of the main Recommendations is for the establishment of a Forum to monitor the application of the Guidelines and to undertake an on-going evaluation of existing and proposed regimes, to assess the effectiveness of counter-measures and to propose ways to improve their effectiveness. It will also be responsible for monitoring the implementation of the other Recommendations.

In addition to these Recommendations, the Report identifies a series of areas where further study could result in new Recommendations. The Forum will be used to examine these areas.

ANNEX

RECOMMENDATIONS AND GUIDELINES FOR DEALING WITH HARMFUL TAX PRACTICES

I. Recommendations concerning domestic legislation and practices

1. ***Recommendation concerning Controlled Foreign Corporations (CFC) or equivalent rules:*** that countries that do not have such rules consider adopting them and that countries that have such rules ensure that they apply in a fashion consistent with the desirability of curbing harmful tax practices.

2. ***Recommendation concerning foreign investment fund or equivalent rules:*** that countries that do not have such rules consider adopting them and that countries that have such rules consider applying them to income and entities covered by practices considered to constitute harmful tax competition.

3. ***Recommendation concerning restrictions on participation exemption and other systems of exempting foreign income in the context of harmful tax competition:*** that countries that apply the exemption method to eliminate double taxation of foreign source income consider adopting rules that would ensure that foreign income that has benefited from tax practices deemed as constituting harmful tax competition do not qualify for the application of the exemption method.

4. ***Recommendation concerning foreign information reporting rules:*** that countries that do not have rules concerning reporting of international transactions and foreign operations of resident taxpayers consider adopting such rules and that countries exchange information obtained under these rules.

5. ***Recommendation concerning rulings:*** that countries, where

administrative decisions concerning the particular position of a taxpayer may be obtained in advance of planned transactions, make public the conditions for granting, denying or revoking such decisions.

6. *Recommendation concerning transfer pricing rules:* that countries follow the principles set out in the OECD's 1995 Guidelines on Transfer Pricing and thereby refrain from applying or not applying their transfer pricing rules in a way that would constitute harmful tax competition.

7. *Recommendation concerning access to banking information for tax purposes:* in the context of counteracting harmful tax competition, countries should review their laws, regulations and practices which govern access to banking information with a view to removing impediments to the access to such information by tax authorities.

II. Recommendations concerning tax treaties

8. *Recommendation concerning greater and more efficient use of exchanges of information:* that countries should undertake programs to intensify exchange of relevant information concerning transactions in tax havens and preferential tax regimes constituting harmful tax competition.

9. *Recommendation concerning the entitlement to treaty benefits:* that countries consider including in their tax conventions provisions aimed at restricting the entitlement to treaty benefits for entities and income covered by measures constituting harmful tax practices and consider how the existing provisions of their tax conventions can be applied for the same purpose; that the Model Tax Convention be modified to include such provisions or clarifications as are needed in that respect.

10. *Recommendation concerning the clarification of the status of domestic anti-abuse rules and doctrines in tax treaties:* that the

domestic anti-abuse rules and doctrines in tax treaties, that the Commentary on the Model Tax Convention be clarified to remove any uncertainty or ambiguity regarding the compatibility of domestic anti-abuse measures with the Model Tax Convention.

11. *Recommendation concerning a list of specific exclusion provisions found in treaties:* that the Committee prepare and maintain a list of provisions used by countries to exclude from the benefits of tax conventions certain specific entities or types of income and that the list be used by Member countries as a reference point when negotiating tax conventions and as a basis for discussions in the Forum.

12. *Recommendation concerning tax treaties with tax havens:* that countries consider terminating their tax conventions with tax havens and consider not entering into tax treaties with such countries in the future.

13. *Recommendation concerning co-ordinated enforcement regimes (joint audits; co-ordinated training programmes, etc.):* that countries consider undertaking co-ordinated enforcement programs (such as simultaneous examinations, specific exchange of information projects or joint training activities) in relation to income or taxpayers benefiting from practices constituting harmful tax competition.

14. *Recommendation concerning assistance in recovery of tax claims:* that countries be encouraged to review the current rules applying to the enforcement of tax claims of other countries and that the Committee pursue its work in this area with a view to drafting provisions that could be included in tax conventions for that purpose.

