13-60684

IN THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BMC SOFTWARE, INCORPORATED,

Petitioner-Appellant

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent-Appellee

ON APPEAL FROM THE DECISION OF THE UNITED STATES TAX COURT

BRIEF FOR THE APPELLEE

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STATEMENT REGARDING ORAL ARGUMENT

Counsel for the Commissioner respectfully advise the Court that we believe oral argument would be helpful in resolving the issue presented in this case of first impression, which is whether accounts receivable, deemed established on specified dates pursuant to a closing agreement, constituted related-party indebtedness as of those dates, thus reducing the taxpayer's claimed deduction under § 965 of the Internal Revenue Code.

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**ON APPEAL FROM THE DECISION OF
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BRIEF FOR THE APPELLEE

STATEMENT OF JURISDICTION

On May 4, 2011, the Commissioner of Internal Revenue ("the Commissioner") timely mailed a notice of deficiency to BMC Software, Inc. ("taxpayer") determining a deficiency in corporate income tax of $12,911,500 for taxpayer's taxable year ending March 31, 2006.

(Doc. 13 at 2.)[1] Taxpayer timely petitioned the Tax Court seeking redetermination of the deficiency. (*Id.*; Doc. 1.)

The Tax Court (Judge Kroupa, 141 T.C. No. 5) upheld the deficiency determination in a September 18, 2013 opinion. (Doc. 33.) On September 20, 2013, the Tax Court entered its decision accordingly, finally resolving all claims of all parties. (Doc. 34.) On September 26, 2013, taxpayer timely filed its notice of appeal to this Court. (Doc. 35); Internal Revenue Code ("I.R.C." or "the Code") § 7483 (26 U.S.C.); Fed. R. App. P. 13(a). This Court has jurisdiction under I.R.C. § 7482.

STATEMENT OF THE ISSUE

Whether the Tax Court correctly held that a closing agreement that taxpayer and the Commissioner entered into under Rev. Proc. 99-32, providing for establishment of accounts receivable on specified dates, bound taxpayer to an agreement that debt was established as of those dates for all federal tax purposes, including for purposes of

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[1] "Doc." references are to the documents comprising the original record on appeal, as numbered by the Tax Court Clerk. "Ex." references are to the sequentially numbered exhibits, attached to the Stipulations of Facts (Docs. 13, 20) or admitted at trial. "Br." references are to taxpayer's opening brief. "Am.Br." references are to the *amicus* brief filed on behalf of Medtronic, Inc. and Microsoft Corporation.

evaluating whether there was an increase in related-party indebtedness within the meaning of I.R.C. § 965(b)(3), so that taxpayer's deduction under I.R.C. § 965 was correspondingly reduced.

STATEMENT OF THE CASE

This case involves the Commissioner's disallowance of part of the deduction that taxpayer claimed under I.R.C. § 965 for its tax year ending March 31, 2006.[2] Section 965, an economic stimulus provision, allowed a one-time deduction in the amount of 85 percent of dividends paid by a controlled foreign corporation to its U.S. parent. Congress, however, imposed certain restrictions on the deduction, including, as relevant here, a provision that the amount eligible for the deduction would be reduced to the extent of any increase in related-party indebtedness between October 3, 2004 and the end of the year in which the dividend was paid. I.R.C. § 965(b)(3). The parties and the Tax Court here referred to this window as the "testing period." (Doc. 33 at 6.)

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[2] References herein to taxpayer's tax year for a specified year are to its tax year ending on March 31 of the referenced year.

In this case of first impression, the Tax Court held (Doc. 33) that accounts receivable established in a closing agreement under Rev. Proc. 99-32 – which allows taxpayers to treat amounts that are held by a foreign subsidiary as debt owed to the parent in order to avoid the adverse tax consequences of secondary adjustments following transfer-pricing adjustments under I.R.C. § 482 – constituted debt for all federal tax purposes as of the dates specified in the closing agreement under Rev. Proc. 99-32. Accordingly, the court held that there was an increase in related-party indebtedness within the meaning of I.R.C. § 965(b)(3), which in turn decreased taxpayer's § 965 deduction.

Taxpayer appeals. Medtronic, Inc. and Microsoft Corporation, together, have filed an *amicus* brief supporting taxpayer.

A. The § 482 adjustments and the transfer-pricing closing agreement

This case began with the Commissioner's examination of taxpayer's 2002 through 2006 tax returns, in which he determined that royalty payments from taxpayer to its controlled foreign corporation, BMC Software European Holding ("BSEH") were not arm's-length amounts, so that additional income should be allocated to taxpayer under I.R.C. § 482. (*See* Doc. 27 at 41-44.) Taxpayer, a U.S. corporation

that develops and licenses computer software (Doc. 13 at 2-3; Doc. 33 at 3), is the parent of foreign affiliates, including BSEH, a dual-status Irish and Cayman Islands corporation. (Doc. 13 at 3.) At all relevant times, taxpayer directly owned 100 percent of BSEH's stock, and BSEH was taxpayer's "controlled foreign corporation," within the meaning of I.R.C. § 957. (*Id.*)[3]

For taxable years before April 1, 2001, taxpayer and BSEH were parties to two research and development cost-sharing agreements for software development that were qualified cost sharing arrangements under Treas. Reg. (26 C.F.R.) § 1.482-7. (Doc. 13 at 12.) Following termination of these agreements, taxpayer took sole ownership of the software and agreed to pay buy-out royalties to BSEH over a period of years. (*Id. a*t 13-14; Doc. 33 at 4.) At the same time, taxpayer granted BSEH a license to use and distribute the software in exchange for a

[3] BSEH, in turn, owned indirectly 100 percent of the shares of BMC Software Europe, an Irish corporation, and owned directly 100 percent of BMC Software Mauritius, a Mauritius corporation. (Doc. 33 at 4 n.3; Doc. 13 at 3.) These entities were treated as entities disregarded from BSEH for federal income tax purposes. As did the Tax Court, we refer to BSEH and the disregarded entities it controlled collectively as BSEH. (Doc. 33 at 4 n.3.)

royalty paid by BSEH to taxpayer. (Doc. 13 at 14.) From 2003 through 2006, taxpayer paid buy-out royalties to BSEH, while BSEH paid royalties in a lesser amount to taxpayer under the license agreement, resulting in net payments from taxpayer to BSEH. (*Id*. at 15.)

On audit, the Commissioner determined the royalty payments were not arm's length, and that the net flow of royalties from taxpayer to BSEH in 2003 through 2006 exceeded what would have been paid between unrelated parties. (Doc. 13 at 15-16.; Ex. 23-J.) The Commissioner therefore proposed adjustments to taxpayer's income for 2003 through 2006 under I.R.C. § 482, which authorizes the Secretary or his delegate to allocate income and deductions among commonly owned or controlled business entities in order to "prevent evasion of taxes or clearly to reflect the income of any such organizations, trades, or businesses." I.R.C. § 482.

In February 2007, taxpayer proposed a settlement of this transfer-pricing dispute, under which it agreed to adjustments for 2003 through 2006 and, accordingly, signed a closing agreement (the "transfer-pricing closing agreement"), pursuant to I.R.C. § 7121, on April 4, 2007. (Doc. 13 at 16-17.) The Commissioner signed the transfer-pricing

closing agreement on August 30, 2007, and it was accepted, following review by the Congressional Joint Committee on Taxation (*see* I.R.C. § 6405), on September 25, 2007. (*Id.* at 17.) Under the agreement, taxpayer's income was increased by $35,360,040 for 2003, $22,900,000 for 2004, $21,700,000 for 2005 and $21,700,000 for 2006 (collectively, the "primary adjustments"). (Ex. 24-J; Doc. 33 at 4-5.)

B. The closing agreement under Rev. Proc. 99-32

In light of these primary adjustments, taxpayer was required, under Treas. Reg. § 1.482-1(g)(3), to make secondary adjustments to conform its accounts to reflect the proper tax treatment. That is, absent any other action by taxpayer, the amounts paid to BSEH, but determined to be in excess of arm's-length royalty payments, would have been treated as deemed capital contributions from taxpayer to BSEH, with the consequence that taxpayer's subsequent receipt of those funds would have been taxed as dividends. *See* Treas. Reg. § 1.482-l(g)(3); Rev. Proc. 99-32, § 2, 1999-2 C.B. 296 (Aug. 3, 1999).

Treas. Reg. § 1.482-1(g)(3), however, authorizes the Commissioner to ameliorate the secondary effects of § 482 adjustments to the extent provided in revenue procedures. Accordingly, the Commissioner has

offered taxpayers facing similar § 482 adjustments the option of setting up accounts receivable between the parties. The money held by the controlled foreign corporation is treated as a debt owed to the U.S. parent (instead of a deemed contribution), which can be repaid without triggering the tax consequences that otherwise would flow from required secondary adjustments (in this case a distribution to taxpayer). (Doc. 13 at 18-19.) The Commissioner originally provided for such relief in Rev. Proc. 65-17, 1965-1 C.B. 833, which has now been superseded by Rev. Proc. 99–32.

Taxpayer chose to seek Rev. Proc. 99-32 relief, and entered into a second closing agreement with the Commissioner (the "agreement") under Rev. Proc. 99-32. This second agreement established, "for federal income tax purposes," accounts receivable reflecting debt owed from BSEH to taxpayer. (Ex. 26-J at Bates No. 000758; *see also* Doc. 13 at 18-20; Doc. 27 at 47-49.) It specified that an account receivable in the amount of the transfer-pricing adjustment for each year at issue would be "establish[ed]" "as of" dates corresponding to the close of the taxable year in which a transfer-pricing adjustment was made. (Ex. 26-J at 000758, ¶2.) As relevant to taxpayer's § 965 deduction, "accounts

receivable from BSEH to BMC" were "[e]stablished" on March 31, 2005 in the amount of $21,700,000, and on March 31, 2006, in the amount of $21,700,000. (*Id.*)

The agreement specified that the accounts receivable would bear interest at the applicable federal rates, starting on the day after the deemed creation of each of the accounts receivable. The agreement also provided that the interest was deductible from BSEH's taxable income and includible in taxpayer's taxable income. (*Id.*, ¶3.) The agreement set forth terms for repayment, and provided that such payment would be "free of the Federal income tax consequences of the secondary adjustments that would otherwise result from the primary adjustment . . . ." (*Id.* at 000758-59, ¶5.) BSEH timely paid the principal and interest as the agreement required. (Doc. 13 at 21.)

Randell Price, taxpayer's Senior Director of Tax, drafted the agreement and submitted it to the Commissioner on July 2, 2007. (Doc. 27 at 28, 49-56; Doc. 20 at 2-3.) Only minor clerical corrections were made on the Commissioner's behalf, and it was signed by taxpayer's Chief Financial Officer the next day. (Doc. 27 at 52-56; Doc. 20 at 2-3; Exs. 26-J, 29-R.) It was executed for the Commissioner

by Jerry Payne, with whom Price had dealt in negotiating the transfer-pricing issue and the Rev. Proc. 99-32 election (Doc. 27 at 43; Ex. 26-J), on August 30, 2007, and it became effective, following Joint Committee review, on September 25, 2007. (Doc. 13 at 19.)

