No. 17-72922

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

AMAZON.COM, INC. AND SUBSIDIARIES,

Petitioners-Appellees

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent-Appellant

ON APPEAL FROM THE DECISION OF THE UNITED STATES TAX COURT

REPLY BRIEF FOR THE APPELLANT

RICHARD E. ZUCKERMAN
Principal Deputy Assistant Attorney General

TRAVIS A. GREAVES
Deputy Assistant Attorney General

GILBERT S. ROTHENBERG **(202) 514-3361**
ARTHUR T. CATTERALL **(202) 514-2937**
JUDITH A. HAGLEY **(202) 514-8126**
Attorneys
Tax Division
Department of Justice
Post Office Box 502
Washington, D.C. 20044

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases: **Page(s)**

Statutes:

Statutes (cont'd): **Page(s)**

Regulations:

Regulations (cont'd): **Page(s)**

Treasury Regulations (26 C.F.R.):

Miscellaneous: **Page(s)**

GLOSSARY

Amazon-LUX	Amazon's affiliated Luxembourg corporations
Amazon-US	Amazon's affiliated U.S. corporations
APA	Administrative Procedure Act
App.	Appendix attached to Amazon-US's answering brief
Br.	Answering brief filed by Amazon-US
CIRBr.	Commissioner's opening brief
CUT	Comparable-uncontrolled-transaction method
Doc.	Docket entries as numbered by the Tax Court
DCF	Discounted-cash-flow method
ER	Excerpts of record filed by the Commissioner
IRS	Internal Revenue Service
Op/ER	Tax Court opinion
R&D	Research and development
SIA-Am.Br.	Brief filed by amici Semiconductor Industry Association and other organizations
SER	Supplemental excerpts of record filed by Amazon-US
Silicon-Valley-Am.Br.	Brief filed by amici Silicon Valley Tax Directors Group and other organizations

INTRODUCTION

This dispute involves the classic case of a U.S. multinational shifting income from its U.S. operations (Amazon-US) to an offshore subsidiary operating in a tax haven (Amazon-LUX). Amazon-US accomplished this tax avoidance by charging an artificially low buy-in payment for the pre-existing intangible property it made available to its cost-sharing arrangement with Amazon-LUX. Exercising his broad discretion under Section 482, the Commissioner determined that the best method for valuing the pre-existing intangibles was a discounted-cash-flow (DCF) method. The Tax Court disagreed, holding that the Commissioner's method violates the relevant Treasury regulations because it (i) includes certain intangibles – "residual business assets" (Op/ER82) – that were not (in the court's view) compensable under those regulations and (ii) values the pre-existing intangibles in part by reference to future cash flows associated with subsequently developed intangibles.

In our opening brief, we demonstrated that the Tax Court's rejection of the Commissioner's DCF method cannot be reconciled with the 1994 and 1995 regulations. Thus, the court effectively nullified

regulations designed to implement Congressional intent (*see* CIRBr.7-13). *E.g.*, Finley, *The TCJA, Tax Court, and Transfer Pricing: Second Time a Charm*, Tax Notes Int'l 1249, 1253 (June 11, 2018) (criticizing *Amazon* decision for (among other things) "tacitly invalidat[ing] key portions of reg. section 1.482-1 and reg. section 1.482-4").

Amazon-US stakes its defense of the Tax Court's decision primarily on the proposition that Treasury and Congress had limited the term "intangibles" for transfer-pricing purposes to those that are "independently transferable" (Br.54). That unsupported proposition conflicts with the plain language of the 1994 regulations, canons of construction, Congressional intent, and regulatory history (including the history of subsequent transfer-pricing rules). Tellingly, Amazon-US grounds its argument on two documents (a notice of proposed rulemaking and a Congressional report, each issued in 1992) that do not even address the definition of intangibles. *See*, below, § A. And, as demonstrated in §§ B-D, Amazon-US's secondary arguments fare no better.

ARGUMENT

A. Amazon-US's contention that compensable intangibles are limited to those that are "independently transferable" is wrong

1. Overview

Section 1.482-4(b) defines the term "intangible" as an asset that –

- "has substantial value independent of the services of any individual," *id.*, and
- "comprises any of" (i) the 28 items specified in paragraph (b)(1) through (5), and (ii) items "similar" to the 28 specified items in that they "derive[ ] [their] value not from [their] physical attributes but from [their] intellectual content or other intangible properties," § 1.482-4(b)(6).

In our opening brief (CIRBr.41-46), we demonstrated that the plain language of § 1.482-4(b) compels the conclusion that residual-business assets – intangible assets that generally are not separable from the business as a whole – fall within the foregoing definition. In response, Amazon-US contends that the definition *excludes* residual-business assets *because* they are "inseparable from a business" (Br.27). Although Amazon-US touches briefly (Br.29-30, 54-55) on the first definitional

requirement listed above, *see*, below, § B, its main argument is that the sentence added to § 1.482-4(b)(6) in 1994 – providing that "an item is considered similar to those listed in paragraph (b)(1) through (5) of this section if it derives its value not from its physical attributes but from its intellectual content or other intangible properties" – does not encompass residual-business assets. But that could only be so if residual-business assets – which indisputably are of a purely intangible nature – had physical attributes from which they derived their value.

Based on the overall tenor of its brief, it appears that what Amazon-US would *like* to argue – rather than arguing that the sentence added to § 1.482-4(b)(6) in 1994 does not mean what it says – is that Treasury lacked the authority to add that sentence in the first place and/or failed to comply with the Administrative Procedure Act (APA) in doing so. But Amazon-US is hamstrung in that regard, as it never once made either of those arguments in the Tax Court. To be sure, Amazon-US touches upon those themes (Br.33, 35-39), but only in support of its argument that Treasury's "interpretation" of the 1994 amendment cannot stand. Thus, Amazon-US argues (Br.33) that accepting Treasury's explanation in the 1994 preamble – *viz.*, that the

amendment to § 1.482-4(b)(6) "clarified" the existing reference to "other similar items" – would "require[ ] this Court to assume that Treasury violated the APA," but it does not ask the Court to hold that the 1994 amendment is procedurally invalid. Amazon-US likewise does not ask the Court to hold that the 1994 amendment impermissibly expanded the statutory definition of "intangible" in Section 936(h)(3)(B);[1] rather, it essentially argues that a regulation whose plain meaning cannot (in its view) be reconciled with the statute must be "interpreted" in a manner that *can* (in its view) be reconciled with the statute. *See* Br.35 (positing that "*any interpretation* of § 1.482-4(b) that exceeds the clear meaning of Section 936(h)(3)(B) *would render* the regulatory definition invalid") (emphasis added).

With the foregoing in mind, we turn to a more comprehensive critique of Amazon-US's primary argument.

