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October 19, 2018

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Molly C. Dwyer, Clerk of Court
U.S. Court of Appeals for the Ninth Circuit
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Re: *Altera Corp. v. Commissioner*, No. 16-70496 (argued Oct. 16, 2018)
(Thomas, C.J., and Graber and O'Malley, JJ.)

Dear Ms. Dwyer:

At oral argument, the Commissioner stated that “nobody’s arguing” that “evidence of third-party behavior could override [the commensurate-with-income provision’s] periodic adjustment rule.” Oral Arg. Video 10:43. Altera in fact made that argument. Supp. Br. 34; Principal Br. 49, 50-51. The Commissioner further maintained that Treasury need not “allow taxpayers to override [the commensurate-with-income requirement’s] terms by resort to evidence of third-party behavior.” Oral Arg. Video 38:38. During the years at issue, however, the Treasury Regulations applicable to transfers or licenses of intangibles disallowed any commensurate-with-income adjustments if related-party prices were adequately established using comparable uncontrolled transactions (Treas. Reg. § 1.482-4(f)(2)(ii)(A), (B)) or other arm’s-length evidence-based pricing methods (Treas. Reg. § 1.482-4(f)(2)(ii)(C)).

The Commissioner also stated that the “periodic adjustment rule does not reflect what parties do in the real world” (Oral Arg. Video 10:00), but Treas. Reg. § 1.482-4(f)(2)(ii)(B)(2), in considering whether a proposed comparable would foreclose a periodic adjustment, requires examination of whether the comparable has “provisions that would permit [a] change to the amount of consideration, a renegotiation, or a termination of the agreement.” *See also* I.R.S. Notice 88-123, 1988-C.B. 458, 480 (the “White Paper”) (“Requiring periodic adjustments is consistent with the arm’s

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length principle, since unrelated parties generally provide some mechanism to adjust for change in the profitability of transferred intangibles”).

The incompatibility of the Commissioner’s latest arguments with Treasury’s regulations underscores why *Chenery*, *State Farm*, and *Fox Television* do not permit an abandonment of arm’s-length evidence and the parity principle, even if the statute permitted it, without complying with the rules governing administrative procedure. Those requirements guard against agency overreaching by subjecting rulemaking proposals to public scrutiny and facilitating orderly judicial review of an agency’s on-the-record justifications for its actions.

Please distribute this letter to the panel.

Sincerely,

/s/ Donald M. Falk

Donald M. Falk

9th Circuit Case Number(s) 16-70496

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