Price, who was the sole witness at trial, reported essentially no negotiations regarding the agreement, and testified that there were no discussions regarding § 965. (Doc. 27 at 53.) He admitted that he conducted research in planning the § 965 deduction and seeking Rev. Proc. 99-32 relief, which included reviewing three IRS Notices: Notice 2005-10, 2005-1 C.B. 474 (Jan. 13. 2005); Notice 2005-38, 2005-1 C.B. 1100 (May 10, 2005); and Notice 2005-64, 2005-2 C.B. 471 (Aug. 19, 2005). (Doc. 27 at 32-35.) Notice 2005-38, § 7.02(a), explains that the term "indebtedness" in § 965(b)(3) has the same meaning as it does under general federal income tax principles. Notice 2005-64, § 10.06, explains that accounts payable established under Rev. Proc. 99-32 constitute related party indebtedness for § 965(b)(3) purposes. Despite having read these Notices, Price testified that he did not believe the accounts receivable would be debt for other federal income tax purposes, including § 965. (Doc. 27 at 55.) He had no discussions regarding this

view with Payne or any other representative of the Commissioner. (*Id*. at 53, 55-56.)

C. Taxpayer's § 965 deduction

In the American Jobs Creation Act of 2004, Congress enacted the provision codified as I.R.C. § 965. P.L. 108-357, Title IV, § 422(a), 118 Stat. 1514 (Oct. 22, 2004). Section 965 provides that, to the extent its requirements are met, a U.S. corporation that repatriates funds from controlled foreign corporations as dividends during a specified period in 2005 and 2006 may deduct, in one tax year, 85 percent of the amount repatriated. In June 2005, taxpayer's President and CEO approved a domestic reinvestment plan under which taxpayer's controlled foreign corporations would issue dividends to taxpayer to allow taxpayer to claim the deduction. (Doc. 13 at 5.) BSEH paid taxpayer dividends totaling $708,840,732 between June 29, 2005 and March 21, 2006, for which taxpayer claimed the deduction. (*Id*. at 9-10.)

Section 965's deduction, however, is subject to certain limitations. Relevant here, the deduction is reduced, under I.R.C. § 965(b)(3), to the extent of the excess of "(A) the amount of indebtedness of the controlled foreign corporation to any related person (as defined in section

954(d)(3)) as of the close of the taxable year for which the election under this section is in effect, over (B) the amount of indebtedness of the controlled foreign corporation to any related person (as so defined) as of the close of October 3, 2004." The statute implements this limitation by comparing the amount of indebtedness the taxpayer's controlled foreign corporations owe to related parties on two measurement dates. The first is October 3, 2004, as specified in the statute, and the second is the last day of the taxable year in which the taxpayer elects to claim the § 965 deduction. If the related-party indebtedness on the second date exceeds the related-party debt outstanding on the first date, the amount eligible for computing the deduction under § 965 is reduced by the amount of that increase in indebtedness. Here, it was undisputed that this "testing period" ran from October 3, 2004 to March 31, 2006. (Doc. 33 at 6-7 n.4; Doc. 13 at 11.)

On its 2006 return, taxpayer reported that there was no increased related-party indebtedness within this testing period that would reduce its § 965 deduction. (Doc. 13 at 2, Ex. 1-J.) In 2007, however, after it had filed that return, taxpayer entered into the closing agreement under Rev. Proc. 99-32. As relevant to the claimed § 965 deduction, the

closing agreement provided that two accounts receivable, each reflecting a debt owed by BSEH to taxpayer in the amount of $21,700,000, were established within the testing period, as of March 31, 2005 and March 31, 2006. (Ex. 26-J.) The Commissioner concluded that, because the agreement deemed a total of $43,400,000 in debt to have been established within the § 965(b)(3) testing period, that increased related-party indebtedness caused a 6-percent reduction in the allowable § 965 deduction. (Doc. 13 at 9-10.)

D. The Tax Court proceedings

Most of the facts were stipulated and a short trial was held at which Randell Price was the sole witness. (Docs. 13, 20, 27.) The Commissioner moved to exclude Price's testimony, arguing that parol evidence should not be considered because the agreement was unambiguous. (Doc. 17; Doc. 27 at 9-20.) The Tax Court allowed Price's testimony, but ultimately agreed with the Commissioner that the agreement established debt, which constituted increased related-party indebtedness under § 965. Accordingly, the court upheld the deficiency determination.

1. The parties' arguments

The Commissioner argued that the reduction of taxpayer's § 965 deduction followed directly from the unambiguous agreement, which established debt as of specified dates within the testing period and bound taxpayer in that regard. Under the plain text of § 965(b)(3), this agreed-upon related-party indebtedness reduced taxpayer's deduction.

Taxpayer argued that § 965(b)(3) was intended only to address abusive transactions in which related-party debt was used to fund the repatriation of assets, and that the accounts receivable fit within the trade-payables exception set out in Notices 2005-38 and 2005-64, for debt arising in the ordinary course of business. And taxpayer maintained that the agreement should be read as recharacterizing its payments to BSEH as debt only for purposes of protecting it from the tax liability that otherwise would result from secondary adjustments necessitated by the transfer-pricing adjustments, and that the agreement should be read as foreclosing any further tax consequences adverse to taxpayer. In support of its argument, taxpayer relied on Price's testimony regarding his interpretation of the agreement. And taxpayer urged that a reading of the agreement as limiting its § 965

deduction was contrary to Rev. Proc. 99-32's tax-relief purpose and § 965's tax-relief and stimulus goals. Finally, taxpayer contended that, even if the agreement created debt for all federal tax purposes, that debt had no relevance for § 965(b)(3) purposes, because it did not arise until the agreement was executed, after the testing period ended.

2. The Tax Court's opinion

The Tax Court upheld the deficiency determinations, concluding that the agreement established related-party indebtedness as of the dates specified therein. (Doc. 33.) The court first rejected taxpayer's argument that § 965(b)(3) applied only to abusive transactions, in which related-party debt was incurred with the intent to fund the dividend for which a deduction was claimed. Emphasizing that plain statutory language is the most persuasive evidence of Congressional intent, the court concluded that the statute lacked the intent requirement taxpayer urged. (Doc. at 9-13.) The statute, the court explained, provided a simple "arithmetic formula," with no exceptions, under which related-party indebtedness is the difference in the "amount of indebtedness" at the beginning of the testing period and at the end. (*Id.* at 11.) The court found unpersuasive taxpayer's reliance on flush language that

Congress later added to § 965(b)(3), conferring authority to issue regulations to prevent transactions that avoid the statute's purposes, and on legislative history explaining the addition of that flush language. (*Id*. at 11-12.) The court opined that Congress did not amend § 965(b)(3)'s operative language when it added the flush language, and that the grant of regulatory authority was not properly construed as adding an intent requirement. Thus, it did not help taxpayer that the debt here was not created to fund a § 965 dividend.[4]

The court next concluded that the accounts receivable under the agreement established indebtedness. The court agreed with the Commissioner that the court should interpret the term "indebtedness"

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[4] Although taxpayer tangentially alludes to the idea that § 965(b)(3) was intended to address abuses, it does not now explicitly maintain that the related-party debt rule is limited to abusive transactions. Because taxpayer has not directly addressed the argument in its opening brief, it is waived and should not be considered on appeal. *United States v. Pompa*, 434 F.3d 800, 806 n.4 (5th Cir. 2005) ("Any issue not raised in an appellant's opening brief is deemed waived."). Arguments of the *amici*, which likewise allude to the argument only tangentially, are insufficient to preserve the issue if taxpayer has not done so. *See World Wide Street Preachers Fellowship v. Town of Columbia*, 591 F.3d 747, 753 n.3 (5th Cir. 2009). In any event, for the reasons stated by the Tax Court, § 965(b)(3)'s application is not limited to abusive transactions. (*See* Doc. 33 at 10-13); p. 32-33, *infra*.

in § 965(b)(3) under general federal income tax principles, and concluded that "[t]o do so would mean that the accounts receivable are indebtedness." (Doc. 33 at 13.) In this regard, the court looked to the definition of the term indebtedness to conclude that "indebtedness" means the condition of owing money or being indebted. (Doc. 33 at 14 (citing BLACK'S LAW DICTIONARY 783 (8th ed. 2004).) The court further concluded, based on the definition of an account receivable as "[a]n account reflecting a balance owed by the debtor" (*id.* (citing BLACK'S LAW DICTIONARY 18)) and on the provisions in Rev. Proc. 99-32 and the agreement itself providing for an interest rate and repayment, that the accounts receivable established under the closing agreement constituted indebtedness. (*Id*. at 14-15.)

The court next rejected taxpayer's argument that the accounts receivable should be exempted from § 965(b)(3) as trade payables. (*Id.* at 15-16.) As the court explained (*id.*), the Commissioner has recognized an exception from § 965(b)(3)'s application for indebtedness that arises in the ordinary course of a business and is paid within 180 days. Here, however, the accounts receivable were not established in the ordinary course of business, but were created as a result of § 482

adjustments, and were paid more than 180 days after they were deemed established.[5]

The court next rejected taxpayer's argument that the terms of the agreement meant that no further federal income tax consequences could flow from the establishment of the accounts receivable or their repayment, so that the accounts receivable could not be considered debt for § 965 purposes. (Doc. 33 at 16.) The court explained that the language of the agreement on which taxpayer relied provided in full that the repayment "would be free of the Federal income tax consequences of the secondary adjustments that would otherwise result from the primary adjustment." (*Id.*) The court agreed with the Commissioner that the agreement generally established accounts receivable for all federal income tax purposes, and that the phrase on which taxpayer relied meant only that taxpayer could avoid the tax that *otherwise* would flow from secondary adjustments necessitated by the primary § 482 adjustments. (*Id.* at 16-17.)

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[5] Because taxpayer did not raise this argument in its opening brief, it is waived. *Pompa*, 434 F.3d at 806 n.4.

The court rejected taxpayer's argument that the agreement precluded any collateral tax consequences. The court explained that the Tax Court had previously concluded in *Schering Corp. v. Commissioner*, 69 T.C. 579 (1978), that a similar closing agreement establishing an account receivable under Rev. Proc. 99-32's predecessor, Rev. Proc. 65-17, did not preclude any federal income tax consequences not specifically addressed. (Doc. 33 at 18-19.) The court explained that, in *Schering*, the taxpayer's controlled foreign corporation declared a dividend to repay the accounts receivable, which the foreign taxing authority taxed as a dividend. The taxpayer claimed a foreign tax credit under § 901 for the foreign tax paid on the dividend, which the Commissioner disallowed. The court in *Schering* rejected the Commissioner's argument that the credit was a tax consequence precluded by the agreement, because the closing agreement did not specifically provide that the taxpayer could not claim the credit. The court concluded that, under Rev. Proc. 65-17 and the closing agreement there, only the tax-free repatriation of money reallocated to the taxpayer under § 482 would be accomplished without further tax consequences, but other collateral tax consequences of the agreement

were not precluded. Thus, the Tax Court here explained (Doc. 33 at 20), *Schering*'s holding was predicated on the principle that the "Commissioner and the taxpayer were bound" to treat the return of money as a repayment of debt rather than a dividend for all federal income tax purposes. "In short," the court concluded, "we did not permit inconsistent characterizations for Federal income tax purposes." (*Id.* at 20.)

