Oct 22, 2010 **Exhibit G.**

Mr and Mrs Just Me

New Zealand

Examiner

Internal Revenue Agent

Phoenix, AZ 85012

Dear Ms Cox,

# I asked Mrs Just Me to sign the extension for tax assessment while she is in Seattle and forward to you. I am still not sure why I am doing this, as I have said, you have all the power and will assess me even if I don’t sign, but since I can’t afford to spend more money for attorney opinions, we will sign and forward back to you. Hope there isn’t some hidden gotcha, or some reference in the instructions to some other form or information booklet I should have read.

# Along with the extension, I have asked Sue to would include some reading for you about how this VD program is affecting minnows. This is taken from a International Tax attorney’s web site. I am also including a recent article from Bloomberg about how Google uses tax havens to save billions, and yet the IRS focuses its attention on us little guys! Something is seriously wrong with this picture.

# I know you are governed by some IRS audit manual, and probably don’t have a lot of latitude. However, maybe you could pass this up your chain of command and see if somewhere up there is some sanity on how the uniform application of penalties is being misapplied. Google, and other Companies escape taxes using loop holes, and yet the IRS wants to expend time and resources to tax away our savings using draconian penalties for some failure to file some obscure form called a FBAR. And we weren’t even avoiding it, or thinking about using tax havens with secrecy laws to evade taxes. We just failed to understand the rules. We were negligent, maybe yes, but certainly not willful. Surely there is a reasonable IRS policy maker that could separate out the categories of offenders and apply penalties differently. We like politicians can readily admit that “Mistakes were made”, but we were not the ones that the IRS was designing their VD program for. You know it, I know it, and imagine Commissioner Shulman knows it, and yet there doesn’t seem to be any reconsideration. I just don’t get it. Why not?

# The impact of this VD program is adversely affecting many ordinary folks, and it is driving otherwise law abiding citizens to say ‘screw it” and move more underground. This is exactly the opposite reaction the government wants. It really gets you exercised about our government’s punitive application of rules and regulations that even other government agencies admit most people are not aware of. It just doesn’t make sense to me, and is soooo very unfair. Does no one in the IRS have any empathy at all for us? I am afraid I already know the answer, and like I have said before, I don’t hold you personally responsible, but I have to vent. Anyway, please, at least pass this onto your supervisor. Read it and weep!

# A real life Voluntary Disclosure Program participant's story

September 21st, 2010 | [2009 FBAR Amnesty](http://hodgen.com/category/2009-fbar-amnesty/)

Over the weekend I received an email from a regular person in the amnesty program.  He is not a client of our firm, and we have never met.  I asked him if he would be willing to let me post his story on the web.  He agreed.

This person is being buffaloed into a $14,000 penalty in the Voluntary Disclosure Program when he owes only $218 of tax for all six years of 2003-2008.  If he does not take it, he is being threatened with vastly higher penalties by the IRS agent.  Much like the school yard bully.  Give him your lunch money now or he’ll be waiting for you after school.

For all of you out in the real world, this is what a foreign bank account criminal looks like to the IRS.

Shame on you, IRS.

Here is his story.

“Call us stupid or naive, but we really didn’t know there was a penalty of 20% when we joined the amnesty program last year.  We just wanted to do the right thing. After informed by IRS VDP Agent of the penalty, I called FBAR and spoke with an agent in July. She gave me indication that they are not enforcing the penalty.

I have always done our tax returns.  I am married with two teenagers and work for [major corporation everyone has heard of]. My spouse is a housewife. Our income tax returns were pretty straightforward from 2003 with 2008 with mainly W-2 salaries, some interest, and very light equity activities (all long-term gains/losses).

Now we are facing a penalty that is 6400% of the extra income tax the IRS decided I owed. It’s much easier to just pay and move on but my wife and I really don’t feel we have done anything wrong.

The problem my wife and I face is that they are the IRS. It’s like David and Goliath.  The total income we did not report from 2003 to 2008 was only $725 but they want us to pay more than $14k penalty for being honest (or stupid enough) to come forward and join the program.

I have two life insurance policies issued by a company in (Country) that I bought in the early 1990′s when I was living overseas.  I pay about $10,000 per year for the premiums on these policies.

The policies paid survival benefits every three years which are also used to pay the premiums so all of the money stays in the policies. The interest of the survival benefits is the cause of my headache.

I did not report $725 of interest from 2003 to 2008. I didn’t know that it was taxable, because the interest payments always stayed in the insurance policy. In addition, the company simply stopped sending annual interest statements in 2007.

