Applying Acquisition Price Method to Post-TCJA Platform Contribution Transactions

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Prior to the Tax Cuts and Jobs Act of 2017 ("TCJA"), the appeal of cost sharing was driven largely by the deferral of U.S. taxation on foreign earnings. Now that excess foreign returns are currently taxable as "global intangible low-taxed income" ("GILTI"), cost sharing is attractive mostly to corporate taxpayers that have decided to continue holding their intangible property ("IP") offshore and face GILTI tax, rather than bring the foreign-based IP back to the U.S. and enjoy the benefits of "foreign-derived intangible income." The cost sharing decision is further affected by TCJA's changes to Code Secs. 367, 482 and 936(h)(3)(B),[1] which enhance the government's ability to increase the taxable amount of outbound transfers made in taxable years beginning after December 31, 2017.[2]

This article explores the impact of the TCJA on the issues typically arising in a common fact pattern targeted by the Internal Revenue Service.[3] Assume a U.S. parent corporation ("USP") has maintained a cost sharing agreement ("CSA") with its controlled foreign subsidiary ("FSub") for many years. USP acquires a U.S. target corporation ("Target") and makes some of Target's resources, capabilities or rights available to the CSA. The purchase price allocation ("PPA") for financial accounting purposes allocates a portion of the price to identified tangible and intangible assets, with the majority allocated to goodwill.[4] The PPA also includes a discounted cash flow calculation that incorporates USP-specific synergies, and is designed to equate the net present value to the price paid for Target stock. However, the purchase price significantly exceeds the present value of Target's cash flows when calculated without regard to USP-specific synergies. Target has generated net operating losses ("NOLs") from its research and development costs and is just beginning to turn a profit from its currently exploitable products. (This fact pattern is referred to herein as "our fact pattern.")

The IRS likely will assert that the acquisition price method ("APM") is the best method for valuing the platform contribution transaction ("PCT"), and that the entire net present value of Target's business, after adjusting for tangible assets and routine return, was made available to the CSA as a PCT. USP may have used

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a different method, and will assert that additional adjustments are necessary if APM is to be used. For purposes of this article, it is assumed that the use of APM will prevail, and the controversy centers on the adjustments to the stock purchase price.[5] It is further assumed that the cost sharing regulations finalized in 2011, and made effective in 2009 (the "Final CSA Regulations"), are applicable.

We begin with a summary of key positions taken by taxpayers and the IRS under pre-TCJA law, and address PCTs both before and after the effective date of the temporary Code Sec. 482 regulations issued in September 2015 ("Temporary 482 Regulations"). Then we address how those positions are affected, if at all, by TCJA's changes to Code Secs. 367, 482 and 936(h)(3)(B), for PCTs arising both before and after the TCJA.

I. Pre-TCJA Key Positions of Taxpayer and IRS Regarding APM

A. Carveout for Goodwill Value

Any discussion of carveouts for goodwill, synergy value or control premium should begin with a focus on the definition of "platform contribution" in the Final CSA Regulations.[6] There are three key components. First, the controlled participant (USP) must be contributing a "resource, capability, or right" to the CSA. Second, the "resource, capability or right" must have been "developed, maintained, or acquired externally" by the controlled participant (USP). Third, the resource, capability, or right must be "reasonably anticipated to contribute to developing cost shared intangibles."

In our fact pattern we know that the discounted cash flows incorporate a unique synergy value contributed by USP that goes beyond what a normal market participant would provide. We also know that from an accounting standpoint, a majority of the stock purchase price is attributable to a residual value, or goodwill. The issue is to what extent, if any, this excess or residual value, which represents the excess of the purchase price over the value of the identified tangible and intangible assets, should be part of the platform contribution.

The IRS approaches the issue from several angles. The first focuses on the *legal* question of whether the acquisition premium represented by the excess or residual value—whether you call it goodwill or synergy value—is a "resource, capability, or right." The second focuses on the *economic* question of the extent to which the excess or residual value should be attributed to the identified intangible assets. These two issues are inter-related and often blur together.

Similar issues were decided in favor of taxpayers in *Veritas*[7] and *Amazon*[8] under the prior cost sharing regulations, which required a buy-in payment for the value of pre-existing intangibles, defined as those intangible assets listed in former Code Sec. 936(h)(3)(B). The IRS attempted in each case to value the buy-in as if it were a geographic sale of part of the U.S. participant's business. The Tax Court rejected the Service's "all value" or "enterprise value" approach to value a buy-in payment on separate but related grounds. First, the enterprise value was substantially attributable to goodwill, and goodwill was not listed in former Code Sec. 936(h)(3)(B). Second, any attempt to associate the enterprise value with the value of identified, pre-existing intangibles would inappropriately tax the value of intangibles outside the scope of former Code Sec. 936(h)(3)(B).

As for the legal question of whether *goodwill* value is part of a platform contribution, the IRS believes that the Final CSA Regulations have made that clear due to the broad definition of "platform contribution." Admittedly the term "platform contribution" was intended to be broader than the term "pre-existing intangibles" used in the old regulations. But the breadth of "platform contribution" is far from certain. In the 75 pages of the Final CSA Regulations, the only references to "goodwill" are in three examples (discussed later) whose meaning is subject to intense debate. There is no reference anywhere in the Final CSA Regulations to former Code Sec. 936(h)(3)(B). Specifically, the term "platform contribution" is entirely silent on whether it is or is not limited to former Code Sec. 936(h)(3)(B) assets.[9]

The IRS's main authority for the legal question is the preamble to the Final CSA Regulations, which states: "These regulations do not turn on whether a given transaction in connection with a CSA involves intangible property within the meaning of section 936(h)(3)(B) …."[10] The preamble says that platform contribution includes a controlled participant's commitment of "a particular research team's experience and expertise," or its contribution of "core entrepreneurial functions such as product selection, market positioning, research strategy, and risk determinations and management."

One has to wonder why these statements were not built into the Final CSA Regulations themselves. Was it because of lack of authority, due to Code Sec. 482's reference to intangible property defined in former Code Sec. 936(h)(3)(B)? In six budgets starting in 2010, the Obama Administration tried to amend former Code Sec. 936(h)(3)(B) to incorporate the IRS's litigating position in *Veritas*, but those efforts failed. Beginning in 2018, former Code Sec. 936(h)(3)(B) assets, now Code Sec. 367(d)(4) assets, include goodwill, but (as discussed later) Congress said that "[n]o inference is intended with respect to the application of section 936(h)(3)(B) or the authority of the Secretary to provide by regulation for such application with taxable years beginning before January 1, 2018." Essentially, the IRS is interpreting the Final CSA Regulations to mean something that Congress felt compelled to address by statute. Suffice it to say that the legal debate over whether the term "platform contribution" includes goodwill will continue for pre-TCJA years.

The goodwill debate is further complicated by three examples in the Final CSA Regulations, which involve the use of APM where a PPA has allocated a portion of the stock purchase price to goodwill.[11] While these examples are focused on whether APM is the best method, the lessons provided cross over to the issue of whether a carveout is appropriate even if APM is the best method.

In Example 1, the PPA made a 50% purchase price allocation to goodwill, but the target company "has nothing of economic value aside from the in-process technology and assembled workforce." Target "is still in a startup phase" and "has no currently exploitable products or marketing intangibles." The example recognizes that, according to the PPA, a significant portion of the target's nonroutine contributions to USP's business activities is goodwill, which "might not be attributable to platform contributions that are to be compensated by PCTs." However, because it is clear under the facts that Target has no goodwill value, the 50% purchase price allocation to goodwill is considered "economically attributable to either of, or both, the in-process technology and the workforce."