Applying *Schering*'s reasoning, the Tax Court here likewise concluded that taxpayer could not avoid the collateral consequences of its agreement to establish debt. (*Id.* at 20-21.) The court was unpersuaded by taxpayer's arguments regarding the equitable purpose behind Rev. Proc. 99-32, noting that Rev. Proc. 99-32 had equitable purposes, but declining to find that the election "allows for inconsistent characterization for Federal tax purposes." (*Id.* at 21.) Rather, the court concluded, the accounts receivable were deemed established for all federal income tax purposes.

Finally, the court rejected taxpayer's argument that taxpayer's § 965 deduction could not be reduced because the accounts receivable were established through a closing agreement entered into after the

testing period ended. Citing I.R.C. § 7121 and regulations thereunder, the court explained that the Commissioner may enter into a written closing agreement with a taxpayer relating to the liability of the taxpayer for any taxable period ending before or after the date of the agreement, and a closing agreement relating to a prior taxable period may relate to one or more separate items affecting the tax liability of the taxpayer. (Doc. 33 at 22.) The court explained, a closing agreement can "decide only specific issues and bind the parties only as to those issues." (*Id.*)

The court thus concluded that the agreement was a binding closing agreement that established debt for all federal income tax purposes, and that two of the accounts receivable were established during the testing period for federal tax purposes. Accordingly, those accounts receivable constituted related-party indebtedness established during the testing period, thus reducing taxpayer's § 965 deduction. (*Id.* at 23.)

SUMMARY OF ARGUMENT

Taxpayer here used overpayments of royalties to shift income to related offshore entities in lower-tax jurisdictions for its 2002 through

2006 tax years. When the Commissioner determined this was impermissible, taxpayer agreed, in the transfer-pricing closing agreement, that over $100 million in additional income should be allocated to it under I.R.C. § 482. Faced with a situation in which the money it had transferred to BSEH as purported royalties otherwise would be deemed a capital contribution, so that return of that money to taxpayer would be a taxable dividend, taxpayer chose to seek relief under Rev. Proc. 99-32.

Rev. Proc. 99-32 allows a taxpayer to elect to treat amounts that are the subject of § 482 adjustments as loans, in order to avoid the secondary tax consequences that otherwise would flow from the § 482 adjustments. When taxpayer elected Rev. Proc. 99-32 relief and signed the agreement thereunder, it entered into a binding contractual arrangement that conclusively determined the matters agreed to therein for federal tax purposes. The Tax Court correctly held that the agreement unambiguously provided that debt, owed by BSEH to taxpayer, was deemed established on dates within the § 965(b)(3) testing period for federal tax purposes. The language of the agreement – providing that, for all federal income tax purposes,

accounts receivable are deemed established on specific dates, and that those accounts will bear interest and reflect an amount owing that must be repaid – is susceptible to no other reasonable reading.

The Tax Court correctly held that it necessarily followed from this agreement and the plain language of § 965(b)(3) that the agreed-upon related-party-indebtedness reduced taxpayer's § 965 deduction. The cases taxpayer and the *amici* cite involving factual indicia of indebtedness in substance-over-form cases, in which the Commissioner challenged a taxpayer's characterization of a transaction as debt, have no relevance here, where the terms of the agreement are dispositive.

Taxpayer has presented no meritorious argument establishing that the Tax Court's construction of the agreement was wrong. The agreement's language does not provide, as taxpayer contends, that debt was established only for the limited purpose of protecting taxpayer from the secondary adjustments flowing from the primary adjustments under § 482, or that taxpayer is protected from all collateral tax consequences. The agreement explicitly protects taxpayer only from the "tax consequences of the secondary adjustments that would otherwise result from the primary [§ 482] adjustments," and it states generally that the

parties agree, "for federal income tax purposes" to the establishment of interest-bearing accounts receivable that must be repaid.

Where a closing agreement binds the parties to specific matters, it is well established that the Commissioner and the courts can apply other federal tax adjustments that normally would flow from the items established therein, unless the agreement expressly provides otherwise. The agreement here thus binds taxpayer to treat debt as established on the dates specified therein for all federal income tax purposes, including § 965. But even if the Court looks beyond the face of the agreement, the circumstances support the Tax Court's reading. The Commissioner made clear his view that a closing agreement under Rev. Proc. 99-32 created related-party indebtedness for § 965 purposes in published Notices, which taxpayer's representative Price admitted he had read, and there were no negotiations in which the Commissioner's representative indicated agreement to any different terms.

Taxpayer and the *amici* mischaracterize the equities and policy concerns implicated by the Tax Court's opinion. But even if their concerns had merit, arguments regarding equities and uncodified policy goals cannot be a basis for setting aside a binding closing agreement,

which § 7121 makes clear is intended to allow the Commissioner to resolve tax issues finally and conclusively. And equitable concerns cannot support an expansive reading of § 965, because deductions must be strictly construed.

The Tax Court's decision is correct and should be affirmed.

ARGUMENT

The Tax Court correctly held that the closing agreement under Rev. Proc. 99-32 established debt as of dates within the § 965 testing period, which constituted related-party indebtedness and reduced taxpayer's § 965 deduction

Standard of review

The Tax Court's decision rests on issues of law, involving application of statutory provisions to an unambiguous closing agreement, which this Court reviews *de novo*. *Waterfowl L.L.C. v. United States*, 473 F.3d 135, 141 (5th Cir. 2006).

A. Taxpayer's agreement established debt within the testing period

Taxpayer chose to enter into a binding closing agreement under which money it transferred to BSEH within the testing period would be treated as debt. As we shall show, the agreement reflects an unambiguous agreement that a debt was owed by BSEH to taxpayer as

of specified dates within the § 965 testing period for all federal income tax purposes.[6] Reduction of taxpayer's § 965 deduction necessarily follows, as a matter of law, from the agreement.

1. Adjustments under § 482

This case stems from adjustments under I.R.C. § 482, which permits the Secretary of the Treasury (or the Commissioner as his delegate) to allocate income and deductions between commonly controlled business entities in order to "prevent evasion of taxes or clearly to reflect the income" of those entities. *See also* Treas. Reg. § 1.482-1(b)(1). Courts have long recognized that § 482 serves as a significant tool for protecting against improper shifting of income, and the consequent tax, among related entities, as well as for protection against abusive tax-avoidance transactions. *See Commissioner v. First Security Bank of Utah*, 405 U.S. 394, 400 (1972) (§ 482 prevents "'artificial shifting, milking or distorting of the true net incomes of

[6] Contrary to taxpayer's suggestion (Br. 28-29), it was not the Tax Court's holding, and we do not contend, that the § 482 adjustments created debt. The Commissioner's authority under § 482 extends only to assigning income to the appropriate entity. *See Cappuccilli v. Commissioner*, 668 F.2d 138 (2d Cir. 1981); p. 49, *infra*. As the Tax Court correctly held, it was the agreement that created related-party indebtedness that affected taxpayer's § 965 deduction.

commonly controlled enterprises'")(quoting B. BITTKER AND J. EUSTICE, FEDERAL INCOME TAXATION OF CORPORATIONS AND SHAREHOLDERS, ¶15.06 at 15-21 (3d ed. 1971)); *E.I. Du Pont de Nemours & Co. v. United States*, 608 F.2d 445, 449-50 (Ct. Cl. 1979).

Contrary to the *amici*'s implication that the Commissioner has unfairly sprung an unanticipated retroactive change on taxpayer (Am.Br. 25), it was taxpayer's aggressive transfer-pricing strategies, shifting income to related entities in tax-haven jurisdictions under the guise of overstated royalties, that led to the § 482 adjustments and set in motion the events leading to this case. *See* pp. 4-7, *supra*; (Doc. 13 at 3 (BSEH was a dual Irish/Cayman Islands corporation, owning disregarded entities in Ireland and Mauritius)); J. Gravelle, *Tax Havens: International Tax Avoidance and Evasion*, Congressional Research Service Report, 2009 WL 6057830, at 3 (July 9, 2009) (identifying Ireland, Cayman Islands, and Mauritius as tax-haven jurisdictions). Taxpayer did not dispute the § 482 adjustments in litigation, but rather agreed to inclusion of an additional $101,560,040 in its income for 2003 through 2006. (Ex. 24-J.)

2. The agreement under Rev. Proc. 99-32

Taxpayer then made another choice regarding how to structure its affairs, aimed at minimizing the tax impact of the § 482 adjustment. Section 482 allows the Commissioner to make allocations of income for the purpose of computing the true taxable income of a commonly controlled entity in a given tax year. It does not empower the Commissioner to actually transfer funds among such entities or, unilaterally, to establish a debt or repayment obligations. *See* I.R.C. § 482; *Cappuccilli,* 668 F.2d at 140. The taxpayer, however, is required to make secondary adjustments to conform its accounts to reflect the proper tax treatment. Treas. Reg. §1.482-1(g)(3)(i). Here, absent other relief, the appropriate secondary adjustment would be to treat the excess royalties, that taxpayer had paid BSEH, as a capital contribution, and any return of that money to taxpayer would be taxable as a dividend. *See id.*

Recognizing, however, that repayment of the money to the entity where it originated following conforming of accounts could lead to the same money being taxed twice, the Secretary granted the Commissioner authority to issue revenue procedures that provide for alternative

mechanisms under which the transferred money could be returned without generating that adverse tax consequence. Treas. Reg. § 1.482-1(g)(3)(i). The Commissioner exercised this discretionary authority in Rev. Proc. 99-32.

Under Rev. Proc. 99-32, a taxpayer can request that the Commissioner agree, in a closing agreement, that a payment from the parent to its controlled foreign corporation in excess of an arm's-length price is to be treated as a "loan," so that those funds can be repaid "without the Federal income tax consequences of the secondary adjustments that would otherwise result from the primary adjustment." Rev. Proc. 99-32, § 4.01. This is accomplished by creating "interest-bearing account[s] receivable" in an amount equal to the primary adjustment for each year in which a § 482 adjustment is made. *Id.*

Rev. Proc. 99-32 makes clear that the taxpayer must agree such debt was established in the year the payment giving rise to a § 482 adjustment was made. *Id.* § 4.01(1) ("[t]he account shall . . . be deemed to have been created as of the last day of the taxpayer's taxable year for which the primary adjustment is made"). Additionally, accounts receivable established under Rev Proc. 99-32 are required to "bear

interest at an arm's length rate," and "be expressed, both as to principal and interest, in the functional currency of a qualified business unit." *Id.,* § 4.01(2)-(3). Rev. Proc. 99-32 further specifies terms of repayment. *Id.*, §§ 4.01(4) and 4.02. As Rev. Proc. 99-32 makes clear, electing relief thereunder required taxpayer to agree to treat its payments to BSEH as a loan, thus creating, for federal tax purposes, a debt obligation from BSEH to taxpayer that was deemed established in each year that a payment giving rise to a § 482 adjustment was made.

