

No. 17-72922

IN THE
UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

AMAZON.COM, INC. AND SUBSIDIARIES,

Petitioners – Appellees,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent – Appellant.

On Appeal from the United States Tax Court, Docket No. 31197-12,
Honorable Albert G. Lauber

**BRIEF FOR THE APPELLEES
[REDACTED]**

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CORPORATE DISCLOSURE STATEMENT

Petitioners-Appellees are Amazon.com, Inc. and an affiliated group of U.S. subsidiaries. Pursuant to Rule 26.1 of the Federal Rules of Appellate Procedure, Petitioners-Appellees state as follows:

1. Amazon.com, Inc., a publicly traded company, is the common parent of the affiliated group of subsidiaries at issue in this case.

2. No publicly held corporation owns 10% or more of the stock of Amazon.com, Inc.

TABLE OF CONTENTS

	Page
CORPORATE DISCLOSURE STATEMENT	i
TABLE OF AUTHORITIES	iv
STATEMENT OF JURISDICTION.....	1
INTRODUCTION	1
BACKGROUND	6
The Definition of “Intangibles”	7
The 1994 Definition of “Intangible”	9
The 1995 Cost-Sharing Regulations.....	12
Amazon’s European Restructuring and CSA	15
The Tax Court Proceedings	17
STANDARD OF REVIEW	21
SUMMARY OF ARGUMENT	21
ARGUMENT	26
I. THE REGULATORY DEFINITION OF “INTANGIBLE” DOES NOT INCLUDE INTANGIBLES THAT ARE INSEPARABLE FROM A BUSINESS	27
A. The Regulatory Definition Is Limited To Intangibles That Can Be Sold Independently Of A Business.....	27
B. The Regulatory History Confirms That The Regulatory Definition Is Limited To Intangibles That Can Be Sold Independently Of A Business.....	31

C.	The Clear Meaning Of The Statutory Definition Precludes The Commissioner’s Interpretation Of The Regulation.....	35
D.	The 2017 Amendments To Section 936 Refute The Commissioner’s Interpretation.....	40
E.	The Commissioner’s Interpretation Is Not Entitled To <i>Auer</i> Deference.....	42
F.	There Is No Conflict Between The Regulation’s Plain Meaning And The “Arm’s-Length” Standard	44
1.	The Commissioner’s “Made Available” Argument Improperly Manufactures Ambiguity and Conflict	44
2.	The Commissioner’s “Made Available” Interpretation Renders the Regulatory Definition of “Intangibles” Superfluous	47
3.	The Commissioner’s “Made Available” Interpretation Eviscerates the Central Purpose of the 1995 Cost-Sharing Regulations.....	49
G.	The Limits Of The Regulatory Definition Do Not Frustrate The Purposes Of Section 482	51
H.	“Growth Options” Are Not Encompassed By The Regulatory Definition Because Of Their “Relationship” To Identified Intangibles	54
II.	THE TAX COURT’S OTHER REASONS FOR REJECTING THE COMMISSIONER’S VALUATION WERE ALSO CORRECT	55
A.	The Tax Court Correctly Found That The Pre-Existing Intangibles Were Expected To Produce Only A Portion Of AEHT’s Expected Future Cash Flows	56
B.	The Tax Court Properly Rejected The Commissioner’s “Realistic Alternatives” Theory	58
C.	The Tax Court Properly Ruled That The Frisch-DCF Artificially Capped AEHT’s Profits.....	61

CONCLUSION.....	63
-----------------	----

TABLE OF AUTHORITIES

	Page
Cases	
<i>Ali v. Fed. Bureau of Prisons</i> , 552 U.S. 214 (2008).....	29
<i>Arcadia v. Ohio Power Co.</i> , 498 U.S. 73 (1990).....	27, 29, 47
<i>AT&T Commc'ns of Cal., Inc. v. Pac-W. Telecomm, Inc.</i> , 651 F.3d 980 (9th Cir. 2011)	28
<i>Auer v. Robbins</i> , 519 U.S. 452 (1997).....	42
<i>Barboza v. Cal. Ass'n of Prof'l Firefighters</i> , 799 F.3d 1257 (9th Cir. 2015)	42
<i>Callejas v. McMahon</i> , 750 F.2d 729 (9th Cir. 1984)	31
<i>Chamber of Commerce v. Dep't of Labor</i> , 885 F.3d 360 (5th Cir. 2018)	35
<i>Chevron, U.S.A., Inc. v. Nat. Res. Def. Council, Inc.</i> , 467 U.S. 837 (1984).....	36
<i>Christopher v. SmithKline Beecham Corp.</i> , 635 F.3d 383 (9th Cir. 2011), <i>aff'd on other grounds</i> , 567 U.S. 142 (2012).....	28, 42
<i>Circuit City Stores, Inc. v. Adams</i> , 532 U.S. 105 (2001).....	28, 29
<i>de Fontbrune v. Wofsy</i> , 838 F.3d 992 (9th Cir. 2016)	43
<i>DHL Corp. v. Comm'r</i> , 285 F.3d 1210 (9th Cir. 2002)	21

<i>Eli Lilly & Co. v. Comm’r</i> , 856 F.2d 855 (7th Cir. 1988)	7
<i>Elliot Coal Mining Co. v. Dir., Office of Workers’ Comp. Programs</i> , 17 F.3d 616 (3d Cir. 1994)	28
<i>Hosp. Corp. of Am. v. Comm’r</i> , 81 T.C. 520 (1983).....	52
<i>Merck & Co. v. United States</i> , 24 Cl. Ct. 73 (1991)	52
<i>Microsoft Corp. v. Comm’r</i> , 311 F.3d 1178 (9th Cir. 2002)	29
<i>Organized Vill. of Kake v. USDA</i> , 795 F.3d 956 (9th Cir. 2015)	32
<i>Russello v. United States</i> , 464 U.S. 16 (1983).....	41
<i>Sequoia Orange Co. v. Yeutter</i> , 973 F.2d 752 (9th Cir. 1992), <i>amended on other grounds</i> , 985 F.2d 1419 (9th Cir. 1993).....	33
<i>Estate of Shapiro v. Comm’r</i> , 111 F.3d 1010 (2d Cir. 1997)	51
<i>Tax Analysts v. IRS</i> , 117 F.3d 607 (D.C. Cir. 1997).....	36
<i>United States v. Hinkson</i> , 585 F.3d 1247 (9th Cir. 2009)	58
<i>United States v. Wilson</i> , 503 U.S. 333 (1992).....	40
<i>Veritas Software Corp. v. Comm’r</i> , 133 T.C. 297 (2009).....	1, 30, 42, 43
<i>Wagner Seed Co. v. Bush</i> , 946 F.2d 918 (D.C. Cir. 1991).....	36

Wis. Cent. Ltd. v. United States,
No. 17-530 (U.S. June 21, 2018)39

Xilinx, Inc. v. Comm’r,
598 F.3d 1191 (9th Cir. 2010)44, 45, 50

Yates v. United States,
135 S. Ct. 1074 (2015).....29

Statutes and Regulations

Pub. L. No. 115-97, 131 Stat. 2054 (2017).....40, 41

1 U.S.C. § 130

26 U.S.C. § 367 (2006)8, 37

26 U.S.C. § 482 (2006)9, 48

26 U.S.C. § 936(h)(3)(b) (2006)23, 30

26 C.F.R. § 1.367(a)-1T(d) (1987)38

26 C.F.R. § 1.367(d)-1T(b) (1987)38

26 C.F.R. § 1.482-1(f)(2)(ii) (2006)58, 59

26 C.F.R. § 1.482-1(f)(2)(i)(e).....60

26 C.F.R. § 1.482-4 (2006)*passim*

26 C.F.R. § 1.482-7T(g)(4)(i)(A) (2009).....60

26 C.F.R. § 1.482-7A (2009)*passim*

26 C.F.R. § 1.482-9T(1) (2007).....52

26 C.F.R. § 1.861-9T(h)(i)(ii) (2006)35

26 C.F.R. § 1.954-2(e)(3)(iv) (2006)35

33 Fed. Reg. 5848 (Apr. 16, 1968)7

57 Fed. Reg. 3571 (Jan. 30, 1992)10, 31

58 Fed. Reg. 5263 (Jan. 21, 1993)	11, 32
58 Fed. Reg. 5310 (Jan. 21, 1993)	11
59 Fed. Reg. 34,971 (July 8, 1994).....	11, 32, 48, 60
60 Fed. Reg. 65,553 (Dec. 20, 1995)	13, 50
74 Fed. Reg. 340 (Jan. 5, 2009)	14, 34

Legislative History

H.R. Rep. No 97-760 (1982) (Conf. Rep.)	7
H.R. Rep. No. 98-432 (1984).....	8, 38
H.R. Rep. No. 99-841 (1986) (Conf. Rep.)	9, 39
H.R. Rep. No. 115-466 (2017) (Conf. Rep.)	41
S. Comm. on Finance, 98th Cong., <i>Explanation of Provisions</i> <i>Approved by the Committee on March 21, 1984</i> (Comm. Print 1984)	8, 37
Staff of J. Comm. on Taxation, 98th Cong., <i>General Explanation of</i> <i>the Revenue Provisions of the Deficit Reduction Act Blue Book</i> (Comm. Print 1984)	8, 38
Staff of J. Comm. on Taxation, 99th Cong., <i>General Explanation of</i> <i>the Tax Reform Act of 1986</i> (Comm. Print 1987).....	9

Scholarly Authorities

David Bowen, <i>Full Value Methods: Has the IRS Finally Hurlled the</i> <i>Holy Hand Grenade?</i> , 37 Tax Mgmt. Int'l J. 3 (2008)	43
Thomas M. Zollo, <i>Clarification or Modification? The Tax Treatment</i> <i>of the Outbound Transfer of Goodwill, Going Concern Value, and</i> <i>Workforce in Place to a Foreign Corporation</i> , 39 Tax Mgmt. Int'l J. 71 (2010)	43

Other Authorities

Notice 88-123, 1988-2 C.B. 458 (1988)	10, 14
---	--------

<i>Report on the Application and Administration of Section 482</i> , 92 TNT 77-19 (Apr. 1992)	10, 31
Harry Davies & Simon Marks, <i>Revealed: How Project Goldcrest Helped Amazon Avoid Huge Sums in Tax</i> , Guardian, Feb. 18, 2016	53
Franklin Foer, <i>World Without Mind: The Existential Threat of Big Tech</i> (2017)	53
Jane Gravelle, Cong. Research Serv. No. R40623, <i>Tax Havens: International Tax Avoidance and Evasion</i> (2015)	53
Simon Marks, <i>Amazon: How the World's Largest Retailer Keeps Tax Collectors at Bay</i> , Newsweek, July 13, 2016	53
N.Y. State Bar Ass'n Tax Section, <i>Report on Section 367(d)</i> (Oct. 12, 2010)	43
Oxford English Dictionary (2d ed 1989), http://www.oed.com/	54

STATEMENT OF JURISDICTION

Appellees Amazon.com, Inc. (“Amazon”) and its subsidiaries agree with the Commissioner’s jurisdictional statement.

INTRODUCTION

This appeal represents the Commissioner’s third attempt to justify a radical re-imagining of the regulations that governed the practice of cost-sharing between related parties from 1995 to 2009. The first two attempts, in *Veritas Software Corp. v. Comm’r*, 133 T.C. 297 (2009), and before the Tax Court in this case, were soundly rejected. The Commissioner’s efforts here should meet the same fate.

As the Tax Court recognized, in 2005 Amazon restructured its European operations to achieve a number of important business objectives. To effectuate that restructuring, Amazon had to provide its website technology, trademarks, and certain other intangible assets to its new European subsidiary, Amazon European Holding Technologies SCS (“AEHT”). Amazon had two options for doing so. One was to license these existing intangibles, and any new technology developed at Amazon’s own expense, to AEHT in return for annual royalties. The other option, which Amazon chose, was to provide its existing intangibles to AEHT under a cost-sharing arrangement (“CSA”). Under the then-governing 1995 cost-sharing regulations, taxpayers such as Amazon and AEHT who elected a CSA would be treated as joint developers and co-owners of intangibles created after entry into the

CSA, provided that each bore its share of the costs and risks of all successful and unsuccessful research and development (“R&D”) efforts. The 1995 regulations also required AEHT to make a “buy-in” payment for the fair-market value of pre-existing intangibles Amazon contributed to the CSA for use in the R&D efforts.

The central dispute in this case concerns the Commissioner’s method of calculating that “buy-in” payment. The Commissioner’s methodology relies on a prediction of AEHT’s future financial results—results that can occur only with technology developed 10, 20, or 50 years after formation of the CSA. Yet, the Commissioner insisted at trial that almost all of AEHT’s future value is attributable to the website technology and marketing and customer intangibles that Amazon contributed to the CSA in 2005, and he demanded that AEHT pay for that future value in its buy-in for Amazon’s “pre-existing intangibles.”

The Tax Court correctly rejected that demand. It ruled that the Commissioner’s methodology impermissibly captured the value of later-developed intangibles that were not subject to a buy-in payment at all, because AEHT would fund their development through cost-sharing payments. The Tax Court also held that, contrary to the Commissioner’s claims at trial, his methodology necessarily required AEHT to make a buy-in payment for intangibles like goodwill, workforce-in-place, “growth options,” “corporate resources,” or “corporate culture”—all of which fall outside the regulatory definition of “intangibles”

because they are inseparable from a business and derive substantial value from the services of individuals. Thus, the Tax Court held, the Commissioner's methodology was arbitrary and capricious and an abuse of discretion because it was inconsistent with the regulatory definition of intangibles and effectively recast the CSA as though it were a sale of Amazon's entire European business.

Having failed to persuade the Tax Court that his methodology *excluded* the value of Amazon's workforce-in-place or growth options, the Commissioner now argues that the value of these intangibles must be *included* in AEHT's buy-in payment. As in *Veritas*, however, the Tax Court here correctly ruled that these intangibles are excluded from the regulatory definition of "intangibles." In fact, the Internal Revenue Service ("IRS") told Congress in 1992 that a CSA participant would *not* have to make a buy-in payment for the value of a research team (*i.e.*, workforce-in-place). And a year later the Treasury Department ("Treasury") retreated from proposals to add intangibles such as goodwill, going concern-value and workforce-in-place to the definition after commenters objected to including them. The Commissioner's suggestion that Treasury thereafter snuck these types of intangibles into the definition through a "clarification" that never mentioned any of them is groundless. Indeed, it impermissibly assumes that Treasury made important substantive changes to a regulation without providing the explanations or responses to comments that bedrock principles of administrative law demand.