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[1] Congress repealed Section 936 in March 2018. P.L. 115-141, § 401(d)(1)(C), 132 Stat. 1206. The definition of intangibles that had been codified at Section 936(h)(3)(B) is now codified at Section 367(d)(4). Section 482 has been amended to reflect this change. 132 Stat. 1207.

2. Plain language of § 1.482-4(b) and related regulations

As mentioned above, Amazon-US's contention (Br.27-30) that § 1.482-4(b) limits compensable intangibles to those that are "independently transferable" conflicts with the plain language of the regulation. *See* CIRBr.41-46. By its terms, § 1.482-4(b) excludes only assets that do not have "substantial value independent of the services of any individual" or that derive their value from "physical attributes." The phrase "independently transferable" – or anything remotely like it – is wholly absent from the regulatory definition.

Amazon-US's attempt to re-write § 1.482-4(b) also conflicts with the plain language of the penalty regulations that apply to tax underpayments related to Section 482. *See* CIRBr.54-55. For purposes of the Section 482 penalty, "[i]ntangible property includes property such as *goodwill* … and any *other* item of intangible property described in § 1.482-4T(b)." 26 C.F.R. § 1.6662-5T(e)(3) (1994) (emphasis added). These regulations make clear that, for purposes of Section 482, "intangibles" include goodwill and are *not* limited to those that are "independently transferable."

Amazon-US dismisses this clear refutation of its argument by noting (Br.34) that § 1.6662-5T defines "intangibles" to include "goodwill" only "for purposes of § 6662(e)'s substantial valuation misstatement penalty – not for purposes of § 482 itself." As Treasury's press release issued with the 1994 transfer-pricing regulations emphasized, however, the "section 482 regulations are inseparable from the section 6662(e) regulations." Treasury Release on Final Section 482 Regulations (July 5, 1994). Amazon-US has not – and cannot – explain why "goodwill" would be an "intangible" for purposes of the Section 482 penalty under Section 6662(e) but would not be an "intangible" for purposes of Section 482 itself. That position is indefensible.[2]

The "made available" language of § 1.482-7A(g) confirms that § 1.482-4(b) does not limit compensable intangibles to those that are "independently transferable." *See* CIRBr.47. Section 1.482-7A(g)(1) provides that "[a] controlled participant that makes intangible property

[2] Amazon-US cites (Br.35) regulations that address intangibles in wholly unrelated contexts. Those regulations shed no light on the meaning of § 1.482-4(b). If anything, one of the corresponding Code sections *supports* the Commissioner's position. *See* Section 861(a)(4) (providing that "good will," "patents," and "copyrights" are all "like property").

available to a qualified cost sharing arrangement *will be treated as having transferred interests in* such property to the other controlled participants" for purposes of the buy-in requirement. (Emphasis added.) Amazon-US does not contend that intangible property cannot be "made available" to a cost-sharing arrangement unless it is independently transferable. Rather, it points to language in § 1.482-7A(a)(2) providing that "[a]n interest in an intangible includes any commercially transferable interest, the benefits of which are susceptible of valuation," and argues that § 1.482-7A(g)(1) therefore must be limited to the situation where an independently transferable interest in intangible property is "made available" to a cost-sharing arrangement. (Br.47-48.) That argument fails for two reasons.

First, that an intangible must be *commercially* transferable does not mean that it must be "*independently* transferable," as Amazon-US contends (Br.32 (emphasis added)). The two terms are not synonymous. An item is commercially transferable if it can be sold or licensed; it need not be sold or licensed as a stand-alone-item but can be sold or licensed as part of a bundle. It is undisputed that growth options and other residual-business assets can be valued and sold. *See* CIRBr.38-40.

That such assets are generally valued and sold only as part of the sale of an entire business (Br.46) does not change the relevant fact that they can be valued and sold.

On a more fundamental level, Amazon-US's reliance on the term "commercially transferable interest" in § 1.482-7A(a)(2) is undermined by its own acknowledgment (Br.48) of the history of that term in the definitional provision of § 1.482-4(b). Specifically, the temporary version of that regulation promulgated in 1993 defined "intangible" as "any commercially transferable interest in" the items set forth in the ensuing six categories (including the "[o]ther similar items" category). Section 1.482-4T(b), 58 Fed. Reg. 5263, 5287 (1993). In the preamble to the 1994 regulations, however, Treasury explained that the "commercially transferable interest" language "was not included in the [final version of the] definition because it was superfluous: if the property was not commercially transferable, then it could not have been transferred in a controlled transaction." 59 Fed. Reg. 34971, 34983 (1994). In other words, Treasury recognized that if a particular type of intangible (as defined in § 1.482-4(b)) could not have been transferred between unrelated parties (*i.e.*, if it was not commercially transferable),

then it could not have been transferred from one related party to another. And that reasoning applies regardless whether the intangible is of a type that is the subject of formal transfers between unrelated parties or, as in the case of cost-sharing arrangements (whether the participants are related or unrelated), is of a type that one of the participants transfers to the other participant(s) in substance by making it available to the cost-sharing arrangement. *See* § 1.482-7A(g)(1).

3. Canons of construction

Recognizing that the plain language of the regulations does not support its "independently transferable" limitation on the definition of intangibles, Amazon-US relies on a statutory canon to prop up its argument (Br.27-29). The canon it selects, however – the "*ejusdem generis*" canon – does not further its cause. That canon provides that where "'general words follow specific words in a statutory enumeration, the general words are construed to embrace only objects similar in nature to those objects enumerated by the preceding specific words.'" *Circuit City Stores, Inc. v. Adams*, 532 U.S. 105, 114-115 (2001) (citation omitted). And, according to Amazon-US (Br.29), "[t]he common

attribute of all 28 specified items [in § 1.482-4(b)(1)-(5)] is that they can be sold independently." But the canon has no application where, as here, the general words ("other similar items") that follow the specific words (the 28 specified intangibles) are themselves followed by specific words ("an item is considered similar to those listed in paragraph (b)(1) through (5) of this section if it derives its value not from its physical attributes but from its intellectual content or other intangible properties"). § 1.482-4(b)(6). Thus, Amazon-US's conception of "the" common attribute of the listed items in § 1.482-4(b)(1)-(5) is irrelevant in light of the clarifying sentence of § 1.482-4(b)(6).

The words carefully chosen by Treasury in that clarifying sentence do not, as Amazon-US contends (Br.28), render the regulatory definition a "meaningless tautology." Rather, they concisely describe an intangible. *Cf.* Black's Law Dictionary 811 (7th ed. 1999) (defining the noun "intangible" as "[s]omething that is not tangible" or "corporeal"). Nor does reading § 1.482-4(b)(6) according to its plain terms eliminate any "reason to specify any particular types of intangibles, let alone list

28 of them" in § 1.482-4(b)(1)-(5) (Br.28).[3] The detailed list provides concrete examples of an otherwise amorphous term. Moreover, even if listing the 28 specific items were "technically unnecessary" given the breadth of § 1.482-4(b)(6), it merely represents "an abundance of caution – a drafting imprecision venerable enough to have left its mark on legal Latin (*ex abundanti cautela*)." *Fort Stewart Sch. v. Fed. Labor Relations Auth.*, 495 U.S. 641, 646 (1990).