Faced with § 482 adjustments, taxpayer could have left the funds in BSEH's hands and accounted for that as a capital contribution (s*ee* Treas. Reg. § 1.482-1(g)(3)) – an option that would have had no effect on its § 965 deduction. Instead, taxpayer chose to pursue relief under Rev. Proc. 99-32, which allowed the return of funds to taxpayer in the amount of the § 482 adjustments without the federal tax consequences that otherwise would have flowed from required secondary adjustments, but which also required taxpayer to enter into a binding closing agreement that accounts receivable owing from BSEH to it were established as of the close of each year in which the payments giving rise to corresponding § 482 adjustments were made.

3. Taxpayer's § 965 deduction

For its 2006 tax year, taxpayer also claimed a deduction under I.R.C. § 965. Under § 965, a corporation that is a U.S. shareholder of a controlled foreign corporation may deduct, for one taxable year, 85-percent of cash dividends received from its controlled foreign corporation during the election year. I.R.C. § 965(a). A taxpayer could claim this deduction only once – in either its last taxable year beginning before October 22, 2004, or its first taxable year beginning on or after that date. I.R.C. § 965(f). Taxpayer here claimed the deduction in its first tax year beginning after October 22, 2004, which ended March 31, 2006. During that year, taxpayer repatriated approximately $709 million and claimed the § 965 deduction for 85 percent of that amount. (Doc. 13 at 9-10.)

Contrary to the *amici*'s suggestion that § 965 offers a "reduced tax rate" (Am.Br. 16), § 965, on its face, clearly allows a deduction, which is restricted by certain limitations. Like other deductions, the income-tax deduction in § 965, "'is a matter of legislative grace and . . . the burden of clearly showing the right to the claimed deduction is on the taxpayer.'" *INDOPCO, Inc. v. Commissioner*, 503 U.S. 79, 84 (1992)

(quoting *Interstate Transit Lines v. Commissioner*, 319 U.S. 590, 593 (1943)). Statutes allowing deductions are to be "strictly construed," and deductions are allowed "only 'as there is clear provision therefor.'" *Id*. (quoting *New Colonial Ice Co. v. Helvering*, 292 U.S. 435, 440 (1934)). *See also Deputy v. du Pont*, 308 U.S. 488, 493 (1940).

Congress placed a number of explicit limitations on the § 965 deduction (*see* I.R.C. § 965(b)(1)-(4)), but only the limitation in I.R.C. § 965(b)(3) is in dispute. Under I.R.C. § 965(b)(3), the amount eligible for the § 965 deduction is reduced to the extent of any increase in related-party indebtedness during the testing period, described in the statute as the period between October 3, 2004 and the end of the taxable period for which the deduction is claimed. I.R.C. § 965(b)(3); *see also* Notice 2005-10, 2005-1 C.B. 474 (explaining operation of § 965). Here, it was undisputed that the testing period ran from October 3, 2004 through March 31, 2006. (Doc. 13 at 10-11; Doc. 33 at 13 n.3.)

The formulation that Congress adopted in § 965(b)(3) ensures that a dividend funded by a U.S. shareholder, directly or indirectly, and that thus does not create a net repatriation of funds, is ineligible for the benefits accorded by § 965. Thus, the Tax Court correctly rejected the

argument that the provision's application is limited to intentionally abusive transactions. (Doc. 33 at 8-13.) Indeed, as the Tax Court explained, no intent language can be found in the statute, and the limitation is determined by a straightforward arithmetic formula, comparing the related-party indebtedness at the beginning of the testing period with that at the end. (*Id.* at 11.)

As we shall show, the agreement under Rev. Proc. 99-32 that taxpayer entered into here provides unambiguously that debt was established within the testing period. And the Tax Court correctly held that taxpayer's § 965 deduction should be reduced by the amount of this increased related-party indebtedness.

B. The agreement established related-party debt within the § 965 testing period, and taxpayer was bound by the agreed-upon facts

Taxpayer, which chose to enter into a binding closing agreement to enjoy the benefits of treating its payments to BSEH as debt, must also accept the other tax consequences that flow from treating its payments as debt, including adjustment of its § 965 deduction. It cannot disavow the debt that it agreed was established "for federal tax

purposes," on the ground that such debt compels a result taxpayer does not like or did not anticipate.

1. Taxpayer is bound by the agreement

a. Closing agreements in general

A closing agreement represents a final and conclusive tax determination, binding both the taxpayer and the Commissioner as to the matters determined in the agreement. *See* I.R.C. § 7121; *Smith v United States*, 850 F.2d 242 (5th Cir. 1988); *Alexander v. United States*, 44 F.3d 328, 332 (5th Cir. 1995); *In re Hopkins*, 146 F.3d 729 (9th Cir. 1998); *In re Spendthrift Farm, Inc.*, 931 F.2d 405 (6th Cir. 1991)); *Zaentz v. Commissioner*, 90 T.C. 753, 761 (1988); *Cramp Shipbuilding Co. v. Commissioner*, 14 T.C. 33, 36-37 (1950). There are three types of closing agreements: (1) agreements resolving a taxpayer's total tax liability for one or more prior years; (2) agreements that reflect a closing of a specific matter affecting a taxpayer's tax liability in one or more years; and (3) combined agreements that relate to both total tax liability for one or more years and specific matters. *See Estate of Magarian v. Commissioner*, 97 T.C. 1 (1991). Here, the agreement is the second type, embodying the parties' agreement to specific matters, *i.e.,* the

agreement that accounts receivable owing from BSEH to taxpayer were established for federal income tax purposes as of the dates specified.

Code Section 7121, the statute authorizing closing agreements, makes clear that a closing agreement is "final and conclusive" as to all matters contained therein, and a court cannot set the agreement aside or infer additional terms, absent a showing of "fraud or malfeasance or misrepresentation of a material fact." I.R.C. § 7121. Because a closing agreement is final and conclusive, a matter resolved in a closing agreement carries the same level of finality as a matter finally resolved in litigation. *See Katz v. United States*, 43 A.F.T.R. 2d 79-1124, 1979 WL 1336 at *2 (D. Mass. 1979).

b. The agreement unambiguously treats debt as established on dates within the § 965 testing period

Closing agreements under § 7121(a) "are contracts and generally are interpreted under ordinary contract principles." *Roach v. United States*, 106 F.3d 720, 723 (6th Cir. 1997). *See also Smith*, 850 F.2d at 245; *United States v. Lane*, 303 F.2d 1, 4 (5th Cir. 1962); *Rink v. Commissioner*, 47 F.3d 168, 171 (6th Cir. 1995); *Spendthrift Farm*, 931 at 507; *cf. Union Pac. R.R. Co. v. United States ex rel. Army Corp. of*

Eng'rs, 591 F.3d 1311, 1315 (10th Cir. 2010) (federal contract law applies in construing a federal contract). Where the parties' mutual intention is clear from the face of the agreement, this Court has held that it will enforce the agreement as written. *Lane*, 303 F.2d at 4; *see also Rink*, 47 F.3d at 171 ("if the essential terms of an agreement are deemed unambiguous, a court will not look beyond the four corners of the document to determine the parties' intent."); *S&O Liquidating Partnership v Commissioner*, 291 F.3d 454, 459 (7th Cir. 2002) ("if a closing agreement's terms are clear and unambiguous, we are obligated to enforce the language as it is written, without resort to extrinsic evidence").

Here, the Tax Court correctly concluded that the agreement unambiguously provided that debt was established as of specified dates within the testing period for federal tax purposes. That conclusion is apparent from the text of the agreement, in which the parties agreed, "for federal income tax purposes," that "accounts receivable" were deemed "[e]stablished" on specified dates and agreed to terms for repayment of and interest on those accounts receivable. (Ex. 26-J at 000758.) This is in accordance with the text of § 4.01(1) of Rev. Proc.

99-32, which provides that the accounts "shall be deemed to have been created as of the last day of the taxpayer's taxable year for which the primary adjustment is made. . . ."

The agreement recites that it is being entered into for purposes of "grant[ing]" taxpayer's "request[ ]" for the "relief described in section 4 of Rev. Proc. 99-32 . . . ." (Ex. 26-J at 00758, Whereas Clause). The agreement provides that enumerated items are "HEREBY DETERMINED AND AGREED *for federal income tax purposes* . . . ." (*Id*. at 000758 (emphasis added).) Those items agreed to include "interest-bearing accounts receivable from BSEH to BMC" that are "[e]stablished" as of specified dates. (*Id*., ¶2.) Relevant here are an account receivable for $21,700,000 established March 31, 2005, and an account receivable for $21,700,000 established March 31, 2006. (*Id.*) The agreement further provides that the "accounts receivable shall bear interest . . . from such dates to the dates of repayment," which interest shall be deductible from BSEH's taxable income and includible in taxpayer's taxable income. (*Id*., ¶3.)

As the Tax Court recognized, the only reasonable reading of an agreement to establish an "account receivable" is that the parties are

agreeing that a debt is owed by one party to another. (Doc. 33 at 14-15 (citing BLACK'S LAW DICTIONARY 18 (defining an "account receivable" as "[a]n account reflecting a balance owed by the debtor"); *see National Bank of Newport v. National Herkimer County Bank*, 225 U.S. 178, 184 (1912) (defining "accounts receivable" as "amounts owing . . . on open account"); *Long v. Commissioner*, 93 T.C. 5, 9 (1989) (describing a closing agreement under Rev. Proc. 65-17 that established accounts receivable as creating debt obligation). Moreover, the agreement provides for these accounts receivable to bear interest, and for repayment within a specified time.[7] Given this language, the agreement must logically be read as providing that debt was established on the dates the agreement provides "accounts receivable" were "established." (Ex. 26-J, ¶2); *Robbins Tire and Rubber Co. v. United States*, 462 F.2d 684, 687 (5th Cir. 1972) (to establish ambiguity so that court could look beyond the agreement's face, taxpayer must

[7] Because these matters in the numbered paragraphs of the agreement were "DETERMINED AND AGREED for federal income tax purposes" (Ex. 26-J), taxpayer's argument (Br. 34), that a taxpayer is not bound by references to a tax attribute as to which no agreement is made, does not further its case.

come forward with a "reasonable" alternative reading); *see also A-Transport Northwest Co., Inc. v. United States*, 36 F.3d 1576, 1584 (Fed. Cir. 1994) (declining to look beyond face of the contract where party urging ambiguity offered only an unreasonable reading).