The IRS certainly likes the result from Example 1, and will assert that the same result—applicability of APM with no goodwill carveout—should apply to our fact pattern, even though our Target is generating revenue from currently exploitable products and likely has some valuable goodwill apart from the value of its identified intangible assets. There is unlikely to be a clear winner on this debate given the limited facts and analysis in Example 1. Nevertheless, it is undeniable that Example 1 suggests that if the target had goodwill value, "it might not be attributable to platform contributions that are to be compensated by PCTs." That statement would seem to contradict any IRS position that goodwill is always part of the platform or, alternatively, that all the enterprise value should be attributable to the identified intangible assets. If the IRS positions are correct, one has to question why Example 1 was included in the regulations. Thus, Example 1 fuels the taxpayer's argument as much as the IRS's argument.

Example 2 involves facts closer to our fact pattern. The target has a "mature software business … with a successful generation of software that it markets under a recognized trademark" in addition to a "research term and new generation software in process that could significantly enhance" the existing CSA between USP and its foreign subsidiary. The PPA allocates the purchase price 50% to the existing software and trademark, 25% to in process technology and research workforce, and 25% to goodwill. The make-or-sell rights under the existing software and trademark were not contributed to the CSA and, therefore, were not considered part of the platform contribution. The example concludes that APM may not be the best method due to the goodwill being economically attributable to the existing U.S. software business rather than to the platform contributions, and the resulting difficulty in valuing the platform contribution.

In the context of our fact pattern, Example 2 is probably a draw for the IRS and taxpayers. It doesn't address what should happen when goodwill is made available to the foreign cost sharing participant as part of the transferred make-sell rights, including when make-sell rights and the PCT are valued in the aggregate. IRS likely will assert that Example 2 provides no authority for carving out goodwill from the aggregate valuation of make-sell rights and PCT, when the goodwill is made available to the foreign cost sharing participant as part of the transferred make-sell rights. While that may be true, nor does the example preclude taxpayer from asserting a goodwill carveout is necessary in those circumstances, particularly given the implication from Example 2 that goodwill might not be part of a compensable platform contribution.

Example 3 is basically the same as Example 1, except in Example 3 there are other assets (trademark, marketing intangibles and goodwill) on which the acquiring company places no value because it has no intention of continuing to produce and market the target company's existing product. Consequently, the acquisition price was paid for no assets other than the identifiable intangible property. Nevertheless, Example 3, like Example 1, is instructive as to the process when there is an allocation of the purchase price for accounting purposes. Specifically, it is necessary to look closer at the assets of the target company and determine if the accounting allocation lines up with the economic value of the target's assets. Only after that first step has been taken can the accounting allocations be regarded as not relevant.

B. Carveout for Synergy Value

Synergy is a form of acquisition premium, like control premium, except it represents the additional value arising from integrating the target with acquirer. Often the buyer will share the synergy value with the seller in arriving at a purchase price.

The carveout issue for synergy value is slightly different than the carveout issue for goodwill. Compared to goodwill, synergy value is more easily seen as an asset contributed by both the United States and foreign cost sharing participant, as opposed to being an asset that is acquired by the U.S. participant from the target and then made available to the foreign participant. This difference goes to a key component of the platform contribution definition in the acquisition context, that is, the "resource, capability, or right" must be "acquired externally" from the target. In other words, if the synergy value has been developed by the cost sharing participants, how can it be "acquired externally" from the target?

While the term synergy (unlike goodwill) cannot be found in the Final CSA Regulations, Treasury recognized in the preamble of those regulations that the acquiring controlled group may obtain benefits beyond cost-shared intangibles: "Comments were received that, with some acquisitions, there may be benefits to the controlled group whose scope extends beyond the development of cost shared intangibles. The Treasury Department and the IRS agree that these facts and circumstances should be taken into account in the appropriate application of the acquisition price method and any other methods for purposes of determining the best method …."[12] It is believed that Treasury was thinking of synergy value when it said that. Specifically, Treasury treated an article by Clark Chandler and Sean Foley,[13] written after the 2009 temporary regulations were issued but before the Final CSA Regulations, as a comment and this statement was a response to that comment.

The gist of the Chandler-Foley article is that the APM results in double counting (compared to the income method) in situations whereby the PCT Payor has already paid for certain items, such as a trademark royalty or routine operating costs, and thus owns the synergies attributable to those items. Synergy value contributed by buyer—at least the buyer-specific synergy value that is beyond what a normal market participant would provide—generally would not be factored into the cash flows under the income method. This is because, under the income method: (1) you need to determine a useful life for the assets (you cannot assume they are perpetual) and (2) the cash flow projections are specific to the target business, that is, they are done on a standalone basis. And, unless synergy value is carved out from the acquisition price, the APM will result in a much higher PCT payment than the income method.

If the APM result exceeds the income method result, there could be a violation of Reg. §1.482-7(g)(1), which requires that any of the listed methods must "yield results consistent with measuring the value of a platform contribution by reference to the future income anticipated to be generated by the resulting cost shared intangibles." Practitioners have interpreted this regulation to mean that all reliable methods including APM must yield a result similar to the income method. That is why economists often corroborate their choice to use APM by comparing the APM results to the results under the income method.

IRS likely will assert that no carveout for synergy is permitted since it is not specifically provided for in the Final CSA Regulations. Another likely assertion is that USP paid for the synergy value when it purchased the target stock despite whether or not it was brought to the table by the cost sharing participants, and the arm's length standard requires that the foreign participant share in that cost. The IRS also asserts that the arm's length standard requires that the specific attributes of the buyer and seller be taken into account.

This debate over what the arm length standard requires has been litigated in other contexts. In *Xilinx*,[14] the regulation at issue required that "all costs" be shared. IRS argued that this regulation required that the cost of stock compensation be shared. The Tax Court and Ninth Circuit rejected that argument, holding that the "all cost" regulation was subject to the overall arm's length standard, which requires an examination of what uncontrolled parties would do by looking at comparable transactions. Since unrelated parties would not share the cost of stock compensation, it was not required among related parties.

Taxpayers can argue that, based on the teaching of *Xilinx*, the arm's length standard requires that no more than synergies of a normal market participant be taken into account.[15] That is, the Tax Court and Ninth Circuit adopted the so-called "behavioral" rule, meaning that the arm's length standard looks to the behavior of uncontrolled taxpayers to test the controlled transaction.[16] Here, instead of an "all cost" regulation, IRS is asserting an "all value" theory, but the issue is similar. We have to ask what an uncontrolled buyer in the foreign participant's circumstances would pay for the platform.

If the arm's length standard requires that the uncontrolled buyer should be viewed as having the exact same assets and capabilities as the actual foreign participant, it would seem impossible to determine an arm's length price by reference to comparable transactions. That is, no third party could be comparable if all the unique characteristics of the actual buyer have to be taken into account. That is why the arm's length standard, in order to be consistent with the holding in *Xilinx*, should look to what a normal market participant would pay.[17] In other words, the PCT payment should be based on the inherent value of the intangibles rather than the unique ability of any specific PCT payor or PCT payee to enhance the value of the intangibles.