The survival benefits was $14,000 every three years and the IRS agent originally thought I also have to pay taxes on that. However, I argued with him since there was no gain (3 year premium is more than the survival benefit paid every three years) and he finally agreed after checking internally.

– In the end I had only $725 of unreported interest income for the six years from 2003 to 2008.

– The tax we have to pay for 2003-2008 is $218.

– The IRS agent is telling us we have to pay a penalty of approximately $14,000.

This is based on the cash surrender value of my life insurance policies.  I had no idea I had to file the FBAR until notified by the IRS agent.  I have a life insurance policy, not a banking account. We had no clue this is treated like a financial account, making it a requirement to file the FBAR.

The letter the IRS agent sent made us uncomfortable and we are afraid they will penalize us severely in the audit for opting out of the program. The more I read, the stronger I felt I should fight this. My case should be at the most negligence per IRS own guidelines which is $500/year max and they are supposed to take discretion.

A person or entity can know about the requirement to file but don’t file and still be negligent. They are saying I’m better off staying in the program because they are comparing with the max penalty for non-willful violation (in my phone discussion with VDP Agent).”

The story is the gentleman’s. I edited his email, and he approved it. Here is his followup email to me–with a single edit within the brackets.

I made minor updates to the text [above] and you can go ahead and post it including my update and wife’s feeling.

I spoke to Agent today to update him of my request for extension and supporting documentation that the 20% is appropriate. I mentioned that my case is negligence at the most. To my surprise, he said he only considered non-willful and will-full violations for my case and was not aware that there is negligent violation. He asked me for the website and I provided to him. Wow, I have to tell IRS their own rules. He is probably a new or junior agent but no excuse for IRS particularly since he mentioned that he had reviewed my case with his manager.

In addition to faxing him my letter, I also mailed it to him along with Federal tax amendments from 2003 – 2006 (I already send him 2007 – 2008) and the document I got from IRS site on the different FBAR violations. I’ll call him later on the week to follow up.

Here is my wife’s feeling (I have to edit since her English is limited).

“After reading Phil’s letter, it’s just like we get a righteous person to speak out for us.  Nobody could help or advice us in the past, not even the CPAs we spoke to. When I first read his letter, my body shook. I did not know if it was because I felt cold at that time. I put on a long sleeve shirt and tried to read again. I really hope we can get rid of this trouble ASAP. May God uses our case to help people…..I do not know.

My deep feeling is just like Psalm 142, 143 (that is my prayer to God) after we joined this trap program and IRS treats us with no basic human passion. They just want to get money. They waste our citizen tax money on our very little honest, stupid case. “

Don says:

[September 21, 2010 at 8:01 pm](http://hodgen.com/a-real-life-voluntary-disclosure-program-participants-story/#comment-217)

…….Then the IRS wonders why 70% of Americans resident abroad do not file income tax forms every year – it’s more risk than its worth. If they’re going to charge penalities in excess of US based taxpayers – screw it.

Thomas says:

[September 22, 2010 at 1:48 am](http://hodgen.com/a-real-life-voluntary-disclosure-program-participants-story/#comment-219)

“The public may be unaware of their obligation to report their foreign bank accounts to the Department of the Treasury……” Source: Website: US Embassy Berlin Sept 22, 2010

Above is a quote taken directly off the US Embassy website in Berlin. Obviously, the US Government knows that there is a huge problem of past (un)awareness regarding the FBAR (they even admit it publicly) ! How can they possiblly impose such draconian penalties when they know the general public may have been unaware of this filing requirement in the past ?

[Reply](http://hodgen.com/a-real-life-voluntary-disclosure-program-participants-story/?replytocom=219#respond)

John Nolan says:

[October 11, 2010 at 11:50 am](http://hodgen.com/a-real-life-voluntary-disclosure-program-participants-story/#comment-222)

So far as I am aware, there has never been a direct constitutional challenge to the penalties imposed for failure to file a FBAR.

Shortly after the Bank Secrecy Act was passed in 1970 the Supreme Court handed down its decision in California Bankers Assn v. Shultz, 416 U.S. 21 (1974).

The Court ruled that certain enumerated provisions that were (rather weakly) challenged by plaintiffs – most of whose standing was legally dubious – were constitutionally valid.

The FBAR filing requirements and penalties were not explicitly challenged or even mentioned by the Court. There is, however, material in the Court’s analysis that might support a challenge since many of the aspects of FBAR reporting differ greatly in substance from the provisions (e.g. reporting cross-border transportation of cash, monetary instruments, etc.) that the court found passed constitutional muster.