In contesting the Tax Court's reading, taxpayer points only to the absence of the actual terms "debt" or "indebtedness" in the agreement (Br. 37), but does not address the well-settled characterization of interest-bearing accounts receivable that must be repaid as indebtedness. This omission presumably stems from the fact that any serious contention that the wording of the agreement did anything other than to create a debt on the dates specified would be fundamentally inconsistent with the agreement's purpose of treating the funds transferred to BSEH as loans, so that repayment could occur without the adverse tax consequences that otherwise would flow from the secondary adjustment necessitated by the § 482 adjustments.[8]

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[8] Because of the obvious problems with such inconsistency, the tax law, in a variety of other contexts, has long rejected the idea that taxpayers can take inconsistent positions. *See Commissioner v. Nat'l Alfalfa Dehydrating & Milling Corp.*, 417 U.S. 134, 148-49 (1974) (taxpayer "must accept the tax consequences of his choice . . . and may not enjoy the benefit of some other route he might have chosen to follow (continued…)

Faced with this problem, taxpayer raises the metaphysical assertion that, despite the express statements regarding when the accounts receivable are deemed established, any debt must be considered, for § 965 purposes, as arising when the agreement was executed, and, alternatively, the argument, unsupported by the agreement's text, that any debt created is debt only for the limited purpose of providing § 482 relief. (Br. 18-19, 22-27, 34-39; Am.Br. 16-21.) Both arguments lack merit. (*See* pp. 46-59, *infra*).

Having chosen to enter into the agreement to obtain the benefits of Rev. Proc. 99-32, taxpayer is bound to its unambiguous agreement to establish debt for federal income tax purposes on dates within the testing period. *See Manko v Commissioner*, 126 T.C. 195, 202 (2006) (closing agreement covering specific matters "binds the parties as to the

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(…continued)
but did not"); *Spector v. Commissioner*, 641 F.2d 376, 381-82 (5th Cir. 1981) (party is bound to the form in which he cast an agreement); *Herrington v. Commissioner*, 854 F.2d 755, 757 (5th Cir. 1988) (duty of consistency bars a taxpayer from taking a position in one year that is to his advantage and, later, when correction for that year is time-barred, adopting a contrary position involving the same facts or transactions).

matters agreed upon"). The closing agreement is dispositive of whether, and when, indebtedness was established.

2. Debt established under the agreement reduces the § 965 deduction

The agreement established that, as of March 31, 2005, and March 31, 2006, there was an increase in related-party indebtedness within the testing period, which reduced taxpayer's § 965 deduction. I.R.C. § 965(b)(3); *see also* Notice 2005-38, 2005-1 C.B. 1100, § 7.02(a) (term "indebtedness" in § 965(b)(3) has the same meaning as it does under general federal income tax principles); Notice 2005-64, 2005-2 C.B. 471, § 10.06 (accounts payable established under Rev. Proc. 99-32 constitute related-party indebtedness for § 965(b)(3) purposes).

Taxpayer and *amici* argue (Br. 21-24; Am.Br.12-21), however, that § 965(b)(3) should be read to mean that a closing agreement entered into after the close of the testing period is irrelevant, even if it expressly provides that debt was established within the testing period. That position is untenable. A closing agreement is binding with respect to all matters provided therein (*Spendthrift Farm*, 931 F.2d at 407), and that includes an agreement that debt was established and when it was established, both of which were specified in the agreement here. *See*

Nadler v. Commissioner, T.C. Memo. 1992-383, 1992 WL 156029 (1992) (closing agreement can be binding as to specific items as of a specified date). Having agreed that debt was established on the dates specified in the agreement, taxpayer is bound to treat the debt as arising on those dates, whether or not it actually did. *See Fickling v. United States,* 507 F.3d 1302, 1305 (11th Cir. 2007) (having claimed legitimate sale occurred and entered into binding closing agreement allowing loss on sale of 70 percent of amount claimed, taxpayer could not reverse course and characterize the transaction as a sham to claim other tax benefits); *Gundotra v. U.S. Internal Revenue Service*, 2001 WL 710621 (S.D. Fla. 2001) (taxpayer was bound to position in closing agreement that his corporation owned property of certain value), *aff'd*, 31 Fed. Appx. 931 (Table) (11th Cir. 2002); *Estate of Johnson v. Commissioner*, 88 T.C. 225 (1987) (after agreeing in closing agreement that basis of debentures at date of decedent's death was $600,000, taxpayer could not later argue basis at same date was a different amount), *aff'd*, 838 F.2d 1202 (2d Cir. 1987); *Cramp*, 14 T.C. at 36-37 (declining to consider Commissioner's arguments that requirements for § 124 deduction were not met, because Commissioner was bound by closing agreement

providing that the taxpayer could take § 124 deductions); *Nadler*, T.C. Memo. 1992-383, 1992 WL 156029 (taxpayer was bound by closing agreement to treat basis as zero as of specified date, and evidence showing otherwise could not "resurrect" basis).[9]

Contrary to the *amici*'s suggestion (Am.Br. 5), § 965(b)(3) does not contain unique language that closes the inquiry as of the last day of the testing period and renders irrelevant a later closing agreement providing that debt was established within the testing period. The Tax Code has numerous provisions that provide that amounts of tax or

[9] Neither party contends that a loan was made from taxpayer to BSEH during the testing period for state or foreign law purposes. Rather, as explained above, funds were transferred via an aggressive transfer-pricing arrangement that the Commissioner determined did not accurately reflect the income of the related entities, and taxpayer, under the relief provision in Rev. Proc. 99-32, agreed to deem debt to be established for federal income tax purposes as of specified dates. As the cases involving closing agreements cited above illustrate, it is well settled that a taxpayer can agree to treat certain things as having occurred at a certain time in a closing agreement, and is bound to that result, whether or not it actually happened. *See also* I.R.C. § 7121. In the same vein, the Code provides for deemed treatment of a transaction or event in certain circumstances. *See Schering-Plough Corp. v. United States*, 651 F. Supp. 2d 219, 221 (D.N.J. 2009) (explaining deemed income inclusion under Subpart F of the Code). Such deemed treatment often is necessary to achieve just results, to avoid abuses, or to finally resolve a matter without further litigation.

deductions turn on evaluation of values or amounts as of a specified time. (*E.g.,* I.R.C. § 1(h)(1) (imposing tax on net capital gain "for any taxable year"); § 152(b)(3) (qualification for dependency deduction depends on status "as of the close of such taxable year"); § 165 (allowing a deduction for losses "sustained during the taxable year"); § 465 (limiting loss deduction to amount at risk at close of taxable year); § 2056 (marital deduction depends on values at date of death); *see also* Treas. Reg. § 20.2056(b)-(4)(a)). And both administrative and judicial determinations or agreements regarding characterization of transactions or the amounts of gains, losses, or deductions routinely occur after the close of the relevant tax year. Indeed, Treasury Regulations make clear that closing agreements can be entered into "for any taxable year ending prior to or subsequent to the date" of the agreement, Treas. Reg. § 301.7121-1(a); that a closing agreement relating to a prior taxable period may relate to one or more separate items affecting the tax liability of the taxpayer, Treas. Reg. § 301.7121-1(b)(2); and that such agreements are "final and conclusive" as to the matters resolved. Treas. Reg. § 301.7121-1(c).[10] Moreover, as explained

[10] These regulations, which make clear that a closing agreement

(continued…)

further *infra* (pp. 54-59), where a closing agreement resolves particular matters, the taxpayer generally is bound to those terms for all federal tax purposes, unless the agreement specifies otherwise, and other tax adjustments can be made as would ordinarily flow from the agreed-upon matters. *See Smith*, 850 F.2d at 245.

It is well settled that when a determination regarding a matter in a prior year becomes final – whether through a closing agreement or litigation – that determination applies for all federal tax purposes, unless otherwise specified, and adjustments must be made accordingly, regardless of whether years have passed. *See Southgate Master Fund, L.L.C. v. United States*, 659 F.3d 466, 492 & 469 n.4 (5th Cir. 2011) (2011 decision, that acquisition of portfolio of non-performing loans in 2002 should be recharacterized as sale, affected partnership losses and tax liability of partners, as would be determined in other proceedings). Nothing in § 965's language suggests that it is somehow immune from the general rule that, if a binding determination is made regarding a

(…continued)
can make binding determinations regarding events in earlier taxable periods, are entitled to judicial deference. *Mayo Foundation for Medical Educ. and Research v. United States*, 131 S. Ct. 704 (2011).

specific matter in a prior tax year, adjustments that ordinarily would flow from that determination can and should be made, so long as the statute of limitations remains open.

3. The cases defining indebtedness that taxpayer and the *amici* cite are irrelevant here, where the agreement is controlling

The cases (Br. 22-26; Am.Br. 13-14, 17) analyzing factual indicia to determine whether and when a taxpayer actually had a debt obligation all arise in the very different context of the Commissioner's challenge to a taxpayer's characterization of its transaction as debt. Although both the taxpayer and the Commissioner are bound by closing agreements (*see* pp. 34-35, *supra*), and taxpayers generally are bound to their characterizations of their transactions (*see Nat'l Alfalfa,* 417 U.S. 134), the Commissioner is not bound by a taxpayer's characterization of a transaction and can make adjustments to reflect a transaction's true substance. *Gregory v. Helvering,* 293 U.S. 465, 469-70 (1935); *Knetsch v. United States*, 364 U.S. 361, 366 (1960); *Interlochen Co. v. Commissioner*, 232 F.2d 873, 877 (1956) ("the Commissioner or the courts may look through the form of a transaction to the substance thereof," but the choice to disregard its classification of a transaction

"does not lie with the taxpayer"). Taxpayer, in short, is poorly positioned to disavow its closing agreement.

The cases that taxpayer and the *amici* urge as defining indebtedness all arose in situations where the taxpayer claimed deductions or other tax benefits that depended on the creation of a debt within the tax year, and the Commissioner challenged taxpayer's characterization of the transaction. *E.g., Estate of Mixon v. United States*, 464 F.2d 394, 402 (5th Cir. 1972) (considering factual indicia of indebtedness to determine whether money advanced to corporation and later distributed back to shareholders was truly a loan or a capital contribution followed by a taxable dividend); *Tomlinson v. 1661 Corp.*, 377 F.2d 291, 294 (5th Cir. 1967) (examining factual indicia to determine if true indebtedness existed so that interest deduction was allowable). The analysis in the debt-versus-equity context is wholly inapplicable here, where a binding closing agreement governs.

