

**TRANSFER PRICING THROUGH §482—LOOKING BEYOND
AMAZON V. COMMISSIONER AND OTHER MNEs WHEN
TRANSFERRING PREEXISTING INTANGIBLES UNDER THE
PRE-2009 CSA REGULATIONS**

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I. INTRODUCTION—THE NEED FOR THE SERVICE TO OBTAIN A
FAVORABLE SECURITY IN TRANSFER PRICING DISPUTES

An extremely difficult and ongoing problem associated with MNEs¹ and their international entities is the concept and idea of double taxation.² Double taxation frequently occurs with MNEs “in the context of transfer pricing adjustments, where tax authorities in competing jurisdictions disagree over income allocations attributable to transfer pricing.”³ Transfer pricing generally refers to the practice and requirement of MNEs to report the prices it used in allocating an appropriate income tax⁴ within

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¹ MNEs refers to “global multinational enterprises” that operate their business on a worldwide scale. See *Definition of Global Multinational Enterprises*, FINANCIAL TIMES, <http://lexicon.ft.com/Term?term=global-multinational-enterprises> [<https://perma.cc/9JCP-N48H>].

² See Robert G. Clark, *Transfer Pricing, Section 482, and International Tax Conflict: Getting Harmonized Income Allocation Measures from Multinational Cacophony*, 42 AM. U. L. REV. 1155, 1157 (1993) (“[D]ouble taxation occurs when two or more countries claim jurisdiction to tax the same income. Where uncertainty exists as to which of two affiliated or commonly controlled companies in different countries has earned taxable income to which both companies have contributed, both countries might tax the same income.”). The Code offers various “tools” and resources to help international transactions mitigate a double taxation between two jurisdictions—such as the foreign tax credit—but these tools do not always eliminate the issue entirely. See *Foreign Tax Credit*, OBLIVIOUS INVESTOR, <https://obliviousinvestor.com/foreign-dividend-tax-credit/> [<https://perma.cc/5M5H-M2J4>].

³ Clark, *supra* note 2, at 1157–58 (“Transfer pricing adjustment, at income allocation, is the means [where] national tax authorities assign market prices to related-party transactions in order to clarify the income attributable to each segment of a multinational corporation, thereby performing the role reserved to the free market in transactions among unrelated parties.”).

⁴ Section 482 of the Internal Revenue Code specifically grants the Commissioner of Internal Revenue power to “[a]llocat[e] . . . income and deductions among taxpayers.”

(continued)

a specific, national jurisdiction when a controlled transaction⁵ occurs.⁶ In the United States, the Service has not successfully won a major transfer pricing dispute with an MNE since 1979.⁷ This continuous line of losses leaves the Service unable to collect more than \$2.5 trillion U.S. dollars from MNEs who use low-income-tax foreign subsidiary jurisdictions when carrying out a transfer.⁸

In *Amazon v. Commissioner*, the action was viewed “as an opportunity for the [Service] to reverse its position and set a precedent for future transfer pricing disputes.”⁹ However, the Service received numerous critical reviews in this case because the arguments made by both parties is nearly identical to the arguments made in the case of *Veritas Software Corporation v. Commissioner*, a case held seven years prior.¹⁰ Although an appeal has been filed¹¹ in *Amazon* by the Service,¹² it is unlikely this

I.R.C. § 482 (2018). The term “allocation of income” is a standard and term of art used for §482 disputes.

⁵ “Controlled Transactions are transactions between two enterprises that are associated enterprises with respect to each other.” *Controlled Transaction Law and Legal Definition*, USLEGAL, <https://definitions.uslegal.com/c/controlled-transaction/> [<https://perma.cc/2VUM-G4B6>]. *But cf. Uncontrolled Transaction*, DEFINED TERM, https://definedterm.com/uncontrolled_transaction [<https://perma.cc/65SS-6BEQ>]. (An uncontrolled transaction is a “[t]ransaction between independent and unrelated enterprises.”).

⁶ See Yariv Brauner, *Value in the Eye of the Beholder: The Valuation of Intangibles for Transfer Pricing Purposes*, 28 VA. TAX REV. 79, 81 (2008) (“Transacting taxpayers are required to establish their transfer prices whenever they transact with related parties, even if they have no other . . . reasons for such (internal) pricing.”).

⁷ See Reuven S. Avi-Yonah, *Amazon vs. Commissioner: Has Cost Sharing Outlived Its Usefulness?*, (U. of Mich. Law & Econ. Research Paper No. 17-003; U. of Mich. Public Law Research Paper No. 551), available at <https://ssrn.com/abstract=2961235> (Recently, MNEs have largely defeated the Service in transfer pricing lawsuits by using a cost-sharing arrangement when conducting a transfer of intangible property).

⁸ “The tax planning behind this achievement has been the focus of numerous Congressional investigations . . .” *Id.*

⁹ *Court Delivers Prime Ruling for Amazon*, MOODY, FAMILIETTI & ANDRONICO (June 2017), <http://www.mfa-cpa.com/en/Our%20Insights/2017/06/Court%20Delivers%20Prime%20Ruling%20for%20Amazon.aspx> [<https://perma.cc/F7J9-DCR5>] (discussing the similarities between *Amazon* and *Veritas* and how the Service tried to use *Amazon* to reverse the *Veritas* precedent previously set in 2009).

¹⁰ *Veritas Software Corp. v. Comm’r.*, 133 T.C. 297, 339 (2009) (The Court ruled that “the CUT method is the best method for determining the requisite buy-in payment relating to VERITAS[’s] [European subsidiary] transfer of intangibles to VERITAS US.”).

¹¹ By the time this article is read or published, it is likely a decision on this appeal has been rendered by the Ninth Circuit Court of Appeals.

¹² See *IRS filed notice of appeal in Amazon case*, DELOITTE (Dec. 2017), http://newsletters.usdbriefs.com/2017/Tax/ALS/171211_10.pdf [<https://perma.cc/8KQE-BPCC>] (The Service filed their notice of appeal in *Amazon v. Commissioner* on September 29, 2017).

appeal will help the Service's overall argument because *Amazon's* transfer pricing CSA¹³ is governed under the pre-2009 CSA regulations.¹⁴ Instead, the Service should look beyond the pre-2009 CSA regulations and move forward into the post-2009 CSA regulations, and the transactions involving the transfer of preexisting intangibles executed under a CSA between MNEs and their foreign subsidiaries. These post-2009 CSA regulations are much more in line with the Service's position¹⁵ and will likely reverse the Service's losing streak in transfer pricing disputes.¹⁶ The need for the Service to control the transfer pricing market will continue to grow as MNEs find other ways to use transfer pricing strategies to avoid certain U.S. income-based taxes, especially when it comes to the transfer of intangibles.¹⁷

¹³ A CSA, or cost sharing arrangement (sometimes also referred to as a cost sharing agreement), is "an arrangement by which controlled participants share the costs and risks of developing cost shared intangibles in proportion to their RAB [Reasonably Anticipated Benefits] shares." Treas. Reg. § 1.482-7(b) (2013). Stated differently, a CSA is

[a]n agreement between two parties to share the cost of developing an intangible asset, such as computer code, production methods, or patents. Such an arrangement is used to reduce or avoid taxes on the transfer of assets. For example, if a parent company wanted a foreign subsidiary to use one of its patents, tax authorities might consider the transfer a taxable transaction. By establishing a cost sharing agreement, the parent company and the subsidiary share in the cost of developing the patent, so that both are entitled to use it, and it is not transferred from one to the other.

Cost Sharing Agreement, BUSINESS DICTIONARY, <http://www.businessdictionary.com/definition/cost-sharing-agreement.html> [<https://perma.cc/33SF-86QH>].

¹⁴ *But see* Neal Kochman, *Amazon.com v. Commissioner: Veritas Redux?*, CAPLIN & DRYSDALE (Aug. 1, 2013), <http://www.capdale.com/iamazoncom-v-commissioner-veritasiredux> [<https://perma.cc/6CQZ-FH4F>] ("Whatever the outcome in the Amazon case, its impact in the cost sharing arena may be fairly limited.").

¹⁵ "The new cost sharing regulations, which took effect in 2009, are much more in line with the [Service's] position [as argued] in *Veritas* . . ." *Id.*

¹⁶ *See* Avi-Yonah, *supra* note 7 (The Service's recent losses in the cost sharing arena include *Xilinx* and *Veritas* in 2009, and *Altera* in 2016).

¹⁷ *See* Joanna Mather, *Lessons for the Tax Office in Amazon's transfer pricing win*, FINANCIAL REVIEW (Apr. 9, 2017, 4:35 PM), <http://www.afr.com/news/policy/tax/lessons-for-the-tax-office-in-amazons-transfer-pricing-win-20170328-gv8nvk> [<https://perma.cc/E7P7-RK7C>] ("Unlike a bank branch or a hole in the ground, [intellectual property] is highly mobile and locating it in low-tax jurisdictions has long been a strategy for multinational companies, and correspondingly, a big concern for tax regulators around the world . . .") (internal quotations omitted).

This Note explains the recent Tax Court decision of *Amazon v. Commissioner*,¹⁸ why the decision is important for MNEs and tax strategists, and what this decision means for MNEs when creating a CSA to transfer preexisting intangibles¹⁹ into a foreign jurisdiction. This Note also explains some basic business and taxing principles associated with the transferring of preexisting intangibles²⁰ executed under a CSA into a foreign subsidiary. Finally, this Note additionally guides the Internal Revenue Service so that future CSA transfers of intangibles by MNEs are in agreement with the Service's position—as argued in the case of *Amazon*

¹⁸ See generally *Amazon.com, Inc. v. Comm'r.*, 148 T.C. 108 (2017). The Court in *Amazon* held the Service's "determination with respect to the buy-in payment [as] arbitrary, capricious, and unreasonable." *Id.* at 112.

¹⁹ Intangibles, or intangible property, is any

patent, invention, formula, process, design, pattern, or know-how; copyright, literary, musical, or artistic composition; trademark, trade name, or brand name; franchise, license, or contract; method, program, system, procedure, campaign, survey, study, forecast, estimate, customer list, or technical data; or any similar item, which has substantial value independent of the services of any individual.

I.R.C. § 936(h)(3)(B) (2012). This definition, for purposes of §482, has since changed from an amendment in the Tax Cuts and Jobs Act of 2017. Compare I.R.C. § 482 (2017) with I.R.C. § 482 (2018) (the amendment now refers to "intangible property" as having the same meaning as section 367(d)(4), rather than section 936(h)(3)(B)). The definition now currently being used for an intangible is much more broader than its pre-TCJA counterpart. See *infra* Section V (for a discussion on how the amended §482 may affect future decisions with transfer pricing intangibles).

²⁰ Although the pre-TCJA §482 says the definition of an intangible is "within the meaning of section 936(h)(3)(B)" of the Internal Revenue Code (see *supra* note 19 & I.R.C. § 482 (2017)), the §482 regulations provide further guidance on the meaning of "intangible" "[f]or purposes of [§]482."

For purposes of section 482, an intangible is an asset that comprises any of the following items and has substantial value independent of the services of any individual—(1) Patents, inventions, formulae, processes, designs, patterns, or know-how; (2) Copyrights and literary, musical, or artistic compositions; (3) Trademarks, trade names, or brand names; (4) Franchises, licenses, or contracts; (5) Methods, programs, systems, procedures, campaigns, surveys, studies, forecasts, estimates, customer lists, or technical data; and (6) Other similar items. For purposes of section 482, an item is considered similar to those listed [within this paragraph] if it derives its value not from its physical attributes but from its intellectual content or other intangible properties.

