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JUN 29 1999

Houston District

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U.S. Department of Justice

Criminal Division

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Washington, D.C.

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EXAMINATION DIVISION

JUN 30 1999

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*[Handwritten signature]*

Mr. Paul Cordova  
District Director  
Department of the Treasury  
Internal Revenue Service  
1919 Smith Street  
Houston, TX 77002

RECEIVED  
JUL 06 1999  
EXAM SHANCH

Re Enron Corporation & Subsidiaries

Dear Mr Cordova:

Your letter dated May 21, 1999 to the Attorney Janet Reno has been forwarded to this office, which has responsibility for prosecutions under the Foreign Corrupt Practices Act of 1977 [FCPA], 15 U.S.C. § 78dd-1, et seq.. We appreciate the receipt of information concerning potential violations of the FCPA and would like to discuss this matter with the Internal Revenue Service personnel most familiar with the documents you have furnished. I may be contacted at (202) 616-0437.

Sincerely,

*[Handwritten signature of Peter B. Clark]*

Peter B. Clark  
Deputy Chief, Fraud Section

RECEIVED  
IRS  
EXAM GROUP 1107

JUL 06 1999

HOUSTON

Senate Finance Committee  
**EXHIBIT 44**

70-700,



**DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
1979 SMITH STREET  
HOUSTON, TEXAS 77002**

**DISTRICT DIRECTOR**

MAY 21 1999

The Honorable Janet Reno  
Attorney General  
Washington, DC 20530

In re Enron Corporation & Subsidiaries  
1400 Smith Street, Enron Building  
Houston, TX 77002

Dear Madam Attorney General:

We have received information in the Houston District Disclosure Office that indicates that the above-captioned business may have violated the Foreign Corrupt Practices Act (15 USC 78dd-1, 78dd-2).

This potential violation involves the negotiations conducted and the payments made pursuant to the acquisition of a Power Sales Agreement by and between Enron and Empresa—the state-owned, primary supplier of thermoelectric power to Guatemala. Enclosed are copies of four internal memorandums from the files of Enron Corporation and Subsidiaries regarding these transactions.

This information is provided pursuant to 26 USC 6103(i)(3)(A) with the understanding that it will be used strictly in accordance with the disclosure provisions of the Internal Revenue Code. It may be disclosed to personnel within your agency only to the extent necessary to enforce the above-cited or other relevant criminal statutes within the purview of your agency.

Any employees having access to this information should be aware of the penalties for the unauthorized disclosure of confidential information as delineated under 18 USC 1905 and 26 USC 7213 and 7431. The information provided herewith must also be safeguarded as mandated by 26 USC 6103(p)(4).

In order for us to properly assess the usefulness of the information we are providing, we would appreciate knowing the final disposition of any action taken as a result of this referral. Our need for feedback on matters such as this is not

diminished or affected by the passage of time. We realize that your own disclosure laws may limit what you can provide us. Any information that you can provide us should be address to:

Internal Revenue Service  
1919 Smith Street, Stop 7000 HOU  
Houston, TX 77002

If you need further assistance with this matter, please contact Disclosure Officer, Linda Sisson, at (713) 209-4010.

Sincerely,



Paul Cordova  
District Director

ORIGINAL

CC. Roberto Figueroa  
 Bill Votaw  
 Vinicio Urdaneta *X*  
 Chuck Emrich  
 Ron Teitelbaum

Re: Tax Liability on Royalty Payments

From Bill Leggatt *BL*

Date: 6 February 1995

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Today Roberto Figueroa, Bill Votaw and myself met with Alvaro Castellanos, Sunking's Counsel, to discuss the issue of withholding tax associated with payments to the Sunking group. He showed us the following documents:

- 1) The original agreement of Feb 24 1992, between Sunking and Texas Ohio that allowed for 16% of capacity payments, 21% of energy payments, and specifically absolved Sunking from payment of any tax.
- 2) The transfer of this contract from Texas Ohio to EDC on March 12 1992
- 3) The letter from Haug, dated June 10 1992, to Sunking agreeing that payments could be made to any account of Sunking's choice.