The cases involving settlements (Br. 24-26; Am.Br. 13) are similarly irrelevant. They turn on the taxpayer's claim that the terms of an agreement with a third party established debt, giving rise to an interest deduction, and the Commissioner's disallowance of the

deduction based on his conclusion that the label given by the parties did not reflect its true substance. *See Indeck Energy Servs., Inc. v. Commissioner*, T.C. Memo. 2003-101 (upholding Commissioner's disallowance of deduction for amount denominated as interest under settlement agreement between private parties, because payment characterized as interest was merely a means of computing the amount to be paid as stock purchase price in settlement of disputed stock buy-out agreement); *Midkiff v. Commissioner*, 96 T.C. 724 (1991), *aff'd, Noguchi v. Commissioner,* 992 F.2d 226 (9th Cir. 1993) (upholding Commissioner's disallowance of interest deduction for amount denominated as "blight of summons damages" in private parties' settlement agreement, which called for payment of set amount plus 5-percent "blight of summons damages" from a specified date, because there was no binding obligation between the parties to the settlement as of the date on which the 5-percent addition began to run that could give rise to interest). In these cases, the Commissioner was allowed to challenge the private parties' characterization of their transactions, and factual indicia of indebtedness were relevant to the courts' analyses in

ascertaining the substance of the transaction. Here, in contrast, the facts regarding whether debt existed are not in issue.

Cappuccilli v. Commissioner, T.C. Memo. 1980-347, 1980 WL 4185, *aff'd*, 668 F.2d 138 (2d Cir. 1981), although it involved a § 482 adjustment, likewise has no bearing here. There, the taxpayer sought a bad-debt or loss deduction for amounts that the Commissioner determined were properly allocable to the taxpayer rather than to a related entity, but that the taxpayer ultimately was unable to recover from the related entity due to bankruptcy. As the Second Circuit made clear in *Cappucilli*, and as is our position here (*see* note 6*, supra*), § 482 does not create a debt obligation that can give rise to such a deduction. It is only where, following the Commissioner's § 482 adjustments, the taxpayer obtains a closing agreement establishing debt under the administrative relief provision in Rev. Proc. 99-32, that such debt is deemed to exist as of the date specified therein. 668 F.2d at 140. Taxpayer's reliance on the Tax Court's reasoning in *Capuccilli* that bad debt deductions could not be claimed because, "*if* a 'debt'" (Br. 25) were created, it did not come into existence until later, when litigation over the § 482 adjustments ended, is ill-found, given the Second Circuit's

holding that the § 482 adjustments did not create debt. *See Capuccilli*, 668 F.2d at 140 & n.4; *see also* Rev. Proc. 99-32, § 5.02.

Factual inquiries to ascertain whether, and when, debt was created by the parties' dealings are irrelevant here, and the cases addressing these questions are inapplicable. To the contrary, the closing agreement is controlling. *See Fickling*, 507 F.3d at 1305; *see also Plante v. Commissioner*, 168 F.3d 1279 (11th Cir. 1999) (where taxpayer and third party executed unambiguous agreement characterizing transfer as a capital contribution on a specified date, taxpayer was bound by its agreement, making further inquiry unnecessary); *cf. Ellinger v. United States*, 470 F.3d 1325 (11th Cir. 2006) (considering argument that prior closing agreement made factual indicia of indebtedness irrelevant, but ultimately concluding that the closing agreement did not cover the transaction at issue so factual inquiry was required).

C. Taxpayer's arguments that the Tax Court erred in construing the agreement lack merit

1. The agreement creates debt for all federal tax purposes and does not preclude collateral tax consequences

Taxpayer incorrectly maintains that the agreement creates debt for the limited purpose of giving taxpayer relief from the secondary adjustments flowing from the § 482 adjustments, and that the agreement precludes other federal tax consequences adverse to taxpayer. The agreement states, without limitation, that the enumerated terms, including establishment of the accounts receivable as of the specified dates, are agreed to "for federal income tax purposes." (Ex. 26-J at 000758 ("IT IS NOW HEREBY DETERMINED AND AGREED for federal income tax purposes that: . . . ."). This language leaves no doubt that the enumerated terms apply for federal income tax purposes generally.

Paragraph 5, which deals with repayment, and on which taxpayer relies (Br. 39, 41, 43) to contend that no further federal income tax consequences can flow from the agreement, states:

> BSEH will pay the account receivable, including interest thereon, by intercompany payment. Such payment will be free of the Federal income tax consequences *of the secondary*

> *adjustments that would otherwise result from the primary adjustment. . . . .*

(Ex. 26-J, ¶5 (emphasis added).) As the Tax Court correctly concluded, when this entire paragraph is considered (rather than selective quotations and without addition of words that are not in the agreement (*see* Br. 43)), it is clear that the parties agreed only that BSEH's payment would be free of the federal income tax consequences of the secondary adjustments, which, in the absence of the Rev. Proc. 99-32 agreement, would have followed from the primary § 482 adjustments. *See also* Rev. Proc. 99-32 (explaining its purpose as allowing taxpayers to conform their accounts following "primary adjustments, without the Federal income tax consequences of the secondary adjustments that would otherwise result under section 482"). This provision confirms that the payment of the accounts receivable would be free of the federal income tax consequences that otherwise would follow from the default (capital contribution) treatment of the excess royalties taxpayer paid to BSEH. It does not relieve the taxpayer of the federal income tax consequences of selecting loan treatment. To the contrary, all of the agreed-upon terms make clear that the agreements entered into are "for

federal income tax purposes" without any restriction.[11] Accordingly, the Tax Court correctly concluded that the agreement unambiguously created debt for all federal income tax purposes as of the dates specified therein, including for § 965 purposes.

Taxpayer's arguments (Br. 32-33) that tax-law provisions not specifically addressed in the agreement cannot be affected by it, and that the Tax Court erroneously "implied" an additional term in order to hold that the agreement affected its § 965 deduction, misperceives relevant law. It is well settled that, where a closing agreement reflects an agreement for treatment of certain specific items but does not entirely resolve the taxpayer's tax liability, penalties, and interest for a given period, the taxpayer is bound to the terms provided for in the

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[11] Taxpayer's suggestion that the use of the plural "secondary adjustments" necessarily implies that the agreement precludes all adverse tax consequences that might result from the closing agreement's recast of the royalty overpayments as loans rather than as capital contributions is unpersuasive. (Br. 44-45.) Because there were multiple § 482 adjustments, for which separate accounts receivable were established, it is logical to use the plural to refer to potential secondary adjustments flowing from the primary adjustments. And the reduction in taxpayer's § 965 deduction is a secondary adjustment resulting from taxpayer's choice of deemed loan treatment, not a secondary adjustment that would have resulted from the capital contribution treatment that otherwise would have followed from the primary adjustments.

agreement for all federal tax purposes, unless the agreement specifies otherwise. Thus, other collateral tax consequences generally apply in accordance with the law, to the same extent as if the matters agreed upon were the true facts. An exception to this rule applies only if the taxpayer has negotiated language specifying otherwise in the agreement.

For example, in *Smith*, 850 F.2d at 245, the parties entered into a closing agreement that determined only the taxpayers' losses from a particular venture, but did not finally determine their tax liability, penalties, or interest for any period. This Court held that the closing agreement did not bar the IRS's claim for interest and penalties as provided by law, because the agreement did not mention interest or penalties. The Court concluded that the limited scope of the closing agreement did not make it ambiguous. Rather, the Court found that, because those matters were not addressed in the agreement, the provisions of law governing penalties and interest applied. The Court explained that a waiver should have been included in the agreement if

the taxpayer wished to foreclose claims for penalties and interest, that followed under the law from the agreed-upon terms. *Id.* at 245.[12]

Numerous other cases are to the same effect. *See United States v. Nat'l Steel Corp.*, 75 F.3d 1146, 1151-52 (7th Cir. 1996) (where closing agreement referenced § 212, but did not specify the use of the section's then-current refund-calculation criteria, amended provision governed); *Spendthrift Farm, Inc.*, 931 F.2d at 404 (closing agreement that did "not mention interest or penalties" did not bar Commissioner's claim for restricted interest; taxpayer should have obtained a specific provision in the agreement if it wanted the agreement to preclude such recovery); *Ewing v. United States*, 914 F.2d 499, 505 (4th Cir. 1990) (where closing agreement addressed amount of income, gains, losses, deductions, and credits attributable to taxpayers' businesses, but did not contain agreement that taxpayers would abstain from claiming refund,

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[12] Like this Court in *Smith*, 850 F.2d at 245, other courts have specifically rejected arguments that a closing agreement addressing only specific matters is ambiguous because it did not address whether other Code provisions would apply to the agreed-upon facts, and have concluded that other Code provisions, although not mentioned, would apply as a matter of law. *Shelton v. United* States, 2008 WL 4346134 at *6 (Fed. Cl. 2008); *Temple v. United States*, 11 Cl. Ct. 302, 305 (1986).

taxpayers could claim refund of amounts paid outside the statute of limitations, which constituted overpayments under § 6401); *Bush v. United States*, 84 Fed. Cl. 90, 95 (2008) (closing agreements did not preclude application of I.R.C. § 469 where the agreements failed to mention it; if taxpayer wanted it not to apply, it should have included specific language to that effect); *Estate of Magarian*, 97 T.C. at 6-7 (if parties intend closing agreement to preclude another provision of law from applying to agreed-upon facts, they must explicitly so provide in the agreement). As explained in *Shelton v. United States*, 2008 WL 4346134 at *6:

> The teaching of these cases is that a closing agreement will not implicitly preclude the imposition of otherwise applicable law. If the parties intend that a law will not apply, they must explicitly agree on that point in the closing agreement.

Because the agreement here did not explicitly restrict the circumstances under which the parties agreed that debt was established, or otherwise provide that the agreed-upon terms were not subject to § 965, the Tax Court correctly applied § 965 to the agreed-upon facts.

Contrary to taxpayer's assertion (Br. 49), *Schering v. Commissioner*, 69 T.C. 579, is consistent with this well-established rule,

and the Tax Court correctly relied upon it to support its holding. *Schering* involved an agreement under Rev. Proc. 99-32's predecessor, Rev. Proc. 65-17. There, the Tax Court held, consistently with the cases just discussed, that the closing agreement did not foreclose collateral tax consequences. Taxpayer and the *amici* misread *Schering* in suggesting that it stands for the proposition that, because Rev. Proc. 99-32 is a tax-relief provision, other Code provisions cannot be applied to facts agreed to in a Rev. Proc. 99-32 agreement in a way that would expand a taxpayer's liability or limit deductions.

