

RESTRICTED

Note for MR. B. P. GARRAWAY

Allocation of Central Research Expenditure to Canada
Tax Problem Arising from Method of Allocation

I spoke to Bob Bégin in Montreal last week about his concern, a concern shared by Matt Glazos, that the Canadian tax authorities will seek to disallow the Contribution to central research expenditure. Such a disallowance could result in an additional tax charge of 46 - 48% of the amount disallowed and a further 10% if the payment to B.A.T. were also to be regarded as a distribution. This latter possibility could also present problems with regard to the relationship of the company to its other shareholders.

As far as tax is concerned the problem is one of satisfying the Revenue agents that the charges are properly made and are all allowable deductions under tax law.

This is not easy because:-

- (a) There is no formal written agreement which can be referred to (correspondence refers in many cases to Technical and Advisory Fees which is rather like showing a red rag to a bull as far as Revenue agents are concerned)
- (b) The percentage of turnover formula has no obvious relationship to the value of research benefits, nor is it obvious to an outsider that such a formula could equate to a cost sharing based on relative turnover.
- (c) The significant increases in the absolute charge and the change in the percentage rate mean that increasing importance will be given to this point by the Revenue on their audit examinations.

These points are not new. They were made by Dava Schechter when a B & W agreement for research was considered, although he was more sanguine that these difficulties could be overcome.

What the Canadians would feel happy with is a formal agreement to share the cost of central research on the basis of the ratio of their turnover to total turnover. Since my understanding is that this is the intention of the fixed percentage formula this would not be a radical change. The fixed percentage formula could be used until actual figures were known, but, of course, adjustments would have to be made retrospectively.

I would appreciate a discussion with you as to what steps should be taken.


K. Etherington

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