In my view, before the Jobs Act of 2004 FBAR was vulnerable to constitutional challenge on the following grounds:

1. privacy (weak) – Query whether Americans have any constitutional right to personal financial privacy vis-a-vis their government. (But see Justice Douglas’ vigorous dissent in California Bankers)

2. substantive due process (solid) – a statutory requirement that is not reasonably related to any legitimate state interest. The FBAR enabling statute – and the Supreme Court emphasized this in the California Bankers decision – says the Treasury may require only reports that Treasury has determined by regulation would have a “high degree of usefulness” in combating the crimes that are the target of the Bank Secrecy Act. Perhaps a “Brandeis brief” based on inquiries directed to Treasury and FINCEN asking them to substantiate with empirical evidence that the information contained on any FBAR filed over the last 40 years has ever led to the discovery of a crime much less the initiation of any successful prosecution of a crime unrelated to the FBAR filing requirement itself. In addition, Treasury officials should be asked to produce Treasury’s own internal analyses from 1970 – if any – predicting what “high degree of usefulness” to law enforcement could expect to realize from future FBAR filings.

After the Jobs Act:

3. 8th Amendment – cruel and unusual punishment – (stronger). I suspect that the IRS’s confusion and indecision about enforcing the 20% “hi-year” FBAR minimum even against the minnows is based on fundamental uncertainty as to what will happen if one of the minnows (especially one whose “financial account” is a foreign life insurance contract) calls their bluff and says: “Take your VD agreement and shove it. You want to try for a max FBAR penalty against me for my failure to declare the legal ownership of something you yourselves have utterly failed to coherently require me to report? Then bring it on. Sue me for the FBAR max and we’ll find out what it takes to make 9 justices gag all at once.”

There is also evidence out there – if it ever gets that far – that the real reason for seeking enhanced FBAR penalties under the Jobs Act of 2004 and the preceding shift of FBAR enforcement from law enforcement to the IRS was totally unrelated to any of the BSA’s lawful purposes but was instead motivated by two things:

1. A desire to discourage and otherwise slow foreign investment by US residents by  
2. turning the FBAR into a compliance weapon and “revenue enhancer”.

In short: keep American capital at home by quasi criminalizing their foreign investment.

The evidence for this proposition: TIGTA Report 2005-30-101. I downloaded the report from somewhere on the internet but the version I got was heavily redacted before release to the general public. Whether the editing was legitimate or not we, of course, do not know.

The report begins like this:

MEMORANDUM FOR DEPUTY COMMISSIONER FOR SERVICES AND ENFORCEMENT  
DATE: July 26, 2005  
FROM: Pamela J. Gardiner  
Deputy Inspector General for Audit  
SUBJECT: Final Audit Report – Compliance Opportunities Exist for the IRS to Use Foreign Source Income Data (Audit #200430002).

“. . . . The overall objective of this review was to determine whether compliance opportunities existed for using the foreign source income data and Reports of Foreign Bank and Financial Accounts (Form TD F 90-22.1) (referred to as FBAR) received as part of the Automatic Exchange of Information Program (AEIP).

In summary, we found that investments made abroad by US residents have grown in recent years, nearly tripling from $2.6 trillion in 1999 to $7.2 trillion in 2003. ” [ a half page of text that follows has been redacted out]

Except for a reference to the transfer of FBAR enforcement authority to the IRS and a sentence or two on treaty restrictions on the use of certain tax information, almost the entire document has been redacted out.

The audit methodology despite redactions is clearly focused on FBAR enforcement and maximizing penalties. They apparently did a random sample of tax information reported from foreign sources under treaties and matched that info with FBAR filing records over the same period to see how much FBAR gold lay in them thar hills.

TIGTA recommendations, however, have been nearly completed edited out.

The reported management response from Deborah M. Nolan, IRS Commissioner, LMSB (no relation) is very interesting because the Service evidently strongly disagreed with TiGTA’s sanguine projections about how much enforcement would bring.

Apparently the IRS management voiced concern about using data received under treaty exchange programs for FBAR enforcement but TIGTA dismissed these concerns as being behind the times.

In addition, in her management response to TIGTA Ms. Nolan points out that “The BSA requires persons to report certain financial transactions to the government; however, its purpose is not to generate revenue for the United States.”

She also says something very interesting that I was previously unaware of and quite frankly don’t know whether it is true or not:

“. . . but the amount of the penalty is determined by the amount on deposit on June 30 following the close of the reportable year. Without proof of the actual amount on deposit on June 30 following the close of the reportable year, the penalty is limited to the lesser figure of $25,000 or the maximum unverified amount in the account.”

She also points out that TIGTA appeared to believe – erroneously – that there were MINIMUM FBAR penalties rather than maximums.