Treas. Reg. § 1.482-4(b) (2011).

and *Veritas*.²¹ These future transactions are governed under the post-2009 CSA regulations and will likely give the Service a more favorable security when faced with transfer pricing disputes associated with the transferring of intangibles executed under a CSA because of the amended requirements.²²

II. BACKGROUND—SECTION 482 AND THE SERVICE’S DECISION TO RE-ALLOCATE AMAZON’S INCOME FROM ITS TRANSACTION WITH AMAZON LUXEMBOURG²³

A. *Background of Amazon v. Commissioner*

1. *Brief Background about Amazon.com, Inc.*

Amazon.com, Inc. is a widely known e-commerce company that offers many types of online goods and services.²⁴ In 2016, Amazon was the leading e-retailer in the United States creating close to \$136 billion U.S.

²¹ See Kochman, *supra* note 14 (“Both *Veritas* and *Amazon* should have limited bearing on the outcome of cases under the new regulations” because both cases follow the pre-2009 CSA regulations).

²² See *Unwrapping the New Cost Sharing Regulations*, MILLER & CHEVALIER (Dec. 22, 2011), <https://www.millerchevalier.com/publication/unwrapping-new-cost-sharing-regulations> [<https://perma.cc/NE66-KAAN>]. (“On December 16, 2011, the [Service] and the Treasury Department issued comprehensive final transfer pricing regulations related to cost sharing arrangements for the development of intangibles (‘CSAs’).”).

²³ See Jesse Neugarten, *Why is Luxembourg considered a tax haven?*, INVESTOPEDIA (Feb. 5, 2018, 6:52 PM), <https://www.investopedia.com/ask/answers/100115/why-luxembourg-considered-tax-haven.asp> [<https://perma.cc/WB3Y-J7E2>] (discussing the popularity of international corporations taking their business into Luxembourg because of its financial tax advantages).

Luxembourg has been the tax haven of choice of many corporations and mega-rich individuals around the world since the 1970s. It has thrived as a tax haven due to its political and economic stability and huge tax incentives, encouraging foreign companies to move there. The country’s small state government has provided offshore bank holders with top-notch confidentiality and asset protection for years. Luxembourg’s tax system allows hundreds of U.S. corporations to store massive chunks of their business outside their home countries, which cuts billions from tax bills.

Id.

²⁴ See *Statistics and Facts about Amazon*, STATISTA, <https://www.statista.com/topics/846/amazon/> [<https://perma.cc/G673-5YAE>] (Amazon’s services include “online retail, computing services, consumer electronics, digital content as well as other local services such as daily deals and groceries.”).

dollars in net sales.²⁵ Amazon “began [its] operations in 1995 and completed an initial public offering of common stock in 1997.”²⁶ Because “Amazon is an online retailer . . . [that] does not have brick-and-mortar stores, but rather sells products exclusively through Amazon.com and related websites,”²⁷ in 2000 Amazon expanded its online retail business by “allowing third parties to sell items on its websites.”²⁸ Amazon further negotiated with other third parties that wanted to use Amazon’s technology—but not to sell their products exclusively on Amazon’s branded website—to build their own independent and custom-made ecommerce websites.²⁹

2. *Amazon’s Desire to Create a European Headquarters and to Establish a European Market*

“In April 1998, Amazon acquired Bookpages, Ltd., . . . and Telebook, Inc.,” online bookstores located in the U.K. and Germany respectively.³⁰ Later, “[i]n August 2000[,] Amazon launched [a] French business organically³¹ rather than by acquisition,”³² to further its international business within the European country.³³

²⁵ *Id.* “The majority of the company’s revenues are generated through e-retail sales of electronics and other products, followed by third-party seller revenues, subscription services and [Amazon Web Service] activities.” See *Net sales revenue of Amazon from 2014 to 2017 (in billion U.S. dollars)*, STATISTA, <https://www.statista.com/statistics/266282/annual-net-revenue-of-amazoncom/> [<https://perma.cc/M9RX-YG4D>].

²⁶ *Amazon.com, Inc. v. Comm’r.*, 148 T.C. 108, 114 (2017) (Amazon “was incorporated in 1994 in Washington[,] and was reincorporated in 1996 in Delaware.” At the time Amazon filed its petition, “[their] principal place of business . . . was in Seattle, Washington.”).

²⁷ *Id.* (“Initially, Amazon sold only books, but by 2000 had expanded its offerings into many other product categories, including music, video, electronics, toys, software, video games, cameras, kitchen items, tools/hardware, and home/garden.”).

²⁸ *Id.* at 115 (“Amazon made available a set of eCommerce platforms, services, and tools that enabled third parties to list their own products and services for sale on Amazon.com . . .”).

²⁹ *Id.* (“Although Amazon built websites for numerous customers, the most successful implementation of its . . . business was the website it built for Target Corp., which enabled Target to sell its retail products through Target.com.”).

³⁰ *Id.* at 116 (“Later that year, Amazon re-launched these websites . . . [as] Amazon.co.uk and Amazon.de,” giving both the U.K. and Germany access to Amazon’s website services.”).

³¹ *Id.* “[O]rganic growth refers to the process of growing a business by reducing costs and increasing sales, either by finding more customers or enhancing output to current clients.” *Tips for Organic Business Growth*, QUICKBOOKS, <https://quickbooks.intuit.com/r/growing-your-business/tips-for-organic-business-growth/> [<https://perma.cc/UXK8-KTW A>].

Although all three nations were EU members, the manner in which Amazon operated its business in each country was in many respects local. . . . Due to differing cultural preferences, retail traditions, and national regulations, the details of these operations—and the technology required to make them happen—often varied from country to country. . . .

Unlike in the United States, where Amazon operated uniform retail websites serving a large geography with a large population, Amazon’s retail business in Europe had a siloed structure. Each European Subsidiary³⁴ had a distinct website employing its own national language. Each European Subsidiary had its own fulfillment centers, often processing country-specific inventory, and a distinct universe of customers residing chiefly within its own borders.

This siloed structure resulted in inefficient operations . . . [and] was also stressing Amazon’s website technology: All website servers were in the United States, and increased website traffic exacerbated latency³⁵ problems. . . .

³² See *Tips for Organic Business Growth*, *supra* note 31 (Acquisition, “[o]n the other hand, . . . occurs when a company merges with or is acquired by a second business.”).

³³ See *Amazon*, 148 T.C. at 116 (Amazon relaunched this French website as Amazon.fr. “During the tax years at issue, Germany, the UK, and France were the only European countries in which Amazon operated.”).

³⁴ Subsidiary refers to “a company with [voting] stock that is more than 50% controlled by another company, which is usually referred to as the parent company.” *Subsidiary*, INVESTOPEDIA, <https://www.investopedia.com/terms/s/subsidiary.asp> [<https://perma.cc/ZGE2-ZJMR>]. A subsidiary can be partly or completely owned by the parent company, which holds a controlling interest in the subsidiary company. *Id.* In cases where a parent company owns a foreign subsidiary, “the subsidiary must follow the laws of the country where it is incorporated and operates,” and the parent company carries the foreign subsidiary’s financials on its consolidated financial statements. *Id.* Amazon’s U.K., German, and French entities are “European Subsidiaries . . . wholly owned by Amazon US.”; meaning all shares of Amazon’s European Subsidiaries are owned by Amazon U.S. *Amazon*, 148 T.C. at 118. *C.f.* I.R.C. § 958(a) (2018) (“[T]he term ‘controlled foreign corporation’ means any foreign corporation if more than 50 percent of—(1) the total combined voting power of all classes of stock of such corporation entitled to vote, or (2) the total value of the stock of such corporation, is owned . . . or is considered owned” by U.S. shareholders).

³⁵ “‘Latency’ refers to the speed . . . a webpage loads; customers prefer faster speeds.” *Amazon*, 148 T.C. at 119.

Recognizing that serving European customers through poorly coordinated national silos was inefficient, Amazon during the early 2000s began to investigate [the] creation of a centralized European headquarters. . . .³⁶

During the planning and decision-making process for the creation of a European headquarters, “[t]ax issues . . . loomed large in Amazon’s thinking.”³⁷ “By establishing a European headquarters, Amazon could collect and remit value added tax (VAT)³⁸ at a single rate in a single jurisdiction (the location of the seller), rather than at multiple rates in multiple jurisdictions (the locations of the buyers).”³⁹ Once Amazon established a European headquarters in Luxembourg, its “plan was to transfer from Amazon US to the Luxembourg headquarters affiliate all of the intangible assets required to operate the European website businesses”⁴⁰ After this process, Luxembourg would “function as the

³⁶ *Id.* at 120.

One goal of this process, [the creation of a European headquarters], was to enhance customer experience by locating servers closer to customers, thus reducing website latency. Other goals were to place top managers in the same time zones as their customers; to standardize best practices for customer service, traffic generation, pricing, and vendor acquisition; to increase efficiency by minimizing duplicative individual country costs; and to create a pan-European fulfillment infrastructure that would facilitate expansion into additional EU countries.

Id.

³⁷ *Id.* (“Amazon was quite aware that the effective marginal rate of corporate income tax was (or could be negotiated to be) significantly lower in certain EU member states—specifically, Luxembourg and Ireland—than it was in the United States.”).

³⁸ Value-added tax is

a [type] of consumption tax placed on a product whenever value is added at each stage of the supply chain, from production to the point of sale. The amount of VAT that the user pays is on the cost of the product, less any of the costs of materials used in the product that have already been taxed.

Value-Added Tax—VAT, INVESTOPEDIA, <https://www.investopedia.com/terms/v/valueaddedtax.asp> [<https://perma.cc/Z38R-N39H>].

³⁹ *Amazon*, 148 T.C. at 120. In the process of deciding where Amazon should establish its European headquarters, “Amazon . . . met with Luxembourg authorities, including Jean-Claude Juncker, Luxembourg’s then prime minister, to discuss the potential for Amazon to locate its European headquarters there.” *Id.* at 121.

⁴⁰ *Id.* at 121 (“Amazon successfully negotiated an advance tax agreement with the Government of Luxembourg” at a tax rate well below the United States’ corporate tax rate).

operational and administrative headquarters for the European businesses”⁴¹

B. The Transaction Leading to the §482 Dispute

1. “Project Goldcrest”

“Beginning in 2004 Amazon undertook a series of [six] transactions, dubbed [as] ‘Project Goldcrest,’”⁴² to carry out Amazon’s goal with establishing Amazon Luxembourg as a European subsidiary.⁴³ One “Project Goldcrest” transaction involved the creation of a CSA between the two entities where Amazon Luxembourg “obtained access to pre-existing intangible property [from] Amazon U.S.”⁴⁴ The CSA further required Amazon Luxembourg to pay its parent for its subsequently-incurred and already-created intangible development costs (IDCs).⁴⁵

⁴¹ *Id.* (Amazon Luxembourg would “own virtually all of the intangible assets required to operate those [European] businesses” located within the U.K., Germany, and France).

⁴² “Goldcrest” refers to Luxembourg’s national bird, and it is also Britain and Europe’s smallest bird. *See Amazon*, 148 T.C. at 121; *Goldcrest Facts—Information About Goldcrest*, TWOOTZ, <https://tweotz.com/bird/Goldcrest> [<https://perma.cc/HZS3-Y32Z>]. These six transactions in “Project Goldcrest” include: “(1) the Cost Sharing Arrangement; (2) the License Agreement For Preexisting Intellectual Property (License Agreement); (3) the Assignment For Preexisting Intellectual Property (Assignment Agreement); (4) the European Subsidiary Contribution; (5) the European Business Contribution, and (6) the Four-Party Agreement.” *Amazon*, 148 T.C. at 121–22.

⁴³ *See Amazon*, 148 T.C. at 121–22. “Project Goldcrest” was a very complex combined set of transactions involving many steps and entities, but the basic outline of the transaction was as follows:

Amazon US formed AEHT, the Luxembourg headquarters entity AEHT elected to be treated as a corporation for U.S. income tax purposes from the date of its formation. . . . Underneath AEHT[,] numerous subsidiaries were created (collectively, [referred to as] Amazon Luxembourg) to perform various functions essential to operation of the European businesses. These functions included holding title to the inventory sold in Europe, licensing Amazon’s intellectual property, housing the servers, and maintaining call centers. Amazon Germany, Amazon UK, and Amazon France thereafter supplied to Amazon Luxembourg the same types of customer-related, fulfillment, and support services . . . they had previously furnished to Amazon US.

