# CONGLOMERATE INDUSTRIES AMALGAMATED, INC.

We're always watching you SM

# Memo

Date: October 22, 2012

To: F.D.Student, Tax Director

From: H.Honcho, Assistant Director, Operations

Subject: Written Assignment: FTC Planning

As you know, The Company has just acquired 95% of Super Hot Instrument Technologies, Inc. (SHITI), and 60% of its HK subsidiary and all of its Canada subsidiary, in a stock purchase. SHITI was a customer of ours, and was paying a royalty on some of the surveillance technology. Due to high US tax costs, no 338 election was made, so as I understand it, the basis of the Super Hot assets is the same for us as in the last SHITI return. One of the lawyers mentioned that there might be some tax planning that would help us increase The Company's foreign tax credits (FTCs). We have been unable to use all our consolidated return FTC for several years, and substantial credits have expired. We're currently providing a valuation allowance against the entire deferred tax asset for FTC, so I've been ignoring them. You've said we have $70 Million (M) of general basket FTC carryover left. I understand that we can do a dividend from SHITI Canada up to $100M without Canada withholding, as a "paid up capital" dividend. I also understand that book and tax numbers are about the same for both CIA and SHITI.

When we bought SHITI, we incurred a lot of debt, all of which sits at The Company parent level. SHITI had very little debt. We're also likely to be spending about $0.3M per year in oversight functions related to SHITI. We also expect SHITI Canada to need about $50M more cash over the next few months to expand inventories, which are too low for comfort. Hong Kong is about OK on cash.

**Task:** Please prepare for me, **by January 4**, a memo discussing some of our options to improve our utilization of FTC both from a tax return and provision standpoint. Planning might include pushing down debt, increasing royalties or charging "management fees". Do not consider tricky things like pricing manipulation or those "hybrid" entities, as we don't want the risk. Stick to things that work. Point out where a particular thing you suggest is just a timing difference that improves things now but hurts us in the future.

In your response, give me a US and foreign tax projection for 3 years for your base case and best case, assuming all the operating income and total interest expense stay the same all three years. Also include any withholding taxes, the amount of expiring FTCs, and how much FTC has not been triggered. Also explain why any deemed repatriations are happening and why we're not getting all the FTC, if we're not. Keep the projections short, and keep the verbiage to 5-8 pages. Also, the Boss doesn't like anyone but the field operatives speaking in "code", so keep it simple.

Don't check with any foreign advisers yet, just give me your own thoughts. Let me know what items are sensitive to foreign consequences, and we'll check those out later.

I have included below the key operating information (all in millions of US dollars) for The Company and SHITI. The accounting department should have additional details you might need. The figures below are stand-alone separate company. SHITI Hong Kong buys all its goods from SHITI US and sells entirely in mainland China. These figures do not include any dividend or interest withholding taxes, since no dividends or interest have been actually paid in the past. I understand that Canada imposes a 5% tax on dividends and 10% on interest, and Hong Kong does not impose any. There are no other intercompany transactions, since the acquisition, except the sales and royalty. I know this may not be all you need for a thorough job, but give me what you can with the information below.

| Company: | CIA group | SHITI US | SHITI Can | SHITI Hong Kong |
|---|---|---|---|---|
| SIC group | 70 | 38 | 38 | 50 |
| | | | | (selling group 38 goods) |
| Sales & Other Revenues | 4,500 | 3,500 | 800 | 800 |
| Gross Margin | 4,500 | 1,000 | 500 | 250 |
| Foreign Gross Margin | 1,000 | -0- | all | all |
| Passive foreign income | 10 | | 30 | 1 |
| Net PreTax Profit | 900 | 100 | 100 | 100 |
| US Income Tax (net) | 245 | 35 | | |
| Foreign Income Tax | 100 | | 45 | 20 |
| Total Interest Expense | 400 | 100 | 10 | |
| R&D expenses | 500 | 400 | | |
| Total Assets | 3,000 | 2,000 | 700 | 150 |
| including US | 2,500 | 2,000 | | |
| including Passive forn. | 50 | | 80 | 3 |
| Total Retained Earnings | | 400 | 100 | |
| Cost Basis in Foreign Subs | | 600 (not included in assets above) | | |
| Royalty from SHITI US | 100 | included in above income & expense figures | | |

Assume that SG&A expenses relate proportionately to all operating income, and that no SG&A expenses relate to passive foreign income.

As always, everything in this memo is on an "eyes only, need to know" basis. Good luck on your trip next week to Bengazi. Keep the pot stirring.