We subsequently showed him the amendment of (1) above, executed by Texas Ohio and Sunking dated March 12 1992, changing the payment to 6% of all revenues, and withdrawing the tax benefit. Alvaro was obviously aware of the existence of this document, and made it plain that it had been the topic of discussion at group meetings on many occasions.

Alvaro told us that there was a split in Sunking regarding the tax issue. This was between those who realised there was no legal basis to claim the payment on a grossed up basis, which comprises Alvaro and Henrik, at a minimum. The other side claims that, on the basis of precedent and a very optimistic interpretation of the agreements, the payments should be grossed up.

We told Alvaro that as far as Enron was concerned there was certainly no precedent either way (since there has been no tax so far), and that we could not see any justification in the documents we had that would give Sunking this security.

We reiterated that the intent of all this was to get the Sunking payment on a more legitimate basis, for the benefit of all; Sunking, PQPC and Enron. However, before we could meet to discuss alternative methods of payment, a formal resolution would have to be made on the tax issue. Therefore, on the

basis of this discussion, Alvaro promised to come back to us with a formal Sinking position. Only then will we know whether we will have to dispute this issue, or whether the Group will accept the benefit of the situation so far, and accede the future liability gracefully. Alvaro promised this response only within a 10 day time frame, since at least one of the group is out of the country.

However, it is apparent that should the response be unfavorable, then this issue can only be resolved at a management level, since Alvaro, from a legal basis, did not contradict our own position/interpretation in any way, nor did he produce any new documentation that would cause our analysis of the situation to alter.

## M E M O R A N D U M

TO: DAVID ODORIZZI  
 FROM: JORGE ASENSIO A  
 REF.: SUN KING BUY OUT APPROACH  
 DATE: DECEMBER 13, 1993

The Sun King issue is one that has captured the attention of everyone involved in the Guatemalan project. We have all expressed a number of opinions in respect of all aspects of this association. This memo is my contribution to help you in the formation of alternatives for an eventual negotiation. It is very clear to me that we have to come to grips with this issue, in order not to jeopardize the whole project, neither in it's local reputation nor in the internal fiscal aspects of such payments.

These opinions are very personal, and derive of what I know of the group, of what I feel ought to be a good solution for Enron, and of my personal experience as a professional in Guatemala. This is not a legal opinion, nor should it be taken as a legal guideline to solve the problem.

1) The group is formed by friends (pal's) who have in common being well off. They are not formal partners in any other endeavors but Sun King. This is not a formal business group like you find in other cases: sugar, coffee, banking, etc. As wealthy individuals that they are, they have the capacity to establish contacts, make pressure, and represent your interests. One of the guys seems to be closer to the army than others, this can be of some benefit if in a given situation if we need to approach the army, but as a group, Sun King is meaningless. In other words, we could be much better off by sustaining individual relationships with one or the other guy, than by having them as a group.

As relatively powerful as they are, we definitely don't want them against our interests if something goes wrong. On the other hand, I feel that Enron has overplayed their influence, and power. Our project is pretty well consolidated now, and the only thing that can go wrong is that the same Sun King group be made public.

2) In my view, the whole affair with Sun King has been approached with some fear, with an excess of preponderance, too complacent. This has lead the company to give-in in almost all respects, but more specifically in the way the payments have to be made. Other aspects of our association with S.K. prove this: =we picked office space in a building where one member of S.K. is a partner in order to show our gratitude; =we hired the wife of another S.K. member to decorate the office, etc.

As a consequence of this generous treatment, they have felt a certain dependance of Enron on Sun King. If not dependance, they have felt that Enron can't find its way around Guatemala without them, both things which are not true.

If you give any credibility to these aspects, you have to agree with me that negotiating a buy out is a complicated task. If you negotiate under this atmosphere, they will be calling the shots, not us.

3) I always argued that Enron had to level its position vis-a-vis Sun King. In a certain way I felt that Enron wanted to be more, "business like" with Sun King, but didn't dare due in great measure to what I describe above.

I personally feel that Sun King did not deliver all the offerings, representations or promises made during the negotiations. Indeed; I understand that they manifested that imports didn't have to pay import duty, that there would be no problem with the Port Authority, that the project would be well taken by everyone in Guatemala, etc.