Id. at 121.

⁴⁴ *Id.* at 122. (The parent and subsidiary agreed through the CSA to “share the costs of further ‘research, development, marketing, and other activities relating to . . . maintaining, improving, enhancing, or extending the Amazon Intellectual Property.’”).

⁴⁵ *Id.* (The CSA was designed to be a “qualified cost sharing arrangement.”). The 2009 temporary CSA regulations repealed the allowance of a “qualified cost sharing arrangement” and were thereby adopted into the finalization of the current post-2009 CSA

(continued)

Because a buy-in payment is required in transactions involving a CSA⁴⁶—and this buy-in payment is thereafter taxed⁴⁷—Amazon believed that the best method⁴⁸ for calculating a “buy-in price” was an unspecified

regulations. *See supra* note 22. Today, a “qualified cost sharing arrangement” no longer exists and is simply referred to as a CSA. *See* Treas. Reg. § 1.482-7(m) (2013) (“An arrangement in existence on January 5, 2009, will be considered a CSA . . . if, prior to such date, it was a qualified cost sharing arrangement . . .”).

⁴⁶ Under the pre-2009 CSA regulations analyzed under the case in *Amazon*, a buy-in payment is required. *See* Treas. Reg. § 1.482-7A(g)(2) (2009).

If a controlled participant makes pre-existing intangible property in which it owns an interest available to other controlled participants for purposes of research in the intangible development area under a qualified cost sharing arrangement, then each such other controlled participant must make a buy-in payment to the owner. The buy-in payment by each such other controlled participant is the arm’s length charge for the use of the intangible . . . multiplied by the controlled participant’s share of reasonably anticipated benefits

Id. The buy-in payment is treated as a form of consideration for the transfer of the parent’s preexisting intangibles, and to obtain an interest in the venture. *See Buy-In Payment*, BUSINESS DICTIONARY, <http://www.businessdictionary.com/definition/buy-in-payment.html> [<https://perma.cc/A3UK-XBFU>].

⁴⁷ *See* Ronald A. Dye, *Cost-Sharing Agreements; A tax-saving device for multinationals*, KELLOGG INSIGHT (April 1, 2008), https://insight.kellogg.northwestern.edu/article/cost_sharing_agreements [<https://perma.cc/323Q-W32Q>] (“[The] buy-in payment is taxable income to the parent and is tax deductible to the sub[idiary].”). *See also* I.R.C. § 61(a) (2017) (The basic source for determining whether an event is “taxable income” is §61, which states that gross income “means all income from whatever source derived . . .”). *See also* I.R.C. § 162(a) (2017) (A business may deduct their expenses so long as such expenses are within the “ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business . . .”).

⁴⁸ The “Best Method Rule” applies to any transaction involving the transfer of intangibles. *See* Treas. Reg. § 1.482-1(c) (2015).

The arm’s length result of a controlled transaction must be determined under the method that, under the facts and circumstances, provide the most reliable measure of an arm’s length result. Thus, there is no strict priority of methods, and no method will invariably be considered to be more reliable than others. An arm’s length result may be determined under any method without establishing the inapplicability of another method, but if another method subsequently is shown to produce a more reliable measure of an arm’s length result, such other method must be used. Similarly, if two or more applications of a single method provide inconsistent results, the arm’s length result must be determined under the application that, under the facts and circumstances, provides the most reliable measure of an arm’s length result.

Id.

income-based method.”⁴⁹ However, the method actually used by Amazon was “principally on the basis of the comparable uncontrolled transaction (CUT) method.”⁵⁰ Amazon’s economic expert determined the transfer of the parent’s preexisting intangibles to Amazon Luxembourg is valued at \$254.5 million dollars, with a seven-year non-perpetual useful life.⁵¹

2. *The Service’s Disagreement and Evaluation of Amazon’s Preexisting Intangibles*

Reviewing the CSA executed under Project Goldcrest, the Service argued that the CUT method is not the best method to use for Amazon’s buy-in payment.⁵² Because of this discrepancy, the Service used its §482⁵³ power to re-allocate Amazon U.S.’s income (with respect to this transaction) and determined that the correct buy-in payment is actually

⁴⁹ See *Amazon*, 148 T.C. at 140. See also *supra* note 46 (a buy-in payment is explicitly required under the pre-2009 CSA regulations).

⁵⁰ *Amazon*, 148 T.C. at 142. “The comparable uncontrolled transaction method evaluates whether the amount charged for a controlled transfer of intangible property was arm’s length by reference to the amount charged in a comparable uncontrolled transaction.” Treas. Reg. § 1.482-4(c)(1) (2011). The CUT method, and other methods that can be used to evaluate preexisting intangibles, will be discussed later in this Note. See *infra* Section III.A.3.

⁵¹ See *Amazon*, 148 T.C. at 141, (“For each species of [intangible] property, Amazon submitted expert reports that estimated the property’s useful life and valued it on the basis of available CUTs.”).

⁵² *Id.* (The Service “contended that the best method for determining an arm’s-length buy-in payment was the discounted cash flow (DCF) methodology,” but “[i]n the event the Court rejects that methodology, [the Service] submitted expert reports that employed a CUT methodology. . . . [The Service] supported values substantially higher than those determined by Amazon’s experts” even when using a CUT methodology).

⁵³ Section 482 gives a power to the Commissioner to re-allocate income for controlled transactions if the Commissioner determines that such allocation is necessary to prevent forms of tax evasion between the controlled entities.

In any case of two or more organizations, trades, or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Secretary may distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among such organizations, trades, or businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organizations, trades, or businesses. In the case of any transfer (or license) of intangible property (within the meaning of section 367(d)(4)), the income with respect to such transfer or license shall be commensurate with the income attributable to the intangible. . . .

\$3.468 billion using a DCF⁵⁴ method—rather than Amazon’s preferred CUT method.⁵⁵ However, the Service further argued that if the Tax Court ends up agreeing with *Amazon*—and finds the CUT method to be the best method under the best method rule—then Amazon’s evaluation of its preexisting intangibles using the CUT method is still, regardless, largely inaccurate.⁵⁶ This difference in evaluation formed because the Service’s expert measuring Amazon’s website technology as having an indefinite useful life, rather than a definite useful life of seven years (as argued by Amazon).⁵⁷

3. §482 Standard for Review

Section 482 of the Internal Revenue Code gives the Commissioner “broad authority to allocate gross income and deductions among commonly controlled entities if he determines that it is necessary ‘to prevent evasion of taxes or clearly to reflect the income.’”⁵⁸ Generally

⁵⁴ DCF refers to discounted cash flow; it is the “valuation method used to estimate the attractiveness of an investment opportunity. DCF analyses use future free cash flow projections and discounts them, using a required annual rate, to arrive at present value estimates. A present value estimate is then used to evaluate the potential for investment.” *Discounted Cash Flow (DCF)*, INVESTOPEDIA, <https://www.investopedia.com/terms/d/DCF.asp> [<https://perma.cc/AK8J-3DPT>].

⁵⁵ *Amazon*, 148 T.C. at 150 (The Service argued a DCF methodology is the best method to use under the “Best Method Rule” as it “supplies the best method for determining an arm’s-length buy-in payment, and that the required payment is \$3.468 billion.”). The disparity between the Service and Amazon’s evaluation is largely caused by the Service’s decision to include R&D value on Amazon’s transfer—and because the Service evaluated Amazon’s preexisting intangibles as having a perpetual useful life. *Id.* at 153.

⁵⁶ *Amazon*, 148 T.C. at 142. Both parties’ economic experts

used an external CUT methodology to determine an arm’s-length buy-in price. In selecting their CUTS, both experts also relied on the same sources of public information. But the two experts came to disparate value determinations, chiefly because of very different conclusions as to the useful life of the transferred property and the proper royalty rate to apply over the property’s useful life. [Amazon’s economic expert] concluded that the arm’s-length value of the marketing intangibles ranged from \$251 million to \$312 million; [the Service’s economic expert] determined a value of \$3.13 billion for the same intangible property.

Id.

⁵⁷ *Id.* at 161 (The Service argues Amazon’s “pre-existing intangibles had an ‘indefinite’ useful life, in the sense that ‘their useful lives, and thus their value, are increasingly uncertain over time.’”).

⁵⁸ *Id.* at 149–50 (citing I.R.C. § 482 (2017)). See also Treas. Reg. § 1.482-1(a)(1) (2015).

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speaking, §482 allows the Commissioner to determine the “true taxable income” of a controlled taxpayer by ascertaining and re-allocating the income a taxpayer would have earned had the taxpayer dealt with its transactions at arm’s length with its controlled parent or subsidiary.⁵⁹ The Commissioner’s broad discretion under §482 is entirely upheld unless the determination is arbitrary, capricious, or unreasonable;⁶⁰ this is entirely a question of fact.⁶¹

III. DISCUSSION AND ANALYSIS—THE HISTORY OF CSAs AND THE NEED TO LOOK BEYOND THE PRE-2009 CSA REGULATIONS

A. *Breaking Down Amazon v. Commissioner*

1. *The General Concept and Examples of a CSA*

In simple terms, a cost-sharing arrangement (“CSA”) is “a contractual agreement between companies in the same multinational group which allows the companies to share costs and risks of developing, producing, or obtaining assets.”⁶² The concept of a CSA is that you have two completely

The purpose of section 482 is to ensure that taxpayers clearly reflect income attributable to controlled transactions and to prevent the avoidance of taxes with respect to such transactions. Section 482 places a controlled taxpayer on a tax parity with an uncontrolled taxpayer by determining the true taxable income of the controlled taxpayer.

Id.

⁵⁹ See *Amazon*, 148 T.C. at 150. See also *Comm’r v. First Sec. Bank*, 405 U.S. 394, 400 (1972) (“The standard to be applied in every case is that of an uncontrolled taxpayer dealing at arm’s length with another uncontrolled taxpayer.”). The arm’s-length principle refers to the concept that “a transfer price should be the same as if the two companies involved were indeed two independents, not part of the same corporate structure.” John Neighbour, *Transfer pricing: Keeping it at arm’s length*, OECD CENTRE FOR TAX POLICY ADMINISTRATION (July 3, 2008), http://oecdobserver.org/news/archivestory.php/aid/670/Transfer_pricing:_Keeping_it_at_arms_length.html [https://perma.cc/2XJT-4HRA].

⁶⁰ See *Seagate Tech., Inc. v. Comm’r.*, 102 T.C. 149, 164 (1994). “Absent a showing of abuse of discretion by the Commissioner, the Commissioner’s section 482 determination must be sustained.” *Id.* (citing *Bausch & Lomb, Inc. v. Comm’r.*, 92 T.C. 525, 582 (1989); *aff’d*, 933 F.2d 1084 (2nd Cir. 1991)).

⁶¹ See *Sunstrand Corp. & Subsidiaries v. Comm’r.*, 96 T.C. 226, 353 (1991). “In reviewing the reasonableness of respondent’s determination, the Court focuses on the reasonableness of the result, not on the details of the methodology used.” *Id.* at 354 (citing *Bausch & Lomb, Inc. v. Comm’r.*, 92 T.C. 525, 582 (1989)).