Amazon-US's attempt to read the definition of "similar items" out of § 1.482-4(b) violates the more general rule of statutory construction that all terms in a statute (or, as here, a regulation) should be given effect. *See United States v. Alpers*, 338 U.S. 680, 682 (1950) (holding that the "rule of *ejusdem generis* is a useful canon of construction" but it "cannot be employed to render general words meaningless"). In *Clark v. United Emergency Animal Clinic, Inc.*, 390 F.3d 1124 (9th Cir. 2004), this Court rejected a similar attempt to redraft a regulation under the

[3] Amazon-US's argument in this regard might have some force if Treasury had been writing on a clean slate in 1994. But the list of intangibles (and the "other similar items" language) had been in the regulation since 1968. It is therefore not surprising that Treasury chose to clarify the "other similar items" category without jettisoning the entire list of specified intangibles.

guise of the *ejusdem generis* canon. There, the Court held that veterinarians fell within the regulatory exception to federal overtime-wage requirements that applied to "physicians and other practitioners of medical science," *see id.* at 1126-1128, even though veterinarians were not included in the separate list of practitioners that, per the regulation, the "other practitioners" category "may include" (each of which involved the practice of medicine on humans). 29 C.F.R. § 541.314(b)(1) (2002). As the Court explained, veterinarians "plainly" fell within the exception because they practice "medicine," and the fact that the types of practitioners listed elsewhere in the provision all practiced medicine on humans could not supply an additional condition to the exception not found in the language of the exception itself. 390 F.3d at 1127. Amazon-US's independently-transferable limitation suffers from that same flaw.

If Treasury had meant to define "[o]ther similar items" as items that could be "sold independently" (Br.29), it would have done so. By defining "similar items" as broadly as it did, Treasury retained the necessary flexibility to ensure that the benefits of new – or newly described – intangibles, such as growth options, are not transferred for

free. Amazon-US's attempt to graft a "sold independently" limitation onto the definition should be rejected because it would "strip the catchall phrase of independent meaning." *Christopher v. SmithKline Beecham Corp.*, 567 U.S. 142, 163 n.20 (2012).

4. Congressional intent

In our opening brief (CIRBr.51-52, 57-59), we demonstrated that Congress has recognized, and endorsed, the breadth of Treasury's definition of intangibles for transfer-pricing purposes. In response, Amazon-US contends (Br.23) that, "prior to 2017, [Section] 936(h)(3)(B) intangibles were limited to those that are independently transferable." That contention conflicts with the statute's plain language and history.

During the years at issue, Section 936(h)(3)(B) did not refer to intangibles that could be independently transferred; the only limitations it contained were that the asset be "similar" to the listed items and have "substantial value independent of the services of any individual." Those limitations are the same limitations contained in § 1.482-4(b). Section 936(h)(3)(B) did not define "similar," leaving it to Treasury to flesh out the meaning of that term in § 1.482-4(b)(6).

Nothing in the legislative history of Section 936(h)(3)(B) suggests that Congress intended to exclude *sub silentio* residual-business assets. To the contrary, when it enacted Section 936(h)(3)(B) in 1982, Congress cited long-standing published IRS guidance that expressly listed "good will" as an intangible for transfer-pricing purposes. H.R. Rep. No. 97-760, at 505 (1982) (Conf. Rep.) (citing Revenue Procedure 63-10 (discussed in the following section)). In citing this administrative guidance, Congress emphasized that it did "not intend any change in current treatment" and that "Revenue Procedure 63-10 … will continue to apply." *Id*. at 505, 510.

Indeed, Congress's actions two years later confirm that it understood that its broad definition of intangibles in Section 936(h)(3)(B) included goodwill and other residual-business assets. In 1984, Congress substantially revised Section 367, which governs otherwise tax-free corporate transactions involving foreign corporations. By way of brief background, certain transfers of appreciated property to a corporation in exchange for its stock (*e.g.*, upon the formation of the transferee corporation) or in exchange for the stock of the transferor (*e.g.*, upon the liquidation of the transferee corporation's subsidiary) do

not trigger recognition of the taxable gain inherent in the property. *See generally* Sections 351(a), 337(a), 332. Section 367 is an exception to the tax-free treatment of such transfers and generally requires a U.S. transferor to recognize gain on the exchange when the transferee is a foreign corporation.

The 1984 amendments to Section 367 introduced different rules for different types of property. New Section 367(a)(3)(A) provided an exception to the general gain-recognition rule of Section 367(a)(1) in the case of property transferred to a foreign corporation for use in that corporation's trade or business outside the United States. That rule was itself subject to exceptions, including one in the form of a "foreign-branch-loss recapture rule" that could apply when a U.S. business operating in a foreign country through an unincorporated branch office effected a transfer of its foreign branch assets to a foreign corporation (in exchange for stock) by incorporating the foreign branch under the foreign country's laws. *See* 26 U.S.C. § 367(a)(3)(C) (2012). And new Section 367(d) provided a special gain-recognition rule for "transfers [of] any intangible property (within the meaning of section 936(h)(3)(B)) to a

foreign corporation" in exchange for stock, even if the property was to be used in the foreign corporation's trade or business.

In the legislative history of the 1984 amendments to Section 367, Congress suggested that Treasury consider promulgating an exception to Section 367(d) for transfers of certain intangibles "developed by a foreign branch." H.R. Rep. No. 98-432(II), at 1317, 1320 (1984). As the Joint Committee on Taxation explained, "it is expected that regulations … will provide exceptions [to Section 367(d)] for" the "transfer of goodwill, going concern value, or marketing intangibles (such as trademarks or trade names) developed by a foreign branch to a foreign corporation" (*i.e.*, upon a U.S. business's incorporation of its foreign branch). *General Explanation of the Revenue Provisions of the Deficit Reduction Act of 1984*, JCS-41-84, at 435 (1984). On the other hand, Congress determined that "transfers [to a foreign corporation] of goodwill, going concern value, and marketing intangibles developed by a [U.S. business's] foreign branch" (*i.e.*, upon incorporation of the foreign branch) *should* be subject to tax (under new Section 367(a)(3)(C)) when the foreign branch previously operated at a loss. *Id.*

at 434. Thus, Congress recognized that residual-business assets such as goodwill were, like trademarks, Section 936(h)(3)(B) intangibles.