If any of the above is true, I sincerely believe that Enron has a valid case in presenting a claim, a formal complaint, a dissatisfaction. In doing so, Enron has to stress that it's association with Sun King brought very little benefits, that sharing all that investment with them is too much for the benefits that were NOT there. Personally I feel that what S. K. did, was introduce Texas Ohio to President Serrano, and talked him into signing the contract. It is the typical "finder fee" arrangement, with the only difference that the fee was -for that service- completely out of hand.

Personal  
Service  
is security  
Contract

This possible claim, could put Enron in a much better position for a buy out. It's simple: Sun King would know, that if they dare sue you for not complying our contract, Enron's defense would also be powerful. If you convey the idea that Enron in many respects is not happy, you'll be sending the correct message to induce a buy out.

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EXACTLY  
WHAT  
HAPPEN

4) Now come the fiscal considerations. Let's face it, the correct way to pay the 6% is by all means through a Quetzal payment in Guatemala, with VAT tax, withholding and all. The stress that we have gone through in trying to pay abroad, to pay tax free, and to pay in dollars, has put this company against the wall, and such payments could severally injure the company in the future.

As a matter of negotiating, we have to come to S.K. and explain what should be evident to them: that we can only pay in quetzales, in Guatemala and complying with all fiscal laws. This overwhelming reality, established by so many opinions, is by all means supportable by Enron, a crude reality, and a business decision that has to be taken now, in order not to mess our first tax return.

Guatemala  
Tax  
Return

If we do this, again our negotiating position will be strengthened, due in great deal to a lesser interest by S.K. to accumulate local currency. In fact, I would start (or continue) the negotiations with S.K. with a concrete manifestation on our part, that we can only pay in Quetzales, that we can not violate the law, that the S.K. agreement can not force us to brake the law. After stating this, I would wait for their reaction, and not touch the possibility of a buy out any more. I would even allow some time to have this system work, in order for them to feel the pressure. Here, the only risk is that they can come to us and say that such payments are risky, that the local community may find out what happened. We have to be straight from the beginning, and respond that we don't care about that problem, and that in any event, this is a much lesser problem than what the other payments can represent in the future.

Paying in quetzales is by no means a violation of our agreement. The agreement only states that they can select a bank to receive deposits. This does not mean that all payments have to be made in dollars. This also means that they can not force us to break the law. These are very important bargaining positions.

5) If these arguments are properly presented, I hope to see a more consolidated position by Enron. The important thing, above all, is that Enron should not be worried as to the consequences of a negotiation of this type. Please don't take the position that if you start a negotiation of this kind, S.K. will get angry, upset, or that it might sue, or that it will harm us in Guatemala. We have to take a strong stand, and have them feel that they are no longer dealing with Development.

**ENRON**  
Power Corp.

**CONFIDENTIAL**

Interoffice  
Memorandum

To: David Odorizzi

From: Carl Waldo *[Signature]*

Department: Operations

Payment and Tax Problems Re 6% Sun King  
Obligation - Guatemala Operations

Date: May 26, 1993

This is in response to your request for details on the subject made at Monday's staff meeting

BACKGROUND

Enron Development Corp. entered into an agreement with Texas-Ohio Power, Inc. (the "TOP agreement") on March 12, 1992 whereby in consideration for TOP transferring the Power Contract with Empresa to EDC, EDC agreed to pay (among other sums) "an amount each month equal to 6% of the gross revenues generated by the sales of electricity and payment for contract capacity under the Power Contract."

In a letter dated March 12, 1992, TOP notified EDC that the "right of a monthly payment of a 6.0% of the gross revenues...has been legally and effectively assigned in favor of SUN KING TRADING COMPANY, INC." The letter further stated that "any monthly payment...must be paid directly to the assignee, SUN KING TRADING COMPANY, INC., 6a. Avenida 20-25 zona 10, 8th floor, Guatemala City, Guatemala," and further requested that EDC notify Sun King of the receipt of this letter. *Receipt*

David Haug, by letters dated March 13, 1992 acknowledged receipt of the letter to TOP and informed Sun King of receipt of the TOP letter and acknowledged that EDC would make the required monthly payments directly to Sun King per that letter.