III. Recommendations to intensify international co-operation in response to harmful tax competition

15. *Recommendation for Guidelines and a Forum on Harmful Tax Practices:* that the Member countries endorse the Guidelines on harmful preferential tax regimes set out in the following Box and establish a Forum to implement the Guidelines and other Recommendations in this Report.

GUIDELINES FOR DEALING WITH HARMFUL PREFERENTIAL TAX REGIMES IN MEMBER COUNTRIES

While recognising the positive aspects of the new global environment in which tax systems operate, Member countries have concluded that they need to act collectively and individually to curb harmful tax competition and to counter the spread of harmful preferential tax regimes directed at financial and service activities. Harmful preferential tax regimes can distort trade and investment patterns, and are a threat

both to domestic tax systems and to the overall structure of international taxation. These regimes undermine the fairness of the tax systems, cause undesired shifts of part of the tax burden from income to consumption, shift part of the tax burden from capital to labour and thereby may have a negative impact on employment. Since it is generally considered that it is difficult for individual countries to combat effectively the spread of harmful preferential tax regimes, a co-ordinated approach, including a dialogue with non-member countries, is required to achieve the "level playing field" which is so essential to the continued expansion of global economic growth. International co-operation must be intensified to avoid an aggressive competitive bidding by countries for geographically mobile activities.

The Guidelines are:

1. To refrain from adopting new measures, or extending the scope of, or strengthening existing measures, in the form of legislative provisions or administrative practices related to taxation, that constitute harmful tax practices as defined in Section III of Chapter 2 of the Report.

2. To review their existing measures for the purpose of identifying those measures, in the form of legislative provisions or administrative practices related to taxation, that constitute harmful tax practices as defined in Section III of Chapter 2 of the Report. These measures will be reported to the Forum on Harmful Tax Practices and will be included in a list within 2 years from the date on which these Guidelines are approved by the OECD Council.

3. To remove, before the end of 5 years starting from the date on which the Guidelines are approved by the OECD Council, the harmful features of their preferential tax regimes identified in the list referred to in

paragraph 2. However, in respect of taxpayers who are benefiting from such regimes on 31 December 2000, the benefits that they derive will be removed at the latest on the 31 December 2005. This will ensure that such particular tax benefits have been entirely removed after that date. The list referred to in paragraph 2 will be reviewed annually to delete those regimes that no longer constitute harmful preferential tax regimes.

4. Each Member country which believes that an existing measure not already included in the list referred to in paragraph 2, or a proposed or new measure of itself or of another country, constitutes a measure, in the form of legislative provision or administrative practice related to taxation, that might constitute a harmful tax practice in light of the factors identified in Section III of Chapter 2 of the Report, may request that the measure be examined by the Member countries, through the Forum on Harmful Tax Practices, for purposes of the application of paragraph 1 or for inclusion in the list referred to in paragraph 2. The Forum may issue a non-binding opinion on that question.

5. To co-ordinate, through the Forum, their national and treaty responses to harmful tax practices adopted by other countries.

6. To use the Forum to encourage actively non-member countries to associate themselves with these Guidelines.

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16. ***Recommendation to produce a list of tax havens:*** that the Forum be mandated to establish, within one year of the first meeting of the Forum, a list of tax havens on the basis of the factors identified in section II of Chapter 2.

17. ***Recommendation concerning links with tax havens:*** that countries that have particular political, economic or other links with tax havens ensure that these links do not contribute to harmful tax competition and, in particular, that countries that have dependencies that are tax havens ensure that the links that they have with these tax havens are not used in a way that increase or promote harmful tax competition.

18. ***Recommendation to develop and actively promote Principles of Good Tax Administration:*** that the Committee be responsible for developing and actively promoting a set of principles that should guide tax administrations in the enforcement of the Recommendations included in this report.

19. ***Recommendation on associating non-member countries with the Recommendation:*** That the new Forum engage in a dialogue with non-member countries using, where appropriate, the fora offered by other international tax organisations, with the aim of promoting the

other international tax organisations, with the aim of promoting the Recommendations set out in this Chapter, including the Guidelines.

Appendix

STATEMENTS BY LUXEMBOURG AND SWITZERLAND

The following statements were made by Luxembourg and Switzerland at the OECD Council meeting on the 9th April 1998.

A. STATEMENT BY LUXEMBOURG

The Council, which met at the Ministerial level in May 1996, gave a mandate "to develop measures to counter the distorting effects introduced by harmful tax competition on investment and financing decisions and the consequences for national tax bases".