Consistent with that history, Treasury issued regulations that included an exception to Section 367(d) for foreign goodwill and going concern value developed by foreign branches (while providing that such items were subject to the branch-loss recapture rule, *see*, below, n.6). 51 Fed. Reg. 17936 (1986).[4] First, the regulations defined "intangible property" ("[f]or purposes of section 367 and regulations thereunder") by reference to Section 936(h)(3)(B) and identified "foreign goodwill or going concern value" as a subset of such property. 26 C.F.R. § 1.367(a)-1T(d)(5)(i), (iii) (1986). And the aforementioned exception to Section 367(d) provided:

> Section 367(d) and the rules of this section shall apply to the transfer of any intangible property, as defined in § 1.367(a)-1T(d)(5)(i). However, section 367(d) and the rules of this section shall not apply to the transfer of foreign goodwill or going concern value, as defined in § 1.367(a)-1T(d)(5)(iii)…

26 C.F.R. § 1.367(d)-1T(b) (1986); *cf.* 26 C.F.R. § 1.367(a)-5T(e) (1986) (providing that certain liquidating distributions of "intangible property"

[4] In 2016, Treasury eliminated this exception because of taxpayer abuse. *See* 81 Fed. Reg. 91012 (2016).

by a U.S. corporation to its foreign parent "shall be subject to section 367(a)(1), unless it constitutes foreign goodwill or going concern value, as defined in § 1.367(a)-1T(d)(5)(iii)").[5] These regulations confirm that "goodwill" and "going concern value" are Section 936(h)(3)(B) intangibles, thus necessitating an explicit carve-out for "foreign goodwill or going concern value" from rules that otherwise would apply to those items because they are "intangible property."[6]

As the above description of Section 367(d) and the related regulations illustrates, the "1984 amendments to § 367" do *not* "confirm that Congress understood intangibles such as goodwill to fall outside the scope of § 936(h)(3)(B)" (Br.23). Amazon-US nonetheless contends

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[5] Section 367(a) no longer applies to the liquidation of a U.S. corporation into its foreign parent. *See* § 1.367(e)-2(a)(2).

[6] Amazon-US's attempt to explain away these regulations (Br.38 n.9) is thoroughly unconvincing. In particular, Amazon-US's argument that Treasury "*had to* include foreign goodwill and going concern value" under the rubric of Section 936(h)(3)(B) intangibles in the Section 367 regulations to account for the fact that Congress had subjected foreign goodwill and going concern value to the branch-loss recapture rule of Section 367(a)(3)(C), *id.* (emphasis added), is refuted by the regulations themselves. *See* 26 C.F.R. §§ 1.367(a)-6T(b)(1) (loss-recapture rule applies to "transfers [of] *any* assets of a foreign branch to a foreign corporation" in an otherwise tax-free exchange) (emphasis added), 1.367(a)-6T(c)(3) (providing that "foreign goodwill and going concern value" are "assets of a foreign branch") (1986).

(Br.37) that if Section 936(h)(3)(B) included "intangibles inseparable from a business," then there would have been no need to tax transfers of foreign goodwill and going concern value under the branch-loss recapture rule of Section 367(a)(3)(C), since those items "would have *always* been taxed under § 367(d) when transferred along with an entire business." But the same can be said of *any* Section 936(h)(3)(B) intangible. Thus, under Amazon-US's reasoning, patents are not Section 936(h)(3)(B) intangibles: if Section 936(h)(3)(B) included patents, then there would have been no need to tax transfers of patents under the branch-loss recapture rule of Section 367(a)(3)(C), since those items would have always been taxed under § 367(d) (including when transferred along with an entire business).[7]

Similarly irrelevant is the fact that the history of Section 367(d) describes a different abuse engaged in by related parties – the distortion that occurs when a U.S. corporation claims extensive

[7] Section 367(a)(3)(C) results in immediate gain recognition, whereas Section 367(d) gain is recognized over time. *See* Section 367(d)(2); § 1.367(d)-1T(g)(3) (1986) (accounting for the overlap of Sections 367(a)(3)(C) and 367(d) that exists with respect to Section 936(h)(3)(B) intangibles other than foreign goodwill and going concern value).

deductions for the creation of "manufacturing intangibles" and then transfers those intangibles to a foreign subsidiary in a tax-free transaction when they are "ready for profitable exploitation," JCS-41-84, at 427-428 – than the abuse at issue here (Br.38-39). That history cannot limit Section 482's broader purpose. Section 482 is concerned with *any* distortion of income, not just those resulting from mismatches of deductions and associated income. It is no less a distortion of income when a U.S. corporation provides a foreign subsidiary access to its intangibles "for free" (ER693) instead of requiring an arm's-length charge.

Finally, Amazon-US's attempt to dismiss the significance of the 2017 amendments to Section 936 (Br.40-41) is unavailing. As we explained (CIRBr.57-59), Congress codified Treasury's interpretation of intangibles for transfer-pricing purposes because it had been rejected by the Tax Court in the proceeding below and in an earlier Tax Court case (*Veritas Software Corp. v. Commissioner*, 133 T.C. 297 (2009), *nonacq.*, 2010-49 I.R.B. (Dec. 6, 2010)). Amazon-US downplays the fact that the Joint Committee on Taxation expressly concluded that this amendment merely "clarified" prior law (Br.41), but, as its amicus acknowledges

(SIA-Am.Br.11-12), that Committee "maintains close oversight of Treasury rules." In any event, the Conference Report likewise concluded that the 2017 amendment "does not modify the basic approach of the existing transfer pricing rules with regard to income from intangible property." H.R. Rep. No. 115-466, at 661 (2017). That conclusion would make no sense if, as Amazon-US contends, the "existing" rules were limited to intangibles that could be transferred independently.

Far from indicating that it had decided to dramatically change the long-standing definition of "intangibles" in Section 936, Congress instead emphasized that it was acting in response to the Tax Court decisions in *Veritas* and *Amazon*. H.R. Rep. No. 115-466, at 661 & n.1552. That Congress was forced to act to resolve a "dispute" that arose between a court and an agency, rather than a "division among courts" (Br.40), does not change the fact that Congress intended to clarify, rather than change, the existing law. As this Court has explained, the "mere fact of an amendment itself does not indicate that the legislature intended to change a law. … Judicial *and executive* interpretations of the original act should also be considered." *Callejas*

v. McMahon, 750 F.2d 729, 731 (9th Cir. 1985) (emphasis added). Treasury had interpreted Sections 482 and 936(h)(3)(B) as applying to residual-business assets, and Congress codified that interpretation to eliminate future disputes. Congress did not intend its 2017 amendments to question "the authority of the Secretary to provide by regulation for such application with respect to taxable years beginning before" the amendment's effective date. H.R. Rep. No. 115-466, at 662.