C. Carveout for Control Premium

The control premium carveout issue is distinct from the carveout issues for goodwill and synergy value in several respects. First, this premium is focused on the value associated with acquiring control of the target company through an acquisition of the *stock*, whereas goodwill and synergy value are associated more with the value of the underlying *assets*. Clearly, the foreign participant does not acquire the right to control the company in a PCT. Rather, the PCT payment is based on the value of the underlying target assets that are part of the platform contribution, not the price paid for the stock. It is difficult to see why a buyer of a portion of target's assets should share in the cost of the control premium, when it is not acquiring control of the target's business. Thus, a control premium is more easily viewed as an asset that does not become part of the platform contribution.[18]

Second, the courts have confirmed that the price paid for stock may be higher than the value of the underlying assets due to a control premium. In *Philip Morris, Inc.*,[19] the acquisition of a controlling interest in a corporation was considered a separate element of a purchase price, "over and above the value that is attributable to the corporation's underlying assets."[20] In *Philip Morris* a tobacco company acquired a beverage company in a hostile tender offer. To encourage shareholders to sell their shares, the taxpayer offered to pay a premium above the publicly traded market price. Because of former Code Sec. 334, the purchase price was allocated to target's assets for tax basis purposes. The determination of basis depended on whether the acquisition price exceeded the value of the underlying assets. The Tax Court held it did, stating that the "portion of the purchase price paid to induce a transfer of shareholder control cannot be considered a payment for a corporate asset …."[21] The Tax Court in *Philip Morris* emphasized the independent value of the positive features of owning a controlling interest in stock: " … the shareholder can unilaterally direct corporate action, select management, decide the amount of distribution, rearrange the capital structure, and decide whether to liquidate, merge or sell assets."[22]

While *Philip Morris* involved a hostile takeover, its holding should not be limited to that fact pattern. The Tax Court broadly described the "price-value equivalence in a stock acquisition transaction" as being applicable where the "the purchaser's objective was to acquire the target company's assets, and both the purchaser and the seller valued such assets … in negotiating the purchase price of the stock."[23] The Tax Court further points out that this price-value equivalence standard applies where "(1) the parties to the transfer were specifically bargaining for the value of the target's business, and (2) the purchaser had sufficient knowledge of such business and its operations, including, for example, preacquisition appraisals of the business or its principal assets, to permit it to engage in reasonably informed negotiations as to the business' value."[24] In short, whether a stock purchase price is a fair proxy for an arm's length price related to the underlying assets is a highly factual determination.

Finally, it is common knowledge that acquisitions of target companies, particularly in the technology sector, are regularly made at a premium above the equity value. It is common to see control premiums range between 20% and 40%, but they can be significantly higher in individual cases.[25] According to Mergerstat, there was a median control premium of 29.4% for U.S. acquisitions from 1998 through 2016, and tech sector acquisitions are typically higher.[26]

D. Carveouts for Tangible Assets and Routine Return

While Reg. §1.482-7(g)(5)(iii) requires that the acquisition price be reduced "by the value of the target's *tangible property*," the example in Reg. §1.482-7(g)(5)(v) goes further and requires a reduction for "tangible property *and other assets*" (emphasis added). The IRS has interpreted this carveout for other assets as including assets that are not tangible in a physical sense. For example, it is common for the IRS to permit adjustments to the acquisition price for working capital. Working capital typically includes non-tangible assets such as trade accounts receivable, trade accounts payable, marketable investments and cash equivalents, in addition to cash and more tangible assets such as inventory.

There is no explicit requirement in the Final CSA Regulations to carve out routine returns associated with the target's business. It is implied, however, in cases where the target has commercialized products and existing customers, in addition to in-process technology and an assembled workforce.

Reg. §1.482-7(g)(5)(i) provides that the APM is ordinarily used where substantially all the target's "nonroutine contributions"[27] made to the PCT payee's business activities are covered by the PCT. Therefore the purpose of Reg. §1.482-7(g)(5)(iii) is to isolate the value of the target's nonroutine contributions.[28] Routine returns are associated with routine contributions.[29]

In some circumstances, a routine return carve-out is ruled out. In Example 1 of Reg. §1.482-7(g)(2)(vii)(B), an acquired company has " … nothing of economic value aside from its in-process technology and assembled workforce …." That is, there are no commercialized products or existing customers. Under those facts, Example 1 states that the PCT payment will be equal to the full acquisition price times the foreign participant's RAB share (*i.e.*, there will be no carve-outs including carve-outs for routine value).[30]

The IRS and taxpayers sometimes disagree on the method for measuring a routine return. For example, the IRS may use a "return on total cost" ("ROTC") as its "profit level indicator" ("PLI"), whereas the taxpayer may use a return on assets as the PLI.

E. Carveout for NOLs

Reducing the acquisition price for the value of target's NOLs is consistent with the definition of platform contribution in Reg. §1.482-7(c)(1) which, in pertinent part, refers to a "right" that a controlled participant has "acquired externally" and is "reasonably anticipated to contribute to develop cost shared intangibles." In our fact pattern, USP acquired Target's NOLs when it acquired the Target stock, but it is not possible to view those NOLs as contributing to FSub's development of cost shared intangibles, as FSub does not have any right (or ability) to use Target's NOLs. Excluding the NOLs from the acquisition price is also consistent with Example 2 in Reg. §1.482-7(g)(2)(vii), in which goodwill "economically attributable to the existing U.S. software business" was not considered part of the platform contribution.

Reducing the acquisition price for the value of target's NOLs is also further consistent with the concept that a platform contribution represents a portion of target's *assets*. Reg. §1.482-7(g)(5)(iii) requires that for APM purposes the acquisition price be "increased by the value of the target's liabilities, other than liabilities not assumed *in the case of an asset purchase*" (emphasis added). The purpose of this rule is to convert a price paid for target stock into a price that would be paid for target's assets, since the platform contribution is comprised of target's *assets,* and not the target stock. The NOLs of course remain with the owner of target stock as deferred tax assets; they are not acquired by a buyer of a portion of target's assets and, therefore, cannot possibly constitute part of the platform contribution.

F. Treatment of Stock Options and Restricted Stock

It is common for a corporate acquiror of target stock to assume target's obligations regarding its outstanding stock options and restricted stock by substituting acquiror stock for the optioned or issued target stock. The issue becomes whether acquiror's assumption of these obligations is considered a liability that is added to the stock acquisition price for purposes of Reg. §1.482-7(g)(5)(iii). The approach in Reg. §1.482-7(g)(5)(iii) of converting an acquisition price for a stock purchase to an acquisition price for an asset purchase is similar to the approach taken in Reg. §1.338-5 for stock purchases for which a Code Sec. 338 election is made. Under Reg. §§1.338-5(b)(1) and (e), the "new target" is treated as acquiring a basis in its assets equal to acquisition price for the stock plus the new target's liabilities, which are liabilities that are "properly taken into account in basis under 'general principles of tax law' that would apply if new target has acquired its assets from an unrelated person for consideration that included the discharge of the liabilities of that unrelated person." In effect, the test under Code Sec. 338 for whether liabilities are added to the stock acquisition price is whether those liabilities would be part of the acquisition price if assets were purchased.

There is no definition of "liabilities" in the Code or Treasury regulations that applies for purposes of determining the acquisition price, or "basis," of assets acquired in a taxable asset purchase. The courts and IRS have developed various principles for determining whether a given obligation is a "liability" for tax purposes, and whether the buyer's assumption of a liability is capitalized as part of the acquisition price or deductible at a later time.

For example, if buyer assumes, pays or performs an obligation of seller that is considered otherwise deductible by seller, it generally follows that buyer will capitalize the assumption, payment or performance as part of the purchase price, and seller will include the assumption, payment or performance in its amount realized with an offsetting deduction (*i.e.*, as if seller had paid or performed the obligation). Conversely, if buyer is entitled to claim a deduction for later payment or performance of the obligation, then it generally follows that buyer does not include the payment as part of its purchase price (*i.e.*, because the obligation is viewed as arising in the ordinary course of buyer's business after the acquisition), and seller does not include the payment as part of its amount realized.

It is difficult to think about how an assumption of stock option or restricted stock obligations would be treated in an asset acquisition since, as a practical matter, those obligations would rarely be assumed as part of an asset deal. However, if we first think about how those obligations are treated in a stock acquisition, starting with nonqualified stock options, it is clear that the acquiror's substitution of its stock options for the target's options is not considered part of the stock acquisition price. If and when the employee exercises the option, acquiror is deemed to contribute its stock to target, and then target, as the employer, will be entitled to claim a compensation deduction.[31]

When an acquiror substitutes its restricted stock for target restricted stock in a stock acquisition, the acquiror does not increase its stock acquisition price for the assumed obligation. If the employee previously made a Code Sec. 83 election upon receipt of the restricted target stock and the target claimed a corresponding compensation deduction, no further deduction may be claimed by buyer. If (i) no Code Sec. 83 election was previously made, (ii) the restrictions lapse in connection with the acquisition of target, and (iii) target stock is converted into unrestricted buyer stock, the buyer is treated as contributing its stock to the capital of target and target is then treated as transferring such stock to the employee as compensation, which is still deductible at the target level.[32] In neither case does the buyer increase the stock acquisition price. If no Code Sec. 83 election was previously made and the restrictions continue after the acquisition, the target—as the employer of the holder of buyer restricted stock—is still entitled to claim a compensation deduction if and when the restrictions lapse.[33] Again, buyer does not increase the stock acquisition price for the value of the restricted stock.