Considering that tax competition—beyond its positive effects—can also present certain harmful aspects, Luxembourg approved this mandate and participated in the subsequent work.

In parallel with the work undertaken at the OECD, Luxembourg has co-operated actively in elaborating a comprehensive approach to this issue within the European Union, where an agreement was reached on 1December1997 on a code of conduct with respect to bus iness taxation and on the issues to consider in the context of taxation of savings in order to guarantee a minimum level of taxation.

This EU agreement is the result of co-ordinated action, reflecting a balanced approach, based on:

1) recognition of the existence of inherently legitimate differences between national legal and fiscal frameworks;

2) recognition that these differences should not be at the origin of harmful tax competition, and;

3) recognition that such harmful tax competition is not due to a single member State in a single sector, and, thus, that the governments of all member States are invited to counter harmful tax competition in all sectors.

By voluntarily limiting itself to financial activities, excluding industrial and commercial activities, the Report developed by the Special Sessions on Harmful Tax Competition adopts a partial and unbalanced approach: it does not fulfil the 1996 mandate.

By taking an almost unilateral approach with respect to the prescribed measures, the Report gives the impression that its purpose is not so much to counter harmful tax competition where it exists as to abolish

bank secrecy.

Luxembourg does not share the Report's implicit belief that bank secrecy is necessarily a source of harmful tax competition.

It cannot accept that an exchange of information that is circumscribed by the respect of international laws and respective national laws be considered a criterion to identify a harmful preferential tax regime and a tax haven.

Just as judicial co-operation in criminal matters is essential to counter any potential abuse of bank secrecy both in criminal law *per se* and in criminal violations of tax law, so should international administrative assistance in tax matters be subject to certain conditions and precise limits, in accordance with general legal principles and respective national legislation.

Furthermore, Luxembourg cannot accept that the underlying philosophy of the Report be extended to the taxation of savings, in respect of which the Committee on Fiscal Affairs has already mandated its Working Party on Tax Evasion and Avoidance to examine how exchange of information and withholding taxes could be used concurrently to prevent cross-border interest flows from escaping taxation. This approach ignores the validity of the so-called model of "coexistence", wherein withholding taxes constitute an alternative to exchange of information.

More generally, Luxembourg is concerned that the Report lends credence to the so-called criterion of reputation—a criterion without any objective basis.

Luxembourg is convinced that the desired effectiveness of international co-operation in countering harmful tax competition requires a strengthening of mutual trust between Member countries, as well as dialogue with OECD non-members. In this context, it appears essential that countries with dependencies contribute actively so that these territories do not in fact remain exempt from the fight against harmful tax competition. Similarly, harmful tax competition resulting from special ties that a country maintains with tax havens cannot remain out of bounds. These problems are not sufficiently covered in the Report.

Considering all the above, Luxembourg states its disagreement with the Report on harmful tax competition.

Hoping that this first approach does not necessarily prejudge future developments, in particular in the Forum, and confident in the ability of the OECD to deal with this important subject while respecting the major concerns of its Member countries, Luxembourg has decided to express

its disagreement in the form of a general abstention in respect of the Report "Harmful Tax Competition: A Global Issue" and the Recommendation of the Council C(98)17.

Accordingly, Luxembourg shall not be bound by the Report nor by the Recommendation to counteract harmful tax competition.

B. STATEMENT BY SWITZERLAND

1. Switzerland has an open and transparent tax regime characterised by a moderate tax burden. At the international level, judicial assistance works effectively to counteract tax fraud, and a system of withholding tax (the rate of which is the highest among OECD countries) aims to prevent tax avoidance.

Switzerland considers that a certain degree of competition in tax matters has positive effects. In particular, it discourages governments from adopting confiscatory regimes, which hamper entrepreneurial spirit and hurt the economy, and it avoids alignment of tax burdens at the highest level.

However, beyond its positive effects, tax competition sometimes can, if excessive, have harmful consequences. Switzerland, like any other country, is not immune to these effects. The Swiss government is determined to curb tax competition to the extent that it is harmful, and it remains convinced that broad and co-ordinated international tax co-operation is the best guarantee of effective and continuing progress in this area. This is why Switzerland subscribed in May1996 to the mandate given by the OECD Council of Ministers and has taken part in the work culminating in a Report on harmful tax competition and its Recommendations.

