UPDATES & OTHER TIDBITS

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ALTERA UPDATE – I.R.S. FILES APPEAL, ALTERA & XILINX RESPOND

As *Insights* previously noted, in *Altera*, the U.S. Tax Court (the "Tax Court") held that Code §482 regulations requiring parties to include stock-based compensation in a qualified cost-sharing agreement ("C.S.A.") were invalid because the regulations lack "a basis in fact" and are invalid as a matter of law.[1] Additionally, the court held that the I.R.S. position of assuming an arm's length standard without looking to the actual facts and empirical data from the taxpayer was flawed.

Earlier this year, the I.R.S. filed an appeal with the Ninth Circuit. In its motion, the I.R.S. argued that it is not required to use an empirical analysis unless such an analysis is required in the statute, and U.S. transfer pricing rules have no such requirement.[2] Since the requirement is absent in the regulations governing the taxation of C.S.A.'s, the I.R.S. interpretation of those regulations is sound so long as its process is "logical and rational."[3] The I.R.S. further argues that the Tax Court's reliance of the *Xilinx* case in making its determination in *Altera* was erroneous, since the court did not consider whether amendments effective after the *Xilinx* decision and governing later tax years rendered the *Xilinx* decision obsolete.[4] Per the I.R.S., the post-*Xilinx* amendments made an empirical analysis requirement unnecessary.

Altera responded to the I.R.S. appeal and disagreed with the I.R.S. analysis. Altera believes that the I.R.S. position that the "commensurate with income" ("C.W.I.") standard, present in the C.S.A. regulations, overrides the arm's length principle, is erroneous since such a position was not expressed when the regulation was drafted. Through a review of legislative history, Altera argues that the C.W.I. standard clarifies but does not override the arm's length standard, by stipulating that the transfer of a related-party intangible should reflect the income actually generated by the intangible. Altera finally notes that the Treasury has taken an inconsistent approach in its appeal, as it has previously stated in various tax treaties that the C.W.I. standard does not override the arm's length standard.

While the case works its way through the appeal process, the aftereffects may be severe. Should the I.R.S. prevail, this may indicate that it possesses the power to

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1 Michael Peggs, Stanley C. Ruchelman, and Beate Erwin, "Tax Court Strikes Down I.R.S. Position On Stock Based Compensation in Altera Case." *Insights* 7 (2015).

2 I.R.S. Brief, Dkt. Nos. 16-70496, 16-70497, p. 43.

3 *Id.*

4 *Id.*, p. 46.

interpret Code §482 regulations, lessening certainty and increasing the likelihood of audit controversy. Additionally, guidance on the C.W.I. standard is in short supply compared to the extensive guidance available relating to the arm's length standard. Should the I.R.S. position succeed, previously successful tax planning strategies that relied on the arm's length standard may not be as dependable when a C.W.I. standard is used instead.

U.S. & INDIA RESOLVING COMPETENT AUTHORITY DECISIONS

In January, the U.S. and India reached an agreement to create a framework to resolve transfer pricing disputes involving information technology and software development. The Treasury estimated that there were 250 pending cases to resolve. The Indian commissioner acknowledged that the cases may be resolved slowly, as the Indian competent authority division was short-staffed. Both Indian and American tax practitioners are hoping that resolving the backlog of cases in the information technology sector will eventually lead to bilateral advanced pricing agreements ("A.P.A.'s").

An A.P.A. is an agreement between the I.R.S. and a taxpayer comprising issues arising under Code §482. A bilateral A.P.A. is an A.P.A. in which the issues and methods covered by the agreement are determined by a competent authority resolution reached between the U.S. competent authority and a foreign competent authority.[5] Bilateral A.P.A.'s are advantageous to multilateral entities, as they provide certainty when developing tax plans.

Since January, cases involving information technology with similar fact patterns have been resolved. However, more complex cases remain on the docket. The I.R.S. hopes that the framework will lead to increased bilateral A.P.A.'s with India, although such agreements have not yet materialized.

JAPANESE CARMAKERS FACING UNCERTAIN FUTURE AFTER BREXIT

Honda, Toyota, and Nissan's U.K. manufacturing facilities are on shaky ground following the June Brexit referendum. Commonly known as Japan's Big Three, the giant carmakers each have plants in the U.K. that face a serious risk of closure once the U.K. leaves the European Union ("E.U.").

The fate of the plants will rest upon the final Brexit terms, since a significant portion of the cars they manufacture are exported to other E.U. Member States. According to *The Financial Times*, 75% of Toyota and Nissan cars produced in the U.K. are exported to the E.U., while Honda's U.K. plant exports 40% of its cars to the E.U.

The U.K. government has said it intends to ensure British business retains the ability to trade efficiently with E.U. Member States. However, Carlos Ghosn, Nissan's

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5 "IRS to Begin Accepting Bilateral Advance Pricing Agreement Requests for India on February 16," last reviewed or updated February 1, 2016.

President and C.E.O., expressed concern that forthcoming negotiations will result in a "hard" Brexit, wherein the U.K. will exit from the European Single Market and the company's car exports will become subject to a 10% E.U. import duty. Mr. Ghosn warned that Nissan would not commit to additional investment in the country. In response, U.K. Prime Minister Theresa May met Mr. Ghosn on October 14. She indicated that the government was committed to supporting the automotive industry and suggested that the U.K. could negotiate E.U. access for certain sectors.

Nissan is not alone in voicing its concerns. Toyota has also indicated that the imposition of E.U. duties after a Brexit deal would significantly affect its car production activities in the U.K. At the September 28 Paris Motor Show, where Mr. Ghosn delivered his comments, the Society of Motor Manufacturers and Traders ("S.M.M.T.") confirmed that the U.K. car sector's biggest trading partner is the E.U. – with 57.3% of U.K.-produced cars being exported there this year alone. S.M.M.T. Chief Executive Mike Hawes noted that "the future success of this sector will hinge upon the ability of the U.K. to maintain the business and trading conditions that make the sector so competitive globally."

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SERIOUSLY DELINQUENT TAX DEBTS PROMPT REVOCATION OR DENIAL OF U.S. PASSPORTS

In early September 2016, the State Department issued final rules concerning passport denial and revocation requirements for individuals who have a seriously delinquent tax debt as defined by the Fixing America's Surface Transportation ("F.A.S.T.") Act, enacted in December 2015. As described in 26 U.S.C. 7345, "[a] seriously delinquent tax debt" is generally an assessment of $50,000 or more (including an interest and penalties) for which a lien or levy has been filed.

The I.R.S. has stated it will issue a certification to the secretary of the treasury for individuals who have a seriously delinquent tax debt, as a result of which the State Department will deny a passport to those individuals. In addition, the State Department may revoke an existing U.S. passport or limit the passport so as to only allow return travel the U.S., once a certification has been received. The State Department maintains the authority to issue a passport, despite receiving a delinquency certification from the I.R.S., for "emergency and for humanitarian reasons."

Exceptions to this rule apply (i) if the debt is being paid in a timely manner pursuant to an agreement to which the individual is party under Code §6159 or §7122, or (ii) if the collection of the debt is suspended because a due process hearing under Code §6330 is requested or pending, or because an election under subsection (b) or (c) of Code §6015 is made or relief under subsection (f) of such section is requested.