Thus, it was established that the Sun King group would receive a monthly payment equal to 6% of the gross revenues of Puerto Quetzal. This has been shown in various projections and budgets as "Guatemalan share of revenue."

You will note that the TOP agreement (as quoted above) gave a local address for the payment and was silent as to the denomination of the currency of payment.

Since Empresa Electrica pays us in Quetzals for the Capacity and Energy - although the rates are quoted in U.S. dollars in the Power Purchase Agreement - PQ must go through the auction process to acquire the dollars it needs to operate - the initial assumptions were that this Sun King payment would be a) made locally and b) in Quetzales. Under such circumstances the payment would be subject to VAT of 7% and a Withholding Tax of 4%.

Sun King then announced through Oswal Herbruger, a member of the Group, that Sun King is entitled to receive payment in either Quetzales or dollars and disputes the withholding or deduction of any tax. *Wald*

Exhibi

EDC agreed to the option of dollars or Quetzales which was tied to which bank account Sun King instructed us to pay into.

On March 1, 1993 David Haug received a letter requesting that the monies be paid into either one of two named bank accounts in Miami for credit to Deutsch - Suedamerikanische Bank A.G., Miami Agency. This meant that they had opted to receive the payment in dollars. 6022

It was also revealed that Sun King Trading Company, Inc. was a Panamanian Corporation not registered in Guatemala. 6022

Payments of this nature by a Guatemalan entity to a person or company abroad is subject to a 25% Withholding Tax and a 3% Stamp Tax.

Procedures had been written by Eric Wycoff outlining the treatment, including withholdings, to be applied to both Quetzal and USD payments to Sun King. This further provided for deducting any costs of conversion to dollars from the payment as well as providing that we could pay in Quetzales in such case as the currency exchange market could not provide adequate dollars or if government restrictions prevented PQPC from obtaining dollars.

These procedures were under discussion when we discovered that the tax law contained the following limitations on such payments.

### ROYALTIES

Payments made for the use of trade marks and patents registered in the Industrial Property Register, formulas, manufacturing rights. However, these payments may in no case exceed 5% of gross income. (If paid abroad will require 25% withholding tax and 3% stamp tax)

### COMMISSIONS

Payments representing commissions on sales or fees for technical, financial, scientific services are limited to 1% of gross income or 15% of Guatemalan worker payroll, whichever is greater. (If paid abroad will require 12 1/2% withholding tax and 3% stamp tax)

These restrictions "threw a spanner" into the entire matter:

- A. The payment to Sun King could not qualify as a "royalty" as defined in the law and, of course, exceeds the 5% limitation.
- B. The payment also did not fit the definition of commission or fee - the 1% limit notwithstanding.

In addition, Sun King continued objecting to the withholding of any taxes whatsoever.

In an attempt to overcome these problems the Fuel Supply and Management Agreement was drawn up between EPOS and Electricidad Enron ("EE") which provided that EPOS would sell the fuel oil to EE acquired under the current contract with Texaco and such other additional fuel that may be required. EE would pay EPOS an amount each month equal to 6% of Puerto Quetzal's gross revenue in exchange for "fuel supply and management services." In addition, EPOS could opt to have EE pay the fuel supplier direct rather than through EPOS. (In the case of the first Texaco invoice to come through EPOS, the payment was made to Texaco out of EPOC. I prepared an EPOS invoice to EE, which PQPC paid out of the USD account at NationsBank.)

*Handwritten note:* 2002!

The problem with this new procedure is that this 6% amount is still a separate item of payment and, as described in the contract, is subject to a 1% limitation (as well as a 25% withholding tax and the 3% stamp tax)

Based on the current estimate for the period April 1 through December 31, 1993, the 6% payments to EPOS would aggregate \$2,217,000 of which only \$28,800 would be deductible in EE. (EE's estimated gross rev. April - Dec. being \$2,876,590 X 1%)

Roberto Garcia, whom everyone claims opined that this arrangement avoided any tax problems, maintains that his understanding was that the 6% was to be billed as part of the fuel price and not as a separate "fee." This too should have been recognized as a nonstarter, however, since a markup of that magnitude cannot possibly be acceptable since it results in an entry price for above "going market price."