In a heavily redacted section she also takes pains to point out to TIGTA that the Service has implemented penalty mitigation guidelines in the IRM and she obviously does not want those ignored.

Guess whose views ultimately prevailed?

This institutional contretemps may account for the IRS’s nearly 5-year dragging of its heels in producing the new TD F 90-22.1 after getting FBAR enforcement authority.

In short, very interesting reading.

Again**, I suspect that the reason why there have been no known efforts to enforce FBAR maximums independent of the VD program is because the IRS justifiably fears that an aroused – conservative – court could wrest the FBAR “revenue enhancer” from its hands completely and for good.**

# Another real-life story from the Voluntary Disclosure Program

September 21st, 2010 | [2009 FBAR Amnesty](http://hodgen.com/category/2009-fbar-amnesty/)

Justice, IRS-style. I posted a story of a [couple who face $14,000 of FBAR penalties and owe $218 of tax](http://www.hodgen.com/a-real-life-voluntary-disclosure-program-participants-story/).

This one is worse.

Zero tax due, $28,280.48 of penalties.

What follows is a real-life email just sent to me, posted here with permission and without edits.  Not a client, and I have never met her.

I am an American living overseas, having moved abroad to improve my foreign language proficiency. One thing led to another and I have now been living and working in country X for 16 years. After once having my US taxes prepared by H&R Block (while still in the US), I have since always prepared them myself by copying the information from the previous year and simply updating the numbers. As a result, I have not carefully read all filing instructions in recent years, and thus failed to file form TD F 90-22.1 (FBAR). In addition, I also failed to report interest income from all accounts with foreign banks due to a fundamental misunderstanding of how this income is treated – again presumably due to a failure to read (or understand) the appropriate instructions. I did, however, consistently indicate the existence of such accounts on Schedule B (Form 1040) (when I actually filed that form, which I also unwittingly failed to do for calendar years 2003 through 2005), as well as duly filing W-9s when any bank requested me to do so. I was certainly not intentionally hiding any information, nor, indeed, could I possibly have had any reason to, as the foreign interest income would have no impact on my tax liability, being well below the amount of my allowed deductions and exemptions.

I became aware of the FBAR filing requirement in late June of 2009. At that time, I was already late in filing my 2008 tax return, so visited www.irs.gov to see if I could e-file it. That is when I saw a note/link on one of the pages on the site about the requirement and the extended deadline to comply by September 23, 2009. I filed the delinquent forms on September 14, 2009, as well as amended tax returns for relevant years, and was accepted into the Voluntary Disclosure program. I had total unreported (taxable) interest income of $6,018.13 for tax years 2003 to 2008, but NO additional tax liability.

In August 2010, I received a Closing Agreement from the IRS requesting me to pay the standard 20% of highest balance penalty, or $28,280.48. I know that “ignorance of the law excuses no man,” but the penalty here hardly seems appropriate for the misdeed.

On what planet does the IRS think it is OK to impose a [divide-by-zero](http://en.wikipedia.org/wiki/Division_by_zero) penalty in cases of misunderstanding laws that few lawyers and accountants knew about? About a form where the IRS has [put a chunk of the filing requirements on hold so they can figure out the rules](http://hodgen.com/another-real-life-story-from-the-voluntary-disclosure-program/www.irs.gov/pub/irs-drop/n-10-23.pdf)? (PDF).

# [A third real-life Voluntary Disclosure Program story](http://hodgen.com/a-third-real-life-voluntary-disclosure-program-story/)

September 22nd, 2010

This arrived by email today with instructions to post anonymously. I do not know him, we do not represent him, and i wouldnt recognize him if I bumped into him on the street.

Phil,

I am writing as an American who has worked overseas for a good part of his career. While overseas, I rose high up in a company with major operations in Switzerland. I also held financial accounts there and most all of the income with respect to my foreign accounts was disclosed on my 1040s. However, in a review conducted by my accountant it was discovered that not all of the income was reported correctly nor did we file the necessary FABR forms (TD F 90-22.1).

After spending about $40K in professional and legal fees, we have filed the FBARs for the past six years and amended all of my tax returns. The net impact of the changes is that I am now due a refund of $398 from the IRS and my adjusted gross income over the past six years changed by less than 1% — almost zero.

Furthermore, of the income earned on the foreign accounts, $271,623 was already recognized on the original 1040 returns filed timely and the amended returns actually reduced this amount due to offsetting items to $270,355. In other words, I reported more than 100% of all the foreign income already on my original 1040 tax returns.