In *Schering*, it was the Commissioner who argued the Court should infer a term that was not in the closing agreement, and asked the court to interpret the agreement to preclude the taxpayer from claiming a foreign tax credit under I.R.C. § 901, although nothing in the agreement expressly precluded the taxpayer from claiming that credit and the taxpayer could satisfy the Code's requirements for the credit.[13]

[13] In *Schering*, Swiss law, where the taxpayer's controlled foreign corporation was located, required the foreign corporation to issue a dividend to make the repayment called for in the closing agreement, and that "dividend" was subject to tax under Swiss law. Although the closing agreement provided that the repayment was to be treated as repayment of a debt for federal tax purposes, that did not change the (continued…)

69 T.C. at 594-595. The court allowed the foreign tax credit, finding that nothing in the closing agreement foreclosed that collateral federal tax consequence. It was the Commissioner who sought to preclude a collateral federal consequence, which would have disadvantaged the taxpayer, and the *Schering* court noted that Rev. Proc. 65-17 was a relief provision. But the court did not hold, as taxpayer and the *amici* suggest (Br. 19-20; Am.Br. 20 n.5), that any such relief purpose was so overriding that an agreement under Rev. Proc. 65-17 must be construed to preclude any collateral tax consequence that would be to the taxpayer's disadvantage. Rather, as the Tax Court correctly held, *Schering* is consistent with the rule that other tax-law provisions, including § 965, apply to the agreed-upon terms in a closing agreement,

(…continued)
Swiss law that required a dividend subject to Swiss income tax be generated to pay it. Because § 901 provided the credit for amounts subject to foreign income tax, and nothing in the closing agreement expressly precluded its application, the requirements for the credit were met.

if, as here, the parties have not specifically agreed that a particular collateral tax consequence will not apply.[14]

2. Even if the Court were to look beyond the agreement, it would not help taxpayer's case

Because closing agreements are contracts interpreted under contract principles, it is inappropriate to look beyond the face of an unambiguous agreement. Parol evidence and other evidence regarding the circumstances of the agreement are relevant only where the agreement is ambiguous, and should not be considered when the meaning is clear from the four corners of the agreement. *Robbins Tire*, 462 F.2d at 687-88 (where agreement on its face had an unambiguous meaning and only proffered alternative construction was unreasonable, it was "error to have received testimony as to the intention of one of the parties"); *Roach*, 106 F.3d at 723; *see also United States v. Taylor,* 293 F.2d 717 (5th Cir. 1961) (contract case); *but see Bethlehem Steel Corp. v United States,* 270 F.3d 135, 139 (3d Cir. 2001) (suggesting that, in that

[14] No inference adverse to the Commissioner should be drawn from IRS Advice Memorandum 2008-010 (Sept. 4, 2008), instructing IRS personnel that future Rev. Proc. 99-32 closing agreements should include a statement that the election may affect § 965 deductions. (Br. 37.) The Commissioner's efforts to add greater clarity to avoid suits like this one do not change the analysis discussed above.

circuit, extrinsic evidence may be relevant in ascertaining whether an agreement is ambiguous). Given the unambiguous language of the agreement, it is both unnecessary and inappropriate to look beyond the face of the agreement to ascertain its meaning. *See Nat'l Steel,* 75 F.3d at 1150 (requirement that closing agreements have high-level IRS approval would be undermined if courts considered testimony regarding understanding of IRS negotiators to alter closing agreements).

Taxpayer relies (Br. 42-43) on the testimony of Randell Price, its Senior Director of Tax when the agreement was executed, to argue that the parties agreed that taxpayer would be protected not only from the secondary adjustments that otherwise would arise from the § 482 adjustments, but also from any collateral tax consequences of the substituted treatment under the agreement. The agreement, however, does not so state; it provides that taxpayer will be protected only from the tax consequences of the capital contribution secondary adjustments. Price's testimony does not reflect an explanation consistent with the terms of the contract that, as taxpayer urges (Br. 42-43), can be considered without violating the parol evidence rule.

Even if this Court were to consider extrinsic evidence or surrounding circumstances, neither Price's testimony nor other surrounding circumstances support taxpayer's interpretation. It is well settled that a contract should be construed against the drafter. *Port Arthur Towing Co. v. Mission Ins. Co.*, 623 F.2d 367, 371 (5th Cir. 1980); *Hills Materials Co. v. Rice*, 982 F.2d 514, 516 (Fed. Cir. 1992). Price drafted the agreement, and, if the Court should find it ambiguous, the rule of construction calls for construction against taxpayer.

Moreover, the entirety of the circumstances make clear that there was no agreement that there could be no collateral federal income tax consequences flowing from the terms agreed to in the agreement. Price's testimony established that there were essentially no negotiations, and he conclusively testified that there was no discussion of § 965. (Doc. 27 at 53.) The Commissioner's position that the debt created by the agreement would be treated as debt for other federal tax purposes, including § 965, was clear, however, from published Notices, which Price testified he had reviewed. (Doc. 27 at 35.) Notice 2005-38, § 7.02(a), explained that the term "indebtedness" in section 965(b)(3) has the same meaning as it does under general federal income tax

principles. Notice 2005-64, § 10.06, clarified that accounts payable established pursuant to Rev. Proc. 99-32 constitute related party indebtedness for § 965(b)(3) purposes.[15] Given these facts, there obviously was no mutual understanding that the agreed-upon debt could not have other tax consequences, including affecting the § 965 deduction. To the contrary, taxpayer knew, or should have known, that the Commissioner believed the agreed-upon accounts receivable would be related-party debt for § 965 purposes. *See Blue Cross & Blue Shield United of Wisconsin & Subsidiaries v. United States*, 117 Fed. Appx. 89, 2004 WL 2633324 at *5 (Fed. Cir. 2004) (IRS's meaning should prevail if taxpayer "knew or should have known" how the IRS understood the provision and did not correct that misunderstanding); *HPI/GSA 3C, LLC v. Perry,* 364 F.3d 1327, 1335 (Fed. Cir. 2004) ("party that enters

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[15] This is not to suggest that these Notices are rulemaking entitled to deference under *Chevron USA, Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837 (1984). But they reflect the Commissioner's understanding regarding the relevance of the agreement to the § 965 deduction. And Price's admission that he read these Notices shows he was apprised of the Commissioner's views. Thus, clearly no meeting of the minds occurred on the terms taxpayer urges. Moreover, the Commissioner's consistent interpretation, as reflected in these Notices, is entitled to some deference. *See United States v. Mead Corp.*, 533 U.S. 218, 226-27 (2001).

without objection into a contract with knowledge of the other party's reasonable interpretation is bound by that reasonable interpretation"); *Robbins Tire*, 462 F.2d at 687 (declining to find ambiguity based on a reading that was unreasonable given the circumstances).

Taxpayer's suggestion (Br. 40) that Treas. Reg. § 1.482-1(g)(3) establishes that the agreement must be construed to allow repayment of the amount overpaid to BSEH without any collateral income tax consequences is unconvincing. The statement authorizing the Commissioner to provide procedures for "repayment of the allocated amount without further income tax consequences," is permissive, allowing relief only to the extent of "such applicable revenue procedures" as may be provided by the Commissioner. And Rev. Proc. 99-32, like the agreement, clearly provides relief that ensures only that the taxpayer will avoid "the Federal income tax consequences of the secondary adjustments that would otherwise result under section 482," not all collateral tax consequences of the treatment agreed to by taxpayer.

Here, where the Commissioner's position was set out in Notices that Price had reviewed, the Tax Court was justified in finding

unpersuasive Price's testimony that he understood taxpayer would be protected from all collateral tax consequences of its agreement. If taxpayer wanted a different result, it should have so stated when it drafted the agreement and provided therein that § 965(b)(3) would not apply. *See* pp. 54-59, *supra.* Given the Commissioner's published Notices, taxpayer's characterization of this case as creating an unfair "'gotcha'" situation is "absurd." (Br. 48.) [16]

D. Concerns regarding tax-relief goals do not warrant reversal

In urging the Court to depart from the agreement's wording, and from what the *amici* concede is a "literal reading" of § 965 by the Tax Court (Am.Br. 26 n.7), taxpayer and the *amici* argue that the Tax Court's opinion disregards tax-relief and economic-stimulus goals. These arguments do not justify reading an ambiguity into either the statute or the closing agreement that simply is not there.

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[16] Neither Price's misunderstanding (Br. 40-43), nor any perception that taxpayer was surprised by the reduction in its § 965 deduction (Br. 46), justifies the Court's relieving taxpayer from the consequences of the agreement that it requested, drafted, and executed. Mistakes of fact or law are not grounds for altering a closing agreement. I.R.C. § 7121(b); *Commissioner v. Ingram,* 87 F.2d 915 (3d Cir. 1937); *Wolverine Petroleum Corp. v. Commissioner*, 75 F.2d 593 (8th Cir. 1935).

Courts have long rejected arguments that equitable concerns warrant disturbing a binding closing agreement. Even where the taxpayer is "sympathetic," such as an unsophisticated individual without counsel, courts have declined to grant relief from closing agreements, weighing the interest in final resolution of matters through closing agreements against equitable concerns. *Hopkins*, 146 F.3d at 733 (9th Cir. 1998); *Wolverine Petroleum,* 75 F.2d at 595; *see also Hering v. Tait*, 65 F.2d 703 (4th Cir. 1933); *Aetna Life Insurance Co. v. Eaton*, 43 F.2d 711 (2d Cir. 1930). Liberally construing § 965 for the sake of achieving a perceived equitable result, or uncodified Congressional goals, likewise is not warranted. "The propriety of a deduction does not turn upon general equitable considerations." *Nat'l Alfalfa*, 417 U.S. at 148-49; *Lettie Page Whitehead Found., Inc. v. United States*, 606 F.2d 534, 539 (5th Cir. 1979) ("deductions are strictly controlled by the code and equity cannot create a deduction."). Rather, deductions are a matter of "legislative grace;" courts strictly construe language granting deductions, and give comprehensive effect to limits on deductions, allowing deductions only to the extent "'there is clear provision therefor.'" *Id.* (quoting *New Colonial Ice*, 292 U.S. at 440).

Accordingly, even if taxpayer's and the *amici*'s contentions regarding adverse economic impact and inequitable results following from the Tax Court's opinion were meritorious, this would not justify disregarding a closing agreement and an express statutory limit on a deduction, or distorting the language of either.

In any event, their arguments regarding the purported adverse effects of the Tax Court's decision are misleading. Because § 965 provided for a one-time deduction in a tax year that already has passed (§ 965(f)), the Tax Court's holding can hardly have a chilling effect on repatriation under the economic stimulus provision. Moreover, the issue presented here will not arise for any corporation that has not engaged in the aggressive transfer-pricing that necessitates the underlying § 482 adjustments.

Those taxpayers facing § 482 adjustments in the same year they claim the § 965 deduction have been offered two generous tax-relief provisions in Rev. Proc. 99-32 and § 965. Companies are free to make a choice, after balancing the tax benefits of a Rev. Proc. 99-32 election against the consequence such treatment has in terms of limiting any

§ 965 deduction they may have claimed.[17] In this balance, the Tax Court's holding is unlikely to "eliminate" the § 965 deduction. (Am.Br. 1.) Here, taxpayer lost only 6 percent of its claimed $603 million § 965 deduction; the remaining 94 percent was allowed. (Doc. 13 at 9-10.) And taxpayer obtained the benefit of relief from secondary tax consequences of over $100 million in § 482 adjustments.

It is true that taxpayers generally will not be able to take full advantage of both Rev. Proc. 99-32 and § 965. And, having chosen Rev. Proc. 99-32 relief, taxpayer cannot also receive its full § 965 deduction, which requires an absence of related-party debt. The law, however, does not grant taxpayer a right to have its cake and eat it too.