*Handwritten note:* Gross Excessiv

I made a study of the markup necessary to the fuel price in order to include the 6% factor (ignoring the timing problem arising out of a monthly payment obligation to Sun King vs. an estimated total of 7 - 8 cargoes of fuel per year!). Based on barrels projected to be consumed over the nine months to December 31st and the 6% payments projected over that period, the fuel would have to be marked up by \$2.36 per barrel. The May 1st cargo of fuel cost \$14.825 per barrel including transportation and insurance etc., the markup would raise this to \$17.185. This is grossly above market and it is all but assured that the authorities would not allow it as a tax cost in Guatemala. (Roberto Garcia is preparing an opinion on this point.)

*Handwritten note:* Gross

The most obvious solution would be for PQPC to assume the obligation, splitting the payment between a royalty agreement with Enron for the use of Enron's trademark/logo in Guatemala providing for a 5% royalty (nebulous since PQPC does not use the logo) and a 1% fee for services to be supported by a credible contract with (EPOC?). These payments would be subject to the withholding tax of 25% and 12.5% respectively, plus stamp tax of 3%. Enron would then pay the net amount to Sun King via the Miami bank.

This, however, is NOT ALLOWED under our agreement with IFC!

*Handwritten note:* IFC PROVIDED REMARKS (NON-RESPONSE) FINANCE

Although Roberto suggested the same scenario through EE, it can't work since EE's gross revenues are only \$2.9 MM/year and the 5% and 1% limitations would result in most of the payments becoming nondeductible.

Eric Wycoff had a scheme several months ago which involved buying the Sun King "royalty" out on a NPV basis and then setting up a Royalty Trust in Guatemala, selling this publicly and recouping our buy out. The payments would then be local, in Quetzales, subject to local taxes without argument, and possibly gain some valuable goodwill and recognition for Enron/PQPC.

THIS IS WHAT HAPPENED  
SUN KING  
WANT  
OUT ON  
NPV  
BASIS

Although this idea generated some enthusiasm at one point, it apparently never progressed beyond the concept stage.

This problem, therefore, remains with us and I do not see a workable solution.

Part of the problem are the tax law limitations. Another facet is Sun King's insistence on receiving dollars, outside of Guatemala, not subject to withholdings of any kind.

Since our formal agreement with TOP did not specify any of the conditions later imposed by Sun King and since the letter of assignment by TOP to Sun King specified payment to a local Guatemala City address thus implying payment in Quetzales, and since Guatemalan tax laws require withholdings on such payments, I suggest we ignore these after-the-fact demands by Sun King. We should pay locally, in Quetzales, net of taxes. This removes one segment of influence on our solution attempts, i.e. the desire to accommodate Sun King beyond the scope of the signed agreements.

The only problem then remaining is for some structure that would fit the percentage limitations in the tax law. The solution to this latter point escapes me at the moment!!

An outstanding issue remains concerning 6% payments already made to Sun King:

-April 12th \$219,330.27 wire transferred from EPOC to Miami bank per R. Lammers

-May 13th \$256,696.09 wire transferred from EPOC to Miami bank per R. Lammers.

These payments were made covering the gross 6% without any withholdings for taxes. When PQPC repays EPOC/EPOS we will have to pay the withholding and stamp tax. Either PQPC will have to "eat" this or Sun King will have to bear an adjustment on subsequent payments. The decision has to be made! (Jim Steele and/or David Haug are the original deal-makers on this.)

STEELE  
DAVID HAUG  
DEAL  
MAKERS

There are other problems outstanding in our Guatemalan business which should be focussed upon.

### Import Permit - Fuel Oil

EE currently has the permit to import fuel free of duty and exempt from distribution tax based on the declaration that EE was the consumer of the fuel. It is not the consumer - it sells the fuel to PQPC. PQPC has neither an exemption on fuel oil duties, distribution tax or import permission. Nonetheless, the contract with Texaco is with PQPC and all billings for fuel have been made naming PQPC as a buyer. This is a festering situation involving customs, the Ministry of Energy, Empresa Electrica and the tax authorities. Steele, Coy and Paz have been attempting to solve this for months without apparent effect. The political situation, influenced by the unpopularity of Empresa, the attempts to settle with the rebels in the north - now no doubt further influenced by the disbanding of Congress by President Serrano - has made negotiation fruitless to date.