The exclusion of such intangibles, moreover, is consistent with the regulatory and statutory scheme, and—contrary to the Commissioner’s rhetoric—results in no tax “abuse.” Indeed, in the mid-1980s, Congress recognized that when intangibles such as goodwill and going-concern value were transferred as part of the sale of an entire business there was ordinarily no reason to tax such intangibles, because they were not generated through deductions. Nor did any Amazon expert testify that third parties would demand arm’s-length compensation for intangibles like growth options *except* when an entire business is sold—something that did not happen here.

In reality, the Commissioner’s insistence that AEHT pay for “growth options” and Amazon’s “culture of innovation” is part of an ongoing bait-and-switch. The 1995 regulations required AEHT to pay fair-market value for the use of pre-existing intangibles that Amazon’s workforce created prior to the CSA. The regulations also required AEHT to pay its share of costs on both successful and unsuccessful new R&D conducted by Amazon’s workforce, and entitled AEHT to co-ownership of any new intangibles. That co-ownership eliminated the uncertainties and burdens (for both taxpayers and the IRS) of the alternative to cost-sharing—namely the licensing regime, where the value of intangibles can be at issue every year. Before the Tax Court, the Commissioner tried to deny AEHT the benefits of such co-ownership by attributing virtually all of the value of later-

developed technology to the pre-existing intangibles subject to the buy-in requirement, even though AEHT would help fund the creation of that new technology through its cost-sharing payments. Now the Commissioner seeks the same result by demanding a buy-in payment for vague concepts like “corporate culture” and “growth options.” Both rationales impermissibly deprive Amazon of the ability to elect cost-sharing and the certainty concerning the value of later-developed intangibles that the cost-sharing regulations were designed to provide.

The Commissioner’s methodology is also a thinly veiled attempt to subject Amazon to new regulations adopted years *after* Amazon and AEHT executed their CSA. Not coincidentally, the valuation methodology the Commissioner used below produced a total buy-in payment comparable to what those new regulations would require. But, as the Commissioner’s own expert acknowledged, those regulations effected a “[sea] change” in the transfer pricing rules. And those new regulations did not apply to this case.

In rejecting the Commissioner’s revisionist gambit, therefore, the Tax Court did not “conjure” regulatory loopholes, frustrate congressional intent, or allow Amazon to transfer “immensely valuable” intangibles “for free.” Br.26, 37, 46-47, 49, 57. Rather, the Tax Court issued a factually-detailed and well-reasoned decision that gave effect to the 1995 regulations. Under those regulations, AEHT’s buy-in payment is approximately \$833 million, and the Commissioner’s own

expert projected that AEHT's cost-sharing payments would exceed [REDACTED]. All of these payments reduce Amazon's U.S. tax deductions and/or increase its U.S. taxable income.

For all of the reasons set forth below, this Court should affirm the Tax Court's decision.

BACKGROUND

Section 482 grants Treasury authority to ensure, through regulatory standards and after-the-fact reallocations, that related parties pay arm's-length prices for services or assets they provide to one another.¹ The Commissioner attempts to portray the parties' CSA as a form of "abuse" that § 482 was designed to prevent. The relevant history demonstrates, however, that Congress blessed cost-sharing arrangements and that, during the relevant time period, Treasury did not require parties to a CSA to pay for intangibles that are inseparable from a business. Because the Commissioner omits much of this history, Amazon provides below a more complete review.

¹ All "Section" and "§" references are to provisions of the Internal Revenue Code, 26 U.S.C., or to Treasury Regulations (26 C.F.R.) in effect during the tax years at issue (2005-2006).

The Definition of “Intangibles”

Treasury first defined “intangibles” for purposes of § 482 in 1968.² Fourteen years later, Congress codified this definition (in a different provision of the Code), in response to practices involving transfers of intangible property that can be sold separately from a business. Prior to 1982, some U.S. companies transferred patents and related manufacturing “know-how” to subsidiaries operating in Puerto Rico, which then manufactured products for sale in the United States and reported substantial income in Puerto Rico instead of the United States. *E.g., Eli Lilly & Co. v. Comm’r*, 856 F.2d 855 (7th Cir. 1988). Congress responded in 1982 by amending § 936 of the Code, which provided tax credits for corporations operating in U.S. possessions such as Puerto Rico. The amendment codified the regulatory definition of “intangible[s]” (with slight modifications) in § 936(h)(3)(B) and prescribed rules for the treatment of income attributable to “manufacturing” intangibles transferred by a U.S. parent to a “possessions” corporation. *See* H. Rep. No. 97-760, at 505-06 (1982) (Conf. Rep.).

Two years later, in 1984, Congress responded to a similar practice involving independently transferable intangibles: U.S. companies were “developing patents

² The 1968 definition provided that intangible property “shall consist of” 27 specified items (such as patents, copyrights, and trademarks), grouped into five lists, each of which ended with the phrase “and other similar items.” 33 Fed. Reg. 5848, 5854 (Apr. 16, 1968).

or similar intangibles at their facilities in the United States,” “deducting substantial research and experimentation expenses,” and “transferring the intangible to a foreign corporation at the point of profitability.” S. Comm. On Finance, 98th Cong., *Explanation of Provisions Approved by the Committee on March 21, 1984* at 361 (Comm. Print 1984). In response, Congress amended a different provision, § 367, in order to tax all § 936(h)(3)(B) intangibles transferred from a U.S. company to a foreign corporation. *See* § 367(d).

In this same legislation, however, Congress chose *not* to tax transfers of goodwill and going-concern value—which would occur when a U.S. corporation’s foreign branch was incorporated into a foreign entity—unless the foreign branch had previously claimed losses. *See* § 367(a)(3)(C); S. Comm. on Finance, *supra*, at 362; H.R. Rep. No. 98-432, pt. 2, at 1317 (1984). Congress treated these intangibles differently because, unlike independently transferable intangibles identified in § 936(h)(3)(B), goodwill and going-concern value “are generated by earning income, not by incurring deductions.” Staff of J. Comm. on Taxation, *General Explanation of the Revenue Provisions of the Deficit Reduction Act Blue Book*, 98th Cong., 428 (Comm. Print 1984) (“*Deficit Reduction Act Blue Book*”).

Finally, in 1986, Congress incorporated § 936(h)(3)(B)’s definition of intangibles into § 482 itself. Once again, Congress was concerned with independently transferable intangibles. Specifically, Congress was concerned that

there were often no comparable transactions for determining the value of such intangibles and that related parties could thus transfer them at low royalty rates before the success of a product was proven. Staff of J. Comm. on Taxation, *General Explanation of the Tax Reform Act of 1986*, 99th Cong., 1014 (Comm. Print 1987). Congress therefore authorized after-the-fact analyses to ensure that, when intangibles as defined in § 936(h)(3)(B) are “*transfer[red] (or license[d])*” by related parties, the price paid is “commensurate with the income” they actually generate. § 482 (emphasis added). Congress also expressed its support for CSAs, but noted that Treasury regulations then in effect did not require participants to pay for “head start” investments, *i.e.*, where a CSA participant expended funds and took risks before others joined. H.R. Rep. 99-841, at II-638 (1986) (Conf. Rep.). Thus, Congress made clear that CSAs were proper when (1) a subsidiary bore “its portion of all research and development costs, on unsuccessful as well as successful products” and “at all relevant development stages,” and (2) a party that expended funds at an earlier point in time received an appropriate return on that investment. *Id.*

The 1994 Definition of “Intangible”

Following the 1986 amendment of § 482, Treasury began a multi-year effort to issue regulations implementing that statutory change. The history of that effort

demonstrates that Treasury did not require buy-in compensation for intangibles that are inseparable from a business.

To address Congress's concern about "head-start" investments, Treasury proposed buy-in payments for CSAs. In a 1988 White Paper, Treasury initially suggested that buy-in payments *should* reflect the "market value of all intangibles," including intangibles such as "going concern value associated with a participant's research facilities and capabilities." Notice 88-123, 1988-2 C.B. 458, 497 (1988) ("White Paper"). When Treasury issued proposed regulations in 1992, however, it noted that commenters had objected to that approach. 57 Fed. Reg. 3571, 3572 (Jan. 30, 1992).³ Accordingly, the proposed definition of "intangible" did not include going-concern value or other intangibles that cannot be transferred independently. Just months later, moreover, the IRS told Congress that "it is not necessary to compensate a participant for the going concern value of its research operations under the buy-in provisions." *Report on the Application and Administration of Section 482*, 92 TNT 77-19, at 32 (Apr. 1992).

In 1993, Treasury issued revised temporary and proposed regulations that defined an "intangible" as "any commercially transferable interest" in the intangibles listed in § 936(h)(3)(B) that had "substantial value independent of the

³ See, e.g., Comments of AT&T, 6 (Mar. 19, 1990); Comments of Section of Taxation, American Bar Association, 37 (July 11, 1989); Comments of Tax Executives Institute, Inc., 60-61 (May 19, 1989). For the Court's convenience, these letters are included in the Appendix to this brief.

services of any individual.” 58 Fed. Reg. 5263, 5287 (Jan. 21, 1993). Treasury then requested comment on “whether the definition of intangible property ... should be *expanded* to include items not normally considered to be items of intellectual property, such as work force in place, goodwill or going concern value.” 58 Fed. Reg. 5310, 5312 (Jan. 21, 1993) (emphasis added). Once again, commenters objected, arguing among other things that Treasury lacked the authority to include such intangibles.⁴

In 1994, Treasury issued its final definition of “intangibles,” which again conspicuously omitted goodwill, going-concern value, workforce-in-place, or other intangibles that cannot be independently transferred. Treasury explained that the final definition deleted “the requirement that the property be ‘commercially transferable’ 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 (July 8, 1994). Treasury also noted that it had added language to the “other similar items” clause, but described this change as merely a “clarifi[cation].” *Id.* Treasury did not state that it had “expanded” the definition to include intangibles inseparable from a business, like going-concern value, nor did Treasury address the comments that had objected to such an expansion.

⁴ See Comments of Dole Food Co., Inc. 2-3 (May 13, 1993); Comments of the American Petroleum Institute, 18-19 (July 20, 1993); Comments of Roberts and Holland, 13-15 (Apr. 22, 1993).

The 1995 Cost-Sharing Regulations

In 1995, Treasury issued final cost-sharing regulations. Under those regulations, a subsidiary like AEHT that entered into a CSA with its parent had to make two distinct payments for the output (the products or services) of the parent’s workforce. First, the subsidiary had to make an arm’s-length buy-in payment for “*pre-existing* intangible property” that the parent contributed. Reg. § 1.482-7A(g)(2) (emphasis added).⁵ “Intangible” property was defined by cross-reference to the definition of “intangible” that Treasury had promulgated the year before in § 1.482-4(b). *See id.* Thus, no buy-in payment was required for intangibles that fell outside § 1.482-4(b)’s definition.

Second, the subsidiary had to pay for the output of the parent’s workforce *under* the CSA. The 1995 regulations thus required a subsidiary to pay a share of intangible development costs “equal to its share of reasonably anticipated benefits attributable to such development,” *i.e.*, the returns expected from the new intangibles. *Id.* § 1.482-7A(a)(2). Intangible development costs included the costs of compensating any workforce involved in developing the new intangibles. *Id.* § 1.482-7A(d)(1)-(2).

⁵ We follow the convention of citing the 1995 cost-sharing regulations as they were redesignated in 2009. *See* Br.11 n.4. For ease of reference, we refer to the 1995 cost-sharing regulations and the 1994 definition as “the 1995 regulations.”

Treasury recognized that paying such costs in proportion to reasonably anticipated benefits on all successful and unsuccessful R&D efforts was “consistent with an arm’s length result.” *Id.* § 1.482-7A(a)(3). Accordingly, Treasury recognized that parties that made such payments and “satisf[ie]d certain formal requirements (enumerated in § 1.482-7[A](b))” were entitled to a “safe harbor.” 60 Fed. Reg. 65,553, 65,555 (Dec. 20, 1995). This safe harbor meant that CSA participants became co-owners of new intangibles without further compensation for the value of those intangibles, *see* Reg. § 1.482-7A(h)(1) (cost-sharing payments are “considered costs of developing intangibles of the payor”). The Commissioner therefore could not re-allocate income from these new intangibles except to ensure that cost-sharing payments were proportional to reasonably anticipated benefits, *id.* § 1.482-7A(a)(2).

These features of the 1995 regulations effectively treated parties to a CSA as partners,⁶ and eliminated the uncertainties and burdens (for taxpayers and the IRS) of the licensing alternative to cost-sharing. Under that alternative, the value of the license (*e.g.*, the royalty rate) would need to be determined annually and could give rise to costly valuation disputes for both the IRS and taxpayer. By contrast, as the Commissioner acknowledges, cost-sharing created “certainty because new

⁶ Indeed, this is why the regulations had to exempt parties to a CSA from partnership tax treatment. *See* Reg. § 1.482-7A(a)(1).

intangibles need not be valued as they are developed by [a] parent and licensed to [a] subsidiary; rather, all cost-sharing participants are considered co-owners of the new intangibles.” Br.11; *see also* White Paper, 1988-2 C.B. at 474 (cost-sharing is “an appropriate method of attributing the ownership of intangibles *ab initio* to the user of the intangible, thus avoiding section 482 transfer pricing issues”).

In 2009, Treasury issued temporary regulations requiring buy-in payments for rights in any “resource or capability reasonably anticipated to contribute to developing cost shared intangibles.” 74 Fed. Reg. 340, 341 (Jan. 5, 2009). Commenters objected that these resources and capabilities “included elements such as workforce, goodwill or going concern value, or business opportunity,” which “either do not constitute intangibles or are not being transferred.” *Id.* at 342. Treasury did not dispute those claims, and instead explained that its proposed temporary regulations “do not limit [the] contributions that must be compensated [in a buy-in payment] to the transfer of intangibles defined in section 936(h)(3)(B).” “For example,” it stated, if “a controlled participant ... contributes the services of its research team for purposes of developing cost shared intangibles ..., the other controlled participant ... would owe compensation” for that contribution. *Id.* At trial, one of the Commissioner’s own experts described the new regulations as a “revolution in thinking” and a “[sea] change.” SER011.

Amazon's European Restructuring and CSA

Amazon is an online retailer that began operating in the United States in 1995. ER10, 12-13. In the late 1990s and early 2000s, Amazon expanded operations into France, Germany, and the United Kingdom, where separate European subsidiaries independently operated and managed the business. ER12-13. These subsidiaries licensed the right to use Amazon's technology, customer information, and marketing intangibles. ER16-18.

This early "siloed" structure "resulted in inefficient operations, lack of coordination among the European businesses, and barriers to pan-European expansion." ER19. In the early 2000s, Amazon began exploring the creation of a centralized European headquarters to address these inefficiencies. It sought to: (1) establish datacenters closer to EU customers, (2) place managers in the same time zones as their customers, (3) standardize best practices across EU operations, (4) centralize certain functions to reduce expenses, and (5) create a pan-European fulfillment infrastructure to enable Amazon to expand into new EU countries quickly and efficiently. ER19-20. Amazon ultimately located its new headquarters in Luxembourg, which offered a central location, the lowest value-added tax rate in Europe, and a relatively low corporate tax rate. ER20-21.