Other types of compensation obligations assumed in an asset acquisition (*e.g.*, pension liabilities, severance pay) may raise a question of whether the assumption is considered part of the purchase price. If the liability is fixed at the time of the acquisition, the buyer's assumption of that liability will be considered part of the purchase price. If the liability is not fixed at the time of the acquisition, the buyer's assumption of that liability will not be considered part of the purchase price.[34]

G. Tax Gross-Up

The temporary CSA regulations issued in 2008 ("Temporary CSA Regulations")[35] suggested that the adjusted acquisition price under APM could be grossed up for taxes if necessary to determine a PCT payment on a pre-tax basis.[36] The specific language referring to APM in the context of a tax gross-up was removed in the same provisions of the Final CSA Regulations.[37] The Final CSA Regulations effectively superseded the Temporary CSA Regulations as of January 5, 2009, as if the Temporary CSA Regulations were never issued. [38] The tax gross-up provision in the Final CSA Regulations makes reference to provisions dealing exclusively with the income method.[39]

The preamble to the Final CSA Regulations explained that the foregoing references and provisions were removed in response to comments "on what types of tax adjustments may be needed" with respect to APM and the market capitalization method. It then said that "the determination as to whether to make such adjustments should be based on the facts and circumstances of each case and thus are best addressed under the general comparability guidance in Treas. Reg. §1.482-1(d) (Comparability)."[40]

IRS has in some cases contended there is a comparability difference between the adjusted acquisition price, which is asserted to be a reflection of *after-tax* cash flows, and the requirement in Reg. §1.482-7(g)(2)(x) that PCT payments must be determined on a *pre-tax* basis. This argument is somewhat strained, given that Reg. §§1.482-7(g)(2)(x) and 1.482-7(g)(5)(ii) were changed in the Final CSA Regulations to eliminate any specific reference to APM; thus, while the Final CSA Regulations appear to require pre-tax valuation for all methods, they are silent on whether methods other than the income method require a gross-up to produce pre-tax results. The IRS's argument also seems to miss the mark, since the comparability rule in Reg. §1.482-1(d) is focused on whether the controlled transaction, here the PCT payment, "produces an arm's length result … by comparing the results of that transaction to results realized by uncontrolled taxpayers engaged in comparable transactions under comparable circumstances."

A comparable uncontrolled transaction would be the purchase of target stock from one third party followed by the sale of a portion of target's assets to another third party. In uncontrolled settings, parties that purchase stock and subsequently sell assets do not, and indeed in most circumstances cannot, require subsequent purchasers of assets to gross up the purchase price to account for the original purchaser's tax liability on the asset sale. At most, a purchaser of assets would increase the price of buying assets over buying stock in an amount up to the present value of the tax benefits from the basis step-up.

IRS also has asserted that the realistic alternative principle, outlined in several provisions of the Code Sec. 482 regulations,[41] requires that the PCT payee be made whole. IRS has reasoned that since APM is initially based on the after-tax adjusted acquisition price, the PCT payee will need a tax gross-up in order to equate APM with a realistic alternative such as self-exploitation or licensing. This view is developed entirely through the lens of the PCT payee, and ignores the economic reality that an asset purchaser acting at arm's length would not gross up the asset seller for its tax liability. Moreover, the Tax Court in *Amazon* rejected the IRS's reliance on the realistic alternative principle in the absence of a showing by IRS that the cost sharing arrangement lacked economic substance.

II. Impact of Temporary 482 Regulations on Use of APM

Following unsuccessful efforts through litigation or legislation to implement either its "any similar item" position under former Code Sec. 936(h)(3)(B) or its "all value" position for valuing identified intangibles, Treasury decided to implement its "all value" position in the Temporary 482 Regulations.[42] These bold and controversial regulations were effective immediately upon their issuance on September 14, 2015, and clearly were premised in large part on the government successfully advancing its "all value" position in *Amazon.* On March 23, 2017, the Tax Court rejected the government's theory that an arm's length payment for the acquisition of rights in intangible property should be determined with reference to all the value, or the "enterprise value," of the associated business. At a time when the government's appeal of the *Amazon* decision was still pending before the Ninth Circuit, the Temporary 482 Regulations were allowed to expire, or "sunset," on September 14, 2018.

While the fate of expired temporary regulations is not always clear, it appears that the Temporary 482 Regulations will be treated as valid and effective for the three-year period from September 14, 2015, to September 14, 2018.[43] The proposed regulations that were issued on September 14, 2015, which are identical to the Temporary 482 Regulations, sprung into effect as outstanding upon the expiration of the temporary regulations.[44] Thus, at least currently, we have a three-year period during which the government may enforce the Temporary Regulations against taxpayers, followed by the current period during which the "all value" regulations are merely proposed and may not be enforced against taxpayers. Taxpayers should be aware that the government could choose to finalize the proposed regulations and, presumably, make them effective as of September 14, 2018, in order to avoid any regulatory gap.

If the government chooses to finalize the proposed regulations effective as of September 14, 2018, taxpayers and the IRS will continue to debate the validity of the Temporary 482 Regulations with respect to periods prior to the effective date of the TCJA changes. If the proposed regulations are never finalized, taxpayers may claim that the government recognized that its "all value" position is not effective without legislation. As discussed *infra*, the "no inference" language in the TCJA Conference Report should preclude the Temporary 482 Regulations from having received any imprimatur from Congress in the TCJA.

Interestingly, proposed Code Sec. 367 regulations issued on the same date as the Temporary 482 regulations focused directly on goodwill, going concern value, and workforce in place,[45] treating those assets as compensable under either Code Sec. 367(a) or Code Sec. 367(d). The Temporary 482 Regulations sidestep the legal issue of whether those assets are "similar items" under former Code Sec. 936(h)(3)(B), and instead pursue the economic argument that all the value received by the transferee must be reflected in the value of the identified intangibles. Effectively, the Temporary 482 Regulations are aligned with the second ("all value") clause added to former Code Sec. 936(h)(3)(B) and current Code Sec. 367(d)(4), but not necessarily the first clause. However, it has been obvious since *Veritas* that the government has pursued its "all value" theory as a "back door" way of taxing goodwill and going concern value—and the Tax Court has rejected it for precisely that reason.

Undoubtedly the Temporary 482 Regulations will make it more difficult, if not impossible, to reach a favorable settlement at IRS Examination or Appeals if the issues involve carveouts for goodwill or synergy value, given the "all value" mandate of those regulations. Taxpayers who filed returns without adequate disclosure in a Form 8275-R or a Schedule UTP statement may face potential Code Sec. 6662 penalties if they took a carve-out position considered contrary to the Temporary 482 Regulations.[46] On the other hand, taxpayers who claim a carveout for a control premium may have a compelling position that the carveout is not at all contrary to the "all value" mandate, on the grounds that premium was paid for the target stock and is not reflected in the value of the PCT assets made available to the foreign cost sharing participant. That is, the requirement to account for "all value" applies with respect to the transferred PCT assets as distinct from the acquired target stock. Similar positions could be taken for carveouts for tangible assets, routine returns, NOLs, and unvested compensation.