2. It is now time to take stock of two years of work. Switzerland

2. It is now time to take stock of two years of work. Switzerland recognises the efforts made by the OECD in preparing the Report on counteracting harmful tax competition. The Swiss authorities must however conclude with regret that the result of this work in no way lives up to their expectations: it is partial and unbalanced. The opposition of the Swiss authorities to the content of the Report and to the Recommendations on harmful tax competition is consistent with what has been expressed and emphasised repeatedly, in particular within the Committee on Fiscal Affairs, the Executive Committee and the OECD Council. Our position is based, *inter alia*, on the following considerations:

A. Since the beginning of the work, Switzerland has stressed the importance of adopting a comprehensive approach to tax competition and of circumventing its harmful aspects. However, the scope of the work was subsequently restricted to geographically mobile activities, such as financial activities and other services. From our point of view, State intervention that distorts competition must be considered in all sectors and in the economy as a whole. Moreover, financial and investment decisions depend on a multiplicity of economic, political and social factors. Whilst the Report recognises that there are effectively other important non-tax factors that play a role in economic competitiveness, it does not take them into account. Under the circumstances, one cannot help but make partial and erroneous evaluations of reality.

B. The Report recognises that each State has sovereignty over its tax system and that levels of taxation can differ from one State to another. However, that same Report presents the fact that tax rates are lower in one country than in

another as a criterion to identifying harmful preferential tax regimes. This results in unacceptable protection of countries with high levels of taxation, which is, moreover, contrary to the economic philosophy of the OECD.

C. The Report ignores the reality of the structural diversity of existing tax regimes. For instance, the only solution adopted is administrative assistance by means of exchange of information, even though this presents certain limits, and the existence of withholding systems is not taken into account, even though such systems are viable alternatives which entail lower administrative costs. This is particularly difficult to understand since, up to now, the OECD had always considered withholding taxes as an alternative to exchange of information.

Switzerland considers that it is legitimate and necessary to protect the confidentiality of personal data. In this respect, the Report and Recommendations are, in certain aspects, in conflict with the Swiss legal system.

D. Finally, the selective and repressive approach that has been adopted does not give territories that make tax attraction a pillar of their economies an incentive to associate themselves with the regulation of the conditions of competition and will therefore fail to combat effectively the harmful excesses of tax competition that develops outside of all rules. On the contrary, it could reinforce the attraction of offshore centres, with all the consequences that this implies.

3. For these reasons, among others, Switzerland cannot declare itself in agreement with the Report nor with the adoption of the Recommendations, and more particularly Recommendations No.4, 7, 8, 14 and 15 included in the Report.

After having seriously considered the possibility of exercising its veto, Switzerland has finally decided to abstain when the Report and its Recommendations are adopted, in order not to prevent their adoption by other OECD Member countries wishing to do so. As far as Switzerland is concerned, it shall not be bound in any manner by the Report or its Recommendations.

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The Corporate Shell Game

How multinational firms use 'transfer pricing' to evade at least $20 billion in U.S. taxes

For taxpayers battling their 1040 forms and legislators peering into the black hole of the federal budget deficit, there's good news: the Internal Revenue Service, armed with fresh troops and new legal tools, is setting out to mine a mother lode of $25 billion in unpaid taxes. But there's also a catch: nobody expects much more than a trickle of new revenue to come from it.

The mother lode is unpaid business taxes, largely from foreign corporations doing business in the United States. In effect, like street-corner artists hiding peas under walnut shells, such companies play games with their profits. By manipulating the prices charged among their own subsidiaries, the multinationals can concentrate profits in countries with low corporate rates and thus get away with a smaller total tax bite (chart). The bottom line is that most foreign corporations operating in the United States pay little or no tax to Washington.

Tax loss: All told, the Treasury's loss is enormous. At hearings last summer before the House Oversight Subcommittee, chairman J. J. Pickle of Texas said he had heard estimates ranging up to $30 billion. IRS Commissioner Fred T. Goldberg Jr. said that was "on the high side," but conceded that the agency should be doing better. Michigan tax experts James Wheeler and Richard Weber calculate that foreign-based multinationals dodge $20 billion in U.S. taxes every year. And that's not considering U.S.-based companies, many of which also find ways to tuck away profits in tax havens. They usually do it on a smaller scale, since it's harder for them to dodge the IRS.