Thus, Amazon formed AEHT in Luxembourg as a holding company, ER21, then transferred its existing European subsidiaries, their operating assets, and their

pre-existing EU intangible rights to AEHT in a series of transactions. ER25-26. By virtue of these transactions, AEHT had substantial assets, including its own workforce-in-place and going-concern value. ER81.n19.

To transfer the rights to its pre-existing intangibles to AEHT, Amazon executed License and Assignment Agreements that granted AEHT (1) exclusive rights to customer information and marketing intangibles in the EU market and (2) non-exclusive rights to website technology, which Amazon also provided to third parties. Thus, Amazon reserved the right to use that technology to compete with AEHT. ER283.

With respect to new intangibles, Amazon chose to enter into a CSA with AEHT. Amazon calculated the required buy-in payment for the relevant intangibles, and reported that amount on its tax return. ER51-57. Amazon also reported cost-sharing payments from AEHT for 2005 and 2006. ER57-65.

Although electing to enter into a CSA could yield tax benefits to Amazon if AEHT's European business proved successful, it could also result in significant tax detriments if AEHT's business underperformed. With cost sharing, Amazon both reports the buy-in payment as taxable U.S. income and loses U.S. deductions for AEHT's share of future intangible development costs. By contrast, under the licensing alternative, Amazon would retain the full amount of its U.S. R&D

deductions, would report no income from a buy-in payment, and would only report income from AEHT's royalty payments if the latter's business were successful.

The Tax Court Proceedings

A central issue in the Tax Court was the amount of the buy-in AEHT had to pay for Amazon's pre-existing intangibles. Amazon contended that each type of intangible property—the website technology, customer information, and marketing intangibles—could be reliably valued by reference to transactions between unrelated parties involving the same or similar intangibles transferred or licensed under similar circumstances. This valuation method is known as the Comparable Uncontrolled Transactions, or “CUTs,” methodology, and the 1995 regulations provided that, when available, CUTs were generally “the most direct and reliable measure of an arm's length result for the controlled transfer of an intangible.” Reg. § 1.482-4(c)(2)(ii).

At trial, the Commissioner offered a set of CUTs that overlapped with Amazon's. His principal valuation methodology, however, did not distinguish between pre-existing and subsequently developed intangibles that AEHT funded through its cost-sharing payments. Instead, his expert, Dr. Frisch, performed a discounted cash flow (“DCF”) analysis that determined the net present value of all expected future cash flows from Amazon's EU business in perpetuity after accounting for AEHT's cost-sharing payments, then subtracted the value of

AEHT's tangible assets and a return for its EU activities. Br.23. Frisch assigned the remaining \$3.5 billion—essentially the value of the entire European enterprise—to intangibles existing in 2005 that were “made available” to AEHT. ER78. At trial, Frisch insisted that his DCF analysis excluded value attributable to Amazon's goodwill or workforce-in-place. SER012-16; SER019; SER020-21. *See also* SER003 (Frisch's “valuation does not include goodwill, going concern or workforce in place”). He also admitted that his DCF analysis was similar to that required under the 2009 temporary/2011 final regulations. SER017:10-14, SER018:2-15, SER022:7-20.

Frisch sought to justify this approach by contending that AEHT was an “empty cash box” that was entitled to only an investor's return on its cost-sharing payments. ER86. The Commissioner also elicited testimony from one of Amazon's experts, Dr. Cornell, who agreed that, if a third-party bought Amazon's entire European business, Amazon would expect compensation for the full value of that business, including its potential growth options. SER026.

After a six-week trial and examination of dozens of witnesses and thousands of pages of documents, Judge Lauber held that the Commissioner's use of the Frisch-DCF was an abuse of discretion. Judge Lauber explained that the Commissioner's methodology assumed that Amazon's pre-existing intangibles “had a perpetual useful life” and that all future cash flows were “attributable to

these pre-existing intangibles”; it thus treated the transfer of those intangibles “as economically equivalent to the sale of an entire business.” ER76. Judge Lauber found that over half of Frisch’s buy-in payment was attributable to years in which the existing website technology would have little, if any, use. ER77. Frisch’s methodology therefore necessarily swept in the value of later-developed intangibles, such as later website technology and products like Kindle, Amazon Prime and Fire TV—all of which AEHT would pay for through its cost-sharing payments and thus was “not required to pay for ... through the upfront buy-in payment.” ER77-78.

Judge Lauber also determined that, because Frisch’s methodology valued the whole business, it captured the value of “assets that were not compensable ‘intangibles’ to begin with,” such as workforce-in-place and growth options. ER78-79. These intangibles, he ruled, fell outside the regulatory definition of intangible because they “cannot be bought and sold independently,” are “an inseparable component of an enterprise’s residual business value,” and often lack “substantial value independent of the services of any individual.” ER79.

Judge Lauber also found as a factual matter that AEHT was not an “empty cash box”—to the contrary, the trial record established that it had substantial assets beyond cash, including a skilled workforce, intangible assets of its own, and goodwill/going-concern value created from six years of European operations.

ER86. Thus, Judge Lauber concluded that the Commissioner’s “cash box” theory impermissibly limited AEHT’s expected return from its cost-sharing payments, an outcome inconsistent with AEHT’s co-ownership of the intangibles developed in cost-sharing. ER87.

Judge Lauber also rejected the Commissioner’s theory that Frisch’s methodology reflected Amazon’s “realistic alternative” of not entering into cost-sharing and, instead, continuing to operate the EU business itself and bearing the risks associated with doing so. This theory, he ruled, deprives taxpayers of the right to elect cost-sharing and obtain the benefits of co-ownership that cost-sharing provides. Moreover, Judge Lauber noted that the 1995 regulations prevented the Commissioner from restructuring taxpayer transactions unless they lack economic substance. Here, the Commissioner never challenged the undeniable economic substance of Amazon’s European transaction, yet his “realistic alternatives” theory effectively restructured that transaction by valuing it as a sale of the entire European business. ER83-84.

After rejecting the Frisch-DCF, Judge Lauber determined that CUTs provided the “best method” for valuing the pre-existing intangibles. Although both parties’ experts agreed to an overlapping set of reliable CUTs for each category of intangibles, ER90, they differed over whether the CUTs should be adjusted to account for the limited useful life of the pre-existing intangibles. Amazon argued

that such an adjustment was necessary because, for example, the third-party licenses for Amazon technology that were used for the CUTs entitled licensees to updates, while AEHT had to pay for such subsequent developments through cost-sharing payments. Based on a thorough and detailed analysis, Judge Lauber accepted the agreed-upon CUTs and adjusted each of them. ER102-21,135-43. With respect to the website technology, he adopted a useful life and decay curve, and also determined that Amazon's software code had research value beyond its operational life; he thus extended its useful life through a "tail" period that accounted for the entire period over which it would support future research. ER117-20. In total, Judge Lauber's decision requires Amazon to include in income an additional \$579 million buy-in from AEHT.

STANDARD OF REVIEW

This Court reviews the Tax Court's "conclusions of law de novo and its factual findings for clear error." *DHL Corp. v. Comm'r*, 285 F.3d 1210, 1216 (9th Cir. 2002).

SUMMARY OF ARGUMENT

Judge Lauber correctly ruled that, by using the Frisch-DCF methodology to determine the buy-in payment in this case, the Commissioner abused his discretion and acted arbitrarily and capriciously in at least three independent ways.

1. First, the Commissioner's use of the Frisch-DCF methodology cannot be reconciled with the regulation's definition of "intangibles." Having claimed below that this methodology excluded value attributable to intangibles that are inseparable from a business, the Commissioner now claims that the regulatory definition included such intangibles. This contention is demonstrably wrong.

The regulatory definition identified 28 specific items of intangible property, required that they have "substantial value independent of the services of any individual," and included "[o]ther similar items" that derive value from their intellectual content or other intangible properties. Reg. § 1.482-4(b). The similar-items catch-all cannot be read to encompass *all* intangible property: that reading renders the rest of the definition superfluous. Ordinary principles of construction therefore dictate that the catch-all is limited to unspecified items that share the common attribute of the 28 items listed, *i.e.*, intangible property that can be transferred independently of a business. That limitation, which is reinforced by the "substantial value" clause, excludes intangibles inseparable from a business. *See* Part I.A.

The regulatory history confirms that exclusion. Treasury invited comment on whether the definition should be "expanded" to include intangibles inseparable from a business and, after commenters objected, Treasury confirmed that the definition was limited to commercially transferable items. The Commissioner now

claims that a sentence Treasury added to “clarify” the catch-all actually expanded the definition to encompass all intangibles. But this “clarification” theory impermissibly assumes that Treasury violated the Administrative Procedure Act (“APA”) by making a significant change without offering any explanation for that change or responding to comments that objected to it. Moreover, when Treasury intended to include intangibles inseparable from a business in other regulations, it *added* them to those identified in § 936(h)(3)(B). *See* Part I.B.

The Commissioner’s interpretation should also be rejected because it exceeds the limits of § 936(h)(3)(B). Ordinary rules of construction demonstrate that, prior to 2017, § 936(h)(3)(B) intangibles were limited to those that are independently transferable. Moreover, the 1984 amendments to § 367 confirm that Congress understood intangibles such as goodwill to fall outside the scope of § 936(h)(3)(B). *See* Part I.C. Indeed, the 2017 amendments to § 936(h)(3)(B) show that prior law did not require buy-in payments for intangibles inseparable from a business, which is why Congress amended the law in order to overturn the uniform view of the Tax Court. *See* Part I.D.

This Court owes no deference to the Commissioner’s interpretation. In light of the text and history of both the regulation and statute, his interpretation is invalid. Deference is also improper because taxpayers lacked fair notice of that interpretation. Indeed, the Commissioner’s own expert acknowledged that later

cost-sharing regulations that purported to require buy-in payments for all intangibles constituted a revolution in thinking and a sea-change. *See* Part I.E.

The limits of the regulatory definition do not conflict with the arm's-length standard. The alleged "conflict" is the product of the Commissioner's untenable view that intangibles such as workforce-in-place and growth options were "made available" to AEHT under the CSA and must be paid for in the buy-in—even though these intangibles are *inseparable* from a business, and Amazon's business was *not* transferred. The Commissioner's interpretation of the "made available" language must be rejected because it (1) purports to compel payments that parties dealing at arm's length would not make; (2) renders the regulatory definition of intangibles superfluous; and (3) eviscerates the central purposes of the 1995 regulations. *See* Part I.F.

Nor do the limits of the regulatory definition stultify the purposes of § 482. The Commissioner repeatedly claims that AEHT was given access to enormously valuable assets "for free." Insofar as that asset was Amazon's workforce, the Commissioner's own expert projects that AEHT will pay over [REDACTED] (in both buy-in and annual cost-sharing payments) for such "access." And insofar as that asset was the opportunity to expand Amazon's business in Europe, other regulations and judicial decisions recognized that subsidiaries need not pay for opportunities that arise simply by virtue of corporate affiliation. *See* Part I.G.

Finally, there is no merit to the Commissioner's contention that growth options are compensable intangibles. The limits of the regulatory definition cannot be evaded simply by positing some relationship between growth options and intangibles that fall within the regulatory definition. The expert testimony the Commissioner cites underscores that growth options fall outside that definition because they lack substantial value independent of the services of individuals and are inseparable from a business. *See* Part I.H.

2. The Commissioner's valuation methodology also improperly denied the parties the benefits of cost-sharing under the 1995 regulations. That methodology impermissibly required a buy-in payment reflecting the value of new intangibles subsequently developed through cost-sharing payments. The Commissioner's theory that the value of virtually *all* later-developed intangibles is attributable to pre-existing technology because "technology-begets-new-technology" is logically flawed and foreclosed by Judge Lauber's factual findings. *See* Part II.A.

The Commissioner's "realistic alternatives" theory is also inconsistent with the 1995 regulations, which did not permit him to restructure transactions unless they lacked economic substance—a claim the Commissioner never made here. Moreover, those regulations did not allow the Commissioner to consider alternatives to cost-sharing itself, and doing so necessarily re-structures the parties' CSA and nullifies their right to elect cost-sharing. In arguing otherwise, the

Commissioner seeks to give retroactive effect to later regulations that affirmatively permit consideration of alternatives to cost-sharing. *See* Part II.B. Finally, by effectively requiring AEHT to make a buy-in payment for later-developed intangibles, the Commissioner artificially capped AEHT's expected return and deprived it of the benefits of co-ownership that its cost-sharing payments were supposed to provide under the 1995 regulations. *See* Part II.C.

ARGUMENT

This case involves a transparent effort by the Commissioner to retroactively change the cost-sharing rules that governed the parties in 2005. Those rules allowed AEHT to become a co-owner of new intangibles developed through appropriate cost-sharing payments. Disavowing his position below, the Commissioner tries to attribute all of the value of these new intangibles to a malleable list of "intangibles" that he struggles to identify with any precision or consistency, but nevertheless insists are encompassed by the regulatory definition of "intangibles." Alternatively, he reprises his argument below that all of AEHT's future value is attributable to Amazon's pre-existing intangibles. Both valuation approaches are fundamentally inconsistent with 1995 cost-sharing regulations.

I. THE REGULATORY DEFINITION OF “INTANGIBLE” DOES NOT INCLUDE INTANGIBLES THAT ARE INSEPARABLE FROM A BUSINESS.

Unable to deny that his valuation methodology required AEHT to pay for intangibles inseparable from Amazon’s business, the Commissioner claims that the regulatory definition “covers the *full range of intangibles*, including intangibles that are not normally considered intellectual property.” Br.55-56 (emphasis added). This claim—a linchpin of his appeal—is demonstrably wrong.

A. The Regulatory Definition Is Limited To Intangibles That Can Be Sold Independently Of A Business.

The 1995 regulatory definition stated that “an intangible is an asset that comprises any of the following items and has substantial value independent of the services of any individual.” Reg. § 1.482-4(b). It then listed 28 specific “items,” before concluding with a catch-all, entitled “[o]ther similar items.” *Id.* The catch-all provided that an item was similar to those specified “if it derives its value not from its physical attributes but from its intellectual content or other intangible properties.” Reg. § 1.482-4(b)(6).

The Commissioner repeatedly invokes this catch-all, Br.42-44, 54, 56, to justify his claim that the definition captures all intangibles. But courts routinely reject such sweeping interpretations of catch-all provisions, because they render the “enumeration of specific subjects entirely superfluous—in effect adding to the detailed list ‘or anything else.’” *Arcadia v. Ohio Power Co.*, 498 U.S. 73, 78

(1990); *see also Circuit City Stores, Inc. v. Adams*, 532 U.S. 105, 114 (2001) (rejecting open-ended construction of catch-all because it “fails to give independent effect to the statute’s enumeration of the specific categories of [property] which precedes [the catch-all]”); *AT&T Commc’ns of Cal., Inc. v. Pac-W. Telecomm, Inc.*, 651 F.3d 980, 992 n.17 (9th Cir. 2011) (principles of statutory interpretation “apply with equal force to the interpretation of regulations”).