5. Regulatory history

Because the "language of the regulation is clear," the Court need not consider § 1.482-4(b)(6)'s "regulatory history." *Lockheed Corp. v. Widnall*, 113 F.3d 1225, 1227 (Fed. Cir. 1997). Nevertheless, we address that history to demonstrate that it does *not* "confirm[ ] that the regulatory definition is limited to independently transferable intangibles" (Br.31).

a. Amazon-US cites no regulatory preamble, published guidance, or any other document in which Treasury endorsed Amazon-US's position (Br.31) that there is an "independently transferable" limitation in the regulations. And it ignores much of the history leading up to the 1994 regulations that undermines its claim. *See* CIRBr.50-56. Indeed,

Treasury's earliest published guidance is to the contrary. In Revenue Procedure 63-10 (which addressed how Section 482 should apply to U.S. companies and their Puerto Rican affiliates), Treasury emphasized the breadth of "intangibles" in transfer-pricing cases: "Intangibles for this purpose include property or rights, such as patents, trademarks, trade names, etc., as well as items such as market position and *consumer acceptance*, flowing from guaranty and warranty practices, distribution and servicing organizations, advertising, etc., and *similar factors in the nature of good will*." Rev. Proc. 63-10, 1963-1 C.B. 490, § 4.01 (emphasis added).[8] Thus, Treasury's earliest published transfer-pricing guidance regarding intangibles (endorsed by Congress in 1982, H.R. Rep. No. 97-760, at 505, 510) expressly included items that may not be independently transferable, such as "good will" and "consumer acceptance."

Likewise, Treasury's subsequent regulations did not include Amazon-US's "independently transferable" qualifier in the definition of intangible. *See* 26 C.F.R. § 1.482-2(d)(3) (1968); 26 C.F.R. § 1.482-4T(b)

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[8] The IRS subsequently noted in internal guidance that Revenue Procedure 63-10's location-savings ruling had been rendered obsolete. *See* 1997 IRS Field Service Advisory, 1997 WL 33314154.

(1993). As a leading tax commentator recognized when the 1968 regulations were first promulgated, "the definition of intangibles [in the 1968 regulations] is still extremely broad, including practically everything that can not be seen and touched, save thin air." Eustice, *Affiliated Corporations Revisited: Recent Developments Under Sections 482 and 367*, 24 Tax L. Rev. 101, 110 (1968).

Even before it clarified the breadth of the term "intangible" by amplifying the term "similar items" in the 1994 regulations, Treasury argued that "intangibles" should be understood expansively in the transfer-pricing context and should not be limited to items (such as patents) that are traditionally considered intellectual property. For example, in *Hospital Corp. of America v. Commissioner*, 81 T.C. 520, 599-600 (1983), the Commissioner argued, and the Tax Court held, that an allocation was proper under the 1968 transfer-pricing regulations for "experience" and "expertise" that the U.S. parent "ma[d]e available" to its foreign subsidiary. Those intangibles – like growth options – are not

bought and sold independently but must nevertheless be paid for when made available to a related party.[9]

b. Ignoring Treasury's long-standing interpretation that intangibles included items such as "good will," Rev. Proc. 63-10, and "experience," *Hospital Corp.*, Amazon-US instead relies (Br.3, 10, 31) on (i) Treasury's preamble to the 1992 proposed regulations, and (ii) a 1992 report the IRS provided to Congress. Citing these two documents, Amazon-US contends (Br.31, 33) that Treasury "made clear" in the preamble to the 1992 regulations "that intangibles inseparable from a business fell outside the definition," and that the IRS "so advised Congress" in the 1992 report. That contention is incorrect. Neither document addresses the definition of intangibles, let alone purports to limit intangibles to those that are "independently transferable."

The preamble to the 1992 proposed regulations describes comments that Treasury had received in response to its 1988 comprehensive transfer-pricing study. 57 Fed. Reg. 3571, 3572 (1992). Those comments questioned (among other things) whether participants

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[9] The IRS issued a "nonacquiescence" with respect to this decision based on its disagreement with other aspects of the court's opinion. *See* A.O.D. 1987-22, 1987 WL 430248.

in a cost-sharing arrangement should have to make a buy-in "payment equal to the going concern value of [another] participant's research facility," instead of "shar[ing] only costs." (App2.) In the 1992 preamble, Treasury acknowledged that these comments raised concerns about the buy-in requirement, "including whether going concern value should be included" in the requirement, and that all of the suggestions "were taken into account in developing sec. 1.482-2(g)." 57 Fed. Reg. at 3572. Thus, far from "ma[king] clear…that intangibles inseparable from a business fell outside the definition" of "intangible" (Br.33), the preamble does not even mention the definition (other than to note that there *is* a definition, *id*.).

Nor does the 1992 report to Congress mention the definition of intangibles. Rather, IRS advised Congress that the 1992 proposed regulations did not require compensation to the U.S. parent for the "going concern value of its research operations under the buy-in provisions." IRS Report on Application & Administration of Section 482, 92 Tax Notes 77-19 at 32 (Apr. 10, 1992). But declining to require the U.S. parent to adjust the valuation of its research operations that it makes available to the arrangement to reflect any going concern value

associated with those operations is hardly the same as excluding going concern value – and all other residual-business assets – altogether from the regulatory definition of intangibles. In suggesting to the contrary (Br.31), Amazon-US misreads the regulatory history.

At most, these 1992 statements evidence uncertainty over the scope of the buy-in requirement, and whether there should be safe-harbor valuation methods for certain intangibles, not ambivalence regarding the definition of intangible. Any uncertainty regarding the buy-in requirement was resolved in the final 1995 regulations, which make clear that there are no "safe harbor" methods for valuing intangibles under the buy-in requirement and that compensation must be provided for *all* § 1.482-4(b) intangibles made available to a cost-sharing arrangement. 60 Fed. Reg. 65553, 65556 (1995). And by rejecting safe-harbor valuation methods, Treasury implemented Congressional intent. *See* H.R. Rep. No. 99-426, at 425 (1985) (rejecting "safe-harbor minimum payment[s] for related party intangible transfers").

c. That Treasury amplified the term "similar items" in 1994 does not mean that Treasury changed the definition of "intangible," as

Amazon-US contends (Br.31-33); it merely clarified the existing definition, as Treasury explained (CIRBr.53-54). Amazon-US argues (Br.31) that Treasury's 1994 revision cannot be a clarification because (in its view) there was no prior "ambiguity." That argument, however, is premised on the incorrect assertion that, prior to the 1994 regulations, Treasury had "expressly stated" (Br.31) that "going concern value" was not an "intangible." As explained above, the 1992 preamble and report that Amazon-US cites contain no such statement.

