Mr. Brookhaven

BROOKHAVEN NATIONAL LABORATORY

MEMORANDUM

DATE: January 23, 1962

TO: Charles F. Dunbar

FROM: N. Peter Rathvon, Jr.

SUBJECT: Retirement Compensation of Dr. Pawsey

I have reviewed the problems posed by Mr. S. W. G. White in his letter of January 17, 1962, to Professor Rabi. The one unsurmountable problem involves the taxability of money paid to the Commonwealth of Australia on Dr. Pawsey's behalf.

Any funds AUI may pay to Dr. Pawsey or the Commonwealth Government for his retirement benefits would be taxable income unless within a specific exception contained in the Internal Revenue Code. Unfortunately, the superannuation scheme of the Commonwealth Government fits none of the exceptions of the Code. The scheme is not "trust" within the meaning of 401, since it is not created or organized in the United States; nor could a system of paying funds to this trust be "qualified" under Section 401.

Our own contributions to TIAA are exempt from taxes in the year made, under Section 403, which deals with the purchase of annuity contracts. The funds, of course, are eventually taxed in future years when actually received by the employee. However, the scheme of the Commonwealth Government does not fit the definition of an annuity contract.

I am forced to the conclusion that, no matter how AUI provides Dr. Pawsey with the equivalent of the Commonwealth Government contributions on behalf of an employee, the money would be regarded as taxable income to Dr. Pawsey in the year it is paid.

Assuming that Dr. Pawsey is given an annual salary of $25,000 and assuming that he is married, without children, and without other income during the taxable year, his income would be in the 38% to 43% tax brackets. Obviously then, to provide him with an additional $2,250 after taxes, AUI would be required to increase his salary by approximately $4,000. Of course some of this would be recouped by waiving the requirement that Dr. Pawsey participate in the AUI retirement plan, thus saving AUI the employer's contributions of $1,875.

I see nothing in the income tax treaty with Australia which would alter my conclusions. These conclusions were discussed with Howard Colgan of Milbank, Tweed, Hope, & Hadley who expressed the opinion that they are correct.

I do not recommend tax evasion devices to avoid this result. One that might succeed is the device of entering into a contract with C.S.I.R.O. whereby it "releases" Dr. Pawsey for service with AUI for an annual consideration of $2,250. The difficulty with this device lies in its artificiality and the fact that once this sum is paid to the Commonwealth on his behalf, there is an inference that C.S.I.R.O. is deriving benefit from his services at N.R.A.O. and that the payments to the Commonwealth stem from services performed in the United States and hence are taxable here. However, it is at least arguable that the payments are made in consideration of past services or to induce his return.

My own conclusion is that we should face the problems clearly dispite the additional cost.

NPR/cac