The Commissioner’s interpretation suffers from precisely these flaws. If Treasury intended to capture all intangibles, there would have been no reason to specify any particular types of intangibles, let alone list 28 of them. The 28-item list serves no function under the Commissioner’s interpretation. Similarly, if Treasury intended to define “intangible” as “anything that derives its value from intangible, rather than physical, properties,” Treasury would have simply said that.

The Commissioner’s interpretation also renders the catch-all a meaningless tautology: The catch-all supposedly “clarifies” the definition of “intangible” by stating that unspecified items are “similar” to 28 specific intangibles if they derive value from “intangible properties.” A regulation that relies on the “very language purportedly being defined clarifies nothing.” *Christopher v. SmithKline Beecham Corp.*, 635 F.3d 383, 394 (9th Cir. 2011), *aff’d on other grounds*, 567 U.S. 142 (2012); *see also Elliot Coal Mining Co. v. Dir., Office of Workers’ Comp.*

Programs, 17 F.3d 616, 635 (3d Cir. 1994) (rejecting interpretation that rendered regulation a “meaningless tautology”).

Accordingly, the Commissioner’s interpretation “should not be adopted unless the language renders it unavoidable.” *Arcadia*, 498 U.S. at 78. Here, the flaws in the Commissioner’s reading are easily avoided. The canon of *ejusdem generis* can “be invoked to prevent the [catch-all clause] from swallowing what precedes it.” *Id.* That canon requires courts to focus “on the common attribute” of the list of items that precedes the catch-all. *Ali v. Fed. Bureau of Prisons*, 552 U.S. 214, 225 (2008).⁷ The common attribute of all 28 specified items is that they can be sold independently—a fact the Commissioner does not dispute. Thus, “similar items” must be restricted to items that share this essential attribute.

The requirement that an intangible have “substantial value independent of the services of any individual,” Reg. § 1.482-4(b), bolsters that interpretation. As the Tax Court explained in *Veritas*, this requirement excludes “access” to marketing or research teams, *i.e.*, workforce-in-place, because the value of a

⁷ See also *Yates v. United States*, 135 S. Ct. 1074, 1085–87 (2015) (plurality) (statute’s reference to “any record, document, or tangible object” reaches only tangible objects “used to record or preserve information”); *Circuit City Stores*, 532 U.S. at 114–15 (statute’s exclusion of “seamen, railroad employees, or any other class of workers engaged in interstate or foreign commerce” reaches only “transportation workers”); *Microsoft Corp. v. Comm’r*, 311 F.3d 1178, 1183, 1185 (9th Cir. 2002) (Code’s exclusion of “films, tapes, records, or similar reproductions” reaches only “things ‘of the same kind’ as ... ‘films, tapes, [and] records’”).

marketing or research team “is based primarily on the services of individuals (*i.e.*, the work, knowledge and skills of team members).” 133 T.C. at 323 n.31. The Commissioner repeatedly claims that Amazon provided “access” to its “culture” of innovation. Br.14-15, 39, 43-44, 61. But that culture is inseparable from the individuals in the company’s workforce. Amazon has adopted “three pillars” of success, ER12, and other leadership principles readily available on the Internet that any company could emulate. The Commissioner cannot claim that anyone would pay Amazon for these concepts. What makes Amazon unique is its workforce’s success in internalizing and *executing* on those concepts. And that workforce lacks substantial value independent of the services of the individuals who comprise it and embody those principles, as the Commissioner’s expert, Frisch, acknowledged. *See* SER013-14 (explaining that, by excluding workforce-in-place, he did not value “intangibles related to the service of an individual”).⁸ Thus, the “substantial value” clause reinforces what the *ejusdem generis* canon requires: the catch-all is restricted to items that are independently transferable.

⁸ The Commissioner implies that the “substantial value” clause excludes only those intangibles that derive substantial value from the services of “any *one*” individual. Br.43-44 (emphasis added). But that reading impermissibly adds a word to the clause. Moreover, the statute’s reference to the “the services of any individual,” § 936(h)(3)(B), is subject to the “Dictionary Act,” which dictates that, in determining the meaning of any Congressional act, “words importing the singular include and apply to several persons, parties, or things.” 1 U.S.C. § 1. Thus, the statute’s “substantial value” clause excludes intangibles that derive value from the services of one, or many, individuals.

B. The Regulatory History Confirms That The Regulatory Definition Is Limited To Intangibles That Can Be Sold Independently Of A Business.

The regulatory history confirms that the regulatory definition is limited to independently transferable intangibles. The Commissioner's attempt to show that Treasury's 1994 "clarification" of the catch-all somehow swept in intangibles that are inseparable from a business is baseless.

First, Treasury could only "clarify" that the regulatory definition encompassed intangibles inseparable from a business if there had been some "ambiguity" about whether such intangibles were included. *Cf. Callejas v. McMahon*, 750 F.2d 729, 731 (9th Cir. 1984) (a "'dispute or ambiguity ... [is] an indication that a subsequent amendment is intended to clarify, rather than change, the existing law"). But there was no ambiguity when Treasury announced its 1994 "clarification." Treasury expressly stated that its 1992 proposed regulations did not include "going concern value," 57 Fed. Reg. at 3572, which is a classic example of an intangible that cannot be sold independently of a business, and later that year, the IRS told Congress that "it is *not* necessary to compensate a participant for the going concern value of its research operations under the buy-in provisions." *Report on the Application and Administration of Section 482*, 92 TNT 77-19, at 32 (emphasis added). In 1993, Treasury issued revised temporary and proposed regulations that once again did not include intangibles inseparable from a

business—which is why it requested comment “as to whether the definition of intangible property ... should be *expanded* to include items *not normally considered to be items of intellectual property, such as work force in place, goodwill or going concern value.*” 58 Fed. Reg. at 5312 (emphasis added).

The Commissioner is thus forced to claim that Treasury did, in fact, “*expand[] the definition* of ‘similar items’” in 1994 to make “clear that it covers the full range of intangibles.” Br.55 (emphasis added). But Treasury itself described its 1994 change to the catch-all as a “clarifi[cation].” 59 Fed. Reg. at 34,983. Having acknowledged that the definition would have to be “expanded” to include intangibles that are not independently transferable, Treasury could not thereafter “clarify” that these intangibles had been included all along.

Second, the 1993 temporary and proposed regulations defined “intangible” as “any commercially transferable interest in any item.” 58 Fed. Reg. at 5287. Treasury later deleted this language “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. at 34,983 (emphasis added). Thus, Treasury could not have “clarified” that the catch-all included intangibles inseparable from a business, because that “clarification” would have conflicted with its recognition—in the immediately preceding sentence of the Federal Register—that the definition reached only independently transferable intangibles.

Third, the Commissioner’s “clarification” theory requires this Court to assume that Treasury violated the APA when it issued the final definition. Prior to the 1994 “clarification,” Treasury had made clear that intangibles inseparable from a business fell outside the definition; the IRS had so advised Congress; Treasury had asked whether it should change its position; and it received comments opposing that change, including some challenging its authority to include such intangibles. *See supra* n.4. If Treasury wished to change its position in 1994, it was required to publish an explanation that “display[ed] ‘awareness that it [was] changing position,’” “show[ed] that ‘the new policy [was] permissible under the statute,’” “provide[d] ‘good reasons’ for the new policy,” *Organized Vill. of Kake v. USDA*, 795 F.3d 956, 966 (9th Cir. 2015) (en banc), and “respond[ed] to comments in a reasoned manner,” *Sequoia Orange Co. v. Yeutter*, 973 F.2d 752, 758 (9th Cir. 1992), *amended on other grounds*, 985 F.2d 1419 (9th Cir. 1993). Yet Treasury did none of these things when it “clarified” the definition. The obvious reason Treasury did not do so was because it was *not* expanding the definition. The Commissioner’s contrary argument impermissibly requires the Court to assume that Treasury misled the public by describing a major change as a mere clarification and failed to comply with the APA requirements listed above.

Finally, Treasury’s more recent actions provide further confirmation—if any were needed—that the regulatory definition was limited to independently

transferable intangibles. In 2009, Treasury issued temporary regulations that did not limit the “contributions that must be compensated [in a buy-in payment] to the transfer of *intangibles defined in section 936(h)(3)(B)*.” 74 Fed. Reg. at 342 (emphases added). “For example,” it explained, if “a controlled participant ... contributes the services of its research team for purposes of developing cost shared intangibles ... , the other controlled participant ... would owe compensation” for that contribution. *Id.* Thus, Treasury acknowledged that, by requiring a buy-in payment for the going-concern value of a research team, its 2009 temporary regulations were sweeping in intangibles outside the “limit[s]” of § 936(h)(3)(B)’s definition, which of course is incorporated into § 482.

The Commissioner points, Br.55, to 1994 temporary regulations that described “goodwill” as intangible property for purposes of § 6662(e)’s substantial valuation misstatement penalty—not for purposes of § 482 itself. Moreover, when an entire business is transferred, any goodwill is transferred as well, and in that circumstance, if the value of the goodwill is misstated, the § 6662 penalty may apply. Thus, the inclusion of goodwill in a list of assets that might be subject to a penalty if its value is misstated does not establish that it is an intangible under § 1.482-4(b), which is limited to intangibles that can be sold separately from a business.

If anything, Treasury’s inclusion of “goodwill” in another 1994 regulation but not in its 1994 definition of “intangibles” raises a strong inference that Treasury intentionally excluded from the definition intangibles that are not independently transferable. That inference is bolstered by other regulations that incorporate § 936(h)(3)(B) intangibles, and then *add* goodwill and going-concern value. *See, e.g.*, Reg. § 1.954-2(e)(3)(iv); § 1.861-9T(h)(1)(ii).

Thus, the history of § 1.482-4(b) as well as other regulations compel the conclusion that Treasury limited the definition to independently transferable intangibles.

C. The Clear Meaning Of The Statutory Definition Precludes The Commissioner’s Interpretation Of The Regulation.

The Commissioner’s interpretation is also foreclosed by the clear meaning of the statutory definition. Congress first codified that definition in § 936(h)(3)(B), then incorporated it by reference in § 482. The 1995 regulations recognized that § 936(h)(3)(B) defines “intangible” for all purposes under § 482. Thus, Treasury explained that the regulatory definition, which closely tracked the language of § 936(h)(3)(B), was promulgated “[f]or purposes of section 482,” Reg. § 1.482-4(b)—not just for purposes of the “commensurate with income” standard. As a result, any interpretation of § 1.482-4(b) that exceeds the clear meaning of § 936(h)(3)(B) would render the regulatory definition invalid. *See Chamber of Commerce v. Dep’t of Labor*, 885 F.3d 360, 379 (5th Cir. 2018) (invalidating

agency definition of “fiduciary” because it exceeded plain meaning of statute). That is true of the Commissioner’s interpretation.

“If a court, employing traditional tools of statutory construction, ascertains that Congress had an intention on the precise question at issue, that intention is the law and must be given effect.” *Chevron, U.S.A., Inc. v. Nat. Res. Def. Council, Inc.*, 467 U.S. 837, 843 n.9 (1984). Here, common sense as well as traditional tools of construction demonstrate that the statutory definition of “intangible” does not include intangibles that cannot be transferred independently of a business.

First, because § 936(h)(3)(B) defines “intangible” as a list of specific items followed by a “similar items” catch-all, it is subject to the same interpretive canons that limit the regulatory definition to independently transferable intangibles. *See, e.g., Tax Analysts v. IRS*, 117 F.3d 607, 616 (D.C. Cir. 1997) (relying in part on *ejusdem generis* to hold that Commissioner’s interpretation, even if “linguistically possible,” was “not a permissible construction”); *cf. Wagner Seed Co. v. Bush*, 946 F.2d 918, 925 (D.C. Cir. 1991) (noting that “the rule of *ejusdem generis*” can “supply a precise meaning to an otherwise ambiguous text” and thus “the specific congressional intent that *Chevron* requires” to foreclose agency interpretation). The limiting inference of these canons applies even more forcefully to the statute, because Congress *added* “know-how” to the original regulation’s list of items.

That action underscores that Congress did not view either the original regulation or the statute's "other similar items" catch-all as all-encompassing.

Second, the 1984 amendments to § 367—which the Commissioner ignores—make plain that § 936(h)(3)(B) was limited to independently transferable intangibles. In 1984, Congress chose to tax *all* transfers of § 936(h)(3)(B) intangibles to foreign corporations, but *not* to tax transfers of foreign goodwill and going-concern value—which occur when a foreign branch is incorporated into a foreign entity—except when the foreign branch had previously deducted losses. *See* S. Comm. on Finance, *supra*, at 365 ("ordinarily, no gain will be recognized on the transfer of goodwill or going concern value"). The mechanisms Congress used to achieve this disparate tax treatment demonstrate that § 936(h)(3)(B) did not include goodwill and going-concern value.

After exempting *all* assets transferred "for use ... in the active conduct of a trade or business outside the United States," § 367(a)(3)(A), Congress excluded from this exemption transfers of "intangible property (within the meaning of section 936(h)(3)(B))," § 367(a)(3)(B)(iv), and taxed those transfers under subsection (d), § 367(d). Thus, if § 936(h)(3)(B) included intangibles inseparable from a business, foreign goodwill and going-concern value would have *always* been taxed under § 367(d) when transferred along with an entire business. But Congress taxed transfers of foreign goodwill and going-concern value under a

different provision, subsection (a)(3)(C), which applied to the transfer of an entire business that had losses. These provisions demonstrate that Congress understood that goodwill and going-concern value—paradigmatic examples of intangibles that cannot be transferred separately from a business—fell outside the scope of § 936(h)(3)(B).⁹

It is also clear *why* Congress chose this disparate tax treatment. Congress taxed transfers of § 936(h)(3)(B) intangibles because they were developed using U.S. deductions and credits for R&D expenses, then transferred abroad “at the point of profitability.” S. Comm. on Finance, *supra*, at 361. *See also* H.R. Rep. No. 98-432, pt. 2, at 1316. This concern did not apply to goodwill and going-concern value, because they were “generated by earning income, not by incurring deductions.” *Deficit Reduction Act Blue Book* at 428; H.R. Rep. No. 98-432, pt. 2, at 1317 (“committee does not anticipate that the transfer of goodwill or going

⁹ Contrary to the Commissioner’s argument below, SER004 n.8, regulations implementing § 367 did not show otherwise. Treasury had to include foreign goodwill and going-concern value in the regulatory definition of intangibles for purposes of § 367, *see* Reg. § 1.367(a)-1T(d)(5)(i), (iii) (1987), because, as just noted, Congress taxed transfers of these intangibles when they were part of a transfer of a foreign branch that had claimed losses. Having chosen to make this definition applicable for purposes of the regulations implementing *both* § 367(a) and § 367(d), *see id.* § 1.367(a)-1T(d) (1987), Treasury had to *exclude* foreign goodwill and going-concern value from the regulations implementing § 367(d), *see id.* § 1.367(d)-1T(b) (1987), because § 367(d) only taxed § 936(h)(3)(B) intangibles, which did not include intangibles inseparable from a business. That exclusion thus confirmed § 936(h)(3)(B)’s limited reach.

concern value developed by a foreign branch to a newly organized foreign corporation will result in abuse of the U.S. tax system”). This rationale applies with equal force to the intangibles the Commissioners purports to tax here, because all of them describe value created through the successful operation of a business, rather than value derived directly from any particular deductible expenditure.