Other provisions of the Temporary 482 Regulations seem less impactful, if at all, on the issues in our fact pattern. First, these regulations expand the general aggregation principle in existing Code Sec. 482 regulations (Reg. §1.482-1(f)(2)(i)(A)) to "clarify" that the principle can apply to transactions governed by multiple provisions of the Code or regulations,[47] or to transactions that produce additional synergy value when aggregated.[48] The main concern in our hypothetical fact pattern is if the aggregation principle were used to aggregate the value of identified intangibles with the residual value associated with goodwill, synergy value or control premium, in a manner that was recently rejected the Tax Court in *Amazon.* Nothing about the expansion of the aggregation principle suggests that Treasury contemplated that particular application of the principle. Second, the Temporary 482 Regulations reaffirm the realistic alternative principle in the existing Code Sec. 482 regulations (*e.g.*, Reg. §1.482-1(f)(2)((ii)(A)) and describe its application in several examples.[49] Again, however, nothing would suggest that the regulations support the particular application of the realistic alternative principle made by the IRS in *Amazon* and rejected by the Tax Court.

Finally, the Temporary 482 Regulations should not have any impact on the tax gross-up issue for APM. While the preamble of the Final CSA Regulations suggests that APM might be subject to a tax gross-up under a comparability analysis,[50] the question of whether the PCT payment should reflect "all value" should be viewed as a separate issue.

III. Impact of TCJA's Changes to Code Secs. 367, 482 and 936(h)(3)(B) on Use of APM

A. Expansion of "Intangible Property" in Former Code Sec. 936(h)(3)(B)

The Obama Administration's proposal to amend former Code Sec. 936(h)(3)(B), contained in six budget proposals starting in 2010, found a home in the TCJA. Indeed, it appears that it was just pulled off the shelf. This amendment was regularly proposed during a deferral regime when returns in excess of the identified intangible value could escape U.S. taxation if they were shifted offshore, at least until they were repatriated. It was designed to give the government a "last chance" to tax those excess profits before they left the United States. Of all the times that this amendment could have been enacted, it is quite curious to see it become law in connection with the adoption of the GILTI regime, that is, a regime that keeps those excess profits subject to U.S. taxation.

There is no explanation in the TCJA or its legislative history of how the amendment to former Code Sec. 936(h)(3)(B), or the addition of Code Sec. 367(d)(4), is to be reconciled, if at all, with the enactment of GILTI. One might theorize that Congress wanted one last chance to tax the excess intangible-related profits at the full 21% corporate rate before they enjoy a lower effective GILTI rate of 10.5%.[51] But that would be purely a theory. If the purpose was to ensure that many of the issues the government lost in *Veritas* and *Amazon* are not re-litigated for post-TCJA outbound transfers, we can say mission accomplished. However, if the purpose was to strengthen the government's ability to challenge pre-TCJA transfers based on those issues, that mission was not really accomplished.

The pre-TCJA version of former Code Sec. 936(h)(3)(B)(vi) referred to "any similar item" following a list of 28 different items of intangible property in clauses (i) through (v). The government argued in both *Veritas* and *Amazon* that "any similar item" included goodwill and going concern value (the "legal" argument), and that all value that is associated with the buy-in other than value attributable to tangible property, the services of an individual and routine return is attributable to the identified intangible property (the "economic" argument), and lost on both grounds. Congress's amendment to Code Sec. 367(d)(4) in the TCJA essentially codified the government's legal and economic arguments, by removing former clause (vi)'s reference to "any similar item" and replacing that clause with new clauses (F) and (G), effective for transfers in tax years beginning after December 31, 2017. The term "intangible property" now means, in addition to the 28 items in statute before the TCJA,[52] the following:

> (F) any goodwill, going concern value, or workforce in place (including its composition and terms and conditions (contractual or otherwise) of its employment; or

(G) any other item the value or potential value of which is not attributable to tangible property or the services of any individual.

Former Code Sec. 936(h)(3)(B)—and now its successor, Code Sec. 367(d)(4)—is cross-referenced in both the statutory and regulatory provisions of Code Sec. 482. Code Sec. 482 was not changed by TCJA at least insofar as the Code Sec. 936(h)(3)(B) or Code Sec. 367(d)(4) cross-reference is concerned. Code Sec. 482, both before and after the TCJA, provides: "In the case of any transfer (or license) of intangible property (within the meaning of section 936(h)(3)(B) [now, section 367(d)(4)]), the income with respect to such transfer of license shall be commensurate with the income attributable to the intangible."

In the cost sharing area, the Final CSA Regulations provide that all platform contributions fall into one of two categories: a transfer of an intangible under Reg. §1.482-4 or a provision of a service under Reg. §1.482-9.[53] If the transferred item is not a Reg. §1.482-9 service, it is, by process of elimination, a Reg. §1.482-4 intangible. The Tax Court in *Veritas* analyzed the buy-in as consideration for a transfer of intangibles under Reg. §1.482-4. Reg. §1.482-4(b) defines "intangible" in the same manner as Code Sec. 936(h)(3)(B). The Tax Court held that goodwill, going concern value and workforce in place were not "intangibles" within the meaning of Reg. §1.482-4(b) and former 936(h)(3)(B). The IRS has been known to argue that the Final CSA Regulations overruled *Veritas* by providing that a PCT could include goodwill, going concern value and workforce in place, based on a statement in the preamble that the "regulations do not turn on whether a given transaction in connection with a CSA involves intangible property within the meaning of section 936(h)(3)(B) …." This argument has some serious limits when you consider that the definition of intangibles in former Code Sec. 936(h)(3)(B), which is the source of the intangibles definition in Reg. §1.482-4(b) and was cross-referenced in Code Sec. 482, has remained the same for decades until it was changed by the TCJA.

The government recently asserted in its appellate brief in *Amazon* that the TCJA changes to Code Sec. 936(h)(3)(B) confirm that its legal and economic positions are "reasonable" and that these changes merely "clarify" rather than "change" the law.[54] That position lacks merit. Congress stated the new law "revises" the statutory definition of intangible property, in contrast to its statement that the Code Sec. 482 change "clarifies" the authority of Treasury to address the aggregation principle and the realistic alternative principle in regulations. The changes to former Code Sec. 936(h)(3)(B) are effective only for post-TCJA transfers. Moreover, Congress added that: "Nothing in the amendment … shall be construed to create any inference with respect to the application of section 936(h)(3) … or the authority of … Treasury to provide regulations for such application, with respect to taxable years beginning before January 1, 2018." Previous attempts by the government to bolster its interpretation of prior law by similar "no inference" language have failed. The Tax Court has read the "no inference" language in connection with a statutory change "to simply mean that the adoption of [Code section] *in no way* altered the law existing before the actual effective date of that section," and that the government's "theory that [Code section] was a mere 'recodification' must fail."[55]

As for how our fact pattern is affected in tax years beginning after December 31, 2017, the door is closed on taxpayers' ability to argue that, as a matter of law, PCT assets do not include goodwill, going concern value or workforce in place. Taxpayers will also be foreclosed from arguing that "all the value" associated with the PCT assets is not required to be counted.[56] However, neither of these new statutory rules in Code Secs. 367(d)(4)(F) and (G) answers the question of *what assets* are included in the platform contribution in any given case. That is still a determination under the Final CSA Regulations of whether the particular asset at issue is (i) a "resource, capability or right" that is (ii) "developed, maintained, or acquired externally" which is (iii) "reasonably anticipated to contribute to cost shared intangibles." For example, there still should be carveouts for tangible assets, routine returns, NOLs, and the assumption of unvested compensation obligations. Taxpayers still can argue that a control premium or buyer-specific synergy value is not part of the PCT assets. Even goodwill and going concern value may not be part of the PCT assets if make-sell rights are not transferred.[57] Finally, taxpayers still can maintain that a tax gross-up is not required for APM.