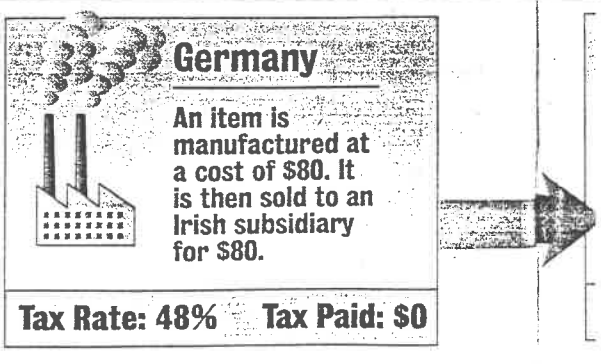
The corporate shell game has been going on for at least 30 years, ever since multinational operations became a significant factor in the corporate world, and there have been periodic attempts to crack down. The latest was prompted last summer, when the IRS published a table showing that foreign-based companies sold $543 billion worth of goods and services in the United States in 1986, but claimed to have net losses of $1.5 billion on that trade. That year was an aberration; before and since, overseas companies in the United States have actually reported net profits, albeit tiny ones. But the 1986 "loss" was riveting. "That tore it," says Ronald Pearlman, former chief of staff of the congressional Joint Tax Committee, now practicing law at Covington & Burling. Congress voted a stiff new 20 percent fine and gave the IRS broader power to subpoena records from parent companies overseas. The tax agency also got to expand its overworked international staff and dangle a small salary premium to recruit talent.

Abuses in pricing across borders—"transfer pricing," in corporate jargon—are illegal, if they can be proved. Corporations dealing with their own subsidiaries are required to set prices at "arm's length," just as they would for unrelated customers. And there's no question that abuses can be enormous. In its biggest known victory, the IRS made its case that Japan's Toyota had been systematically overcharging its U.S. subsidiary for years on most of the cars, trucks and parts sold in the United States. What would have been profits from the United States had wafted back to Japan. Toyota denied improprieties but agreed to a reported $1 billion settlement, paid in part with tax rebates from the government of Japan.

But such triumphs are rare, and the hurdles are mountainous. For one thing, small armies of accountants are needed to sift through corporate records in several countries, even if access is granted—by no means a sure thing. In one case, an agent who requested a specific document was sent 40 boxes of papers, without an index. Trained economists must rule in each case whether costs were realistically allocated. And since real-world cases are usually far more subtle than simple illustrative anecdotes, there is room for years of legal maneuvering over disputed facts, accounting practices and business judgments.

Who's Got the Profits?

By using tax havens and "trick" pricing, a corporation could slash its U.S. tax bill by transferring profits to low-tax countries. This typical transaction follows one trail.



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PHOTOS BY LOUIS PSIHOYOS—MATRIX

ROB CRANDALL—PICTURE GROUP

Dodge ball: *Toyota workers (above), Westinghouse researcher (left), Goldberg*

Some abuses are blatant. One foreign manufacturer, for instance, sold TV sets to its U.S. subsidiary for $250 each, but charged an unrelated company just $150. Most cases are nowhere near as clear. What if the set sold outside has a slight change in the casing? Which subsidiary gets charged for shipping and insurance? In one current case, the IRS says Japan's Yamaha forced Yamaha Motor Corp., U.S.A., to overstock motorcycles and all-terrain vehicles in the early '80s, and then made the subsidiary pay for discounts and promotions to unload the excess inventory. The result, says the tax agency, was that Yamaha Motor U.S.A. paid only $5,272 in corporate tax to Washington over four years. Proper accounting would have shown a profit of $500 million and taxes of $127 million, the agency says. But Yamaha argues that the IRS case ignores the colossal reality of the 1982 recession, which caught the company just as unprepared as its U.S. competitors. The U.S. Tax Court is mulling the case.