Thus, Congress’s 1984 actions make clear that § 936(h)(3)(B) did not include intangibles inseparable from a business. *Cf. Wis. Cent. Ltd. v. United States*, No. 17-530, slip op. at 3-4 (U.S. June 21, 2018) (disparate treatment of economic concepts in related statute enacted two years later shed light on meaning of those same concepts in earlier statute). And Congress did not expand the scope of § 936(h)(3)(B) when it incorporated that definition, without alteration, into § 482 in 1986. To the contrary, Congress was concerned that then-extant valuation methodologies did not capture the value of high-profit, independently transferable intangibles, or require a buy-in payment, *see* H.R. Rep. No. 99-841, at II-637-38, not that the definition of intangible was too narrow.

Because § 936(h)(3)(B)’s definition is limited to independently transferable intangibles, the Commissioner’s interpretation of the regulatory definition cannot be accepted. By purporting to sweep in intangibles outside § 936(h)(3)(B), that interpretation would render the regulatory definition invalid.

D. The 2017 Amendments To Section 936 Refute The Commissioner's Interpretation.

Far from supporting the Commissioner's interpretation, the 2017 amendments to § 936 refute it.

Congress provided that the new law should not be “construed to create any inference with respect to the application of § 936(h)(3) ... with respect to taxable years beginning before January 1, 2018.” Pub. L. No. 115-97, § 14221(c)(2), 131 Stat. 2054, 2219 (2017). That instruction bars the Commissioner's strained claim that, by *adding* intangibles like workforce-in-place to § 936(h)(3)(B) in 2017, Congress somehow confirmed that intangibles that are not independently transferable always fell within the statutory definition.

If this Court accepts the Commissioner's invitation to consider the interpretive import of the 2017 amendments, those amendments confirm the impropriety of his interpretation. The “general presumption” is that, “when Congress alters the words of a statute, it must intend to change the statute's meaning.” *United States v. Wilson*, 503 U.S. 333, 336 (1992). The Commissioner notes that an amendment can be clarifying when it resolves “an ongoing ‘dispute.’” Br.59 (citing *Callejas*). But the “dispute” in *Callejas* was a division among courts, not an agency's *disagreement* with the uniform view of the courts. By overturning the Tax Court's consistent rulings, the 2017 amendments necessarily *changed* the law.

The Commissioner also relies on a summary listing prepared by the staff of the Joint Committee on Taxation that simply compares the House- and Senate-passed bills, not the statute ultimately enacted. *See* Br.57. Even if such a document were entitled to any interpretive weight, it cannot trump the language of the statute or the Conference Report. Congress amended § 936(h)(3)(B) under the heading “Definition of Intangible Asset,” while describing amendments concerning Treasury’s authority to use certain valuation methods for § 482 and § 367 under the heading “*Clarification of Allowable Valuation Methods.*” Pub. L. No. 115-97, § 14221(a)&(b), 131 Stat. at 2218-19 (emphasis added; capitalization altered). This selective use of the word “clarification” shows that the amendment of § 936(h)(3)(B) was *not* a clarification. *See Russello v. United States*, 464 U.S. 16, 23 (1983) (“it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion” of terms in the same law). This same careful distinction is reflected in the Conference Report, which states that the new law “*revises* th[e] definition” of intangible, and “*clarifies* the authority of the Secretary to specify the method to be used to determine the value of intangible property.” H.R. Rep. No. 115-466, at 661 (2017) (Conf. Rep.) (emphases added).

Thus, if any inference is to be drawn from the new law, it confirms that, prior to 2017, § 936(h)(3)(B) was limited to independently transferable intangibles.

E. The Commissioner's Interpretation Is Not Entitled To *Auer* Deference.

As a fallback, the Commissioner argues that, under *Auer v. Robbins*, 519 U.S. 452 (1997), his interpretation is entitled to deference even though it was advanced in litigation. Br.56. But no deference is owed to an interpretation that is “plainly erroneous or inconsistent with the regulation.” *Christopher*, 567 U.S. at 155. For all the reasons discussed above, that is true here. *Supra* § I.A.-C.

In addition, *Auer* deference is inapplicable where, as here, regulated parties lacked “fair warning” of the agency’s interpretation. *Barboza v. Cal. Ass’n of Prof’l Firefighters*, 799 F.3d 1257, 1267 (9th Cir. 2015). The Commissioner suggests that it has always been clear that intangibles inseparable from a business were subject to § 482. Br.50-56. He cites no case, however, in which a court has so held, and the lone case in which he ever previously pursued such a claim squarely rejected it. *See Veritas*, 133 T.C. 297. The reasons for this are obvious: the IRS had disavowed this position in its 1992 report to Congress; Treasury admitted, in its 1993 proposals, that these intangibles were not covered; and Treasury did not expand the regulatory definition in 1994 after commenters objected to including such intangibles.

Indeed, the evidence that taxpayers lacked fair warning that the 1995 regulations required buy-in payments for intangibles inseparable from a business is irrefutable. When Treasury and Administration officials began, in 2005, to claim

that the transfer-pricing regulations would be changed to “clarify” that they included such intangibles, commentators objected that such changes were not clarifications at all, but clear modifications beyond the agency’s authority.¹⁰ In *Veritas*, the Tax Court rejected the Commissioner’s efforts to require compensation under the 1995 regulations for workforce-in-place, goodwill and going-concern value as an improper attempt to apply new regulations retroactively. *See* 133 T.C. at 316 (noting lack of authorization for including such items under the 1995 regulations and criticizing the IRS because “[t]axpayers are merely required to be compliant, not prescient”). And, one of the Commissioner’s own experts in this case admitted that the 2009 regulations constituted a “revolution in thinking” and a

¹⁰ *See* Thomas M. Zollo, *Clarification or Modification? The Tax Treatment of the Outbound Transfer of Goodwill, Going Concern Value, and Workforce in place to a Foreign Corporation*, 39 Tax Mgmt. Int’l J. 71 (2010) (claim that, under “current law,” “goodwill, going concern value and workforce in place are ‘similar’ to those items specifically listed [in the statute and regulation] is squarely at odds with the statute, the legislative history, and the Treasury Department’s longstanding regulations”); David Bowen, *Full Value Methods: Has the IRS Finally Hurlled the Holy Hand Grenade?*, 37 Tax Mgmt. Int’l J. 3 (2008) (“relevant inquiry is whether under the existing statutes and regulations [goodwill, going concern value, and workforce-in-place] constitute ‘intangible property (within the meaning of section 936(h)(3)(B))’.... [T]he answer to that inquiry is ‘no.’”); *see also* N.Y. State Bar Ass’n Tax Section, *Report on Section 367(d)*, at 8 (Oct. 12, 2010) (proposal “to include workforce-in-place, goodwill and going concern value in the definition of intangible property for purposes of Section 367(d) [which incorporates § 936(h)(3)(B)] as a clarification of existing law is not consistent with the legislative history of Section 367(d)”). The Court may consider these materials, which do not concern the disputed facts of this case and instead show the understanding tax commentators had of the 1995 regulations. *See de Fontbrune v. Wofsy*, 838 F.3d 992, 999 (9th Cir. 2016) (court may rely on scholarly articles).

“[sea] change.” SER011. The Commissioner argued below that this testimony referred only to a “revolution” and “[sea] change” in how taxpayers understood cost-sharing. SER006. But even that strained argument is an admission that taxpayers lacked notice of his interpretation of the 1995 regulations. As Judge Fisher recognized when considering conflicting CSA regulations, deference is inappropriate when taxpayers have “not been given clear, fair notice of how the regulations will affect them.” *Xilinx, Inc. v. Comm’r*, 598 F.3d 1191, 1198 (9th Cir. 2010) (Fisher, J., concurring).

F. There Is No Conflict Between The Regulation’s Plain Meaning And The “Arm’s-Length” Standard.

Invoking *Xilinx*, the Commissioner claims that “[a]ny interpretation of a transfer-pricing regulation that is inconsistent with the arm’s-length standard must be rejected.” Br.48. But there is no conflict between the limits of the regulatory definition and the arm’s-length standard. Instead, the Commissioner attempts to manufacture a “conflict” based on an overbroad reading of the phrase “made available.” It is the Commissioner’s reading of “made available,” not the limits of the regulatory definition, that must be rejected.

1. The Commissioner’s “Made Available” Argument Improperly Manufactures Ambiguity and Conflict.

In *Xilinx*, this Court relied on the arm’s-length standard to resolve an inescapable clash between two cost-sharing regulations, where each provision

unambiguously mandated a different result with respect to the same issue. *See* 598 F.3d at 1196. Here, however, there is no inescapable clash. The 1995 regulations provided that, when “pre-existing *intangible property*” was made “available to other controlled participants for purposes of research in the intangible development area,” the other controlled participants must pay “the arm’s length charge for the use of the *intangible*.” Reg. § 1.482-7A(g)(2) (emphases added). The regulations then stated: “*See § 1.482-4(b) for the definition of an intangible.*” *Id.* § 1.482-7A(a)(2) (emphasis added). Thus, the buy-in had to include an arm’s-length payment for intangibles *that fall within* § 1.482-4(b)’s definition and were “made available.” Because that definition *excludes* intangibles inseparable from a business, the regulations required no arm’s-length or any other payment for such intangibles.

That result is fully consistent with the arm’s-length standard. As the Commissioner acknowledges, intangibles like workforce-in-place, going-concern value, goodwill, “growth options,” and corporate “resources” or “opportunities” “generally cannot be transferred independently from the business enterprise.” Br.47. Indeed, Judge Lauber found that these intangibles “cannot be bought and sold independently; they are an inseparable component of an enterprise’s residual business value.” ER79-80.

Amazon's expert did not testify to the contrary. Cornell stated that, "[i]f you are selling *everything* including the growth options, you would charge the full price," and he agreed that "[a] third party wouldn't sell *a business* for less than its DCF value." SER026:12-13, SER027:18-19 (emphases added). *See also* ER781 (to prove people pay for growth options, Commissioner's expert said: "look at the *acquisition of companies*") (emphasis added). Cornell also repeatedly distinguished the position of an outside investor (who would pay for growth options) from that of a partner (who would not). SER023:16-23, SER024:10-21, SER025:9-15, SER026:12-17. *See also* SER025:11 (Frisch's conclusion that AEHT would pay full value of growth options assumes AEHT is "not a partner").¹¹

The "conflict" that the Commissioner posits, therefore, arises only because he insists that intangibles inseparable from a business, such as growth options, can somehow be "made available" even when, as here, the business is not sold or transferred, and that there must be an arm's-length buy-in payment for these intangibles. Thus, just as in *Xilinx*, the Commissioner has manufactured a "conflict" between § 1.482-1(b)(1) and another provision by demanding payments that parties dealing at arm's length would not make. This Court should once again reject such a demand, particularly because it is based on a strained interpretation of

¹¹ As noted, the 1995 regulations recognized that parties to a CSA undertake joint development activities much as partners would and therefore had to explicitly exempt them from partnership tax treatment. *See supra* at 13.

regulatory language. Thus, *Xilinx* alone disposes of the Commissioner’s claimed “conflict.”

2. The Commissioner’s “Made Available” Interpretation Renders the Regulatory Definition of “Intangibles” Superfluous.

The Commissioner’s interpretation of “made available” should also be rejected because it renders the definition of intangibles superfluous. He argues that “*anything* of value that is made available between related parties must be paid for” in the buy-in, “*whether defined as intangibles or otherwise.*” Br.49 (second emphasis added). By his own reasoning, therefore, his interpretation of the “made available” language strips the regulatory definition of any purpose. That interpretation cannot be accepted “unless the language renders it unavoidable.” *Arcadia*, 498 U.S. at 78.

In fact, other regulatory language used in conjunction with the “made available” phrase refutes his reading. The 1995 cost-sharing regulations provided that, if a party that “makes pre-existing intangible property in which it owns *an interest* available,” it is “treated as having transferred *interests* in such property” to the other parties, who must pay arm’s-length consideration “for the acquisition *of the interest* in such intangible.” Reg. § 1.482-7A(g)(1)-(2), -7A(a)(2) (emphases added). The regulations further provided that an “*interest* in an intangible includes any *commercially transferable interest.*” *Id.* § 1.482-7A(a)(2) (emphases added).

Read in context, therefore, the phrase “made available” requires CSA participants to pay for interests in *defined* intangibles (*i.e.*, “*commercially transferable interests*”) no matter how they are “made available.” Thus, related parties are “treated as having transferred” or received interests that can actually be transferred or sold independent of an entire business, even if the formalities of a transfer or license are not observed. The phrase does not create fictional “transfers” of intangibles that cannot be transferred separately. That understanding of the phrase is consistent with, and confirmed by, Treasury’s explanation that it deleted “the requirement that the property be ‘commercially transferable’” because, “if the property was not commercially transferable, then it could not have been transferred in a controlled transaction” in the first place. 59 Fed. Reg. at 34,983.

Nothing in the text or history of the statute supports—much less compels—the Commissioner’s strained reading. Reflecting Congress’s intent that related parties pay for intangibles that are independently transferable, the pertinent provisions of Section 482 do not include the phrase “made available,” and instead refer to “any *transfer (or license)* of intangible property.” § 482 (emphasis added). And the legislative history of the 1986 amendments to § 482 reflects no concerns about transfers of intangibles inseparable from a business. By contrast, just two years earlier, Congress did tax transfers of such intangibles that occur in connection with the transfer of an entire business, but only in limited

circumstances. *See supra* at 4. Quite simply, the Commissioner’s overbroad reading of “made available” should be rejected because it would nullify the limitations of the regulatory definition of intangibles.

3. The Commissioner’s “Made Available” Interpretation Eviscerates the Central Purpose of the 1995 Cost-Sharing Regulations.