B. Clarification of Regulatory Authority in Code Sec. 482

The statutory language added to Code Sec. 482 directs Treasury to "require the valuation of transfers of intangible property (including intangible property transferred with other property or services) on an aggregate basis or the valuation of such a transfer on the basis of the realistic alternatives to such a transfer, if the Secretary determined that such basis is the most reliable means of valuation of such transfers." This amendment to Code Sec. 482

is effective for transfers in tax years beginning after December 31, 2017. Similar language was added in Code Sec. 367(d)(2)(D), also effective for transfers in tax years beginning after December 31, 2017.

It is common for Congress to direct Treasury to issue regulations that carry out the purposes of a new tax statute. In some cases Congress is prescriptive in its direction. A body of case law has developed standards for determining whether a particular direction from Congress is self-executing, that is, effective when the direction is incorporated into the statute, regardless of whether, or when, regulations are actually issued pursuant to that direction. The IRS recently described the applicable principle: "A statute is self-executing when Congress states what a particular rule is to provide and articulates the overall purposes behind a given section in the legislative history, but leaves the mechanics or details affecting the application of the statute to the Secretary."[58] Courts have been more prone to treat a regulatory authority provision as currently effective in the absence of regulations where the authority favors taxpayers and the government has delayed in issuing guidance.[59] In cases where the regulatory authority provision favors the government, the courts tend to focus on whether the meaning of the regulatory authority is fairly obvious from both the statutory language and the legislative history.[60]

The direction to issue regulations in amended Code Sec. 482, however, is unique. It is not literally designed to carry out an actual amendment to Code Sec. 482 apart from what is in the directive itself. Specifically, it is not by its terms designed to carry out the amendments to Code Sec. 936(h)(3)(B).

Even more curious is that the Code Sec. 482 regulations directed by Congress *have already been issued*. The aggregation and realistic alternative principles appear to be amply covered in longstanding Code Sec. 482 regulations,[61] the Final CSA Regulations[62] and the Temporary 482 Regulations.[63] While the aggregation and realistic alternative principles have not been specifically incorporated into regulations governing Code Sec. 367(d) transfers, the final Code Sec. 367(d) regulations issued on December 15, 2016 (T.D. 9803) provide that the value of the transferred property is to be determined under Code Sec. 482 regulations.[64]

What was Congress thinking? That additional regulations are necessary, covering topics or transactions not addressed by existing regulations? If so, what are those topics or transactions? Following our lead from case law addressing regulatory directives in tax statutes, we should consult the legislative history of the TCJA regulatory directives.

The TCJA Conference Report is not particularly illuminating. It says "the provision," which includes changes to Code Secs. 367(d), 482 and 936(h)(3)(B), "addresses recurring definitional and methodological issues that have arisen in controversies," citing *Veritas* and *Amazon* for their "definitional" holdings that goodwill and going concern value are not within the "intangible property" definition.[65] Clearly Congress reversed those "definitional" holdings with its revisions to Code Sec. 936(h)(3)(B) and the addition of Code Sec. 367(d)(4). It is not at all clear, however, whether Congress believed its regulatory directive language in Code Secs. 367(d)(2)(D) and 482 altered the "methodological issues" in those cases, namely the Tax Court's application of the aggregation and realistic alternative principles, or the concepts already addressed in existing regulations. In discussing what these regulatory directives require, the Conference Report more or less repeats the identical concepts that are found in existing Code Sec. 482 regulations. In the case of aggregation, Congress states that the directive is "consistent with the cost-sharing regulations," specifically Reg. §1.482-7(g)(2)(iv). Congress also mentions that the aggregation approach in the directive is "consistent with cases outside of the section 482 context, where collections of multiple, related intangible assets were viewed by the Tax Court in the aggregate." Apart from being a curious analogy out of left field, the application of the aggregation principle to multiple, related intangible assets is already addressed in existing Code Sec. 482 regulations.

The question remains whether the new regulatory directive in Code Sec. 482, combined with the legislative history, supports an IRS position that the aggregation and realistic alternative principles may be applied more broadly in light of the revisions to Code Sec. 936(h)(3)(B). In *Amazon* the IRS argued that the identified, pre-existing intangibles had to be aggregated with the subsequently developed intangibles and residual business assets, in an effort to effectively tax goodwill and going concern value as well as to implement its "all value" position. The Tax Court rejected that application of the aggregation principle, as it would improperly tax assets that are not compensable. The reasonable alternative argument made by the IRS in *Amazon* was similarly designed by IRS to shift value from non-compensable assets to compensable assets, and also was rejected by the Tax Court. Did Congress intend that regulations could adopt—or otherwise be applied to reflect—aggregation and realistic alternative principles that the IRS litigated and lost in *Amazon*?

The answer is perhaps, with two significant caveats. First, under the body of case law addressing the effect of regulatory directives, the new regulatory directive in Code Sec. 482 should not be regarded as self-executing. It is not sufficiently clear from the statute and legislative history to know what regulatory changes, if any, were intended by Congress. Thus, unless and until regulations are issued to implement whatever it is that Congress intended, the new statutory language added to Code Sec. 482 should not, *by itself*, be used by the IRS to support an adverse position against a taxpayer.

Second, the regulatory directive does not support the ability of the IRS to apply the aggregation and realistic alternative principles *under existing Code Sec. 482 regulations* in pre-TCJA years in a manner designed to support IRS's positions that goodwill and going concern value are compensable, or that valuations of identified intangible property must reflect "all value." In pre-TCJA years the Code Sec. 482 regulations are what they are. Taxpayers and IRS may still debate whether the Final CSA Regulations and Temporary 482 Regulations fixed the arguments that the IRS lost in *Veritas* and *Amazon*, but it would not be correct for the IRS to assert that its position in that debate has been enhanced by the TCJA. To the extent that the IRS is drawing power from the changes to Code Sec. 936(h)(3)(B) and the addition of Code Sec. 367(d)(4), the "no inference" statement from Congress should prevent that, as discussed. To the extent that the IRS is drawing power from Congress's characterization of the regulatory directive as a "clarification," the effective date of the "clarification" should prevent that. In other words, when Congress said the regulatory directive is effective for transfers in tax years beginning after December 31, 2017, it should not be possible for the IRS to broaden its application of the aggregation and realistic alternative principles in pre-TCJA years based on some inference from the Conference Report.

IV. Conclusion

Our fact pattern will continue to arise in tax years governed by the TCJA, and we should expect that the IRS will continue to favor use of the APM. If the taxpayer uses a method other than APM to value the PCT, there will be a threshold issue of whose method is the best method. This article has assumed APM will prevail in order to focus exclusively on the carveout-related issues. While Code Sec. 367(d)(4) of the TCJA makes clear that PCT assets may include goodwill, going concern value, and workforce in place, and that all the value of the PCT assets must be counted, the value of the PCT should not simply be the stock acquisition price multiplied by the RAB share. Only those assets that are appropriately considered part of the PCT may be counted. Certain carveouts should still be noncontroversial, such as carveouts for tangible assets, routine returns, NOLs, and the assumption of unvested compensation obligations. Taxpayers still can argue that a control premium or buyer-specific synergy value should not be considered part of the PCT assets under the PCT requirements of the Final CSA Regulations, but that position will likely be opposed by the IRS. Taxpayers may also experience some IRS opposition on the tax gross-up issue.

None of the foregoing issues should be affected by the regulatory authority granted in Code Secs. 367(d)(2)(D) and 482. Those TCJA changes are relevant only if Treasury and IRS decide to exercise this new authority by amending the existing Code Sec. 482 regulations.

ENDNOTES

* The author appreciates the valuable contributions from his colleagues, Jason Osborn and Elena Khripounova, also members of the firm's Tax Controversy and Transfer Pricing practice.

1 All section references are to the Internal Revenue Code of 1986, as amended, or the Treasury regulations promulgated thereunder, unless otherwise indicated.