However, the IRS is deeming my failure to file the FBARs and disclose my accounts as ”willful” and either I am subject to huge penalties – which I am advised could exceed $7 million. Or, alternatively, I can stay in the “Amnesty Program” which was launched last year and just pay a fine of 20% of the highest balance over the past six years, which in my instance will be more than a $1,000,000!

In short, I am writing to ask why don’t we have rules that limit the penalties for failure to file FBAR’s to only instances where the failure meaningfully under reports income? Frankly, I know of younger Americans who are working overseas and are tracking with keen interest what is happing to me and others and are starting to wonder the value of being a US Citizen. I’m glad I am one and that I kept my citizenship over the years, but it is getting hard to justify this to colleagues of mine who have opted out over the years to become citizens of other countries.

I am writing your blog in hopes that if enough citizens speak up perhaps the rules will be changed (and retroactively) and the penalties for filing FBARs will not be so onerous and bear more of a relationship to the amount of tax that was not properly paid to the IRS.

Perverse incentives.

# FBAR Story #4 – just learned of requirements

October 19th, 2010 | [2009 FBAR Amnesty](http://hodgen.com/category/2009-fbar-amnesty/) | [3 Comments »](http://hodgen.com/fbar-story-4-just-learned-of-requirements/#comments)

Here, with permission, is Cindy’s email to me.  We’ve never met, I don’t know her full name, and she is not a client of the firm.

I’ve been in total shock for the past month as I stumbled upon this requirement by total chance.

I’ve lost countless nights of sleep, all of my weekends and evenings to gathering past information in order to file taxes (I’m not taxable), so that I can then submit the FBAR. I’m petrified to do so. I’ll probably have everything I need to do so in the next couple weeks.

This has affected my life in every way – I think it’s sinful that I’m crying myself to sleep, because of the IRS – while I am an honest tax-paying citizen.

My story is probably boring, but I could discuss over the phone if you like if this interests you or might bring something to your article.

I’m 33 and single, I’ve been living in France for 13 years, am naturalized French (and born American).  
I had NO idea about these reports until I started searching on tax information for stock options I need to cash due to leaving a company.

The worst part is I’m seriously considering revoking my American citizenship over it (it being thousands of dollars) – and as a proud American, it’s breaking my heart.

Cindy’s reaction is — in my experience — typical, except with less profanity.  I would guess that the vast, vast majority of Americans living abroad are unaware of the paperwork requirements that the IRS Commissioner blithely assumes all taxpayers know backwards and forwards. Heh.  As if.

[The country’s in the very best of hands](http://lyricsplayground.com/alpha/songs/t/thecountrysintheverybestofhandslilabnerthemusical.shtml).

[Perverse incentives](http://en.wikipedia.org/wiki/Perverse_incentive), Mr. Shulman.

**Finally from Bloomberg**

http://www.bloomberg.com/news/2010-10-21/google-2-4-rate-shows-how-60-billion-u-s-revenue-lost-to-tax-loopholes.html

# Google 2.4% Rate Shows How $60 Billion Lost to Tax Loopholes

By *Jesse Drucker* - *Oct 21, 2010*

[Google Inc.](http://www.bloomberg.com/apps/quote?ticker=GOOG:US) cut its taxes by $3.1 billion in the last three years using a technique that moves most of its foreign profits through Ireland and the Netherlands to Bermuda.

Google’s income shifting -- involving strategies known to lawyers as the “Double Irish” and the “Dutch Sandwich” -- helped reduce its overseas tax rate to 2.4 percent, the lowest of the top five U.S. technology companies by market capitalization, according to [regulatory filings](http://www.bloomberg.com/apps/quote?ticker=GOOG:US) in six countries.

“It’s remarkable that Google’s effective rate is that low,” said [Martin A. Sullivan](http://search.bloomberg.com/search?q=Martin%20A.%20Sullivan&site=wnews&client=wnews&proxystylesheet=wnews&output=xml_no_dtd&ie=UTF-8&oe=UTF-8&filter=p&getfields=wnnis&sort=date:D:S:d1&partialfields=-wnnis:NOAVSYND&lr=-lang_ja), a tax economist who formerly worked for the U.S. Treasury Department. “We know this company operates throughout the world mostly in high-tax countries where the average corporate rate is well over 20 percent.”

The U.S. corporate income-tax rate is 35 percent. In the U.K., Google’s second-biggest market by revenue, it’s 28 percent.

Google, the owner of the world’s most popular search engine, uses a strategy that has gained favor among such companies as Facebook Inc. and Microsoft Corp. The method takes advantage of Irish tax law to legally shuttle profits into and out of subsidiaries there, largely escaping the country’s 12.5 percent income tax. (See an interactive graphic on Google’s tax strategy [here](http://www.businessweek.com/technology/google-tax-cut/google-terminal.html).)