Moreover, in denying that there was an ambiguity, Amazon-US overlooks the fact that shortly before the 1992-1995 overhaul of the Section 482 regulations, a court rejected Treasury's interpretation of intangibles, ruling that intangibles were limited to "enforceable property right[s]." *Merck & Co. v. United States*, 24 Cl. Ct. 73, 87 (1991). That decision cast doubt on Treasury's long-standing interpretation that the definition of intangibles extended to more than enforceable intellectual property rights. *E.g.*, Rev. Proc. 63-10; *Hosp. Corp.*, 81 T.C. at 599-600. To resolve any ambiguity, Treasury clarified the definition of intangibles in the 1994 regulations by broadly defining "similar items" in § 1.482-4(b)(6) so as to make clear that – contrary to

the ruling in *Merck* – "intangibles" included items that were not normally considered intellectual property. *See* 57 Fed. Reg. at 3578 (noting adverse *Merck* decision); 59 Fed. Reg. at 34983 (noting "clarifi[cation]" provided by definition of "similar items").[10]

d. Finally, Amazon-US contends (Br.23) that, if the definition of intangibles in the 1994 regulations includes growth options and other residual-business assets, then this Court would have to "assume[ ] that Treasury violated the [APA] by making a significant change without offering any explanation for that change or responding to comments that objected to it." As explained above (at pp. 4-5), Amazon-US does not ask the Court to hold that the 1994 amendment to § 1.482-4(b)(6) is procedurally invalid; rather, it obliquely references the APA only in support of its argument that Treasury's "interpretation" (of the plain language) of the 1994 amendment cannot stand. In any event, Amazon-US's newly minted APA argument is infirm.

First, Amazon-US failed to preserve any APA argument. In the Tax Court proceedings, the Commissioner argued that § 1.482-4(b)'s

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[10] Indeed, the Comments attached to Amazon-US's brief urged Treasury to "clarify" the definition of intangibles in response to *Merck*. (App17-18.)

definition of intangibles included growth options, goodwill, and other residual-business assets (Doc.218, Pre-Trial Memorandum 34-35; ER808-830). In response, Amazon-US spent dozens of pages disputing the Commissioner's definitional argument. (Doc.219, Pre-Trial Memorandum 4, 10, 59, 67-70, 153-176; Doc.388, Post-Trial Br. 239-243; Doc.389, Post-Trial Reply Br. 67-77.) It never once, however, argued in the alternative that Treasury violated the APA in promulgating the 1994 amendment to § 1.482-4(b)(6). Accordingly, even if Amazon-US had directly argued in its appellate brief that Treasury violated the APA, any such argument would not have been preserved for appeal. *See Gieg v. DDR, Inc.*, 407 F.3d 1038, 1046 n.10 (9th Cir. 2005) (holding that appellees had waived argument not raised below).

Moreover, Amazon-US's subjunctive APA argument is predicated on the false assumption (Br.33) that amplifying the term "other similar items" in § 1.482-4(b)(6) to make clear that it includes residual-business assets was a "major change." That is incorrect. As explained in our opening brief (CIRBr.50-53) and further demonstrated above, Treasury's Section 482 regulations have never carved out any type of intangible – other than those that do not have substantial value

independent of the services of any individual – from the scope of the definition. The 1994 regulations clarified the definition of intangibles by defining "similar items," but did not change its meaning. *See Public Lands Council v. Babbitt*, 529 U.S. 728, 743 (2000) (accepting Solicitor General's assertion that "definitional changes" "'merely clarif[ied] the regulations'") (citation omitted).

6. Subsequent transfer-pricing regulations

Amazon-US fares no better by citing the history of subsequent transfer-pricing regulations. In fact, "Treasury's more recent actions" belie Amazon-US's claim that the 1994 "regulatory definition was limited to independently transferable intangibles" (Br.33-34). In 2005 – before Amazon-US had fully implemented its IP Migration Project and before it had filed its first tax return reporting Amazon-LUX's buy-in payment – Treasury rejected the cramped interpretation of its regulations promoted by taxpayers like Amazon-US and its amici, emphasizing in the preamble to the 2005 proposed regulations that "an existing research team" constitutes "intangible property within the meaning of § 1.482-4(b) and section 936(h)(3)(B)." 70 Fed. Reg. 51116, 51120 (2005). Although the regulations proposed in 2005, made

temporary in 2009, and finalized in 2011 introduced new "concept[s]" in order "to ensure" that participants in a cost-sharing arrangement pay arm's-length consideration for contributions to the arrangement by other participants, *id.* at 51119, those concepts were grounded in the same legislative history that undergirds the regulations at issue in this appeal. *Id.* at 51117 (quoting H.R. Rep. No. 99-841, at II-638 (1986)); *see* CIRBr.12.

Amazon-US's contention that the new concepts in the 2009 regulations represent a "[sea] change" (Br.43-44) regarding the meaning of intangible is incorrect. The 2009 regulations were designed to counter taxpayer intransigence under the earlier regulations. As Treasury explained when it proposed the regulations in 2005, the new regulations were promulgated to "dispel the misconception that cost sharing is a safe harbor," and were designed to "improve compliance" with – not alter the substance of – the existing rules. 70 Fed. Reg. at 51116, 51128; *see* Collins, Sotos, and Mullaney, *Revisiting Certain Fundamentals in Light of the New Wave of Outbound Reorganization Guidance*, Tax Mgmt. Int'l J. (Bloomberg BNA) (January 11, 2013) (observing that "the Service has previously, and consistently, expressed

the view that GGCV [*i.e.*, goodwill and going concern value] is generally described in § 936(h)(3)(B)"); Calianno & Dokko, *Foreign Goodwill & Going-Concern Value*, Corporate Taxation, 2017 WL 3635344, at *4 (2017) (recognizing the "historical position of the IRS and Treasury that foreign goodwill and going-concern value is a Section 936(h)(3)(B) intangible" but that "some taxpayers, practitioners,[11] and courts have taken the view that it is not").

Similarly lacking merit is Amazon-US's contention that the Commissioner's expert acknowledged that the 2009 regulations "effected a '[sea] change' in the transfer pricing rules" (Br.5 (alteration in original)). Rather, he testified about the "[sea] change in the profession," which he described as the transfer-pricing community's growing recognition that the "specified methods" for valuing intangibles, such as the "CUT" method applied by the Tax Court here, failed to capture "the full value of the preexisting intangibles." (SER11.)

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[11] Such practitioners include Amazon-US's amici and the authors it describes as "scholarly" (Br.43 n.10).