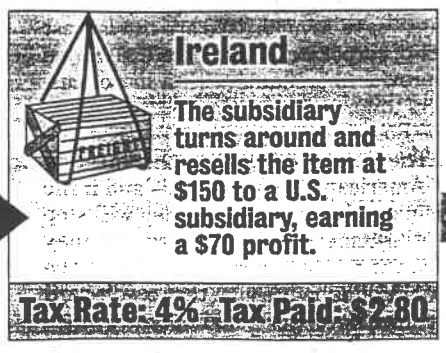
American-based multinationals have also been accused of squirreling profits away. Tax agents find it easier to monitor their books, since they're all in this country and follow SEC standards; as Wheeler explains it, "It's the difference between examining the head and several arms of an octopus, rather than just one tentacle." Even so, he thinks the U.S. multinationals could easily account for an additional $5 billion in lost taxes on profits dubiously allocated to tax havens. Wheeler and Richard Weber say they've found one case that is suggestive: Westinghouse Electric managed to book 27 percent of its 1986 domestic profit in Puerto Rico, where its final sales are tiny. To spur the Puerto Rican economy, Washington has set the corporate-tax rate there at zero. (Westinghouse says the accounting is proper, since its "highest-profit products are made in Puerto Rico.")

The IRS professes to be delighted with its new powers and loaded for bear. "We've been outmanned and outgunned in the past," says Steven Lainoff, chief IRS lawyer for international enforcement. "Now we've got the tools and people to really attack this problem." But that is at least questionable. The new fine, for instance, stipulates a 20 percent penalty for any company whose transfer pricing results in underpayment of $10 million or more in taxes. Experts call that a crude weapon that may well fail to stand up in court; even the IRS initially objected to it. And in testing their new subpoena powers in foreign countries, IRS agents will be under the scrutiny of tax people there, who stand to lose any taxes that Uncle Sam succeeds in claiming. The prospects for litigation are wearying.

When it comes to litigation, the IRS may also find little comfort in its expanded international staff (to 700 from 550) or its big-city salary premiums of 8 percent over government standards. The agency is now eight years behind in merely auditing multinationals; corporate officials who make a decision may well be dead or transferred when the tax people finally show up to question it. And in competing for legal and accounting talent, the IRS is still severely outmatched. Senior partners in private tax practice routinely get $500,000 to $1 million a year. Goldberg recalls ruefully that when he took office as IRS commissioner in 1989, his new salary of $80,000 was just what his former firm was paying newly fledged lawyers fresh out of school.

Bad record: All told, it's not surprising that when the IRS does bring a case, it frequently loses. Thomas Field of Tax Analysts says the agency typically settles for just 10 cents on the dollar of its initial claims against foreigners, and the IRS doesn't dispute that. At one major multinational firm, the head of taxes says he tries to do the right thing. "But there's no way the IRS is going to find chinks in our armor," he says. "We're just too smart and way too well prepared."

If the new reforms don't bear fruit, Pickle and Senate Finance Committee chairman Lloyd Bentsen say they are ready to propose something else. Ideally, that might be a whole new approach to international taxes, one that ignores the details of transactions and focuses on allocating shares of the total profit. Most U.S. states have similar laws, essentially basing corporate taxes on what percentage of a company's employees, sales and assets are located in the state. In the long run, reforming international taxes along those lines may be inevitable. But any such attempt would be formidably complicated; few major foreign countries would welcome an overhaul of the entire structure, which in effect would require unanimous consent. For the foreseeable future, the corporate shell game goes on.



HAMILTON—NEWSWEEK

LARRY MARTZ *with* RICH THOMAS *in Washington*

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WILL THE EMPEROR DISCOVER HE HAS NO CLOTHES BEFORE THE EMPIRE IS SOLD?

The Problem of Transfer Pricing for State and Federal Governments

Dan R. Bucks, Executive Director
Multistate Tax Commission

Presentation to the National Tax Association
May 9, 1991

My presentation today will not be in the National Tax Association tradition of an elegant, sophisticated presentation on tax research that addresses some detailed intricacy of American taxation. As is implied by my choice of title, my primary purpose is to draw attention to a major problem in U.S. tax policy -- a problem that seriously impacts the states as well as the federal government -- and to persuade you as important members of the American tax community to help solve this problem.