The [earnings](http://www.bloomberg.com/apps/quote?ticker=GOOG:US) wind up in island havens that levy no corporate income taxes at all. Companies that use the Double Irish arrangement avoid taxes at home and abroad as the U.S. government struggles to close a projected $1.4 trillion [budget gap](http://www.bloomberg.com/apps/quote?ticker=FDEBTY:IND) and European Union countries face a collective projected deficit of 868 billion euros.

Countless Companies

Google, the third-largest U.S. technology company by market capitalization, hasn’t been accused of breaking tax laws. “Google’s practices are very similar to those at countless other global companies operating across a wide range of industries,” said [Jane Penner](http://search.bloomberg.com/search?q=Jane%20Penner&site=wnews&client=wnews&proxystylesheet=wnews&output=xml_no_dtd&ie=UTF-8&oe=UTF-8&filter=p&getfields=wnnis&sort=date:D:S:d1&partialfields=-wnnis:NOAVSYND&lr=-lang_ja), a spokeswoman for the Mountain View, California-based company. Penner declined to address the particulars of its tax strategies.

Facebook, the world’s biggest social network, is preparing a structure similar to Google’s that will send earnings from Ireland to the Cayman Islands, according to the company’s filings in Ireland and the Caymans and to a person familiar with its plans. A spokesman for the Palo Alto, California-based company declined to comment.

Transfer Pricing

The tactics of Google and Facebook depend on “transfer pricing,” paper transactions among corporate [subsidiaries](http://www.bloomberg.com/apps/quote?ticker=GOOG:US) that allow for allocating income to tax havens while attributing expenses to higher-tax countries. Such income shifting costs the U.S. government as much as $60 billion in annual revenue, according to Kimberly A. Clausing, an economics professor at Reed College in Portland, Oregon.

U.S. Representative [Dave Camp](http://search.bloomberg.com/search?q=Dave%20Camp&site=wnews&client=wnews&proxystylesheet=wnews&output=xml_no_dtd&ie=UTF-8&oe=UTF-8&filter=p&getfields=wnnis&sort=date:D:S:d1&partialfields=-wnnis:NOAVSYND&lr=-lang_ja) of Michigan, the ranking Republican on the House Ways and Means Committee, and other politicians say the 35 percent U.S. statutory rate is too high relative to foreign countries. International income-shifting, which helped cut Google’s overall effective tax rate to 22.2 percent last year, shows one way that loopholes undermine that top U.S. rate.

Two thousand U.S. companies paid a median effective cash rate of 28.3 percent in federal, state and foreign income taxes in a 2005 study by academics at the University of Michigan and the University of North Carolina. The combined national-local statutory rate is 34.4 percent in France, 30.2 percent in Germany and 39.5 percent in Japan, according to the Paris-based Organization for Economic Cooperation and Development.

The Double Irish

As a strategy for limiting taxes, the Double Irish method is “very common at the moment, particularly with companies with intellectual property,” said [Richard Murphy](http://search.bloomberg.com/search?q=Richard%20Murphy&site=wnews&client=wnews&proxystylesheet=wnews&output=xml_no_dtd&ie=UTF-8&oe=UTF-8&filter=p&getfields=wnnis&sort=date:D:S:d1&partialfields=-wnnis:NOAVSYND&lr=-lang_ja), director of U.K.- based Tax Research LLP. Murphy, who has worked on similar transactions, estimates that hundreds of multinationals use some version of the method.

The high corporate tax rate in the U.S. motivates companies to move activities and related income to lower-tax countries, said Irving H. Plotkin, a senior managing director at PricewaterhouseCoopers LLP’s national tax practice in Boston. He delivered a presentation in Washington, D.C. this year titled “Transfer Pricing is Not a Four Letter Word.”

“A company’s obligation to its shareholders is to try to minimize its taxes and all costs, but to do so legally,” Plotkin said in an interview.

Boosting Earnings

Google’s transfer pricing contributed to international tax benefits that boosted its earnings by 26 percent last year, company filings show. Based on a rough analysis, if the company paid taxes at the 35 percent rate on all its earnings, its share price might be reduced by about $100, said [Clayton Moran](http://search.bloomberg.com/search?q=Clayton%20Moran&site=wnews&client=wnews&proxystylesheet=wnews&output=xml_no_dtd&ie=UTF-8&oe=UTF-8&filter=p&getfields=wnnis&sort=date:D:S:d1&partialfields=-wnnis:NOAVSYND&lr=-lang_ja), an analyst at Benchmark Co. in Boca Raton, Florida. He recommends buying Google stock, which closed yesterday at $607.98.