Solution? Transfer the Import Permit to PQPC and let PQPC buy fuel direct? (Would make EE as "operator" virtually unnecessary, however!).

### Advance Tax Payments

Under guatemalan tax law, every business has to pay 1.5% of its gross quarterly revenues as an advance income tax. These advances are then incorporated into the tax return after year end and any excess refunded. In the present situation where EE is buying fuel oil and reselling it to PQPC, EE is creating gross revenues upon which it must pay this advance tax. There is no "income" inherent in these "wash" transactions so that all of the advance taxes would be refunded, but the tax, which would aggregate 1.5% on approximately \$18MM of fuel purchases in a year or \$270,000 would be tied up for a period ranging from a full year to three months minimum - not allowing for the time it might take to receive the refund! This same feature applies to the O&M payments made by EE in its role as Operator and billed to PQPC for reimbursement. This, for 1993, adds another \$7.3 MM of gross revenues subject to the 1.5% advance tax. (\$109,500)

This comprises another argument against our Guatemalan structure. Solution? (Eliminate EE as "operator" of PQPC.)

These problems cannot be solved by any one individual. It will require concerted senior discussion and action concerning both the basic structure of the Guatemalan Organization and on-the-scene senior negotiations with Sun King, Empresa, the Ministry of Energy and Customs. Such action should be implemented ASAP.

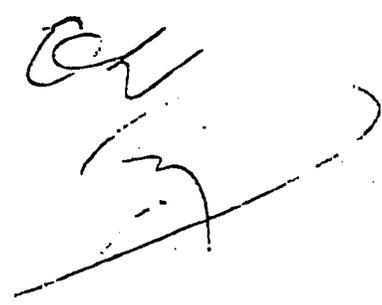
## MEMORANDUM

TO: James J. Steele / Bill 

FROM: Jorge Asensio A.

DATE: February 26, 1993

REF: Payments to the Sun King group.



To comply with the Sun King Group we basically have two options. One is to pay in Guatemala with local currency, and the other is to pay in dollars abroad. Both alternatives however, have local tax implications that have to be met in order to be able to account for these payments legally, and be able to deduct such a substantial expense for tax purposes in Guatemala.

I have very little information on the Sun King contract, but I do know that they can select their bank of preference. Please be aware that this does not mean that if they select a bank in the U.S. or in England we have to pay in Dollars or in Pounds. Above all, I understand that this provision means that we can not force that group over the use of one bank.

The commitment to pay such commission that was inherited from the Texas-Ohio contract should be seen as an obligation that arises out of the Guatemalan operation. It should not be taken as an obligation by Enron Power Development Corp. just for the fact that this was the company that originally took the contract. Whatever contract was accepted by Enron, it had as a main goal to develop a project in Guatemala, so the commission should always be linked to that project, and as such to its local earnings.

Of course, any company in Guatemala may have expenses and obligations payable abroad, and have the obligation to get the dollars to meet those obligations. Foreign contractual obligations are also tax deductible.

So, in order to establish a frame work of references recommend the following

- a) Not to obligate Puerto Quetzal Power Corp to pay in dollars;
- b) To allow payment in dollars provided that Puerto Quetzal Power Corp. can get dollars without limiting its own access to hard currency. In other words, Puerto Quetzal Power Corp. will leave any dollar obligation in last place, so if we are able to comply by getting the dollars we will, but if no sufficient dollars are available we will pay in Quetzales. This is strongly supported by two things: - We are paid in Quetzales and not in dollars; - The exchange mechanisms do not allow a free conversion to dollars, so it is obvious that Puerto Quetzal Power Corp. will apply its few dollars to pay for the elements that are needed to maintain the operation running. By the way, in David

Haug's letter to the Sun King group dated March 12, 1992 he indicates that payments will be made to them at 6 av. 20-25 zona 10 in Guatemala City. There is no indication of payments abroad. The actual agreement between Enron and Texas-Ohio does not indicate anything with respect to form or place of payment.