That the preamble to the 2009 temporary regulations notes the "commentators' view" that "workforce, goodwill or going concern value … do not constitute intangibles" (Br.14) does not mean that Treasury endorsed that view. 74 Fed. Reg. 340, 342 (2009). Treasury did not. Rather, it stated that, under the new regulations, such items must be paid for regardless of whether they are "defined in section 936(h)(3)(B)." *Id.* But, in decoupling the buy-in requirement from the definition of "intangible," Treasury emphasized that the new regulations were promulgated "without any inference concerning" the scope of Section 936(h)(3)(B). *Id.* In other words, the goal of the 2009 regulations was to moot the debate regarding the scope of intangibles by making clear that *all things valuable* made available to a cost-sharing arrangement had to be paid for one way or another, no matter what one called them.

B. Growth options and other workforce-related intangibles have substantial value independent of the services of any individual

In our opening brief (CIRBr.43-44), we demonstrated that the value of Amazon-US's growth options and other residual-business assets captured by Frisch's DCF method is independent of the services of any individual. In response, Amazon-US contends (Br.30) that those

items cannot have value independent of the services of any individual because they relate to Amazon-US's "workforce." That contention misses the mark.

Several of the listed intangibles (such as "know-how," § 1.482-4(b)(1)) also relate to Amazon-US's workforce, but are nevertheless intangibles that Treasury recognized can have value independent of the services of any individual. Indeed, Congress implicitly rejected Amazon-US's argument when it amended former Section 936(h)(3)(B) and listed "workforce in place" as an intangible the value of which "is not attributable to … the services of any individual." Section 367(d)(4)(F)&(G).

Moreover, that an intangible may be "inseparable from" the services of individuals (Br.30) does not mean that the intangible's value cannot be separated from the value of those services. It can. The purpose of defining an intangible as having value independent of the services of any individual is to prevent double compensation for a single item of value as both a service and an intangible. The mechanics of Frisch's DCF methodology prevents such double-counting. *See* CIRBr.23-25, 70-73. Frisch eliminated the value of the services of

Amazon-US's employees by subtracting from his computations Amazon-LUX's share of Amazon-US's projected intangible-development costs, which include the salaries paid to Amazon-US employees. (ER378.) After subtracting those projected cost-sharing payments (along with Amazon-LUX's other contributions), the remaining discounted value is attributable to Amazon-US's pre-existing intangibles, including its growth options and workforce-in-place.

For this same reason, Amazon-US's contention that Amazon-LUX will pay for these workforce-related intangibles through its on-going cost-sharing payments (Br.51-52) is incorrect. Those payments compensate Amazon-US for the services provided by its individual researchers by paying a portion of their salaries. But the intangible value of the assembled research team itself that is captured by the DCF valuation is *net* of the salaries paid to the individual researchers. The salary of each individual researcher measures the value of the individual employee's services; the value of the research-team intangibles reflects the *additional value* that the team has as a whole and synergistically in combination with other intangibles, such as in-process projects that the team has been working on and related know-

how.[12] Amazon-US's cramped definition of intangibles (endorsed by the Tax Court) allowed Amazon-LUX to obtain the greater intangible value – over and above the value of the services – "for free." (ER690, 693.)

Amazon-US's related contention (Br.52-53) that Amazon-LUX need not pay for a "business opportunity" is a red herring; we have never argued that it must. The DCF method does not value the "opportunity" to expand in Europe. Rather, it values Amazon-US's *assets* made available to Amazon-LUX so that it could expand in Europe. (ER752.)

C. Amazon-US's arguments regarding the realistic-alternatives principle lack merit

In our opening brief, we demonstrated that the Tax Court's rejection of the DCF method conflicts with the realistic-alternatives principle codified in § 1.482-1(f)(2)(ii). *See* CIRBr.65-70. In response, Amazon-US primarily replicates the court's analysis (Br.58-61). We address only Amazon-US's additional errors.

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[12] Even the tax practitioners cited by Amazon-US – while wrong on other points – acknowledge that "definitionally, any value attributable to workforce-in-place … should be independent of the services performed by the individuals." N.Y. State Bar Ass'n Tax Section, *Report on Section 367(d)*, at 55 n.78 (Oct. 12, 2010).

Amazon-US contends (Br.60) that the "2009 temporary regulations were the first to require taxpayers to consider realistic alternatives to cost-sharing." That is incorrect. The 1995 regulations expressly incorporated in the buy-in requirement the realistic-alternatives principle codified in §§ 1.482-1(f) and 1.482-4(d). § 1.482-7A(g)(2) (incorporating §§ 1.482-1 and 1.482-4). Long before the 2009 regulations, the IRS emphasized that the realistic-alternatives principle, codified in the 1994 regulations and incorporated by reference in the 1995 regulations, was "central to the arm's length standard and the traditional notion of comparability." 58 Fed. Reg. at 5267.

That the realistic-alternatives examples provided in the 1994 regulations (§§ 1.482-1(f)(2)(ii)(B), 1.482-4(d)(2)) do not involve a cost-sharing fact pattern (Br.59) does not mean that those regulations – expressly incorporated into the 1995 cost-sharing regulations – do not apply in the cost-sharing context. Indeed, the absence of cost-sharing examples in the CUT regulations, *see* § 1.482-4(c)(4), did not stop Amazon-US (or the Tax Court) from applying the CUT valuation method in the cost-sharing context.

In addition to misconstruing the regulations, Amazon-US also misconstrues the Commissioner's realistic-alternatives analysis. That analysis did not determine "the value Amazon would obtain by selling its European business" (Br.60 n.15); rather it determined the value Amazon-US would obtain if it "instead continued to operate the business" (Op/ER83; ER363-364), as noted in our opening brief (CIRBr.26). That analysis is fully compliant with the regulations. *See* § 1.482-4(d)(2)(ii) (example).

Finally, Amazon-US contends that the realistic-alternatives principle is inapposite because Amazon-LUX is a "co-developer," not just a "user," of the "intangibles at issue" (Br.59). That is incorrect. The "intangibles at issue" for the buy-in payment are the pre-existing intangibles; Amazon-LUX is *not* a "co-developer" (Br.59) of those intangibles, which were developed solely by Amazon-US during 1995-2004. During that time period, Amazon-US made enormous investments in the development of, and was exposed to great risks regarding, its intangibles, including residual-business assets. (ER501, 506.) *See* CIRBr.14-15. Amazon-US must be fairly compensated for that prior "investment" and "risk" before its arrangement with Amazon-

LUX can qualify for cost-sharing treatment under § 1.482-7A. H.R. Rep. No. 99-841, at II-638.[13]

D. Amazon-US has failed to refute our argument that the Commissioner's DCF method correctly isolates the value of the pre-existing intangibles

We argued in our opening brief (CIRBr.59-76) that the Tax Court improperly rejected the DCF method for valuing the pre-existing intangibles by reference to cash flows expected to result, in part, from subsequently developed intangibles. As we explained (CIRBr.60-62), existing and future intangibles are not wholly independent; because the former indisputably contribute to the development of the latter, it necessarily follows that the projected value of the subsequently developed intangibles is attributable to both pre-existing intangibles and future cost-sharing payments. The DCF method is designed to isolate the value attributable to the pre-existing intangibles (which

[13] One amicus (Silicon-Valley-Am.Br.22-23) contends that the Commissioner's realistic-alternatives analysis fails to account for the different risk profiles as between cost-sharing and licensing. That is incorrect. The risk that Amazon-LUX takes on is reflected in the 18% expected return on its cost-sharing payments allocated to it by the DCF method for purposes of determining the buy-in payment, and in the corresponding reduction – *vis-à-vis* a reduced buy-in payment – of Amazon-US's expected return. (ER365-368.)

belongs to Amazon-US) from the value attributable to the cost-sharing payments (which belongs to Amazon-LUX). *See* CIRBr.70-74.