⁶² *Cost Sharing Agreements an Effective Tax Planning Tool*, VALUATION RESEARCH (Nov. 21, 2011), <https://www.valuationresearch.com/pure-perspectives/cost-sharing-agreements-an-effective-tax-planning-tool/> [https://perma.cc/3QER-ZYAB] (“Typically companies with R & D [Research and Development] or technology-related assets, such as pharmaceutical or software companies, have entered into this type of agreement.”). See

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separate but controlled taxpayers (typically a parent located in the U.S. and a subsidiary positioned in a different foreign country) that act as co-owners as they develop, create, and research certain intangibles.⁶³ In *Amazon*, the action was governed under the pre-2009 CSA regulations because the transaction between the parent and its subsidiary occurred prior to January 5, 2009.⁶⁴ The pre-2009 CSA regulations have a history of being invaluable when looking at the Service's position with MNEs transferring intangibles governed under a CSA.⁶⁵

Amazon's CSA provided that the "parties agreed to share the costs of further 'research, development, marketing, and other activities relating to * * * maintaining, improving, enhancing, or extending the Amazon Intellectual Property.'" ⁶⁶ CSAs are favorable to MNEs because an MNE can share the costs of developing future-created intangibles between the two separate jurisdictions, rather than simply one jurisdiction separately

also Treas. Reg. § 1.482-7(b) (2013) ("A cost sharing arrangement is an arrangement by which controlled participants share the costs and risks of developing shared intangibles in proportion to their RAB [Reasonably Anticipated Benefits] shares."). For the pre-2009 CSA definition, *see* Treas. Reg. § 1.482-7A(a) (2009) (A CSA "is an agreement under which the parties agree to share the costs of development of one or more intangibles in proportion to their shares of reasonably anticipated benefits . . .") *Id.* § 1.482-7A(a)(1).

⁶³ *See* Bittker & Lokken, *Transfers of Intangible Property*, FED. TAX'N INCOME, EST. & GIFTS ¶79.8, July 2018, at 10 (The taxpayers make arrangements for "jointly bearing the costs of developing and owning intangibles.").

⁶⁴ *See* Treas. Reg. § 1.482-7A (2009), which applies exclusively to CSA transactions occurring before January 4, 2009; these pre-2009 regulations further only apply "for taxable years beginning on or after January 1, 1996." *Id.* § 1.482-7A(k). *Amazon U.S. entered into a CSA with Amazon Luxembourg in 2005. Amazon.com, Inc. v. Comm'r.*, 148 T.C. 108, 108 (2017).

⁶⁵ *See* Kochman, *supra* note 14.

As we emphasized in *Veritas*, the cost sharing regulations "unequivocally require[] a buy-in payment to be made with respect to transfers of 'pre-existing intangible property.' No buy-in payment is required for subsequently developed intangibles." *Id.* at 323. By valuing "short-lived intangibles * * * as if they have a perpetual life," the Commissioner's buy-in computation improperly took into account the value of "intangibles that were subsequently developed rather than preexisting." *Id.* at 321. We concluded in *Veritas* that reliable CUTs existed for each form of intangible property transferred pursuant to the QCSA and that, with certain adjustments, "the CUT method is the best method for determining the requisite buy-in payment." *Id.* at 339.

Amazon, 148 T.C. at 153 (citing *Veritas Software Corp. v. Comm'r.*, 133 T.C. 297 (2009)).

⁶⁶ *Amazon*, 148 T.C. at 122 (Amazon's CSA was intended to be a "qualified cost sharing arrangement" ("QCSA") under the meaning of the pre-2009 CSA regulations). For the definition of a QCSA, *see* Treas. Reg. § 1.482-7A(b) (2009).

buying the future intangibles through the other jurisdiction at an arm's-length transaction.⁶⁷ Although §482 regulations require MNEs to transfer preexisting intangibles at arm's length,⁶⁸ MNEs "often have discretion in selecting transfer prices because these internally transferred products or services have no identical external, or market, counterparts."⁶⁹

To give an example as to why CSAs are preferred with MNEs, assume a parent company (such as Amazon U.S.) creates a foreign subsidiary (like Amazon Luxembourg) where the parent's corporate tax rate is 35% while the subsidiary's corporate tax rate is 10%. If the two controlled entities enter into a CSA to share the costs of future intangibles, the shared costs can be calculated based on the *relative earnings* of any future product or patent created between the two entities. Assume further that Amazon U.S. creates a patented product that costs Amazon U.S. \$100 million to develop, and this product increases the net earnings⁷⁰ for Amazon U.S. and Amazon Luxembourg by \$30 million and \$20 million respectively. Amazon Luxembourg, as a controlled subsidiary of Amazon U.S., will pay \$40 million to Amazon U.S. for the rights to use this patent because Amazon

⁶⁷ Dye, *supra* note 47 ("These tax consequences arise because of the differences in tax rates across the jurisdictions in which the various divisions of the company do business.").

⁶⁸ "If at any time . . . a controlled participant transfers an interest in a cost shared intangible to another controlled taxpayer, the controlled participant must receive an arm's length amount of consideration from the transferee . . ." Treas. Reg. § 1.482-7(a)(3)(ii) (2013); "If a controlled taxpayer acquires an interest in intangible property from another controlled taxpayer . . . then the district director may make appropriate allocations to reflect an arm's length consideration for the acquisition of the interest in such intangible . . ." Treas. Reg. § 1.482-7A(a)(2) (2009). Both the pre and post-2009 CSA regulations incorporate and require a controlled entities transfer of preexisting intangibles to be paid at an arm's length consideration.

⁶⁹ Dye, *supra* note 47. *See also* Treas. Reg. § 1.482-7(a) (2013) ("The arm's length amount charged in a controlled transaction reasonably anticipated to contribute to developing intangibles pursuant to a cost sharing agreement (CSA) . . . must be determined under a method described *in this section*." (emphasis added)). The current regulations attempt to restrict MNEs from using only a method "in this section" within 1.482-7 to determine the arm's-length amount of intangibles within a CSA.

⁷⁰ *See Net Earnings*, INVESTING ANSWERS, <http://www.investinganswers.com/financial-dictionary/financial-statement-analysis/net-earnings-2231> [<https://perma.cc/F8L6-UJLC>] ("Net earnings represent the amount of sales revenue left over after all operating expenses, interest, taxes and preferred stock dividends (but not common stock dividends) have been deducted from a company's total revenue."). In the above example, the 30 million net earnings Amazon U.S. incurred from its patented product would be the income or cash earned after "recouping" the \$100 million for the costs associated to create this product (typically referred to as the "Costs of Goods Sold"), minus any other operating expenses, such as salaries, utilities, depreciation, and other expenses associated with this product's creation.

Luxembourg benefits from two-fifths (2/5) of the total embodied use of this shared patent.⁷¹

From this example, Amazon U.S. will be taxed on the \$40 million paid by its subsidiary and will owe \$14 million in U.S. taxes.⁷² However, Amazon Luxembourg is just a subsidiary of Amazon U.S. where both entities are wholly-owned by the corporate company and its U.S. shareholders, Amazon.com, Inc. Thus, this \$14 million reduces the overall taxes paid by Amazon as a whole between the U.S. and Luxembourg jurisdictions because Amazon Luxembourg can deduct the \$40 million payment. Therefore, in this specific example and using the tax benefit rule,⁷³ Amazon.com, Inc. as a whole incurs \$10 million in total tax liability between both the U.S. and Luxembourg jurisdictions.⁷⁴

Applying the same facts from the above example to a traditional transfer pricing agreement⁷⁵ (and not a CSA), controlled entities are

⁷¹ Amazon U.S. gains \$30 million in its net earnings while Amazon Luxembourg gains \$20 million for this patent. Thus, the total benefits or net earnings derived from the use of this patented product is \$50 million (30 + 20 million) between the two entities. Of this \$50 million, Amazon Luxembourg benefits from two-fifths (20/50 million) total from this patent. Thus, Amazon Luxembourg, which must “share” the costs associated with the rights from the creation of this patent at an arm’s-length value, will pay \$40 million to Amazon U.S. under a CSA (\$100 million * 2/5 = \$40 million).

⁷² \$40 million represents the amount Amazon Luxembourg pays to Amazon U.S. under a CSA, and for the use and rights of this patented product to Amazon Luxembourg, multiplied by 35% (the U.S. corporate tax rate) resulting in \$14 million owed in U.S. corporate tax by Amazon U.S.

⁷³ See Robert Flach, *What is the Tax Benefit Rule?*, THE STREET (Feb. 19, 2014, 9:20 AM), <https://www.thestreet.com/story/12785072/1/what-tax-benefit-rule.html> [<https://perma.cc/XG7L-YYV7>].

When you claim a tax deduction on Schedule A, . . . you receive a “tax benefit,” because the deduction has reduced your taxable income and therefore your tax liability. The tax benefit is the lessor of the actual deduction claimed or the amount the deduction causes your total itemized deductions to exceed your applicable Standard Deduction amount.

Id.

⁷⁴ Amazon Luxembourg, by paying \$40 million to Amazon U.S., will deduct this \$40 million payment in Luxembourg which yields a tax benefit of \$4 million (\$40 million paid by Luxembourg * 10% (Luxembourg corporate tax rate) = \$4 million saved in Luxembourg taxes). Thus, if Amazon U.S. owes \$14 million in taxes, but Amazon Luxembourg has a tax benefit of \$4 million, Amazon as a wholly owned MNE incurs \$10 million in total tax liability from this patented-product transaction because of its existing CSA.

⁷⁵ See Jessica Silbering-Meyer, *OECD Releases 2017 Edition of Transfer Pricing Guidelines*, THOMSON REUTERS: TAX & ACCOUNTING BLOG (July 14, 2017), <https://tax.thomsonreuters.com/blog/checkpoint/transfer-pricing-guidelines-2017> [<https://pe> (continued)]

required to sell intangibles at arm's length at its estimated "value"—which includes goodwill value⁷⁶—of the license or rights of this patented product.⁷⁷ Assuming further that the market or "value" price for the license of this patented product is \$200 million, the tax consequences are less favorable to Amazon as a whole. Amazon would instead owe \$50 million⁷⁸ in total tax liability versus the \$10 million if the two entities entered into a CSA. Thus, Amazon is saving \$40 million (or 80%) in overall taxes because a CSA was created between the two related entities.⁷⁹

2. The "Big" Requirement for Entering into a CSA under the Pre and Post 2009 CSA Regulations

Looking at the above example,⁸⁰ it is easy to see how favorable—in terms of overall tax consequences—a CSA can be for MNEs.⁸¹ This favorability is slightly mitigated because a "buy-in payment" is required for created CSAs between a parent and its subsidiary.⁸² This buy-in

rma.cc/UPE7-2YBU] (discussing the 2017 release of the OECD (Organization for Economic Co-operation and Development) Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations; this release provides guidance on the international standard and application of the arm's-length principle).

⁷⁶ See *Goodwill*, INVESTOPEDIA, <https://www.investopedia.com/terms/g/goodwill.asp> (last visited Jan. 3, 2018) [<https://perma.cc/9NKV-ZYT5>] ("Goodwill is an intangible asset that arises when one company purchases another for a premium value. The value of a company's brand name, solid customer base, good customer relations, good employee relations, and any patents or proprietary technology represent goodwill."). The recent amendment of §482 gives a new definition of an intangible, which now includes goodwill value. Compare I.R.C. § 482 (2017) with *id.* § 482 (2018); see also *id.* § 367(d)(4).

⁷⁷ See Dye, *supra* note 47 (A CSA does not incorporate the "value," like a traditional transfer pricing agreement, of the intangible; only the costs associated with the development of the intangible is incorporated into determining the arm's-length price when transferred under a CSA.).

⁷⁸ Using the arm's-length principle, Amazon Luxembourg must purchase the license of this patented product at arm's length for \$200 million because this transaction is not governed under a CSA. Amazon U.S. would then owe \$70 million in taxes (\$200 million * 35%) from this transaction and Amazon Luxembourg yields a tax benefit of \$20 million (\$200 million * 10%). Thus, under this example, Amazon as a whole incurs \$50 million in total tax liability using a traditional transfer pricing agreement.

⁷⁹ Example taken and found at Dye, *supra* note 47 ("While people naturally tend to be bored by tax-related issues and, in particular, transfer prices, when a firm can shrink its worldwide tax payments by 80% (\$10m vs. \$50m) by substituting a cost-sharing scheme for a traditional transfer pricing policy, this is something to get excited about!").