The problem I want to discuss is transfer pricing and the failure of the arms-length method to attribute income correctly to taxing jurisdictions. Last year's hearings by Rep. Pickle's Subcommittee on Oversight of the House Ways and Means Committee has helped to focus attention by some public officials and members of the press on the federal revenue loss associated with transfer-pricing problems. The Subcommittee estimated that the federal government was losing $30 billion annually just from transfer-pricing problems associated with U.S. subsidiaries of foreign multinationals.[1]

The Pickle Subcommittee estimate does not include the state revenue losses associated with the same problem. In the mid-80's, under pressure from both the federal government and multinationals, a number of state governments stopped employing the worldwide unitary method of accounting. The states were promised at the time that the federal government would take care of transfer-pricing problems through more effective international enforcement efforts. The promises were made, but the reality is that the federal government has not solved the problem. Because state corporation taxes are now largely dependent on the federal arms-length method for determining income attributable to the U.S., a loss of federal revenue also translates into a

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loss of state revenue. If one assumes that the weighted-average state corporate tax rate is approximately one-fourth of the federal tax rate, then the states are losing on the order of $7 billion annually from taxes that should be properly due from the subsidiaries of foreign multinationals. Thus, if the Pickle Subcommittee's estimates are sound, the combined estimated federal and state revenue loss rises to approximately $37 billion annually.

But that is still not a full measure of the problem. The $37 billion does not include any federal and state underpayments by U.S. multinationals with foreign subsidiaries. We don't know how big that problem is. U.S. multinationals generally assert that transfer-pricing problems are less significant in their operations than in the case of their foreign competitors. However, in the September, 1990, issue of the National Tax Journal[2], Lowell Dworin of the Office of Tax Analysis of the U.S. Treasury Department, presents data indicating that U.S. multinationals attribute, in relative terms, over ten times as much taxable income to their foreign assets as they attribute to their U.S. assets. If, indeed, foreign assets earned a rate of return over ten times as great as U.S. assets, the U.S. economy would have long since witnessed a capital flight launching us on a economic trajectory down toward the levels of production of a developing nation. Interpreting his own data, Mr. Dworin sensibly concludes that the data indicate not an imminent collapse of the U.S. economy, but instead, in his words, that " . . . transfer pricing problems may be quite prevalent, both with respect to inbound and outbound investment." [3] (Outbound investment refers, presumably, to the overseas operations of U.S.-based multinationals.) Unlike Rep. Pickle's Subcommittee, Mr. Dworin does not offer us an estimate of the revenue loss associated with any U.S. multinational share of the problem.

So we are left for the time being with approximately $37 billion a year as a partial estimate of the revenue loss associated with transfer-pricing problems. How big is that problem? As a point of comparison, I understand that the savings and loan bailout cost is estimated at $500 billion spread over a twenty-year period. That estimate includes the borrowing costs to the federal treasury associated with the bailout. If $37 billion -- which is not the full extent of the problem -- is extended over 20 years, we are already above $700 billion in lost federal and

state revenue without adding the borrowing cost to the federal treasury. Even if one chooses to take away a few hundred billion for potentially overestimated costs -- (and can anyone remember the last time federal costs were overestimated?) -- the transfer-pricing problem ranks on a scale equivalent to the S & L bailout.

Surely, in these terms, the transfer-pricing problem is one that ought to occupy our attention. It is major problem for a deficit-ridden federal government and a major problem for states -- whose current fiscal difficulties are well-known to this audience. Indeed, from a state perspective, the continued existence of this problem represents de facto preemption by the federal government of state tax bases.

However, the Treasury Department believes it has the problem covered by arms-length pricing adjustments. Others, however, may well conclude this is a case analogous to the problem of the emperor without any clothes. The difficulties of the arms-length method extend from the conceptual to the practical. The method is an effort to apply market concepts to conditions and circumstances of non-standardized products, services or intangibles exchanged under non-market conditions. In 1981, the GAO found that the IRS was able to employ its preferred pricing adjustment method -- the comparable uncontrolled price method -- in only 3% of the cases. Comparable market circumstances simply do not exist in the overwhelming majority of pricing cases.

The GAO found in the same study that the IRS was able to use its next two preferred adjustment methods -- the resale price and cost plus methods -- only 11% of the time. That meant that 86% of the time in transfer-pricing cases, the IRS had to fall back on some "reasonable fourth method" -- some unspecified technique selected for each case.

Is it any wonder, if the IRS, in effect, has to invent or select special methods most of the time, that arms-length pricing cases produce marathon litigation? An opinion in a single, recent case exceeded 260 pages. If the decision was a book, one can be assured that the briefs and exhibits

in the case likely comprised at least a small library. There are reports, as well, of auditors confronting significant problems and delays in securing information from taxpayers on which to base pricing adjustments. Indeed, those information-gathering problems are compounded when auditors must search out comparable price information from third parties not involved in the audits at hand.