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[17] There is nothing "egregious" (Am.Br. 12) in the Commissioner's protectively making anticipated § 965 adjustments, before § 482 adjustments are finally determined and before any Rev. Proc. 99-32 election. Notices of proposed adjustments apprise taxpayers of potential outcomes, and, where there are disputed § 482 adjustments that may take time to resolve, a notice of deficiency may be a necessary protective measure if the limitations period is a factor. But any protective notices do not mean a deficiency will be collected if facts do not evolve to support it. *See Davis v. Commissioner*, 716 F.3d 560, 572 (11th Cir. 2013) (after liability was resolved, related cases involving protective deficiency notices were dismissed in taxpayers' favor).

CONCLUSION

The decision of the Tax Court should be affirmed.

Respectfully submitted,

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STATUTORY ADDENDUM

INTERNAL REVENUE CODE (26 U.S.C.):

§ 482. Allocation of income and deductions among taxpayers

In any case of two or more organizations, trades, or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Secretary may distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among such organizations, trades, or businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organizations, trades, or businesses. In the case of any transfer (or license) of intangible property (within the meaning of section 936(h)(3)(B)), the income with respect to such transfer or license shall be commensurate with the income attributable to the intangible.

§ 965. Temporary dividends received deduction

(a) Deduction.--

(1) In general.--In the case of a corporation which is a United States shareholder and for which the election under this section is in effect for the taxable year, there shall be allowed as a deduction an amount equal to 85 percent of the cash dividends which are received during such taxable year by such shareholder from controlled foreign corporations.

(2) Dividends paid indirectly from controlled foreign corporations.--If, within the taxable year for which the election under this section is in effect, a United States shareholder receives a cash distribution from a controlled foreign corporation which is excluded from gross income under section 959(a), such distribution shall be treated for purposes of this section as a cash dividend to the extent of any amount included in

income by such United States shareholder under section 951(a)(1)(A) as a result of any cash dividend during such taxable year to--

(A) such controlled foreign corporation from another controlled foreign corporation that is in a chain of ownership described in section 958(a), or

(B) any other controlled foreign corporation in such chain of ownership from another controlled foreign corporation in such chain of ownership, but only to the extent of cash distributions described in section 959(b) which are made during such taxable year to the controlled foreign corporation from which such United States shareholder received such distribution.

(b) Limitations.--

(1) In general.--The amount of dividends taken into account under subsection (a) shall not exceed the greater of--

(A) $500,000,000,

(B) the amount shown on the applicable financial statement as earnings permanently reinvested outside the United States, or

(C) in the case of an applicable financial statement which fails to show a specific amount of earnings permanently reinvested outside the United States and which shows a specific amount of tax liability attributable to such earnings, the amount equal to the amount of such liability divided by 0.35.

The amounts described in subparagraphs (B) and (C) shall be treated as being zero if there is no such statement or such statement fails to show a specific amount of such earnings or liability, as the case may be.

(2) Dividends must be extraordinary.--The amount of dividends taken into account under subsection (a) shall not exceed the excess (if any) of--

(A) the cash dividends received during the taxable year by such shareholder from controlled foreign corporations, over

(B) the annual average for the base period years of--

(i) the dividends received during each base period year by such shareholder from controlled foreign corporations,

(ii) the amounts includible in such shareholder's gross income for each base period year under section 951(a)(1)(B) with respect to controlled foreign corporations, and

(iii) the amounts that would have been included for each base period year but for section 959(a) with respect to controlled foreign corporations.

The amount taken into account under clause (iii) for any base period year shall not include any amount which is not includible in gross income by reason of an amount described in clause (ii) with respect to a prior taxable year. Amounts described in subparagraph (B) for any base period year shall be such amounts as shown on the most recent return filed for such year; except that amended returns filed after June 30, 2003, shall not be taken into account.

(3) Reduction of benefit if increase in related party indebtedness.--The amount of dividends which would (but for this paragraph) be taken into account under subsection (a) shall be reduced by the excess (if any) of--

(A) the amount of indebtedness of the controlled foreign corporation to any related person (as defined in section 954(d)(3)) as of the close of the taxable year for which the election under this section is in effect, over

(B) the amount of indebtedness of the controlled foreign corporation to any related person (as so defined) as of the close of October 3, 2004.

All controlled foreign corporations with respect to which the taxpayer is a United States shareholder shall be treated as 1 controlled foreign corporation for purposes of this paragraph. The Secretary may prescribe such regulations as may be necessary or appropriate to prevent the avoidance of the purposes of this paragraph, including regulations which provide that cash dividends shall not be taken into account under subsection (a) to the extent such dividends are attributable to the direct or indirect transfer (including through the use of intervening entities or capital contributions) of cash or other property from a related person (as so defined) to a controlled foreign corporation.

(4) Requirement to invest in United States.--Subsection (a) shall not apply to any dividend received by a United States shareholder unless the amount of the dividend is invested in the United States pursuant to a domestic reinvestment plan which--

(A) is approved by the taxpayer's president, chief executive officer, or comparable official before the payment of such dividend and subsequently approved by the taxpayer's board of directors, management committee, executive committee, or similar body, and

(B) provides for the reinvestment of such dividend in the United States (other than as payment for executive compensation), including as a source for the funding of worker hiring and training, infrastructure, research and development, capital investments, or the financial stabilization of the corporation for the purposes of job retention or creation.

* * *

(f) Election.--The taxpayer may elect to apply this section to--

(1) the taxpayer's last taxable year which begins before the date of the enactment of this section, or

(2) the taxpayer's first taxable year which begins during the 1-year period beginning on such date.

Such election may be made for a taxable year only if made on or before the due date (including extensions) for filing the return of tax for such taxable year.

§ 7121. Closing agreements

(a) Authorization.--The Secretary is authorized to enter into an agreement in writing with any person relating to the liability of such person (or of the person or estate for whom he acts) in respect of any internal revenue tax for any taxable period.

(b) Finality.--If such agreement is approved by the Secretary (within such time as may be stated in such agreement, or later agreed to) such agreement shall be final and conclusive, and, except upon a showing of fraud or malfeasance, or misrepresentation of a material fact--

(1) the case shall not be reopened as to the matters agreed upon or the agreement modified by any officer, employee, or agent of the United States, and

(2) in any suit, action, or proceeding, such agreement, or any determination, assessment, collection, payment, abatement, refund, or credit made in accordance therewith, shall not be annulled, modified, set aside, or disregarded.

TREASURY REGULATIONS (26 C.F.R.):

§ 1.482–1 Allocation of income and deductions among taxpayers.

* * *

(g) Collateral adjustments with respect to allocations under section 482.

* * *

(3) Adjustments to conform accounts to reflect section 482 allocations—

(i) In general. Appropriate adjustments must be made to conform a taxpayer's accounts to reflect allocations made under section 482. Such adjustments may include the treatment of an allocated amount as a dividend or a capital contribution (as appropriate), or, in appropriate cases, pursuant to such applicable revenue procedures as may be provided by the Commissioner (see § 601.601(d)(2) of this chapter), repayment of the allocated amount without further income tax consequences.

(ii) Example. The following example illustrates the principles of this paragraph (g)(3). Example Conforming cash accounts. (i) USD, a United States corporation, buys Product from its foreign parent, FP. In reviewing USD's income tax return, the district director determines that the arm's length price would have increased USD's taxable income by $5 million. The district director accordingly adjusts USD's income to reflect its true taxable income. (ii) To conform its cash accounts to reflect the section 482 allocation made by the district director, USD applies for relief under Rev. Proc. 65–17, 1965–1 C.B. 833 (see § 601.601(d)(2)(ii)(b) of this chapter), to treat the $5 million adjustment as an account receivable from FP, due as of the last day of the year of the transaction, with interest accruing therefrom.

* * *

§ 301.7121–1 Closing agreements.

(a) In general. The Commissioner may enter into a written agreement with any person relating to the liability of such person (or of the person or estate for whom he acts) in respect of any internal revenue tax for any taxable period ending prior or subsequent to the date of such agreement. A closing agreement may be entered into in any case in which there appears to be an advantage in having the case permanently and conclusively closed, or if good and sufficient reasons are shown by the taxpayer for desiring a closing agreement and it is determined by the Commissioner that the United States will sustain no disadvantage through consummation of such an agreement.

(b) Scope of closing agreement—

(1) In general. A closing agreement may be executed even though under the agreement the taxpayer is not liable for any tax for the period to which the agreement relates. There may be a series of closing agreements relating to the tax liability for a single period.

(2) Taxable periods ended prior to date of closing agreement. Closing agreements with respect to taxable periods ended prior to the date of the agreement may relate to the total tax liability of the taxpayer or to one or more separate items affecting the tax liability of the taxpayer, as, for example, the amount of gross income, deduction for losses, depreciation, depletion, the year in which an item of income is to be included in gross income, the year in which an item of loss is to be deducted, or the value of property on a specific date. A closing agreement may also be entered into for the purpose of allowing a deficiency dividend deduction under section 547. In addition, a closing agreement constitutes a determination as defined by section 1313.

(3) Taxable periods ending subsequent to date of closing agreement. Closing agreements with respect to taxable periods ending subsequent to the date of the agreement may relate to one or more separate items affecting the tax liability of the taxpayer.

(4) Illustration. The provisions of this paragraph may be illustrated by the following example:

> Example. A owns 500 shares of stock in the XYZ Corporation which he purchased prior to March 1, 1913. A is considering selling 200 shares of such stock but is uncertain as to the basis of the stock for the purpose of computing gain. Either prior or subsequent to the sale, a closing agreement may be entered into determining the market value of such stock as of March 1, 1913, which represents the basis for determining gain if it exceeds the adjusted basis otherwise determined as of such date. Not only may the closing agreement determine the basis for computing gain on the sale of the 200 shares of stock, but such an agreement may

also determine the basis (unless or until the law is changed to require the use of some other factor to determine basis) of the remaining 300 shares of stock upon which gain will be computed in a subsequent sale.

(c) Finality. A closing agreement which is approved within such time as may be stated in such agreement, or later agreed to, shall be final and conclusive, and, except upon a showing of fraud or malfeasance, or misrepresentation of a material fact:

(1) The case shall not be reopened as to the matters agreed upon or the agreement modified by any officer, employee, or agent of the United States, and

(2) In any suit, action, or proceeding, such agreement, or any determination, assessment, collection, payment, abatement, refund, or credit made in accordance therewith, shall not be annulled, modified, set aside, or disregarded.

However, a closing agreement with respect to a taxable period ending subsequent to the date of the agreement is subject to any change in, or modification of, the law enacted subsequent to the date of the agreement and made applicable to such taxable period, and each closing agreement shall so recite.

* * *

CERTIFICATE OF SERVICE

It is hereby certified that, on this 26th day of March, 2014 that:

- this brief was filed with the Clerk of the United States Court of Appeals for the Fifth Circuit by using the CM/ECF system;
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/s/ ELLEN PAGE DELSOLE
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Case No. 13-60684

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(s) /s/ Ellen Page DelSole

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Dated: March 26, 2014