⁸⁰ See *supra* at 448–452 (for an example of a transaction with and without a CSA).

⁸¹ See *supra* at 448–452; Dye, *supra* note 47 ("If one has never heard of cost-sharing schemes before, this seems almost too good to be true.").

⁸² See Treas. Reg. § 1.482-7A(g)(1) (2009) ("A controlled participant that makes intangible property available to a qualified cost sharing arrangement will be treated as

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payment is made—under both the pre and post-2009 CSA regulations—using the arm’s-length principle.⁸³ The arm’s-length principle (“ALP”) is “the principle by which transfer prices between members of a commonly controlled organi[z]ation (controlled transactions) are evaluated.”⁸⁴

a. Finding the “Correct” Arm’s-Length Buy-In Payment for Preexisting Intangibles

In practice, the arm’s-length principle tends to be quite difficult when evaluating intangibles.⁸⁵ Prior to the creation of a subsidiary, the parent typically possesses previously developed (“preexisting”) intangibles; these intangibles must be transferred to the newly-developed subsidiary.⁸⁶

having transferred interests in such property to the other controlled participants, and such other controlled participants must make buy-in payments to it . . .”). The current CSA regulations refer to the use of a “platform contribution transaction,” which is similar to the “buy-in payment” as required in the pre-2009 CSA regulations. *See* Treas. Reg. § 1.482-7(b)(1)(ii) (2013).

⁸³ *See* Treas. Reg. § 1.482-7A(g)(2) (2009) (“The buy-in payment by each such other controlled participant is the arm’s length charge for the use of the intangible Such payments will be treated as consideration for a transfer of an interest in the intangible property made available to the qualified cost sharing arrangement by the payee.”). The current CSA regulations require similar actions. *See* Treas. Reg. § 1.482-7(b)(1)(ii) (2013) (“[E]ach controlled participant . . . is obligated to, and must in fact, make arm’s length payments . . . to each controlled participant . . . that provides a platform contribution.”). *But see infra* note 142 (At one time, when §482 was relatively new to international tax principles, it was uncertain if an MNE’s buy-in payment must conform with the arm’s-length principle.).

⁸⁴ John Neighbour & Jeffrey Owens, *Transfer Pricing in the New Millennium: Will the Arm’s Length Principle Survive?*, 10 GEO. MASON L. REV. 951, 952 (2002).

The principle requires that, for tax purposes, the transfer prices of controlled transactions should be similar to those of comparable transactions between independents in comparable circumstances (uncontrolled transactions). The theory is that uncontrolled transactions are subject to the full play of market forces and so these are, by definition, arm’s length. They provide a benchmark against which the controlled transaction can be evaluated.

Id.

⁸⁵ *See* Brauner, *supra* note 6, at 85 (There is an “inherent complexity of the issues and analyses involved and the general uneasiness that lawyers have with uncertainty, especially when uncertainty dominates the ‘facts’ (the value of intangibles in our case).”).

⁸⁶ Dye, *supra* note 47.

In a typical relationship between a parent and a sub[sidiary], . . . it is unlikely that the parent will start developing intangibles only after entering into a [CSA] with the sub[sidiary]. Instead, the parent will have supplied intangibles to the sub[sidiary]—such as the use of the parent’s brand name, marketing know-how, and production

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“[W]here a parent has developed these pre-buy-in intangibles, . . . in order to implement a [CSA], the sub[sidiary] has to make a one-time payment to the parent—the buy-in payment—equal to the estimated market value to the sub[sidiary] of the pre-buy-in intangibles”⁸⁷ This buy-in payment is a “taxable event”⁸⁸ and the Service tends to be skeptical as to the validity of the buy-in payment because of the relationship between the controlled entities;⁸⁹ the Service tries to eliminate the potential for fraud as much as possible during these types of transactions.⁹⁰

technology—throughout the sub[sidiary]’s existence. Those intangibles that the parent supplie[s] to its sub[sidiary] prior to constructing a [CSA] are referred to as its pre-buy-in [or pre-existing] intangibles.

Id.

⁸⁷ *Id.* (The estimated market value of the preexisting intangibles is “calculated as of the date the [CSA] becomes effective.”).

⁸⁸ *Id.* See also *Taxable Event*, INVESTOPEDIA, <https://www.investopedia.com/terms/t/taxableevent.asp> [<https://perma.cc/BUC2-HGYD>] (A taxable event is “[a]ny event or transaction that results in a tax consequence for the party who execute[d] the event.”).

⁸⁹ See *Transfer Pricing Fraud*, WHISTLEBLOWINGPROTECTION, <http://www.whistleblowingprotection.org/?q=node/38> [<https://perma.cc/CS2R-EN2F>].

Transfer pricing is a negotiation between related but singular companies. Frequently[,] the relationship is that of a parent and subsidiary company. In this situation, the parent company needs to purchase goods from the subsidiary, but since the transfer of goods is internal, the negotiation of price is also internal. Although the subsidiary company might grant a special price for the parent company, the deal is still legal in this case. The point when it becomes illegal is when the transfer is used to manipulate the market. Often[,] it is used so that a parent company may take advantage of a subsidiary company, using it to evade taxes.

Id.

⁹⁰ See *Allocation of Income and Deductions—IRC Section 482*, IRS, https://www.irs.gov/irm/part4/irm_04-011-005 [<https://perma.cc/D67M-TF6B>].

The purpose of IRC section 482 is to ensure taxpayers clearly reflect income attributable to controlled transactions and to prevent avoidance of taxes regarding such transactions. IRC section 482 places a controlled taxpayer on a tax parity with an uncontrolled taxpayer by determining the true taxable income. Transactions between one controlled taxpayer and another will be subject to special scrutiny to ascertain whether common control is being used to reduce, avoid, or escape taxes. In determining the true taxable income of a controlled taxpayer, the Service is not restricted to the case of improper accounting, to the case of a fraudulent or sham transaction, or to the case of a device designed to reduce or avoid tax by shifting or distorting income, deductions, credits, or allowances. The authority to determine the true taxable income extends to any case in which either by

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Determining an arm's-length price for a buy-in payment has proven to be quite difficult because the payment places a physical number on the value of certain preexisting intangibles when transferred to a parent's subsidiary.⁹¹ However, in other situations, it is rather simple to place an actual value on a specific type of intangible; this typically occurs if the intangible can easily be separated from the actual or physical tangible property that holds the intangible product.⁹² For example, take a computer with word-processing software, such as Microsoft Word,⁹³ that is already loaded within a computer before the tangible computer is purchased by a consumer. The evaluation of this word-processing software is rather easy because Microsoft Word is also sold as a stand-alone independent product.⁹⁴

Unfortunately, very few intangibles are specifically sold and embedded as stand-alone products; this makes it difficult to determine the arm's-length value of an intangible independently. Take, for example, a complex medical device that, within the device, holds highly customized software that has little or no value without the specific tangible product.⁹⁵ Further,

inadvertence or design the taxable income of a controlled taxpayer is other than it would have been had the taxpayer, in the conduct of his affairs, been dealing at arm's length with an uncontrolled taxpayer.

Id.

⁹¹ See Brauner, *supra* note 6, at 88.

An important feature of many intangibles is that they have public goods characteristics, since they are easily diffused. In many cases the same intangibles are also easy (and cheap) to transfer. In other cases, however, they may be impossible or very costly to transfer (or at least lose significant value upon transfer). In these cases, one may reach very different valuations based on what one's approach is: for the owner firm, the latter intangibles may be worth a lot and expected to generate significant income, but for others it may have little value. It is naturally very difficult to reflect this nuance in valuation.

Id.

⁹² See *id.* ("An attempt to delineate the value of the intangibles from the embedded tangible property may be easy and reasonable in some, but not all, cases.")

⁹³ See *Microsoft Word*, TECHNOPEdia, <https://www.techopedia.com/definition/3840/microsoft-word> [<https://perma.cc/93YP-KV53>] ("Microsoft Word is a widely used commercial word processor designed by Microsoft. . . . It was initially launched in 1983 and has since been revised numerous times.")

⁹⁴ See Brauner, *supra* note 6, at 88 ("The sale by a PC manufacturer of a desktop PC with OEM software embedded . . . may be delineated quite simply if the software is also sold separately on the market.")

⁹⁵ See *id.* ("It might be difficult and quite arbitrary to try and put a separate price tag on the hardware, software, optic device and the various expertise sets involved.")

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some intangibles exist and are created entirely for different reasons, and are even considered “nontradeable.”⁹⁶ Indeed, many intangibles are not even recorded on a company’s balance sheet because they hold no book value⁹⁷ and they cannot be evaluated independently nor appropriately using the arm’s-length principle.⁹⁸

b. The “Best Method Rule”

Section 482 authorizes the Commissioner of Internal Revenue “to adjust the results of controlled transactions to clearly reflect the income of commonly controlled taxpayers in accordance with the arm’s-length standard and, in the case of the transfer of intangible property, so as to be commensurate with the income attributable to the intangible.”⁹⁹ In 1994, the Treasury introduced the “best method rule” and supplemented it into the §482 regulations.¹⁰⁰ The rule requires “the methodology used to

“often interact with tangible and financial assets to create value. Therefore, even if the intangible is not embedded into a tangible product, the intangible may still create value that could not be captured by separately valuing the participating assets, assuming such separation were possible.” *Id.* at 88–89.

⁹⁶ *Id.* at 91 (“[U]nique intangibles do not have markets and hence they are considered nontradeable. The lack of markets means lack of the best contribution that markets provide: good information about the traded assets.”).

⁹⁷ See *Book Value*, INVESTOPEDIA, <https://www.investopedia.com/terms/b/bookvalue.asp> [<https://perma.cc/N9E5-J6FM>] (Book value is the value at which the assets is carried on a balance sheet and calculated by taking the cost of an asset minus the accumulated depreciation. “Book value is also the net asset value of a company, calculated as total assets minus intangible assets . . . and liabilities.”).

⁹⁸ See Brauner, *supra* note 6, at 91–92 (Because some intangibles are not reflected as holding a book value, the arm’s-length value is “further distort[ed] [by] whatever the market response may be to them.”). See also Denise Caruso, *The Real Value of Intangibles*, STRATEGY+BUSINESS (Aug. 26, 2008), <https://www.strategy-business.com/article/08302?gko=47f49> [<https://perma.cc/77Z7-LUDP>] (“[B]usinesses are losing access to as much as \$3 trillion a year in capital stock by leaving intangibles out of the value equation. This directly affects the ability of individual companies to compete, to innovate, and to invest.”).

⁹⁹ Alistair M. Nevius, *Transfer Pricing Arm’s-Length Standard and Transfers of Foreign Goodwill Clarified*, THE TAX ADVISOR (Sept. 14, 2015), <https://www.the-taxadviser.com/news/2015/sep/irs-clarifies-arms-length-standard-201513007.html> [<https://perma.cc/7FXU-CX5U>] (“While the determination of arm’s-length prices for controlled transactions is governed by Sec. 482, other Code sections and regulations also apply to controlled transactions.”). See also I.R.C. § 482 (2018) (“In the case of any transfer (or license) of intangible property[,] . . . the income with respect to such transfer or license shall be commensurate with the income attributable to the intangible.”) (emphasis added).