2 The TCJA amended Code Sec. 936(h)(3)(B) to drop former clause (vi) and add new clauses (vi) and (vii). On March 23, 2018, the Consolidated Appropriations Act of 2018 (P.L. 115-141), §§401(d)(1)(C) and (D) repealed Code Sec. 936 as deadwood, added Code Sec. 367(d)(4)(A) through (G) to reflect the TCJA version of Code Sec. 936(h)(3)(B)(i) through (vii), and modify Code Sec. 482 to add a reference to Code Sec. 367(d)(4) and strike the reference to Code Sec. 936(h)(3)(B). These changes are effective as if they were included in the TCJA, that is, for taxable years beginning after December 31, 2017.

3 LB&I International Practice Service Transaction Unit, DCN ISO/9411.01_02 (2013) (updated Dec. 23, 2015).

4 Compare Reg. §1.482-7(g)(2)(vii) ("Allocations or other valuations done for accounting purposes may provide a useful starting point but will not be conclusive for purposes of the best method analysis in evaluating the arm's length charge in a PCT, particularly where the accounting treatment is inconsistent with its economic value") with LB&I International Practice Service Transaction Unit, DCN ISO/9411.01_02 (2013) ("Many taxpayers compute the subsequent acquisition PCT payment focusing solely on limited IP for example per the purchase price allocation ('PPA') … ignoring other platform contributions—resources, capabilities and rights acquired from Target that require compensation").

5 Another issue that typically arises is the reasonably anticipated benefits (RAB) share that should be used in calculating a PCT payment under APM. That issue is not addressed in this article. *See* LB&I Directive 04-0118-004 (Jan. 12, 2018), in which LB&I directed its agents to stop developing adjustments based on changing the taxpayer's RAB shares to a single RAB share when PCTs are added to an existing CSA, at least until an IRS-wide position is

finalized. In CCM 2018-003 (July 26, 2018), the National Office of IRS Chief Counsel concluded that it may be appropriate for cost sharing participants to use a separate RAB share to determine PCT payments with respect to a subsequent PCT.

[6] Reg. §1.482-7(c)(1).

[7] *Veritas*, 133 TC 297, Dec. 58,016 (2009), *nonacq.* 2010-49 IRB.

[8] *Amazon*, 148 TC 108 (2017), appeal pending in 9th Circuit (No. 17-72922).

[9] Note, however, that Reg. §1.482-7(j)(3) of the Final CSA Regulations defines a platform contribution to be either a transfer of an intangible under Reg. §1.482-4 or a provision of a service under Reg. §1.482-9, that Reg. §1.482-4(b) has for many years (that is, both before and after the issuance of the Final CSA Regulations) defined intangible property as property defined in former Code Sec. 936(h)(3)(B), and that the Tax Court has held that intangible property under Reg. §1.482-4(b) does not include goodwill, going concern value or workforce in place. *See infra* discussion accompanying footnote 53.

[10] T.D. 9568 (Dec. 22, 2011), preamble.

[11] Reg. §1.482-7(g)(2)(vii)(B), Examples 1, 2 and 3.

[12] T.D. 9568, *Federal Register*, Vol. 76, No. 246 (Dec. 22, 2011), at 80085.

[13] Chandler and Foley, *Why the Acquisition Price Method and Income Method Give Different Answers Under the Same Set of Facts*, 19 Transfer Pricing Report 861 (BNA, Dec. 2, 2010).

[14] *Xilinx*, CA-9, 2010-1 USTC ¶50,302, 598 F3d 1191.

[15] Buyer-specific synergies are synergies over and above the market participant synergies that are created by the specific buyer. Such synergies exist when one specific buyer can make more efficient use of the assets of target than a typical market participant. For financial accounting purposes, if buyer-specific synergies are part of the purchase price, they are removed in carrying out the purchase price allocation.

[16] The IRS disagrees with this holding in *Xilinx,* stating that the court "mistakenly interprets the arm's length standard to limit the behavior of controlled taxpayers, or the transactions into which they enter, based on the behavior or transactions into which uncontrolled taxpayers may or may not enter." AOD 201003 (July 16, 2010).

[17] There is nothing explicit in the Code Sec. 482 regulations requiring that arm's length be determined by reference to the hypothetical market participant, rather than the specific attributes of the individual buyer and seller. The regulations do refer to an uncontrolled party involved in the "same transaction" under the "same circumstances." Reg. §1.482-1(b)(1). The issue of course is what is meant by "same." This regulation then acknowledges that "because identical transactions can rarely be located, whether a transaction produces an arm's length result generally will be determined by reference to the results of *comparable* transactions under *comparable* circumstances" (emphasis added). If there were truly a requirement to take the unique characteristics of the buyer and seller into account, it would make no sense for the regulation to acknowledge that it is difficult to find comparable parties with those same characteristics, and then direct you to look for "comparable" situations, which suggests that you should look for "market participant" situations. Indeed, in the concurring opinion in the 9th Circuit's opinion in *Xilinx,* the judge notes that taxpayer argued that the regulation requires an examination of "comparable circumstances," whereas the IRS argued that regulation forces you to view the unrelated parties under the "same circumstances" and that analyzing comparable transactions is not dispositive.

[18] *See* Reg. §1.482-7(g)(5)(iii), which requires that the acquisition price must be reduced by any resources, capabilities and rights that are "not covered by a PCT."

[19] *Philip Morris, Inc.*, 96 TC 606, Dec. 47,289 (1991), *aff'd without opinion*, CA-2, 970 F2d 897 (1992).

[20] *Id.*, at 628. Further, Section 20.2031-2(f), Estate Tax Regulations sets forth guidelines for estate tax valuation of stock in cases of inadequate or otherwise non-representative market transactions, and requires that consideration be given to the "degree of control of the business represented by the block of stock to be valued."

[21] *Id.*, at 629.

[22] *Id.*

[23] *Philip Morris* at 627, citing *J. Daniels Distillery*, CtCls, 67-2 USTC ¶9499, 379 F2d 569, 579, 180 CtCls 308.

[24] *Id*.

[25] De Souza, *Financial Versus Tax Valuation: The Great Wall of Controversy*, BNA Weekly Report (June 4, 2012): Davis, *Control Premiums: Minimizing the Cost of Your Next Acquisition,* Mgmt Accounting Quarterly, Vol. 6, No. 3 (Spring 2005).

[26] FactSet Mergerstat/BVR Control Premium Study.

[27] Reg. §1.482-7(j)(1)(i) defines nonroutine contributions as follows: "Nonroutine contributions means a controlled participant's contributions to the relevant business activities that are not routine contributions. Nonroutine contributions ordinarily include both nonroutine platform contributions and nonroutine operating contributions used by controlled participants in the commercial exploitation of their interests in the cost shared intangibles (for example marketing intangibles used by a controlled participant in its division to sell products that are based on the cost shared intangible)."

[28] The definition of nonroutine contributions per Reg. §1.482-7(j)(1)(i) focuses on a "controlled participant's" nonroutine contributions. However, in terms of the PCT, Reg. §1.482-7(g)(5)(i) is focused on the "target's nonroutine contributions" to the PCT payee's business and what is being made available to the PCT payor.

[29] Routine contributions are defined by Reg. §1.482-7(j)(1)(i): "Routine contributions means a controlled participant's contributions to the relevant business activities that are of the same or similar kind to those made by uncontrolled taxpayers involved in similar business activities for which it is possible to identify market returns. Routine contributions ordinarily include contributions of tangible property, services and intangibles that are generally owned by uncontrolled taxpayers engaged in similar activities. A functional analysis is required to identify these contributions according to the functions performed, risks assumed, and resources employed by each of the controlled participants."

[30] *See also* Reg. §1.482-7(g)(2)(vii)(B) Example 3 for similar facts and a similar conclusion.

[31] Rev. Rul. 2003-98, 2003-2 CB 98.