Amazon-US does not dispute our argument that pre-existing and subsequent intangibles are related but contends that the Tax Court recognized the "relationship" between these intangibles in its "CUT analysis" (Br.56). That would not, however, rectify the error in the court's analysis of the DCF method.

Nor can Amazon-US prop up the Tax Court's error in this regard based on the court's "factual findings" (Br.57). That much of Amazon-US's "old technology was completely replaced" (Br.58) does not change the undisputed fact (CIRBr.61-62) that its pre-existing innovative culture and R&D workforce-in-place intangibles contribute to the development of new intangibles (technology-related and otherwise). Amazon-US's only response is to repeat its erroneous legal argument that "such residual business assets are outside the scope of the regulatory definition of preexisting intangibles" (Br.58).

Amazon-US also repeats the Tax Court's error that the DCF method "attributed *virtually all* future value to [pre-existing] intangibles" (Br.57). That contention is wrong for the reasons explained

in our opening brief (CIRBr.70-76). Those reasons bear repeating, however, especially since the amici echo this error (Silicon-Valley-Am.Br.11-12). This erroneous view ignores that much of the future value redounds to the benefit of Amazon-LUX through the reduction of its required buy-in payment by an expected 18% return on all of its contributions, including its share of intangible-development costs. (ER561, 761.) In addition, Amazon-LUX is the sole beneficiary of future value in excess of Frisch's projections. (ER759-760.) Amazon-US obscures the import of this latter point by mischaracterizing Frisch's projections. His projections did not assume that Amazon-US would continue to "grow commensurate with its past performance" (Br.57); indeed, they assumed the contrary. Although the European Business's past growth supported management's projected future growth rates of 23-31%, Frisch – to be "conservative" (Op/ER74 & n.15) – assumed that its annual growth rate during 2012-2024 (the bulk of the DCF computations) would be only 3.8%. (ER377-378.) Whenever the European Business grows more than 3.8% annually, that excess value redounds solely to the benefit of Amazon-LUX. (ER741-744.)

Nor did Frisch allocate "virtually all of the value of future [product] developments" (Br.57) to Amazon-US. Rather, he allocated only such value as was expected in 2005 (and thus partially attributable to the intangibles then in existence (ER709, 751-752)), and only that portion of the value that remained after first subtracting Amazon-LUX's contributions from the future cash flows (thus giving those contributions an expected 18% return). *See* CIRBr.71-72. Amazon-US's contention (Br.57) that the substantial value so allocated to it under Frisch's method is necessarily "attributable to the technology Amazon used to sell its first book in 1995" is doubly wrong: the relevant technology is that existing in 2005, and the main value-driver is Amazon-US's growth options – in particular, its relentless product innovation – not its technology.

That the DCF method computes a present value of the pre-existing intangibles by reference to net future cash flows does not mean that the Commissioner is "reallocat[ing] *future income* to pre-existing intangibles" (Br.61). Rather, he is only determining the arm's-length price of the required initial buy-in through a valuation method (permitted by the regulations) that determines *current value* based on

expected *future cash flows*. *See* § 1.482-4(d)(1)&(2) (illustrating method that determines present value of intangibles based on expected future profits attributable to those intangibles), incorporated by reference in § 1.482-7A(g)'s buy-in requirement. *All* future income generated by the European Business belongs to Amazon-LUX; *none* will be reallocated to Amazon-US. But the price for obtaining that income stream includes an arm's-length buy-in payment to compensate Amazon-US "up front" for the portion of the projected cash flows attributable to its pre-existing intangibles.

What Amazon-US and the amici would have this Court ignore is that the regulations allow Amazon-LUX to be treated as a "co-owner" of the subsequently developed intangibles (Br.62; *e.g.*, Silicon-Valley-Am.Br.8-10) if – and *only if* – it first pays an arm's-length amount for the pre-existing intangibles. Moreover, Amazon-US erroneously states (Br.62) that Frisch's method "affords [Amazon-LUX] an expected return of $0 from cost sharing, because [that method] requires [Amazon-LUX] to pay Amazon[-US] the full present value of all expected future cash flows." Again, the projected future cash flows that determine the amount of the buy-in payment to Amazon-US are *reduced* by Amazon-

LUX's projected cost-sharing payments, which has the effect of providing Amazon-LUX an expected 18% return on those payments. *See* CIRBr.70-76.

Finally, we have not "mischaracterize[d] [Amazon-LUX's] return under the Frisch-DCF" (Br.62). As noted in our opening brief (CIRBr.24), the projected return that Frisch utilized was the market rate of return (18%) that an unrelated party would have expected to earn on its cost-sharing payments had it entered into a cost-sharing arrangement with Amazon-US under the same circumstances as those presented here. (ER500.) It is undisputed that in "a DCF analysis, the expected rate of return is equal to the discount rate." (ER366, 462-464.) The Tax Court twice agreed that 18% was the "appropriate" discount rate. (Op/ER126, 146.) That the court nevertheless effectively concluded that, for purposes of determining the amount of the required buy-in payment, Amazon-LUX should be allocated a greater return than that which an unrelated party would expect simply highlights that the court's decision cannot be reconciled with the central purpose of Section 482 and must be reversed.

CONCLUSION

The decision of the Tax Court should be vacated, and the case remanded for the court to determine an arm's-length buy-in payment utilizing the DCF method.

Respectfully submitted,

RICHARD E. ZUCKERMAN
Principal Deputy Assistant Attorney General

TRAVIS A. GREAVES
Deputy Assistant Attorney General

/s/ Judith A. Hagley

GILBERT S. ROTHENBERG (202) 514-3321
ARTHUR T. CATTERALL (202) 514-2937
JUDITH A. HAGLEY (202) 514-8126
Attorneys
Tax Division
Department of Justice
Post Office Box 502
Washington, D.C. 20044

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/s/ Judith A. Hagley
JUDITH A. HAGLEY
Attorney for Appellant Commissioner