The company, which tells employees “[don’t be evil](http://investor.google.com/corporate/code-of-conduct.html)” in its code of conduct, has cut its effective tax rate abroad more than its peers in the technology sector: Apple Inc., the maker of the iPhone; [Microsoft](http://www.bloomberg.com/apps/quote?ticker=MSFT:US), the largest software company; [International Business Machines Corp.](http://www.bloomberg.com/apps/quote?ticker=IBM:US), the biggest computer-services provider; and Oracle Corp., the second-biggest software company. Those companies reported rates that ranged between 4.5 percent and 25.8 percent for 2007 through 2009.

Google is “flying a [banner](http://www.bloomberg.com/apps/quote?ticker=GOOG:US) of doing no evil, and then they’re perpetrating evil under our noses,” said [Abraham J. Briloff](http://search.bloomberg.com/search?q=Abraham%20J.%20Briloff&site=wnews&client=wnews&proxystylesheet=wnews&output=xml_no_dtd&ie=UTF-8&oe=UTF-8&filter=p&getfields=wnnis&sort=date:D:S:d1&partialfields=-wnnis:NOAVSYND&lr=-lang_ja), a professor emeritus of accounting at Baruch College in New York who has examined Google’s tax disclosures.

“Who is it that paid for the underlying concept on which they built these billions of dollars of revenues?” Briloff said. “It was paid for by the United States citizenry.”

Taxpayer Funding

The U.S. [National Science Foundation](http://www.nsf.gov/) funded the mid-1990s research at Stanford University that helped lead to Google’s creation. Taxpayers also paid for a scholarship for the company’s cofounder, Sergey Brin, while he worked on that research. Google now has a stock market value of $194.2 billion.

Google’s annual reports from 2007 to 2009 ascribe a cumulative $3.1 billion tax savings to the “foreign rate differential.” Such entries typically describe how much tax U.S. companies save from profits earned overseas.

In February, the [Obama](http://search.bloomberg.com/search?q=Obama&site=wnews&client=wnews&proxystylesheet=wnews&output=xml_no_dtd&ie=UTF-8&oe=UTF-8&filter=p&getfields=wnnis&sort=date:D:S:d1&partialfields=-wnnis:NOAVSYND&lr=-lang_ja) administration proposed measures to curb shifting profits offshore, part of a package intended to raise $12 billion a year over the coming decade. While the key proposals largely haven’t advanced in Congress, the IRS said in April it would devote additional agents and lawyers to focus on five large transfer pricing arrangements.

Arm’s Length

Income shifting commonly begins when companies like Google sell or license the foreign rights to intellectual property developed in the U.S. to a subsidiary in a low-tax country. That means foreign profits based on the technology get attributed to the offshore unit, not the parent. Under U.S. tax rules, subsidiaries must pay “arm’s length” prices for the rights -- or the amount an unrelated company would.

Because the payments contribute to taxable income, the parent company has an incentive to set them as low as possible. Cutting the foreign subsidiary’s expenses effectively shifts profits overseas.

After three years of negotiations, Google received approval from the IRS in 2006 for its transfer pricing arrangement, according to filings with the Securities and Exchange Commission.

The IRS gave its consent in a secret pact known as an advanced pricing agreement. Google wouldn’t discuss the price set under the arrangement, which licensed the rights to its search and advertising technology and other intangible property for Europe, the Middle East and Africa to a unit called Google Ireland Holdings, according to a person familiar with the matter.

Dublin Office

That licensee in turn owns Google Ireland Limited, which employs almost 2,000 people in a silvery glass office building in central Dublin, a block from the city’s Grand Canal. The Dublin subsidiary sells advertising globally and was credited by Google with 88 percent of its $12.5 billion in non-U.S. sales in 2009.

Allocating the revenue to Ireland helps Google avoid income taxes in the U.S., where most of its technology was developed. The arrangement also reduces the company’s liabilities in relatively high-tax European countries where many of its customers are located.

The profits don’t stay with the Dublin subsidiary, which reported pretax income of less than 1 percent of sales in 2008, according to Irish records. That’s largely because it paid $5.4 billion in royalties to Google Ireland Holdings, which has its “effective centre of management” in Bermuda, according to company filings.

Law Firm Directors

This Bermuda-managed entity is owned by a pair of Google subsidiaries that list as their directors two attorneys and a manager at Conyers Dill & Pearman, a Hamilton, Bermuda law firm.