Other problems with the arms-length method can be recited and certainly were recounted in some detail for the Pickle Subcommittee. Ultimately, however, the test of the method rests with the results it has produced, and in those terms, any method that leaves behind it a multi-billion-dollar problem can only be judged a failure.

What can be done? Well, the emperor can begin by returning to his storehouse where legal fabric aplenty exists out of which he could fashion a new suit of clothes to cover the need to attribute income reasonably to where it was earned. Indeed, the emperor might find fabrics in the legal storehouse he never knew were there.

Recently, Alan Friedman, General Counsel, and Scott Smith, Assistant Counsel, of the Multistate Tax Commission, researched the history of Section 482 of the Internal Revenue Code and its predecessor provisions back to 1926.[4] They find in both current language and the legislative history ample authority for the Treasury Department and the IRS to employ income attribution methods of a wide variety. Indeed, the plain language of Section 482, authorizes, in cases of jointly-controlled businesses, the Secretary of the Treasury to ". . . distribute, apportion or allocate gross income, deductions, credits, or allowances between or among such organizations, trades, or businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly reflect income of any of such organizations, trades, or businesses." Friedman and Smith have found that in 1962, the Congress declined to adopt a specific apportionment formula to be used in cases where market prices could not be discovered, because according to the Ways and Means Committee Report issued at the time, the judgment was that the Secretary of the Treasury already had the legal

authority to employ formulas in such cases.[5] Thus, it appears that the Treasury Department has broad authority to solve the transfer-pricing problem -- sufficient authority to adopt any of the formula methods that states have used in various permutations and combinations to solve such problems in the past.

If there is broad legal authority for Treasury to adopt methods well beyond the narrow arms-length pricing techniques that have failed to this time, then the question is posed: What is the most appropriate method or combination of methods to solve the problem? That brings me to my plea for assistance from this audience. Surely a problem that measures on the same scale as the savings and loan bailout should occupy the best efforts and attention of the scholars and public and private practitioners who comprise the core of the American tax community. We need major lines of inquiry and dialogue on finding alternative solutions to the transfer-pricing problem.

I am disappointed, quite frankly, that given the dimensions of the transfer-pricing problem, public finance economists have not devoted more attention to this issue. Certainly, there have been some economists who have examined this issue in recent years. But there is not the broad range of research, study and professional dialogue going forward that this subject deserves. For those of you who protest that there are a lot of other issues to explore, I would simply ask whether there are many issues, really, that rival this problem in terms of its fiscal implications. There may be two or three other broad issues that rank with this topic, but few others come to mind.

I am hard-pressed to understand why the community of scholars is not working harder to help find a solution to this problem. Perhaps the reason lies in the traditional discomfort that some economists have with corporate income taxation. If that is the case, I would like to make some suggestions that might ease that discomfort. Economists frequently protest that "corporations don't pay taxes," and with the protest imply somehow that efforts to tax corporations are misguided. Indeed, economists often relegate the corporation tax to the role of a backstop to

the individual income tax. In the protest that "corporations don't pay taxes," economists miss the essential rationale for corporation taxes. The purpose of taxes on corporations is not to tax the corporations themselves, but the economic activity that flows through the corporations. It is appropriate to tax that activity under the benefits principle of taxation -- so that economic activity bears its reasonable and appropriate share of the cost of public services. Income is just one measure of that activity. Other measures could be chosen. However, the purpose of general taxes levied on corporations is to ask for payment in return for a reasonable share of costs of government that is required by the economic activity that flows through a corporation.

Viewed in those terms, corporation taxes have a legitimate role to play in the system of public finance. The question for the tax community is not so much the role of these taxes, but how to make them work effectively in a global economy.

ENDNOTES

1. Pickle, Honorable J.J., statement of July 12, 1990, in House of Representatives (1990), p. 226. See also the statement by the Honorable Byron L. Dorgan as quoted in Rowe (1990).

2. Dworin (1990).

3. Ibid., p. 289.

4. Friedman and Smith (1991).

5. H.R. Rept. No. 2508, 87th Cong., 2d Sess. (1962) (Conference Committee Report), cited in Friedman and Smith (1991), p. 28.

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