

Mr Blackman Lines

Could we have a  
Talk + Ken Edington  
about this

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N.W.G.  
- 8 APR 1981  
Ans'd .....

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27th April 1981

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NOTE FOR:- N.W. GODDARD, ESQ.

Copy for:- P.A. Richardson, Esq.

RESEARCH & DEVELOPMENT

I understand that changes are being considered in the amount to be regarded as Central Group Research for the purposes of the formula in the Canadian Agreement. In this connection I would like to make the following points.

1. The reason for the formula basis being incorporated in a formal agreement was for tax reasons viz. to justify a tax deduction to the paying company.
2. Underlying the levy system was a formula basis. Unfortunately, the levy system did not take sufficient account of inflation and the movement of exchange rates. The formula basis adjusts for these factors automatically.
3. In order to satisfy tax authorities both in the U.K. and abroad we have endeavoured to produce a cost sharing arrangement which can be shown to be within the spirit of the 1979 OECD Report on Transfer Pricing & Multi-National Enterprises. (A report which seems to be widely accepted). The cost sharing formula is:-

$$\text{Cost of Central Group Research} \times \frac{\text{Turnover of Participant}}{\text{Total Turnover of all Participants}}$$

4. The Cost of Central Group Research is the cost of pursuing the programme agreed by B.A.T. and the participants as Central Group Research. It must, therefore, be the same cost for all participants. Furthermore, unless it is the same cost for all participants, it could not be a true cost sharing agreement and it would not be possible to recover the total cost of Central Group Research even in theory. As such it could not be justified to the U.K. Revenue.

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5. Since the levy like the formula was intended to recover Central Group Research costs any change in what constitutes Central Research Costs affects the basis of any levy. I mention this not because the levy basis is acceptable for tax purposes, I do not believe it is, but to forestall the idea that a levy basis might be better than a formula basis from the point of view of the payer or the receiver. Since they are designed to achieve the same objective they are intrinsically neither better nor worse than each other from a strictly financial point of view.



K. ETHERINGTON

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