Tax planners call such an arrangement a Double Irish because it relies on two Irish companies. One pays royalties to use intellectual property, generating expenses that reduce Irish taxable income. The second collects the royalties in a tax haven like Bermuda, avoiding Irish taxes.

To steer clear of an Irish withholding tax, payments from Google’s Dublin unit don’t go directly to Bermuda. A brief detour to the Netherlands avoids that liability, because Irish tax law exempts certain royalties to companies in other EU- member nations. The fees first go to a Dutch unit, Google Netherlands Holdings B.V., which pays out about 99.8 percent of what it collects to the Bermuda entity, company filings show. The Amsterdam-based subsidiary lists no employees.

The Dutch Sandwich

Inserting the Netherlands stopover between two other units gives rise to the “Dutch Sandwich” nickname.

“The sandwich leaves no tax behind to taste,” said Murphy of Tax Research LLP.

Microsoft, based in Redmond, Washington, has also used a Double Irish structure, according to company filings overseas. [Forest Laboratories Inc.](http://www.bloomberg.com/apps/quote?ticker=FRX:US), maker of the antidepressant Lexapro, does as well, Bloomberg News reported in May. The New York-based drug manufacturer claims that most of its profits are earned overseas even though its sales are almost entirely in the U.S. Forest later disclosed that its transfer pricing was being audited by the IRS.

Since the 1960s, Ireland has pursued a strategy of offering tax incentives to attract multinationals. A lesser-appreciated aspect of Ireland’s appeal is that it allows companies to shift income out of the country with minimal tax consequences, said Jim Stewart, a senior lecturer in finance at Trinity College’s school of business in Dublin.

Getting Profits Out

“You accumulate profits within Ireland, but then you get them out of the country relatively easily,” Stewart said. “And you do it by using Bermuda.”

Eoin Dorgan, a spokesman for the [Irish Department of Finance](http://www.finance.gov.ie/), declined to comment on Google’s strategies specifically. “Ireland always seeks to ensure that the profits charged in Ireland fully reflect the functions, assets and risks located here by multinational groups,” he said.

Once Google’s non-U.S. profits hit Bermuda, they become difficult to track. The subsidiary managed there changed its legal form of organization in 2006 to become a so-called unlimited liability company. Under Irish rules, that means it’s not required to disclose such financial information as income statements or balance sheets.

“Sticking an unlimited company in the group structure has become more common in Ireland, largely to prevent disclosure,” Stewart said.

Deferred Indefinitely

Technically, multinationals that shift profits overseas are deferring U.S. income taxes, not avoiding them permanently. The deferral lasts until companies decide to bring the earnings back to the U.S. In practice, they rarely repatriate significant portions, thus avoiding the taxes indefinitely, said Michelle Hanlon, an accounting professor at the Massachusetts Institute of Technology.

U.S. policy makers, meanwhile, have taken halting steps to address concerns about transfer pricing. In 2009, the Treasury Department proposed levying taxes on certain payments between U.S. companies’ foreign subsidiaries.

Treasury officials, who estimated the policy change would raise $86.5 billion in new revenue over the next decade, dropped it after Congress and Treasury were lobbied by companies, including manufacturing and media conglomerate General Electric Co., health-product maker [Johnson & Johnson](http://www.bloomberg.com/apps/quote?ticker=JNJ:US) and coffee giant Starbucks Corp., according to federal disclosures compiled by the non-profit Center for Responsive Politics.

Administration Concerned

While the administration “remains concerned” about potential abuses, officials decided “to defer consideration of how to reform those rules until they can be studied more broadly,” said Sandra Salstrom, a Treasury spokeswoman. The White House still proposes to tax excessive profits of offshore subsidiaries as a curb on income shifting, she said.

The rules for transfer pricing should be replaced with a system that allocates profits among countries the way most U.S. states with a corporate income tax do -- based on such aspects as sales or number of employees in each jurisdiction, said [Reuven S. Avi-Yonah](http://search.bloomberg.com/search?q=Reuven%20S.%20Avi-Yonah&site=wnews&client=wnews&proxystylesheet=wnews&output=xml_no_dtd&ie=UTF-8&oe=UTF-8&filter=p&getfields=wnnis&sort=date:D:S:d1&partialfields=-wnnis:NOAVSYND&lr=-lang_ja), director of the international tax program at the University of Michigan Law School.

“The system is broken and I think it needs to be scrapped,” said Avi-Yonah, also a special counsel at law firm Steptoe & Johnson LLP in Washington D.C. “Companies are getting away with murder.”

See additional stories about corporate tax avoidance:

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Well, Ms Examiner that is it for now. Hope you enjoyed the read!

Best Regards

Just Me