[32] *Cf.* Rev. Rul. 2003-98, in which buyer's issuance of its unrestricted stock or the payment of cash to target's holders of employee options in connection with a taxable stock acquisition is treated as a capital contribution by buyer to target. While buyer increases its basis in target stock due to the deemed capital contribution, the cash is not viewed as additional purchase price for the target stock. Similarly, if buyer provides cash which is used to cash out holders of restricted stock or options, buyer is treated as contributing cash to the capital of target and target is then treated as transferring such cash to the employee as compensation, which is deductible at the target level. *See also* Rev. Rul. 84-68; TAM 8834051; TAM 9438001. Where target *stock* is acquired in a tax-free reorganization under Code Sec. 368, and buyer issues its *unrestricted* stock to holders of employee options, target is similarly viewed as acquiring buyer stock in the reorganization and then transferring it to its employees as compensation; target is allowed the compensation deduction. TAM 9102037 (Oct. 17, 1990).

[33] *Cf.* Rev. Rul. 2003-98 (buyer substituted its option for each target option held by target employees, and issued its stock upon later exercise of the option; at that time buyer is treated as contributing its stock to the capital of target, and target is then treated as transferring such stock to the employee; target is entitled to the compensation deduction).

[34] *See, e.g.,* TAM 9721002 (Jan. 24, 1997) (severance payments triggered two days after buyer's acquisition of target stock as a result of buyer terminating employees were not capitalized as part of the deemed acquisition price in a Code Sec. 338(h)(10) transaction since the buyer was free to decide after the acquisition whether or not to terminate employees and, consequently, whether or not to incur this liability).

[35] T.D. 9568 (Dec. 22, 2008).

36 Temporary Regs. §§1.482-7(g)(2)(x), -7(g)(5)(ii), and -7(g)(5)(v).

37 Regs. §§1.482-7(g)(2)(x), -7(g)(5)(ii), and -7(g)(5)(v).

38 While the Final CSA Regulations state they are "effective on December 16, 2011," the transition rule in Reg. §1.482-7(m) effectively requires that any CSA in existence on January 5, 2009, comply with the provisions of the Final CSA Regulations. Further, T.D. 9568 confirms that the Final CSA Regulations supersede the temporary regulations that were effective on January 5, 2009, by "removing" the temporary regulations. In effect, the 2009 temporary regulations have disappeared for all time.

39 Reg. §1.482-7(g)(2)(x) makes reference to paragraphs (g)(2)(v)B)(3), (g)(4)(i)(G), (g)(5)(ii), and (g)(6)(ii) of Reg. §1.482-7.

40 T.D. 9568 (Dec. 16, 2011).

41 *See* general statement in Reg. §1.482-1(f)(2)(iii); additional statements for unspecified methods in Regs. §§1.482-3(e), -4(d) and -9(h); and further guidance for cost sharing agreements in Reg. §1.482-7(g)(2)(iii).

42 T.D. 9738 (Sept. 14, 2015) ("All value provided between controlled taxpayers in a controlled transaction requires an arm's length amount of compensation ….").

43 *See* Technical and Miscellaneous Revenue Act of 1988 (H.R. 4333), Conference Report at 305 (The Senate Report stated: "The expiration of temporary regulations at the end of this two-year period is not to affect the validity of those regulations during the two-year period." The Conference Report followed the Senate Report, except the two-year period was changed to three years).

44 The proposed regulations were issued as REG-139483-13. *See also* T.D. 9738 for the Temporary 482 Regulations, which says "The text of the temporary regulations also serves in part as the text of the proposed regulations (REG-139483-13) published in the Proposed Rules section of this issue of the Federal Register." The proposed regulations focused mostly on Code Sec. 367(d) and were finalized on Dec. 15, 2016, in T.D. 9803; however, a portion of the proposed regulations is still considered to exist in the form of regulations that are identical to the expired Temporary 482 Regulations.

45 The proposed regulations that were finalized on December 15, 2016, are effective for outbound transfers occurring on or after September 14, 2015.

46 *See* Regs. §§1.6662-3(c), 1.6664-4(c)(1)(ii).

47 Temporary Reg. §1.482-1T(f)(2)(i)(E), Examples 6, 7 and 8.

48 Temporary Reg. §1.482-1T(f)(2)(i)(E), Example 5.

49 Temporary Reg. §1.482-1T(f)(2)(i)(E), Examples 6 and 8.

50 *See supra* Section 1.G.

51 That statement is somewhat tongue in cheek, since we know that the effective U.S. tax rate on GILTI can go well beyond 10.5% to the extent that the expense allocation rules apply for purposes of determining foreign source taxable income in the GILTI foreign tax credit basket. *Cf.* REG-105600-18, 83 FR 63200 (Dec. 7, 2018).

52 These items are: "(i) patent, invention, formula, process, design, pattern or knowhow; (ii) copyright, literary, musical, or artistic composition; (iii) trademark, trade name, or brand name; (iv) franchise, license, or contract; and (v) method, program, system, procedure, campaign, survey, study, forecast, estimate, customer list, or technical data."

53 Regs. §§1.482-7(j)(3)(ii) ("[PCT payments] will be treated as either consideration for a transfer of an intangible property or for services"); 1.482-7(c)(5), Example (1) (to the extent platform contribution is a transfer of intangibles, it is "governed by 1.482-4"); and Example (2) (to the extent platform contribution is a provision of services, it is "governed by 1.482-9").

54 Brief for the Appellant at 57–59, *Amazon, Inc. and Subsidiaries*, No. 17-72922 (9th Cir. 2018).

55 *R.O. Jacobson*, 96 TC 577, Dec. 47,264 (1991), *aff'd*, CA-8, 963 F2d 218 (1992). In *Jacobson* the Tax Court addressed whether a so-called "disguised sale" transaction was to be treated in substance as a taxable sale or instead respected as a contribution followed by a distribution. The transaction occurred before the effective date of Code Sec. 707(a)(2)(B), which meant that the issue was decided based on various factors developed by case law. The IRS argued that the new legislation effectively confirmed that one of the leading taxpayer-favorable cases, *J.H. Otey, Jr.*, 70 TC 312, Dec. 35,167 (1978) was decided incorrectly. Focusing on similar "no inference" language in the legislative history, the Tax Court stated that "the adoption of section 707(a)(2)(B) *in no way* altered the law existing before the actual effective date of that section," and that "[IRS's] theory that section 707(a)(2)(B) was a mere 'recodification' of preexisting law must fail."

56 This is similar to the challenge that taxpayers face under pre-TCJA law during periods that the Temporary 482 Regulations apply, but is even more challenging after the TCJA since the "all value" requirement is codified in the Code.

57 Reg. §1.482-7(g)(2)(vii)(B), Example 2.

58 CCA 201009013 (Nov. 24, 2009).

59 *Occidental Petroleum Corp.*, 82 TC 819, Dec. 41,240 (1984); *International Multifoods Corp.*, 108 TC 579, Dec. 52,100 (1997).

60 *H Enterprises International, Inc.*, 105 TC 71, Dec. 50,785 (1995), *aff'd*, CA-8, 99-2 USTC ¶50,723, 183 F3d 907; *Neumann Est.*, 106 TC 16 (1996); *D.H. Hillman*, CA-4, 2001-1 USTC ¶50,354, 250 F3d 228, *reversing* 114 TC 103, Dec. 53,768 (2000).

61 Reg. §§1.482-1(d)(3)(iv)(H) (realistic alternatives), -1(f)(2)(ii)(A) (realistic alternatives).

62 Reg. §§1.482-7(g)(2)(iii)(A) (realistic alternatives), -7(g)(2)(iv) (aggregation), -7(g)(4)(i)(A) (realistic alternatives).

63 Temporary Regs. §§1.482-1T(f)(2)(i)(B) (aggregation), -1T(f)(2)(ii)(B) (realistic alternatives).

64 Reg. §1.367(a)-1(b)(3).

65 H.R. Rep. No. 115-466, at 675 (2017).