The Commissioner’s “made available” argument also improperly upends the central purpose of the 1995 regulations. At its heart, the Commissioner’s “made available” argument is an attempt to force AEHT to pay for Amazon’s workforce in the buy-in. But, as noted earlier, the 1995 regulations required AEHT to pay for the *output* (the products or services) of Amazon’s workforce through two distinct payments. First, they required a buy-in payment for the then-existing output of Amazon’s workforce (the “pre-existing” intangibles). Reg. § 1.482-7A(g)(2). Judge Lauber determined the arm’s-length value of that existing output, including the value it would contribute to future intangibles, through his adjusted CUTs, and the Commissioner does not challenge those CUTs on appeal. Second, the regulations required AEHT to pay for the output of Amazon’s workforce *during* the CSA (the “covered” intangibles). *Id.* § 1.482-7A(b)(4)(iv).

Determining the value of the latter output was a potentially complex and contentious issue for both taxpayers and the IRS. A central purpose of the regulations, therefore, was to resolve those difficulties by (1) requiring a company

like AEHT to pay its share of the costs (and to share in the risks) of Amazon’s R&D efforts under the CSA, and (2) providing that such cost- and risk-sharing was “consistent with an arm’s length result.” *Id.* § 1.482-7A(a)(3). Treasury indisputably has the authority to deem results to be arm’s-length. Indeed, the Commissioner makes this point himself. *See* Br.38 n.10 (explaining that § 1.482-7A(a)(3) “condition[s] arm’s-length status on the sharing of all R&D-related costs in proportion to reasonably anticipated benefits”).¹² Moreover, in the 1995 regulations, Treasury invited reliance on its exercise of this authority, by describing cost-sharing payments as a “safe harbor.” 60 Fed. Reg. at 65,555.

By now insisting that AEHT pay for all of the output of Amazon’s workforce in the buy-in, the Commissioner is destroying the safe harbor for cost-sharing payments. It is meaningless to say that there is a “safe harbor” for appropriate cost-sharing payments, which indisputably pay for Amazon’s R&D workforce, *see* Reg. § 1.482-7A(d)(1)-(2), if the Commissioner can nevertheless demand massive adjustments to reflect the asserted value of Amazon’s workforce as a *pre-existing intangible* subject to a buy-in payment. That demand upsets

¹² This exercise of authority is consistent with § 482, which provides that Treasury “may” allocate income to reflect arm’s-length results, but does not compel Treasury to do so. This is why Treasury can permit taxpayers that transact in certain intercompany loans to use “safe haven” interest rates for such loans. Reg. § 1.482-2(a)(2)(iii). *Cf. Xilinx*, 598 F.3d at 1196-97 (Commissioner may not compel taxpayers to report non-arm’s-length results).

invited, and settled, reliance interests, and destroys the certainty that these regulations were supposed to provide to the IRS and taxpayers alike—certainty that can foster beneficial investment by innovators like Amazon. For all these reasons, therefore, the Commissioner’s “made available” argument should be rejected because it is a clear abuse of discretion. *See Estate of Shapiro v. Comm’r*, 111 F.3d 1010, 1018 (2d Cir. 1997) (Commissioner abuses his discretion when he “fails to observe self-imposed limits upon the exercise of his discretion, provided he has invited reliance upon such limitations”).

G. The Limits Of The Regulatory Definition Do Not Frustrate The Purposes Of Section 482.

There is also no merit to the Commissioner’s claim that adhering to the limits of the regulatory definition of intangibles stultifies the purposes of § 482. If that were true, Treasury could never have believed it was appropriate to exclude intangibles inseparable from a business from the buy-in requirement. Yet in 1992, the IRS advised Congress that no buy-in payment was required for the going-concern value of research operations.

In an effort to justify the wildly different position he now advocates, the Commissioner claims (nearly a dozen times) that, if intangibles inseparable from a business are excluded from the buy-in requirement, AEHT will gain access to enormously valuable assets “for free.” *See* Br.4, 6, 26, 32, 33, 37, 39, 46-48, 49, 57. But insofar as the Commissioner is referring to “access” to Amazon’s

workforce (or his synonyms for that asset, such as “corporate culture” or “culture of innovation”), this claim is absurd. Under Judge Lauber’s CUT analysis, AEHT will pay \$833 million for the intangibles that Amazon’s workforce created before the CSA, and AEHT is projected to incur another [REDACTED] in costs for R&D performed by Amazon’s workforce under the CSA. SER039-41.

Alternatively, insofar as the Commissioner is referring to AEHT’s “opportunity” to expand Amazon’s business in Europe, *see* SER015-16, that theory is inconsistent with other § 482 regulations that recognize that a controlled party need not pay for value that accrues to it simply by virtue of being a member of a particular corporate group (described as the benefits of passive association). *See* Reg. § 1.482-9T(l)(3)(v), -9T(l)(5) example 15 (2007) (no compensation required where a company was able to secure a customer project “significantly larger and more complex than any other project undertaken [by it] to date,” due to its “status as a member of the ... controlled group”). And that theory is also inconsistent with the longstanding recognition that allowing an affiliate to pursue a business opportunity available to a corporate group is not, in and of itself, a compensable act. *See Merck & Co. v. United States*, 24 Cl. Ct. 73, 88 (1991) (parent’s “power to determine who in a controlled group will earn income cannot justify a Section 482 allocation from the entity that actually earned the income”); *Hosp. Corp. of Am. v.*

Comm'r, 81 T.C. 520, 588-91 (1983) (permitting subsidiary to pursue a “business opportunity” not a transfer of “property” under § 367).

Ignoring this authority, the Commissioner relies on books and periodicals to suggest that the parties’ CSA will allow them to “manipulat[e]” and “drastically understate[]” value to “minimise their tax bill.” Br.35-36. One of these publications, however, is utterly irrelevant,¹³ and the others add nothing to the Commissioner’s position here because they rely solely on the Commissioner’s submissions below.¹⁴ Thus, the Commissioner effectively asks this Court to accept *reporters’* assessments of his allegations over the impartial judgment of the Tax Court. Most fundamentally, none of these materials analyzes the regulatory and statutory text, or the legislative and regulatory history and structure. The Commissioner’s reliance on such materials serves only to highlight the weakness of his position.

¹³ The Congressional Research Service publication notes that it is often difficult to identify comparables for some intangibles. *See* Jane Gravelle, Cong. Research Serv. No. R40623, *Tax Havens: International Tax Avoidance and Evasion* (2015). Here, however, the parties agreed on the relevant CUTs. *Supra* at 20.

¹⁴ *See* Harry Davies & Simon Marks, *Revealed: How Project Goldcrest Helped Amazon Avoid Huge Sums in Tax*, Guardian, Feb. 18, 2016 (citing assertions by IRS and its expert below); Simon Marks, *Amazon: How the World’s Largest Retailer Keeps Tax Collectors at Bay*, Newsweek, July 13, 2016 (“IRS ... presents a compelling case” concerning project Goldcrest); Franklin Foer, *World Without Mind: The Existential Threat of Big Tech* 197 (2017) (describing “[c]alculations by the IRS”).

H. “Growth Options” Are Not Encompassed By The Regulatory Definition Because Of Any “Relationship” To Identified Intangibles.

The Commissioner’s final gambit is to argue that growth options “fit comfortably within” the regulatory definition because they (1) are “‘not totally separate’ from,” (2) “overlap” with, (3) “are created by,” or (4) “comprise” intangibles specifically listed in the regulation. Br.43, 45. This argument is baseless.

The word “comprise” means “[t]o contain, as parts making up the whole, to consist of (the parts specified).” Oxford English Dictionary (2d ed 1989), <http://www.oed.com>. Growth options do not “consist of” or “contain” “systems,” “processes,” or any other item listed in the definition. Moreover, neither Treasury nor Congress defined “intangibles” as anything “created by,” “related to,” or “overlapping with” the 28 items listed. Instead, their definitions capture independently transferable intangibles—a characteristic “growth options” lack.

Indeed, in arguing that growth options are primarily attributable to Amazon’s “culture of innovation,” the Commissioner stresses testimony from Cornell, who explained that culture is “people and how they interrelate.” Br.43 (quoting ER704). *See also* ER685 (Tesla’s market value reflects growth options attributable to the “genius” of its executive and “all these really creative people”). Because it is directly tied to its workforce, a company’s culture lacks substantial

value independent of the services of any individuals and is not separately transferable. Thus, insofar as growth options are primarily attributable to an intangible (culture) that falls outside the regulatory definition, growth options must also fall outside that definition.

The other testimony to which the Commissioner points, Br.45, explains that growth options are created by “*everything* that makes the business valuable,” ER686-87 (emphasis added), and thus growth options “are attached to the ownership of *existing assets*,” which “could be *physical assets* or intangible assets,” ER782 (emphases added). Of course, by linking growth options to both physical as well as intangible assets, the expert testimony squarely refutes the Commissioner’s assertion that they “derive their value from intangible, *rather than* physical, attributes.” Br.43 (emphasis added). More fundamentally, an intangible that is attached to *all* of a business’s assets and *everything* that makes it valuable cannot be transferred independently of the business itself. Thus, the record underscores why growth options were not “intangibles” under the 1995 regulatory definition.

II. THE TAX COURT’S OTHER REASONS FOR REJECTING THE COMMISSIONER’S VALUATION WERE ALSO CORRECT.

Judge Lauber’s determination that AEHT was not required to make a buy-in payment for intangibles inseparable from a business is dispositive of this appeal.

Should this Court nevertheless decide to address the Commissioner's other challenges to Judge Lauber's decision, those challenges should also be rejected.

A. The Tax Court Correctly Found That The Pre-Existing Intangibles Were Expected To Produce Only A Portion Of AEHT's Expected Future Cash Flows.

Judge Lauber rejected the Commissioner's valuation methodology not only because it included intangibles outside the statutory and regulatory definition, but because it also improperly required a buy-in payment for later-developed intangibles created through the parties' cost-sharing payments. ER76-78. The Commissioner's challenge to this ruling is groundless.

He argues that, because there is a "relationship" between pre-existing and later-developed intangibles, "*some portion* of the cash flows expected to result from the new intangibles would necessarily be attributable to the pre-existing intangibles." Br.62 (emphasis added). But Judge Lauber recognized that there was some relationship between pre- and post-CSA intangibles, and accounted for it. He concluded that the old technology had "R&D value" beyond its useful life, and required AEHT "to pay for the value of intangible property made available to it 'for purposes of research in the intangible development area.'" ER118 (citing Reg. § 1.482-7(g)(2)). That research value is reflected in Judge Lauber's CUT analysis, ER117-21, 77 n.16, which the Commissioner has not appealed.

The problem Judge Lauber identified in the Frisch methodology is not that it attributed *some* future value to pre-existing intangibles, but that it attributed *virtually all* future value to such intangibles. The financial projections Frisch relied upon assumed that Amazon would continue to innovate, create new intangibles, and grow commensurate with its past performance. SER034:16-24; SER030:3-033:4; SER028:17-030:8, SER031:16-033:4; SER035:3-10. But the Commissioner does not, and could not possibly, demonstrate that virtually all of the value of future developments such as Amazon Prime, Fire TV, Amazon’s digital music and video offerings, cloud computing, and cloud storage services, is attributable to the Amazon intangibles that existed in 2005. His “but-for” theory that “existing technology begets new technology,” Br.61, is untenable, leading ineluctably to the counter-factual conclusion that the value of the products listed above, as well as products yet to be conceived, is attributable to the technology Amazon used to sell its first book in 1995.

Judge Lauber’s factual findings foreclose this but-for theory. He found that Amazon completely replaced its core technology. ER35 (“transition from Obidos to Gurupa was an architectural shift from a monolithic to a distributed system and involved rewriting software in different programming languages); ER37-38 (the “shift [from Gurupa] to Santana required Amazon to rewrite virtually all of its eCommerce services”). Thus, Judge Lauber found that much of the old technology

did *not* “beget” new technology—that old technology was completely replaced. That factual finding cannot be overturned because it is obviously not “(1) illogical, (2) implausible, or (3) without support in inferences that may be drawn from the facts in the record.” *United States v. Hinkson*, 585 F.3d 1247, 1262 (9th Cir. 2009) (en banc).

The Commissioner therefore returns to the same flawed legal theory—that AEHT should make a buy-in payment for Amazon’s “residual business assets ... such as its culture of relentless product innovation and its R&D workforce-in-place,” which “contribute[] to the conversion of existing technology into new technology.” Br.61-62. This theory fails, however, because such residual business assets are outside the scope of the regulatory definition of preexisting intangibles. As both a factual and legal matter, AEHT’s cost-sharing payments fund the efforts of the workforce that develop new technology and no further compensation is required. *Supra* I.

B. The Tax Court Properly Rejected The Commissioner’s “Realistic Alternatives” Theory.

Judge Lauber also properly rejected the Commissioner’s claim that the Frisch-DCF reflected the value of “realistic alternatives” available to Amazon. Under the 1995 regulations, the Commissioner had to evaluate the results of Amazon’s transaction “as actually structured” unless it lacked economic substance, Reg. § 1.482-1(f)(2)(ii)(A), and he never contested the economic substance of the

parties' CSA. ER84. The Commissioner therefore claims that Frisch considered realistic alternatives only to “*re-price[]*,” “not *restructure*,” the parties' transaction. Br.68. But “re-pricing” based on a fundamentally different transaction *does* effectively restructure that transaction. The Commissioner seeks to do precisely that here, by positing the “alternative” of not entering into cost-sharing at all. And, as Judge Lauber found, that “alternative” denies the parties the right to elect cost-sharing.

The realistic-alternatives principle is incorporated by reference in the 1995 cost-sharing provisions only for purposes of determining the arms-length consideration for pre-existing intangibles, not the value of the entire CSA itself. *See* Reg. § 1.482-7A(g)(1). Nor do the two examples the Commissioner cites from the regulations, Br.68, illustrate how realistic alternatives can be used to determine the “opportunity cost of entering into the cost-sharing.” Br.66. Both examples consider the value a party could derive from exploiting a fully developed intangible for current use rather than licensing that intangible over its life. *See* Reg. § 1.482-1(f)(2)(ii)(B) (example); § 1.482-4(d)(2) (example). Cost-sharing, however, involves exploiting existing intangibles while developing entirely new ones. Neither example Commissioner is remotely comparable to a CSA, as the licensee in each example is merely a user, not a co-developer, of the intangibles at issue.