¹⁰⁰ See Bibiana A. Cruz Martinez, *The Arm’s Length Standard vs the Commensurate with Income Standard: Transfer Pricing Issues in the Valuation of Intangible Assets*, 2 U. P.R. BUS. L.J. 302, 310 (2011) (In 1994, in addition to introducing the best method rule, the Treasury released regulations re-emphasizing the arm’s length standard as the leading standard to follow in setting prices for controlled transactions.).

determine the transfer price be the one that offers the greatest precising in matching the price of an arm's-length transaction between unrelated parties."¹⁰¹ Before transferred to a subsidiary, the valuation of the intangibles must "commensurate with the income"¹⁰² and be "earned by the [t]ransferee from its commercial exploitation."¹⁰³ This "commensurate with income" standard is executed through the "best method rule" because it allows a parent company to use a limited number of methods when evaluating its preexisting intangibles, so long as this limitation is still in accordance with the best method rule.¹⁰⁴ Parent companies are limited to roughly four different methods for evaluation, but these methods must still comply with the best method rule when determining an arm's-length value or range¹⁰⁵ of the transferred preexisting intangibles.¹⁰⁶

¹⁰¹ *Best Method Rule*, USTRANSFERPRICING, http://www.ustransferpricing.com/best_method_rule.html [<https://perma.cc/ZSQ2-E52Z>]. See also Treas. Reg. § 1.482-1(c)(1) (2015).

The arm's length result of a controlled transaction must be determined under the method that, under the facts and circumstances, provides the most reliable measure of an arm's length result. Thus, there is no strict priority of methods, and no method will invariably be considered to be more reliable than others. An arm's length result may be determined under any method without establishing the inapplicability of another method, but if another method subsequently is shown to produce a more reliable measure of an arm's length result, such other method must be used. Similarly, if two or more applications of a single method provide inconsistent results, the arm's length result must be determined under the application that, under the facts and circumstances, provides the most reliable measure of an arm's length result.

Id.

¹⁰² Section 482 provides that intangibles transferred must "commensurate with the income attributable to the intangible." I.R.C. § 482 (2018). When the Commissioner does not feel a transfer of intangible property "commensurate[s] with the income attributable to the intangible," the Commissioner may use his §482 powers to "distribute, apportion, or allocate gross income . . . in order to prevent evasion of taxes or clearly to reflect the income" with the transferred intangible. *Id.*

¹⁰³ Brauner, *supra* note 6, at 127 ("These payments are subject to adjustment [by the Service] to ensure that the commensurate with income standard is maintained.").

¹⁰⁴ *Id.* at 123 ("This mean[s] that no predetermined hierarchy between the available methods exist[s], yet it require[s] the taxpayer to defend the method chosen based on the levels of comparability and data available.").

¹⁰⁵ See *infra* note 130. See also Treas. Reg. § 1.482-4(a) (2011) ("The arm's length amount charged in a controlled transfer of intangible property must be determined under one of the four methods listed . . . Each of the methods must be applied in accordance with . . . the best method rule . . . and the arm's length range.").

In *Amazon v. Commissioner*, Amazon argued its transaction conformed with the best method rule under the comparable uncontrolled transaction (CUT) method and it should therefore be the method used as a buy-in payment for the CSA between Amazon U.S. and Amazon Luxembourg.¹⁰⁷ The Service conceded that the CUT method could be used in Amazon's transfer, but they argued that this method was not the "best method" to use per the "best method rule" to "commensurate with the income attributable to the intangible."¹⁰⁸ However, the Service also argued that if the Tax Court agrees with *Amazon* and finds the CUT method to be the "best method," then Amazon regardless did not "properly" evaluate its intangibles under the CUT method.¹⁰⁹

3. *Methods for Evaluating Intangibles Under 1.482-4*

a. *The Comparable Uncontrolled Transaction ("CUT") Method*

"The comparable uncontrolled transaction method evaluates whether the amount charged for a controlled transfer of intangible property was arm's length by reference to the amount charged in a comparable uncontrolled transaction."¹¹⁰ The CUT method yields a result from comparing similar transactions with either the same intangible property, or with that of similar comparable intangible property, with the intangibles being transferred to the controlled entity.¹¹¹ "Reliability"¹¹² and

¹⁰⁶ "The arm's length amount charged in a controlled transfer of intangible property must be determined under one of the four methods listed in this paragraph. . . . The available methods are—(1) The comparable uncontrolled transaction method . . . (2) The comparable profits method . . . (3) The profit split method . . . and . . . (4) Unspecified methods . . ." Treas. Reg. § 1.482-4(a)(1)-(4) (2011).

¹⁰⁷ *Amazon.com, Inc. v. Comm'r.*, 148 T.C. 108, 163 (2017) (Amazon "submit[ed] that the CUT method 'is the best method for valuing the pre-existing intangibles.'").

¹⁰⁸ The Service argued the best method for evaluating Amazon's preexisting intangibles was a discounted cash flow (DCF) method as described under the "unspecified methods" category in §1.482-4(a)(4). *Id.* at 141. See also I.R.C. § 482 (2017) (A buy-in payment must "commensurate with the income attributable to the intangible" as described in §482).

¹⁰⁹ *Amazon*, 148 T.C. at 141 ("In the event the Court rejects that [DCF] methodology, [the Service] submitted expert reports that employed a CUT methodology. . . . [The Service] supported values *substantially higher* than those determined by Amazon's experts.") (emphasis added).

¹¹⁰ Treas. Reg. § 1.482-4(c)(1) (2011). "Whether results derived from applications of this method are the most reliable measure of an arm's length result is determined using the factors described under the best method rule . . ." *Id.* § 1.482-4(c)(2)(i).

¹¹¹ See Mark R. Martin, *International Transfer Pricing*, THE HOUSTON LAWYER (July/August 2006), http://www.thehoustonlawyer.com/aa_july06/page24.htm [https://perma.cc/42WP-CCL4] ("To be comparable, both intangibles must (i) be used in connection

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“comparability”¹¹³ are factors to consider when applying the CUT method and evaluating the intangibles to obtain an arm’s-length result for the transfer to a controlled entity.¹¹⁴

b. Other Methods for Evaluation

According to the current¹¹⁵ §482 regulations (focusing on the rules of evaluation before an entity transfers its intangibles), besides the CUT

with similar products or processes within the same general industry or market, and (ii) have similar profit potential.”).

¹¹² See Treas. Reg. § 1.482-4(c)(2)(ii) (2011).

If an uncontrolled transaction involves the transfer of the same intangible under the same, or substantially the same, circumstances as the controlled transaction, the results derived from applying the comparable uncontrolled transaction method will generally be the most direct and reliable measure of the arm’s length result for the controlled transfer of an intangible. Circumstances between the controlled and uncontrolled transactions will be considered substantially the same if there are at most only minor differences that have a definite and reasonably ascertainable effect on the amount charged and for which appropriate adjustments are made. If such uncontrolled transactions cannot be identified, uncontrolled transactions that involve the transfer of comparable intangibles under comparable circumstances may be used to apply this method, but the reliability of the analysis will be reduced.

Id.

¹¹³ See Treas. Reg. § 1.482-4(c)(2)(iii) (2011) (“The degree of comparability . . . is [to be] determined by applying the comparability provisions of § 1.482-1(d).”).

Whether a controlled transaction produces an arm’s length result is generally evaluated by comparing the results of that transaction to results realized by uncontrolled taxpayers engaged in comparable transactions under comparable circumstances. For this purpose, the comparability of transactions and circumstances must be evaluated considering all factors that could affect prices or profits in arm’s length dealings (comparability factors). While a specific comparability factor may be of particular importance in applying a method, each method requires analysis of all of the factors that affect comparability under that method. Such factors include . . . (i) Functions; (ii) Contractual terms; (iii) Risks; (iv) Economic conditions; and (v) Property or services.

Treas. Reg. § 1.482-1(d)(1) (2016).

¹¹⁴ See Treas. Reg. § 1.482-4(c)(2) (2011). Additionally, “[t]he reliability of the results derived from the comparable uncontrolled transaction method is affected by the completeness and accuracy of the data used and the reliability of the assumptions made to apply this [CUT] method.” *Id.* § 1.482-4(c)(2)(iv).

method, the comparable profits method,¹¹⁶ the profit split method,¹¹⁷ or an unspecified method¹¹⁸ may also be used for evaluating a buy-in payment, so long as the evaluation is still in accordance with the best method rule.¹¹⁹ In *Amazon*, the Commissioner originally argued that a Discounted Cash Flow (DCF)¹²⁰ method should be used, falling within the “unspecified methods” category of the §482 regulations.¹²¹ However, the Service

¹¹⁵ See Treas. Reg. § 1.482-4 (2018) (The current regulations refer to the §482 regulations in effect as of August 31, 2018; specifically, those regulations focusing on the transfer of intangible property).

¹¹⁶ For more information on the comparable profits method, *see generally* Treas. Reg. § 1.482-5 (2011). “The comparable profits method evaluates whether the amount charged in a controlled transaction is arm’s length based on objective measures of profitability (profit level indicators) derived from uncontrolled taxpayers that engage in similar business activities under similar circumstances.” *Id.* § 1.482-5(a).

¹¹⁷ For more information on the profits split method, *see generally* Treas. Reg. § 1.482-6 (2009). “The profit split method evaluates whether the allocation of the combined operating profit or loss attributable to one or more controlled transactions is arm’s length by reference to the relative value of each controlled taxpayer’s contribution to that combined operating profit or loss.” *Id.* § 1.482-6(a).

¹¹⁸ *See generally* Treas. Reg. § 1.482-4(d) (2011).

[A]n unspecified method should take into account the general principle that uncontrolled taxpayers evaluate the terms of a transaction by considering the realistic alternatives to that transaction, and only enter into a particular transaction if none of the alternatives is preferable to it. . . . [A]n unspecified method should provide information on the prices or profits that the controlled taxpayer could have realized by choosing a realistic alternative to the controlled transaction. . . . [T]he reliability of a method will be affected by the reliability of the data and assumptions used to apply the method, including any projections used.

Id. § 1.482-4(d)(1).

¹¹⁹ See Treas. Reg. § 1.482-4(a) (2011) (“Each of the methods must be applied in accordance with . . . the best method rule . . .”).

¹²⁰ For the definition of DCF, *see Discounted Cash Flow (DCF)*, *supra* note 54 (“If the value arrived at through DCF analysis is higher than the current cost of the investment, the opportunity may be a good one.”).

¹²¹ See *Amazon.com, Inc. v. Comm’r.*, 148 T.C. 108, 140 (2017). The §482 Regulations

allow for the use of unspecified methods where the specified methods set forth are not applicable or do not produce a meaningful result. An unspecified method can be any quantitative analytical framework that yields a reliable measure of an arm’s length result. Any unspecified method must be applied in accordance with the general rules applicable to all specified methods. Thus, the . . . 482 Regulations provide flexibility in applying alternative analyses where the taxpayer can demonstrate that an unspecified method provides the most reliable measure of an arm’s length result.

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further argued that if the DCF method is rejected for any reason by the Tax Court, Amazon's CUT method was still not appropriately evaluated to create an arm's-length result.¹²² Indeed, when comparing the CUT results from Amazon and the Service, they differ by more than \$3 billion.¹²³

B. The Need to Reform the Arm's-Length Principle with Transferring Intangibles through a CSA

1. The History, Principles and Policies of Transfer Pricing

a. The Creation of §482

The idea of double taxation always creates controversies with Congress and Tax critics.¹²⁴ The early concepts towards the creation of §482 began in 1917, when Congress responded to potential pricing abuses "in the War Revenue Act of 1917[,] by requiring every corporation to supply the Commissioner of Internal Revenue Service with information describing its relations with other affiliated corporations."¹²⁵ Shortly thereafter, the Revenue Act of 1921 was passed and it further "vested the Commissioner with the direct power to prepare consolidated tax returns in order to reflect the taxpayer's 'accurate' income."¹²⁶ Just seven years later,

Transfer Pricing Methods, TRANSFER PRICING ANALYTICS, <http://tpa.randomanalyst.com/tp-reference/learning-resources/transfer-pricing-methods/> [<https://perma.cc/64ZU-C6YC>].

¹²² *Amazon*, 149 T.C. at 141–42 (The Service's economic expert "agreed that the CUT method could be used to value the pre-existing [intangible] technology However, he concluded that Amazon's website technology had an indefinite useful life. On th[at] basis[,] . . . [the Service's expert] valued the website technology transferred by Amazon US to [Amazon Luxembourg] at \$3.34 billion.").