- c) All payments are gross, including any taxes levied in Guatemala to either local or foreign obligations. Puerto Quetzal Power Corp. will not pay any taxes on behalf of Sun King. You must understand that guatemalan tax legislation levies withholding taxes on payments abroad where the payee is the taxpayer, even if the payor has the obligation to pay the withholding.
- d) Any charges or expenses, present or future that are charged in the exchange mechanism, and all fees involved in the Quetzal-Dollar conversion will also be discounted to the payee.
- e) Payments only cover the revenue obtained from the sale of electricity derived from the two barges. Any other revenue derived from future production is not part of the deal. By now Enron can promote itself in Guatemala.
- f) The term of the obligation in the original Texas-Ohio - Empresa Eléctrica de Guatemala, S.A. contract is 15 years. If the Sun King contract does not refer to any term, we should try to negotiate a more convenient term. I suggest 5 years. I understand that the 15 year term of the original contract was something requested by Empresa Eléctrica de Guatemala S.A. to Texas-Ohio and not a product of Sun King as a group pushing for that term.
- g) Given the fact that the Sun King payments do not represent any REAL service to Puerto Quetzal Power Corp. it is always possible that our tax authorities could disallow that deduction in the future. In this regard, I strongly recommend that we condition payments on the basis of their deductibility: payments will be made provided that they are deductible. I also recommend that the contract as such, and the invoicing be carefully drafted in order to avoid these problems. We should be very credible at the time of invoicing.
 

6220  
 SERVICE  
 CONTRACT  
 T. 20  
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 1992
- h) It is also important to try to "lock-in" today's charges in the Empresa Eléctrica de Guatemala S.A. - Puerto Quetzal Power Corp. contract in order to avoid an endless increase in the 6% commission. If any increases for electricity charge have to be made to Empresa Eléctrica de Guatemala S.A. due to oil prices or otherwise, we should be able to invoice these increments as "overcharges" or "overcosts" in order to keep current prices permanently charged as our basic contractual stipulation, and only pay the 6% based on this basic price. Otherwise, any increment in cost is directly favorable to Sun King, an aspect of our relationship with Empresa Eléctrica de Guatemala, S.A. that doesn't help much.

After giving you these ideas, I now want to explain the difference between local and foreign payments regarding the tax issue.

I will use an example of a monthly gross income of Q20,000,000.00

#### LOCAL PAYMENTS

Q20,000,000.00 = 6% = Q1,800,000.00 which should be INVOICED as follows:

Sun King invoice for	Q1,682,242.99
+ VAT tax of 7%	<u>Q 117,757.01</u>
<b>TOTAL INVOICED AMOUNT</b>	<b>Q1,800,000.00</b>
This is paid as follows:	Q1,682,242.99
VAT tax	<u>Q 117,757.01</u>
	Q1,800,000.00
4% withholding on fees and commissions:	<u>Q 67,289.72-</u>
Actual payment:	Q1,732,710.28

The withholding tax is paid by us to the tax department on account of Sun King's income tax.

#### FOREIGN PAYMENTS:

Q20,000,000.00 6% =	Q1,800,000.00
Withholding of 25% =	<u>Q 432,000.00</u>
Balance due =	Q1,368,000.00

If we pay dollars at 5.30 x US\$ = US\$ 258,113.21 and this will be the amount paid.

If Sun King is an American company it should pay income tax in the US if they receive payment this way. In the event of local payments in Guatemala they will also be subject to income tax of 25% after expenses are deducted.

Another warning which I find very important in this case, is the one related to the definition of "Commissions", as we are considering periodical payments of commissions to Sun King. The Guatemalan Tax Authorities have always considered that a "commission" is a one shot deal, payable upon termination of a single transaction. A commission payable periodically is understood by them as being a "royalty". I recommend to define our payments to Sun King correctly as "royalties" in order to withhold 25% but, in the event of any adjustments or tax modifications, Sun King could petition Government for recognition of commission status and thus pay a 12.5% withholding due on commissions. The advantage of paying royalties is the fact that these are basically justified by the contract. Commissions though, have to be justified by the nature of the transaction involved.

If you need further information I will be delighted to extend this memo.