Thus, the Commissioner’s “re-pricing” effectively—and impermissibly—restructures the parties’ CSA. The Frisch-DCF does not value the CSA by viewing it as partnership to exploit existing intangibles and develop new ones, but rather as a vastly different arrangement—“maintaining the status quo,” which results in a materially different allocation of functions, risks, and rewards. *See* 59 Fed. Reg. at 34,980 (in considering realistic alternatives, Commissioner cannot “treat a controlled transaction as if it actually had been structured differently”). As Judge Lauber correctly held, therefore, this “alternative” did in fact restructure the transaction and deprived the parties of the right to enter into cost-sharing. ER84.¹⁵

In reality, the Commissioner’s realistic-alternatives argument seeks (once again) to apply later-adopted regulations retroactively to Amazon’s CSA. ER85 n.21. The 2009 temporary regulations were the first to require taxpayers to consider realistic alternatives to cost-sharing. *See* Reg. § 1.482-7T(g)(4)(i)(A) (2009) (“[T]he arm’s length charge for a [buy-in] will be an amount such that a controlled participant’s present value, as of the date of the [buy-in], of its cost-sharing alternative of entering into a [cost-sharing arrangement] equals the present value of its best realistic alternative”). And Examples 7 and 8 of Reg. § 1.482-

¹⁵ Compounding this impropriety, the Frisch-DCF valued the “status quo” alternative by determining the value Amazon would obtain by selling its European business. In the actual transaction, however, Amazon retained the right to use its pre-existing website technology to compete with AEHT—something that would never happen when an entire business is sold.

1T(f)(2)(i)(E) (2018), which were added in 2015, were the first to illustrate how this new requirement worked. By requiring Amazon to consider realistic alternatives to cost-sharing, the Commissioner impermissibly seeks to apply the 2009 temporary regulations to Amazon’s 2005 transaction.¹⁶

C. The Tax Court Properly Ruled That The Frisch-DCF Artificially Capped AEHT’s Profits.

Judge Lauber also properly concluded that the Frisch-DCF deprived AEHT of the full expected return from its risky investments in cost-sharing. ER87. The 1995 regulations provided that AEHT would be a co-owner of intangibles developed through cost-sharing and recognized that new intangibles could produce future benefits (income). They further provided that the Commissioner could make reallocations only to ensure that costs are shared appropriately. Reg. § 1.482-7A(a)(2). The regulations did not require or permit any reallocation of *future income* to pre-existing intangibles. *Id.* § 1.482-7A(e), (f)(3)(iii). By artificially limiting AEHT’s expected return from its cost-sharing payments to 18%, which has the effect of requiring income from intangibles developed in the future to be paid for in the buy-in, the Frisch-DCF violates this regulatory mandate.

That limitation also rendered the determination of “reasonably anticipated benefits”—a centerpiece of the cost-sharing the 1995 regulations—essentially

¹⁶ The Commissioner also relies, Br.68 n.16, on irrelevant statements in a periodical from an economist who does not discuss the regulatory text or structure.

irrelevant. No matter what research costs are incurred, or what share of those costs is allocated to AEHT, AEHT's expected economic return will never change. A methodology that eliminates the purpose of determining reasonably anticipated benefits cannot be correct.

Moreover, the Commissioner mischaracterizes AEHT's return under the Frisch-DCF. Judge Lauber did not conclude that 18% was an "appropriate" market rate of return for AEHT's cost-sharing investments. Br.76. He found that the Commissioner's position limiting AEHT's return to 18% was wrong. ER87-88. Even characterizing the 18% discount rate as a "return" to AEHT is inaccurate. On a net present value basis, the Frisch-DCF affords AEHT an expected return of \$0 from cost sharing, because the Frisch-DCF requires AEHT to pay Amazon the full present value of all expected future cash flows. ER74. The Commissioner's artificial cap is thus inconsistent with the regulatory mandate that AEHT be treated as a co-owner of those intangibles and posits an absurd result in which AEHT gets only the risk and responsibility, but none of the expected reward, of co-development of intangibles under the CSA.

CONCLUSION

For the foregoing reasons, this Court should affirm the judgment of the Tax Court.

Dated: June 29, 2018

Respectfully submitted,

SIDLEY AUSTIN LLP

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Attorneys for Appellees

STATEMENT OF RELATED CASES

I hereby certify, pursuant to 9th Cir. R. 28-2.6, that there are no related cases pending in this Court.

/s/ David R. Carpenter

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APPENDIX

Comments of AT&T (Mar. 19, 1990) (excerpt)	App001
Comments of Section of Taxation, American Bar Association (July 11, 1989) (excerpt)	App003
Comments of Tax Executives Institute, Inc. (May 19, 1989) (excerpt)	App006
Comments of Dole Food Co., Inc. (May 13, 1993)	App009
Comments of American Petroleum Institute (July 20, 1993) (excerpt)	App012
Comments of Roberts and Holland (Apr. 22, 1993) (excerpt)	App015

Doc 90-2071



Martin J. Elsen
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March 5, 1990

16-401-88
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MAR 13 1990

REGULATIONS UNIT CC:CORP:T

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Counsel (International)
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Attention: CC:INTL:BRL

Dear Sir:

American Telephone and Telegraph Company ("AT&T"), respectfully submits comments on the Study of Intercompany Pricing, dated October 18, 1988, as issued by the Internal Revenue Service and the Treasury Department (the "White Paper").

A. INTRODUCTION

1. Background

AT&T, directly or through its affiliated companies, provides domestic and international long distance telecommunications services and is engaged in the manufacture and sale of telecommunications products. It conducts business in the United States and in many foreign countries through wholly owned subsidiaries, joint ventures, and other arrangements. AT&T Bell Laboratories ("Bell Labs"), a division of AT&T and the principal AT&T unit engaged in research and development activities in support of AT&T's domestic and international business, is one of the world's premier private research and development organizations. Bell Labs has traditionally been, and continues to be, engaged in research and development projects related to telecommunications as well as basic research projects that have no immediate commercial application.

2. Scope of Comments

AT&T's comments, at this time, are limited to that portion of Chapter 13 of the White Paper which addresses the "buy-in" requirements for certain "cost sharing" arrangements. The buy-in requirements set forth in the White Paper are an

research are permitted where costs are shared on a reasonable basis.

3. Buy-in Payment for Going Concern Value

It is unclear what is meant by the White Paper's reference to a buy-in for the researcher's going concern value. If the White Paper means that a payment equal to the going concern value of the participant's research facility is required, it ignores commercial reality. The participant is not selling its research facility; it is merely employing the facility for specific research efforts. To require a buy-in payment equal to the research facility's going concern value ignores the fact that the participant is retaining the research facility and its going concern value. Further, it assumes a cost sharer's willingness to pay a going concern premium that does not exist in an arm's length transaction.

Such an interpretation would make it very difficult for a taxpayer to enter into a cost sharing arrangement with a commonly controlled entity. An Internal Revenue Service agent could argue that a buy-in payment equal to the research facility's going concern value is required. The specific amount of the buy-in would be very difficult, if not impossible, to determine. This requirement is unrealistic and creates the anomalous situation wherein a taxpayer could enter into cost sharing arrangements with unrelated parties but not with its own controlled subsidiaries.

The fact that such payments are not required by the arm's-length and commensurate with income standards is clearly reflected by the fact that taxpayers regularly enter into various cost sharing arrangements with unrelated parties, and the research facility rarely, if ever, receives a premium of this kind. In all of these arrangements, the parties agree to share only costs. While a research facility's reputation may influence a potential cost sharer's choice of partner, potential cost sharers generally are unwilling to pay a separately negotiated premium because of this reputation.

Indeed, the concept behind cost sharing is that costs are shared in a joint development effort. The idea of a payment for the going concern value of a research facility introduces a concept of profit into the cost sharing arrangement which is not present in most arm's-length cost sharing arrangements. The purpose of a cost sharing arrangement is to share costs and risks, not to generate income for a participant prior to completion of the development of an intangible. The concept of buy-in for going concern value is inconsistent with the cost sharing concept.



AMERICAN BAR ASSOCIATION Section of Taxation
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July 11, 1989

Fred T. Goldberg
Commissioner
Internal Revenue Service
Room 3000
1111 Constitution Avenue, NW
Washington, D.C. 20224

Re: Comments on Proposed Regulations on § 482 White
Paper Concerning Inter-Company Pricing

Dear Mr. Goldberg:

I am enclosing comments on the above noted White Paper as prepared by members of our Committees on Affiliated and Related Corporations and Foreign Activities of U.S. Taxpayers. These comments were reviewed by members of our Committee on Government Submissions.

The comments represent the individual views of the members who prepared them and do not represent the position of the American Bar Association or of the Section of Taxation.

Sincerely,

Irwin L. Treiger
Chair, Section of Taxation

Enclosure

cc: Peter K. Scott, Acting Chief Counsel
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89-5614

SECTION OF TAXATION
AMERICAN BAR ASSOCIATION

COMMENTS ON SECTION 482 WHITE PAPER
CONCERNING INTER-COMPANY PRICING

The following comments are the individual views of members of the Section of Taxation who prepared them and do not represent the position of the American Bar Association or of the Section of Taxation.

These comments were prepared by individual members of the Committees on Affiliated and Related Corporations and Foreign Activities of U.S. Taxpayers. Principal responsibility was exercised by John M. Peterson, Jr. and Peter L. Baumbusch along with key committee members Steve Audereith, Robert T. Cole, Alan O. Dixler, James P. Fuller, Alan W. Granwell, Joseph H. Guttentag, David R. Hardy, Patricia G. Lewis, Fred F. Murray, Lon Musslewhite, Steve Nauheim, Mark A. Oates, James Rafferty and Richard C. Shea. The comments were reviewed by Herbert Beller and Eric Fox of the Section's Committee on Government Submissions.

Contact Person: Peter L. Baumbusch (202) 955-8530

Dated: July 8, 1989

11. The regulations should make clear that a cost sharing formula based on profits will not give rise to a joint venture such that the foreign participants could become subject to U.S. tax.
12. We believe that it is appropriate to provide for prospective adjustments to reflect changes in relative benefits, but are concerned with the after-the-fact analysis that an examining agent might be able to perform. Therefore, hindsight adjustments by the Service to cost sharing payments should not be permitted based on subsequent developments that could not reasonably have been anticipated by the participants. Furthermore, we believe that in the event that a cost sharing agreement was entered into in good faith but somehow "failed" to meet regulatory criteria, the normal adjustment should be to require an increase or decrease in the cost sharing payment rather than to abandon the cost sharing completely and impose a royalty.
13. We believe that it is inappropriate to include overall interest expense in the research and development cost base because it is a cost of capital item. Furthermore, affiliated group allocation and apportionment of interest and other expenses under the principles of Section 864(e) (if intended by the White Paper) would be fundamentally incompatible with the purpose of Section 482 to require transactions between commonly controlled taxpayers to be conducted on an arms length basis and not to produce results equivalent to consolidation. See Treas. Reg. § 1.482-1(b).
14. One of the major problems with the White Paper is the approach taken with respect to buy-ins. We believe that the buy-in requirements are not workable and will serve to preclude many, if not most, companies from entering into cost sharing agreements.
 - a. The requirement that a valuation charge be paid for the going concern value associated with a participant's research facilities and capabilities to be utilized in the arrangement appears unnecessarily restrictive and unnecessary. There is no way that a foreign country will permit the subsidiary of a U.S. parent company to

Comments
of
TAX EXECUTIVES INSTITUTE, INC.
on
THE SECTION 482 WHITE PAPER: A STUDY OF INTERCOMPANY PRICING
(A DEPARTMENT OF THE TREASURY AND
INTERNAL REVENUE SERVICE DISCUSSION DRAFT)
OCTOBER 18, 1988
submitted to
the Internal Revenue Service
May 19, 1989

On October 18, 1988, the Department of the Treasury and the Internal Revenue Service released a discussion draft entitled "A Study of Intercompany Pricing" (hereinafter referred to as the "White Paper"). The draft emanates from 1986 amendments to section 482 of the Internal Revenue Code requiring that income with respect to certain transfers of intangible property be "commensurate with the income" attributable to that property. At the same time, Congress requested further study of the intercompany pricing regulations under section 482:

The conferees are . . . aware that many important and difficult issues under section 482 are left unresolved by this legislation. The conferees believe that a comprehensive study of intercompany pricing rules by the IRS should be conducted and that careful consideration should be given as to whether the existing regulations could be modified in any respect.

f. Buy-Ins. The White Paper defines three types of intangibles subject to the buy-in requirement: (i) pre-existing (but not fully developed) intangibles; (ii) basic research; and (iii) going-concern value associated with research facilities and capabilities. (Page 121.) Once these intangibles have been identified, they must be charged at full fair market value, not merely cost. TEI believes that these requirements (particularly as they relate to going-concern value) are unworkable and will preclude many taxpayers from entering into cost-sharing agreements.

Requiring the identification and measurement of going-concern value presents enormous practical difficulties. Almost no guidance exists with respect to the measurement of going-concern value; because it is not amortizable, it is often lumped in with goodwill in acquisitions of existing businesses. See, e.g., Temp. Reg. § 1.338(b)-2T. Identification of going-concern value in this context has been one of the most contentious areas of the tax law. This ongoing controversy led to the enactment of section 1060, through which Congress attempted to eliminate the need for quantifying goodwill and going-concern value. We find it difficult to believe that the IRS and Treasury would now seek to reintroduce this ambiguous concept into the cost-sharing area.⁴⁵

⁴⁵ It is unlikely that a foreign country will permit a foreign subsidiary to deduct what could potentially be a large
(continued...)

With respect to the amount of the buy-in, TEI agrees that the historic cost incurred is not the appropriate benchmark. We submit, however, that merely substituting fair market value will create massive uncertainty in this area. It is simply not feasible to estimate accurately the value of the types of intangibles subject to the buy-in. Requiring a fair market value buy-in without establishing a safe harbor thus merely invites litigation. Therefore, we suggest that a safe harbor be developed whereby the buy-in is a pro rata portion of the amount of the investment in the intangible plus a reasonable rate of return.

g. Transitional Issues. The White Paper essentially discards any pre-1987 cost-sharing agreement existing for less than five years if it does not "conform substantially" to the new rules. (Pages 126, 129). The significance of the five-year period, however, is unexplained and the term "conform substantially" is undefined.

This harsh retroactive provision unduly penalizes taxpayers that have made a good faith effort to establish a reasonable

45 (...continued)
charge for "going-concern value."

Doc. 93-6427



Food Company, Inc.

P.O. Box 5132 • Westlake Village, CA 91359-5132 • Phone (818) 879-6600

EL-401-88

JUN 3 1993

May 13, 1993

RECEIVED
REGULATIONS UNIT CC: CORP: T
SEO/WOOD

Commissioner
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Washington, D.C. 20044

RE: COMMENTS: TEMPORARY REGULATIONS UNDER
SECTION 482

Dear Sir:

On behalf of Dole Food Company, Inc., we are pleased to submit our comments with regard to the above-captioned regulations (the "Temporary Regulations").

Specific areas of potential concern include the following:

a) Under Temp. Reg. §1.482-1T(d)(3)(v) which deals with the use of multiple year data, the district director may consider information about the uncontrolled comparables or the controlled taxpayer for one or more years before or after the year under review. The Service is requesting taxpayer's comments on whether an exception should be added to this section so that taxpayers would be permitted to determine an arm's length result for a particular year by reference to data from comparable controlled transactions that occurred in previous years.