¹²³ Amazon's experts, on the other hand, came to "disparate value determinations" compared to the Service, even when using the same "external CUT methodology to determine an arm's-length buy-in price." *Amazon*, 149 T.C. at 142. This was "chiefly because of very different conclusions as to the useful life of the transferred property and the proper royalty rate to apply over the property's useful life. [Amazon's expert] concluded that the arm's-length value of the marketing intangibles ranged from \$251 million to \$312 million . . ." *Id.*

¹²⁴ See Clark, *supra* note 2, at 1157–1158. "Double taxation generally occurs in the context of transfer pricing adjustments, where tax authorities in competing jurisdictions disagree over income allocations attributable to transfer pricing." *Id.* at 1157.

¹²⁵ Josh O. Ungerman, *The White Paper: The Stealth Bomber of the Section 482 Arsenal*, 42 Sw. L.J. 1107, 1109 (1989). "The Commissioner required corporations to file consolidated tax returns to properly 'determine' income." *Id.* at 1109–10.

¹²⁶ *Id.* at 1110. See also Joseph J. Thorndike, *The Republican Roots of New Deal Tax Policy*, TAX ANALYSTS (Aug. 28, 2003), <http://www.taxhistory.org/thp/readings.nsf/ArtWeb/DC6A3F1BAA03052A85256DFE005981FB?OpenDocument> [<https://perma.cc/K94F-ZD8N>] (The 1921 Revenue Act "pleased almost no one" and "[c]ritics complained that it was a pastiche of unrelated, politically driven compromises.").

Congress passed “section 45, labeled ‘Allocation of Income and Deductions,’” which again further “provided the Commissioner with authority to make allocations necessary in order to prevent tax evasion and to reflect clearly the ‘true’ tax liability of commonly controlled businesses.”¹²⁷

In 1935, the Treasury officially incorporated the arm’s-length standard into the Tax Code.¹²⁸ However, there was no published information available that could “provide guidance on the transfer or sale of services, tangible property, and intangible property” using the arm’s-length principle, until the Treasury released such guidance through regulations in 1968.¹²⁹ Building off these 1968 regulations, the Treasury also allowed for an entity to establish “an arm’s-length range¹³⁰ that was based upon all reasonable comparables.”¹³¹ The 1968 regulations further addressed the initial concepts found in issues with companies under common ownership

¹²⁷ Ungerman, *supra* note 125, at 1110 (“With section 45 Congress went beyond the narrow scope of the consolidated return provisions of prior revenue acts into the broader area of allocation of income and deductions.”).

¹²⁸ *Id.* The 1935 regulations required taxpayers to “treat their transactions, in all cases, as if the negotiations involved uncontrolled taxpayers dealing at arm’s length . . .” *Id.* “The 1935 regulations did not define the term ‘uncontrolled taxpayers,’ but implied that it meant two or more organizations, trades, or businesses with no common interests.” *Id.* at 1110–11.

¹²⁹ Ungerman, *supra* note 125, at 1112 (“The regulations mandate allocations in the event that the amount charged for a service differs from an arm’s length charge . . . [G]enerally[,] the arm’s length charge is deemed to be equal to the costs or deductions incurred by the members with respect to the services.”).

¹³⁰ The “arm’s length range” is still incorporated within the current §482 regulations. *See generally* Treas. Reg. § 1.482-1(e) (2016).

In some cases, application of a pricing method will produce a single result that is the most reliable measure of an arm’s length result. In other cases, application of a method may produce a number of results from which a range of reliable results may be derived. *A taxpayer will not be subject to adjustment if its results fall within such range (arm’s length range).*

Id. § 1.482-1(e)(1) (emphasis added).

¹³¹ Edward B. Dix, *From General to Specific: The Arm’s-Length Standard’s Evolution and its Relevancy in Determining Costs to be Shared in Cost-Sharing Agreements*, 64 TAX LAW. 197, 214 (2010). “[B]ecause identical transactions can rarely be located” for the evaluation of an intangible, “whether a transaction produces an arm’s length result generally will be determined by reference to the results of comparable transactions under comparable circumstances.” Treas. Reg. § 1.482-1(b)(1) (2015). This concept is similar to the idea of the CUT method. *See supra* at 458–459.

or control, where they would transfer intangible property into a different foreign jurisdiction.¹³²

In 1986, §482 was amended to include the provision: “In the case of any transfer (or license) of intangible property (within the meaning of section 936(h)(3)(B)),¹³³ the income with respect to such transfer or license shall be commensurate with the income attributable to the intangible.”¹³⁴ At the time of the creation of the 1986 amendment, the “commensurate with income” standard, commonly referred to as the “super royalty rule,”¹³⁵ was thought not just to extend the traditional arm’s-length principle to intangible property, but to also allow the Service to “insure that the income of the United States parent and its foreign subsidiary ‘reasonably reflect the relative economic activity undertaken by each.’”¹³⁶

The newly-created regulations addressing the “commensurate with income” amendment requires two steps to determine if an intangible is transferred appropriately under the super royalty rule.¹³⁷ First, the initial

¹³² See Ungerman, *supra* note 125, at 1113 (“[T]he [1968] regulations authorize[d] the [Commissioner] to reallocate costs when related parties fail to charge an arm’s length price for the purchase or use of an intangible.”).

¹³³ The regulations released following this amendment provide further guidance on the meaning of intangible property as defined in the Code. See Treas. Reg. § 1.482-4(b) (2011). This definition was recently changed following the Tax Cuts and Jobs Act of 2017 to reflect a broader meaning of “intangible property.” See *supra* Section V (for a discussion on this amendment, and other amendments made following the Tax Cuts and Jobs Act of 2017).

¹³⁴ I.R.C. § 482 (2017). See also Ungerman, *supra* note 125, at 1109 (This “1986 amendment to section 482 is commonly referred to as the ‘super royalty provision.’”).

¹³⁵ *Id.* See also *Super Royalty Provision*, INVESTORWORDS, http://www.investorwords.com/18971/super_royalty_provision.html [[https://perma.cc/Y33J -W6JX](https://perma.cc/Y33J-W6JX)]. The super royalty provision is

[a] provision of the Tax Reform Act of 1986 which stipulates that the arm’s length transfer of intellectual property between a U.S. entity and a related foreign entity constitutes an exchange of value commensurate with the income that would otherwise be attributable to the intellectual property. In such cases, the IRS would adjust the transaction to reflect an effective transfer of income.

Id.

¹³⁶ Gaetano C. Lanciano, *Proctor & Gamble Co. v. Commissioner: Should Foreign law Control U.S. Tax Liability of U.S. Shareholders?*, 17 DEL. J. CORP. L. 515, 529–30 (1992) (quoting H.R. Rep. No. 426, 99th Cong., 1st Sess. 424 (1985)). “By adding the ‘commensurate with income’ provision to section 482, Congress made it clear that industry norms would no longer provide a safe harbor for related parties transferring intangible property within their control group.” *Id.* at 530.

¹³⁷ See Cruz Martinez, *supra* note 100, at 308 (“The commensurate with income” standard “requires taxpayers to consider the actual profit from the exploitation of the intangible.”).

royalty agreement between the two controlled entities must be at arm's length in the year of the transfer.¹³⁸ Second, the regulations published following the 1986 amendment created a concept of "periodic adjustments" following the initial assessment of an intangible;¹³⁹ this allows entities a safe-harbor if its initial assessment does not create an arm's-length result.¹⁴⁰ Further, these regulations also allow the Service to make "retroactive adjustments" of a lump sum or royalty payment so that the payment is still "consistent with the arm's length standard"—the main issue in *Amazon*.¹⁴¹

The release of the "commensurate with income" provision in 1986 initially caused serious confusion as to the standard's overall meaning and application.¹⁴² Tax enthusiasts were confused as to whether the provision would reject the traditional and "world-standard"¹⁴³ arm's-length principle,

¹³⁸ *Id.* ("This means that an analysis of the facts and circumstances at the time of the transfer should be made" to yield an arm's-length result).

¹³⁹ The concept of "periodic adjustments" continues to exist under the current regulations today. *See* Treas. Reg. § 1.482-4(f)(2) (2011). "If an intangible is transferred under an arrangement that covers more than one year, the consideration charged in each taxable year *may be adjusted to ensure that it is commensurate with the income attributable to the intangible.*" *Id.* § 1.482-4(f)(2)(i) (emphasis added).

¹⁴⁰ *See* Cruz Martinez, *supra* note 100, at 308. Typically, "the original transfer price would be adjusted periodically to reflect unforeseen changes in the profitability of the intangibles transferred." *Id.* at 308–09.

¹⁴¹ *Id.* at 309 (quoting Treas. Reg. § 1.482-4(f)(2)(i)).

In determining whether to make such adjustments in the taxable year under examination, the district director may consider all relevant facts and circumstances throughout the period the intangible is used. The determination in an earlier year that the amount charged for an intangible was an arm's length amount will not preclude the district director in a subsequent taxable year from making an adjustment to the amount charged for the intangible in the subsequent year.

Treas. Reg. § 1.482-4(f)(2)(i) (2011).

¹⁴² When first added in 1986, the super-royalty provision caused so much doubt as to its intended meaning that the Service issued a Notice in 1988 to give further clarification. *See A study of Intercompany Pricing under Section 482 of the Code*, Notice 88-123, 1988-2 C.B. 458 (1988).

¹⁴³ The Organization for Economic Cooperation and Development's (OECD) international guidelines follow the arm's-length principle entirely; "a transfer price should be the same as if the two companies involved were indeed two independents, not part of the same corporate structure." Neighbour, *supra* note 59. The OECD

is a unique forum where the government of 34 democracies with market economies work with each other, as well as with more than 70 non-member economies to promote economic growth, prosperity, and sustainable development.

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or if this amendment would follow it entirely.¹⁴⁴ In 1994, the Treasury released even more regulations relating to the evaluation of intangible property, which re-emphasized the arm's-length standard "as the leading standard to be followed in setting prices for controlled transactions"¹⁴⁵ This 1994 regulation provided clarity and relief to taxpayers by reinforcing that the arm's-length standard would be imposed on the transfer of intangibles to a controlled entity because "U.S. treaty obligations required adherence to an arm's length standard, and trading partners voiced concerns about what they perceived as amended section 482's divergence from the international norm."¹⁴⁶

The Organization provides a setting where governments can compare policy experiences, seek answers to common problems, identify good practice and coordinate domestic and international policies.

What is the OECD?, U.S. MISSION TO THE ORGANIZATION FOR ECONOMIC COOPERATION & DEVELOPMENT, <https://usoecd.usmission.gov/our-relationship/about-the-oecd/what-is-the-oecd/> [<https://perma.cc/CAZ5-NB8K>].

¹⁴⁴ See Notice 88-123, *supra* note 142.

The arm's length standard is embodied in all U.S. tax treaties; it is in each major model treaty, including the U.S. Model Convention; it is incorporated into most tax treaties to which the United States is not a party; it has been explicitly adopted by international organizations that have addressed themselves to transfer pricing issues; and virtually every major industrial nation takes the arm's length standard as its frame of reference in transfer pricing cases. This overwhelming evidence indicates that there in fact is an international norm for making transfer pricing adjustments and that the norm is the arm's length standard.

It is equally clear as a policy matter that, in the interest of avoiding extreme positions by other jurisdictions and minimizing the incidence of disputes over primary taxing jurisdiction in international transactions, the United States should continue to adhere to the arm's length standard.

Id. at 475.

¹⁴⁵ Cruz Martinez, *supra* note 100, at 310 (The 1994 regulations is also when the Treasury first introduced the "best method rule"). See *supra* Section III.A.2.b (for a brief description of the best method rule). See also *Amazon.com, Inc. v. Comm'r.*, 148 T.C. 108, 141 (2017) (The Service argued in *Amazon* that Amazon's method used to evaluate its intangibles is not the "best method" to use under the circumstances and under the "best method rule.").