If a particular methodology as outlined in Temp Reg. §1.482-1T(d)(3)(v) is available to the district director for determining an arm's length price, it should be available to the taxpayer as well. However, even assuming that prior year or subsequent year transactions are in fact comparable to the year under audit, we have a fundamental question as to whether or not the district director should be able to use subsequent years data in determining the adequacy of transfer prices. In the real world, taxpayers have to make decisions (including setting transfer prices) with the information at hand. Taxpayers do not have the luxury of hindsight. If the district director is given the ability to use subsequent years information to judge the adequacy of transfer prices, the taxpayers should also be able to use this same information to make corrections in transfer prices for prior years.

Since transfer prices are also used to report profits to foreign governments, the ability of the district director to use subsequent events and information that was unavailable to the taxpayer at the time it set its transfer prices, raises the potential for double taxation. This is especially true with respect to the less developed countries in which we and many other taxpayers operate. In those countries, there is no practical way for a U.S.-controlled taxpayer to obtain a refund for local taxes if on audit the IRS reallocates income from that country to the United States. There are no tax treaties with most of these countries. Moreover, local refund procedures are not a practical solution when these countries are effectively bankrupt and do not have the ready cash to refund even a small customs duty overpayment, let alone major income tax overpayment. We are very concerned that in practical operation the Temporary Regulations will create a major potential for international double taxation.¹ In this regard, we also are very concerned about the resultant negative effects on published financial statements that will arise from the double taxation of income.

The Service is now requesting comments on whether taxpayers should be allowed to use prior year data on a consistently applied basis to determine current year transfer prices. Taxpayers should be allowed to use the best information available to compute their transfer prices, even if this information arises in a prior year.

b) The Service is also requesting comments on whether or not the definition of intangible property incorporated in Temp. Reg. §1.482-4T(b) should be expanded to include items not normally considered to be items of intellectual property, such as work force in place, goodwill and going concern value. The purpose of including these items in the definition of intangible is so that an amount could be charged when these new types of intangibles are transferred.

We question whether the Service has the statutory authority to make this addition to the regulations. Internal Revenue Code Section 482 states that "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". Section 936(h)(3)(B) lists various types of intangibles and it further states that any intangibles included under that section have to have "substantial value independent of the services of any individual".

¹ We are aware that even if there is a proposed reallocation, under existing rules and procedures, U.S. taxpayers under certain circumstances may continue to credit these local taxes for foreign tax credit purposes.

Page 3

93 - 64274

All of the items specifically listed in Section 936(h)(3)(B) are items that could be independently bought or sold. Items such as goodwill, going concern value or work force in place cannot be bought or sold. These new types of intangibles that are being suggested for addition to the definition of intangibles do not appear to fit within the statutory definition of intangible required by section 482. Therefore, we question the Service's authority to add these items to the definition for purposes of section 482.

The Service's preferred methods for determining taxable income from the transfer of intangible property are the comparable uncontrolled transaction method and the comparable profits method. Both of these methods involve getting information on similar products. This is difficult enough in the case of an intangible such as a patent. It would be impossible in the case of going concern value or goodwill since no two companies or fact patterns are exactly alike.

We appreciate the opportunity to comment on the Temporary Regulations. If you have any questions or comments, please do not hesitate to contact me at (818) 879-6944.

Very truly yours,



Karen Will
Director of International Taxes

KW:ms

c: W. Hain
D. Perrigo
A. Sellers

Doc. 73-7442-401-98

JUN 20 1993

COMMENTS BY THE AMERICAN PETROLEUM INSTITUTE
ON THE TEMPORARY AND PROPOSED REGULATIONS
ON INTERCOMPANY TRANSFER PRICING UNDER CODE SECTION 482
[INTL-0401-88]

REGULATIONS UNIT CC: CORP: T

JEO/WOOD

Introduction

The American Petroleum Institute (API) is a trade association with approximately 300 member companies representing all segments of the U.S. petroleum industry. Its members are engaged in world-wide exploration for, and production, transportation, refining, and marketing of, oil and gas.

API commends the Temporary and Proposed Regulations on Intercompany Transfer Pricing, as published in the Federal Register on January 21, 1993¹, as a step that brings back the internationally recognized arm's length standard; the goal of emulating uncontrolled transactions is no longer subordinated to the phantom of a "precise" answer that is supposed to be computed from often inapposite third party financial profitability data which would rarely be available in any segmental detail.

However, it appears that the comparable profit method (CPM) still enjoys a preferred position in the mechanics of method selection; API feels that any profit based method has to be relegated to a secondary role, to be available to the district director only if no primary or other reasonable method could be used, as a tool to demonstrate the unusual, clearly abusive situations; and, to be used by the taxpayer only if elected as a reasonable "other method".

With respect to primary or specific pricing methods for tangible transfers, API's foremost concern continues to be commodities pricing. While the Proposed Regulations demonstrate an impressive responsiveness to many of the comments on the 1992 proposed regulations, API finds the commodities pricing issue not addressed. Thus, the request for a recognition of commodities pricing as a method (either as a specific tangibles transfer pricing method or as part of the comparable uncontrolled price method [CUP]) is again submitted; such a step would also be in the interest of efficiency and enhanced administrability². In addition, these comments advocate relaxations and liberalizations and recommend clarifications.

¹ 58 F.R. 5263, the Temporary Regulations are part of the Proposed Regulations according to NOPRM 58 F.R. 5310; both hereafter referred to as the "Proposed Regulations" or "Regulations"; all section references, unless indicated otherwise, are to the Regulations.

² See Commissioner's Advisory Group, International Subgroup, Report on Third-Party Transfer Price Information, at 4 (June 1993), contrasting the easy availability of commodity prices with the problems of obtaining other third party transaction data.

93-7992

determine the price after a volume discount. However, a taxpayer engaging in any controlled sale falling either outside a published price which included a volume discount or outside an uncontrolled sale under the published price will not be allowed to rely on only a linear extrapolation but must provide additional "proper economic and statistical analysis" to meet its burden of proof. If this is the proper interpretation, the Example should be rewritten to clearly identify the rationale.

An additional issue is whether a taxpayer is required to make a hypothetical adjustment based on a linear extrapolation of a volume discount where the controlled sale is priced between a the discounts of 2% and 5% found in uncontrolled sales. If a published price is the only discount given and an uncontrolled sale at any price would only involve a 2% or 5% discount, what rationale requires the controlled price to be different from the uncontrolled price? The courts have rejected the IRS contention that volume discounts must be used by related parties to achieve some theoretical arm's length price even if in the actual market there are comparable third party sales which do not include such volume discounts. These regulations should not be used to achieve what the courts have declared an improper result. See U.S. Steel and Bausch & Lomb, Inc. v. CIR²².

X. CONTRACTUAL TERMS AND TAXABLE INCOME

Section 1T(d)(3)(ii) allows the district director to disregard either the existence or lack of contractual arrangements and rely on the course of conduct of the parties to determine true taxable income. Where a contract exists and the parties' conduct is inconsistent with the agreement, the district director may disregard the contract. API believes that contractual arrangements should not be disregarded unless the course of conduct of the parties deviates substantially and materially on a regular or continuing basis from contract terms. Unless such a standard is applied, the district director is empowered to set aside bona fide contracts with legal effect.

Furthermore, where no contract exists and a taxpayer sells substantially all of its output to another member of the controlled group, the district director may determine that the producer does not bear the risk that the buyer will fail to purchase its output. API believes that it is improper to eliminate market risk and existing case law does not support the elimination of market risk.

XI. DEFINITION OF AN INTANGIBLE

The Preamble in the Notice of Proposed Rulemaking solicits, inter alia, comments as to whether the definition of intangible property incorporated in section 4T(b) should be expanded to

²² 92 T.C. 525 (1989), aff'd 933 F.2d 1084 (2nd Cir. 1991).

93-7992

include items not normally considered to be items of intellectual property, such as work force in place, goodwill or going concern value.

API strongly advises against such an expansion of the definition of intangible property for purposes of Code section 482. Such intangibles are not normally considered intellectual property because they are not readily commercially transferable per se, but are typically included in the transfer of other assets, like a business. As another aspect of this dependent nature, there is no legal protection of the exclusivity of such items; their protection, if any, is under the umbrella of another asset.

Because of this dependent nature which disqualifies these items for ready valuation and independent commercial transfer they are outside the scope of Code section 482. The considerations which led to the recent "Intangibles Bills"²³ highlights the dependency of these items. Their value was always perceived in the context of the transfer of a trade or business.²⁴ The "intangibles" subject to amortization under proposed Code section 197 have to be distinguished and kept separate from the subject of "intangible property transfers" under Code section 482.

"Work force in place", "goodwill", or "going concern value" are not in pari materia with Code section 482 intangibles. Since the enactment of the predecessor of Code section 482 in the Revenue Act of 1928 the administrative and judicial practice never reached for the suggested items. On the other hand, the recovery of the part of the purchase price of a trade or business allocable to such intangibles has been always the subject of administrative and judicial review, without giving rise to concerns of abusive related party transfers.

Finally, apart from the qualitative differences, the inclusion of these items would merely add to the already overwhelming uncertainties and complexities in the administration of Code section 482.

- The End -

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202.682.8455

²³ H.R.13, Tax Simplification Act of 1993; Revenue Reconciliation Act of 1993, as reported by the HW&M Committee.

²⁴ E.g., Joint Committee on Taxation, Technical Explanation of the Tax Simplification Act of 1993 (H.R. 13), at 149 (JCS-1-93).

ROBERTS & HOLLAND

93-5109

Internal Revenue Service
April 22, 1993
Page 2

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93 - 5109

- 13 -

provisions, such as withholding, sourcing, etc. On the other hand, what authority does the IRS have to treat tangible property as intangible for some, but not all purposes? We believe that except in those cases where the U.S. distributor has some legally protected rights, the IRS has no authority to treat the distributor as owning an intangible. Moreover, such treatment is inconsistent with the tax treatment of the distributor's advertising costs, even taking into account Indopco v. Commissioner, 112 S. Ct. 1039 (1992).

I. Miscellaneous

1. The Preamble to the proposed regulations states that comments are requested as to whether the definition of intangible property in section 1.482-4T(b) should be expanded "to include items not normally considered to be items of intellectual property, such as work in place, goodwill or going concern value." There appears to be no purpose in expanding the definition other than to add items that have been rejected by the courts as constituting intangibles. See, e.g., Merck & Co., Inc. v. U.S., 24 Cl. Ct. 73 (1991).

Since an intangible will only be recognized as such under the regulations if it has substantial commercial value independent of the services of an individual, and since there clearly needs to be an element that clearly distinguishes intan-

93-5109

- 14 -

gibles from services, we are assuming that a property right must exist in order for there to be an intangible. Since the regulations concern themselves about the application of the use or transfer of intangibles and the application of the commensurate with income standard, we also assume that an item can only be an intangible if it can be licensed and if it is capable potentially of fluctuating in value. Moreover, the only statutory definition of intangible is contained in section 936(h), which is the same definition that is used in the section 482 regulations. We are assuming that the definition in section 936(h) is intended to be the same as the definition in the section 482 regulations. If this assumption is not correct, we would all like to know how to understand the difference.

It would significantly help to simplify the law and to avoid considerable confusion and unnecessary time and expense if the regulations took the opportunity to clarify, rather than exacerbate the problem with the existing definition in the regulations. We therefore urge that the regulations provide that an item can only be an intangible if, under basic concepts of intellectual property law, it would be recognized as an intangible, which in turn means that it must have local law legal protection and have substantial value independent of the services of any individual. Similarly, it will only have substantial value if it could be sold on the open market to an informed and reasonable purchaser or provide the owner with a discernable economic ad-

- 15 -

vantage over the competition. This obviously can only occur if the item constitutes a property right, has legal protection, and rises to the level of an "enforceable property right." This is consistent with the Court of Claims decision in Merck & Co., Inc., 91-2, USTC ¶50,450 and the IRS's own position in other areas, including the section 351 area and the capital gains area. See, Rev. Rul. 64-56, 1964-1 CB 13; Rev. Rul. 71-564, 1971-2 CB 79.

We urge you to clarify the regulations in such manner.

2. Many of the commentators are probably going to state that they have great concern that our treaty partners will not apply the same standards that are set forth in the proposed and temporary regulations, thereby resulting in double taxation. We share this concern, but we also have a significant concern regarding the way other U.S. government agencies will view these regulations. A case in point is the following; a U.S. distributor, who is a subsidiary of a Japanese parent company manufacturer, makes attempts to revise its pricing as a result of the new regulations, because it is greatly concerned the IRS may view the U.S. distributor as having "developed" an intangible. The U.S. distributor is buying products from the Japanese parent, and the Japanese parent has world wide trademark rights to the product. The trademark is very valuable in Japan, but has not yet become valuable in the United States. The U.S. distributor

Form 8. Certificate of Compliance Pursuant to 9th Circuit Rules 28.1-1(f), 29-2(c)(2) and (3), 32-1, 32-2 or 32-4 for Case Number 17-72922

Note: This form must be signed by the attorney or unrepresented litigant *and attached to the end of the brief*.
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Signature of Attorney or
Unrepresented Litigant

s/ David R. Carpenter

Date

Jun 29, 2018

("s/" plus typed name is acceptable for electronically-filed documents)

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

CERTIFICATE OF SERVICE SEALED DOCUMENTS INTERIM CIRCUIT RULE 27-13

Case Number: 17-72922

Case Title: Amazon.Com & Subsidiaries v. CIR

Note: Documents to be filed under seal are to be submitted electronically. As the parties will not have online access to those documents once they are submitted, the CM/ECF electronic notice of filing will not act to cause service of those documents under FRAP 25(c)(2) and Ninth Circuit Rule 25-5(f). Interim Circuit Rule 27-13(c) therefore requires an alternative method of serving the motion or notice to seal and the materials to be sealed.

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I certify that, having obtained prior consent, I have provided a copy of the document(s) ☐ listed below to all other parties via electronic mail. *See* FRAP 25(c)(1)(D); Interim Circuit Rule 27-13(c).

DESCRIPTION OF DOCUMENTS:

- 1) Petitioners-Appellees' Unopposed Motion to Seal Regarding Appellees' Brief and Supplemental Excerpts of Record
- 2) Declaration of Shelley L. Reynolds in Support of Petitioners-Appellees' Unopposed Motion to Seal regarding Appellees' Brief and Supplemental Excerpts of Record
- 3) [Under Seal] Brief for the Appellees
- 4) [Under Seal] Volume II of Supplemental Excerpts of Record
- 5) [Proposed Redacted] Brief for the Appellees
- 6) Certificate of Service of Sealed Documents

Signature: /s/ David R. Carpenter
(use "s/" format with typed name)

Date: June 29, 2018

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