¹⁴⁶ Dix, *supra* note 131.

Although it was clear from the legislative history that the traditional understanding of the arm's-length standard should no longer carry force, Treasury pledged to the international community that it would—and, more startlingly, that it could—interpret the amended section 482

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b. Post 1994 Regulations Incorporating the Arm's-Length Principle for CSAs

A large concern of the release of the 1994 regulations, and the clarification that the super-royalty rule simply follows the arm's-length standard when transferring intangibles, was the fact that the 1994 regulations did “not contemplate application of the arm's length standard to CSAs.”¹⁴⁷ The Treasury was “certainly aware that the new arm's-length standard was no longer applicable to CSAs, for nowhere in the context of CSAs do the 1994 regulations reference the arm's-length standard.”¹⁴⁸ To overcome this concern, the Treasury issued a final regulation in 1995 to clarify how the added super royalty provision, as added in 1986 to §482, effects CSAs and the arm's-length principle between controlled entities when transferring intangibles.¹⁴⁹ In addition to providing such guidance, the 1995 regulations further allowed CSAs to be a “qualified cost-sharing arrangement” (QCSA) if the CSA meets the requirements as set forth in the 1995 regulations to be a traditional CSA.¹⁵⁰ The 1995 regulations provided

so as to remain consonant with the arm's-length international norm. With this promise in mind, the [Treasury] began drafting what would eventually become the final regulations of 1994.

Id.

¹⁴⁷ Dix, *supra* note 131, at 215 (“[T]he pricing methods detailed in the transfer pricing regulations are patently inapplicable to questions concerning the selection of costs to be shared under a CSA.”). For the definition and a general description of a cost-sharing arrangement (CSA), *see supra* note 62.

¹⁴⁸ Dix, *Supra* note 131, at 216. “In contrast, the 1968 regulations held CSAs to an explicit arm's-length requirement: . . . ‘to qualify as a bona fide arrangement, it must reflect an effort in good faith by the participating members to bear their respective share of all the costs and risk of development on an arm's length basis.’” *Id.* (quoting Treas. Reg. § 1.482-2(d)(4) (1969)).

¹⁴⁹ See JAMES J. HALL, *Cost Sharing Agreements*, 12 MERTENS LAW OF FED. INCOME TAX'N § 451:55 (2018) (“The 1995 regulations are effective for taxable years beginning on or after January 1, 1996 and set forth more detailed rules.”). For the definition of a CSA under the current regulations, *see* Treas. Reg. § 1.482-7(b) (2013).

¹⁵⁰ See HALL, *supra* note 149. *See also* Treas. Reg. § 1.482-7A(b) (2009) (where the requirements are listed for a CSA to be considered a QCSA). *But see* Treas. Reg. § 1.482-7T (2009). In 2009, the Treasury passed and amended the §482 regulations with temporary regulations where CSA transactions occurring pre-2009 follow §1.482-7A—which are the pre-2009 and un-amended regulations—and post-2009 CSA transactions follow the amended §1.482-7T regulations. *See US Tax Court sides with Amazon in intangibles transfer case*, DELOITTE (Mar. 27, 2017), <https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-global-transfer-pricing-alert-17-008-27-march-2017.pdf> [<https://perma.cc/NF3T-FTWA>] (The temporary regulations were thereafter finalized in December of 2011). The current §1.482-7 final regulations now replace the temporary regulations and they do not contain a provision referring a CSA to be a QCSA; a transaction

(continued)

a fairly steady stream for interpretation when evaluating intangibles under a CSA until 2009, when the Treasury released temporary regulations to provide guidance on the application of §482 and the super royalty rule when dealing with intangibles under a CSA.¹⁵¹ These temporary regulations released in 2009 were finalized in December 2011 and apply to all CSAs created after January 4, 2009.¹⁵²

The 1995 regulations, commonly referred to as the pre-2009 CSA regulations, conform with the super-royalty rule¹⁵³ by requiring a buy-in payment when transferring a parent's preexisting intangibles through a CSA to a foreign subsidiary.¹⁵⁴ These regulations state that a buy-in payment conforms with the "commensurate with income" standard if the value of the preexisting intangibles transferred through a CSA is at arm's length.¹⁵⁵ This buy-in payment, or lump sum payment, is treated as "an advance payment of a stream of royalties over the useful life of the intangible (or the period covered by an agreement, if shorter)"¹⁵⁶ Thus, to determine the proper arm's-length value for a buy-in payment, three findings are required: A present value calculation based on the lump

can no longer be a QCSA unless the transaction occurred before 2009. *See* Treas. Reg. § 1.482-7(m)(1) (2013).

¹⁵¹ *See* HALL, *supra* note 149 ("The temporary regulations are generally applicable for cost-sharing arrangements commencing on or after January 5, 2009, with transition rules for certain pre-existing arrangements.").

¹⁵² *See* DELOITTE, *supra* note 150 ("The IRS and Treasury . . . issued final regulations on December 22, 2011 . . . which adopted the effective date of the temporary regulations.").

¹⁵³ *See* Treas. Reg. § 1.482-7A(g)(1) (2009) (Because the 1995 regulations provide guidance on how to approach the super royalty rule when transferring intangibles through a CSA, a buy-in payment "shall be commensurate with the income attributable to the intangible" if it is dealt at arm's length or for an "arm's length consideration.").

¹⁵⁴ *See* Treas. Reg. § 1.482-7A(g)(1) (2009) ("A controlled participant that makes intangible property available to a qualified cost sharing arrangement will be treated as having transferred interests in such property to the other controlled participants, and such other controlled participants must make buy-in payments to it"). *See also supra* note 46 (for the authority of a buy-in payment).

¹⁵⁵ *See* Treas. Reg. § 1.482-7A(g)(1) (2009) (Within a controlled transaction, if a subsidiary fails to make a buy-in payment to its parent for the transfer of the parent's preexisting intangibles, "the district director may make appropriate allocations, under the [section 482 regulations], to reflect an *arm's length consideration* for the transferred intangible property.") (emphasis added). "A lump sum is commensurate with income in a taxable year if the equivalent royalty amount for that taxable year is equal to an arm's-length royalty." Treas. Reg. § 1.482-4(f)(6)(i) (2011). For the pre-2009 CSA regulations requiring a buy-in payment for the transfer of preexisting intangibles executed through a CSA, *see supra* note 46.

¹⁵⁶ Treas. Reg. § 1.482-4(f)(6)(i) (2011). *See also* HALL, *supra* note 149 (discussing the "equivalent royalty amount" as serving a basis for determining if the consideration is made at arm's length).

sum;¹⁵⁷ an appropriate discount rate,¹⁵⁸ and the projected sales over the relevant period.¹⁵⁹ The Service may also “make appropriate allocations to reflect an arm’s length payment for the transferred intangibles” if such allocations are not “arbitrary, capricious, or involves abuse of discretion” by the Service.¹⁶⁰

2. *The Precedent set before Amazon v. Commissioner on the Evaluation of Preexisting Intangibles Under a CSA*

a. *Veritas Software Corporation v. Commissioner*

In 2009, *Veritas Software Corporation v. Commissioner* was published and “it is clear the trial did not go well for the IRS.”¹⁶¹ Like *Amazon*,

¹⁵⁷ See *supra* note 155 & *supra* note 156. “If an intangible is transferred in a controlled transaction for a lump sum, that amount must be commensurate with the income attributable to the intangible.” Treas. Reg. § 1.482-4(f)(6)(i) (2011).

¹⁵⁸ See Treas. Reg. § 1.482-7(g)(2)(v)(A) (2013).

The best method analysis in connection with certain methods or forms of payments may depend on a rate or rates of return used to convert projected results of transactions to present value, or to otherwise convert monetary amounts at one or more points in time to equivalent amounts at a different point or points in time. For this purpose, a discount rate or rates should be used that most reliably reflect the market-correlated risks of activities or transactions and should be applied to the best estimates of the relevant projected results, based on all the information potentially available at the time for which the present value calculation is to be performed. Depending on the particular facts and circumstances, the market-correlated risk involved and thus, the discount rate, may differ among a company’s various activities or transactions. Normally, discount rates are most reliably determined by reference to market information.

Id.

¹⁵⁹ See Treas. Reg. § 1.482-4(f)(6)(i) (2011) (“The equivalent royalty amount is subject to periodic adjustments . . .”). “If an intangible is transferred under an arrangement that covers more than one year, the consideration charged in each taxable year *may be adjusted* to ensure that it is commensurate with the income attributable to the intangible. Adjustments . . . shall be consistent with the arm’s length standard . . .” Treas. Reg. § 1.482-4(f)(2)(i) (2011) (emphasis added). For more information on periodic adjustments, see *supra* notes 139 & 140.

¹⁶⁰ Jerald David August, *Altera and Cost-Sharing Requirements under Section 482—Another Tax Court Rebuke to the IRS*, 18 NO. 1 BUS. ENTITIES 04, 15 (2016) (“The IRS’ authority to make Section 482 allocations is limited to situations where it is necessary to make each participant’s share of costs equal to its share of reasonably anticipated benefits or situations where it is necessary to ensure an arm’s-length buy-in payment for transferred preexisting intangibles.”).

¹⁶¹ Kochman, *supra* note 14 (Judge Foley, writing for the Tax Court in *Veritas*, “concluded the [Service’s] expert had employed unreasonable growth rates” and “the

(continued)

Veritas used an economic expert that found the comparable uncontrolled transaction (CUT) method to be the best method, per the best-method rule,¹⁶² for determining the buy-in payment of *Veritas*'s preexisting intangibles.¹⁶³ By using comparable uncontrolled transactions of licensing agreements between *Veritas* and their OEMs,¹⁶⁴ *Veritas*'s economic experts derived a range of royalties to calculate the buy-in payment for the transfer of its preexisting intangibles to its foreign subsidiary.¹⁶⁵ Most importantly, *Veritas*'s economic experts assumed its preexisting intangibles had a two to four-year useful life, which reduced the yearly royalty rates over the buy-in period based on similar decay provisions found between *Veritas* and their past OEM agreements.¹⁶⁶

Like *Amazon*,¹⁶⁷ the Service argued that *Veritas*'s preexisting intangibles have a perpetual useful life and should therefore be considered when evaluating the transfer of its intangibles,¹⁶⁸ and *Veritas*'s CUT method is also not the best method to use in accordance with the best

discount rate was too low . . ."). For more information on the regulations for discount rates under a CSA, *see supra* note 158.

¹⁶² For information on the regulations with the best method rule, and how the best method rule applies in the process of evaluating intangibles, *see supra* Section III.A.2.b.

¹⁶³ *See* Hochman, *supra* note 14. *See also supra* note 110 (discussing the CUT method); *supra* note 52 (discussing the "best-method rule"); *supra* note 50 (discussing the CUT method as the method used in the case of *Amazon.com, Inc. v. Commissioner.*). *See also* *Veritas Software Corp. v. Comm'r.*, 133 T.C. 297, 327 (2009).

¹⁶⁴ OEMs is short for "original equipment manufacturers," and is used to describe a company that has a special relationship with computer and IT (Information Technology) producers. *See* Vangie Beal, *OEM—Original Equipment Manufacturer*, WEBOPEDIA, <https://www.webopedia.com/TERM/O/OEM.html> [<https://perma.cc/8KGS-N4KS>] (Simply stated, OEMs are manufacturers who resell a company's products under their own name and branding).

¹⁶⁵ *See* Kochman, *supra* note 14. *See also supra* note 130 (discussing the regulations regarding the "arm's length range" of a controlled transaction). *See also Veritas*, 133 T.C. at 328.

¹⁶⁶ *See* Kochman, *supra* note 14 (*Veritas*'s economic experts valued the preexisting intangibles within the range of \$94 to \$315 million, concluding that most of the values fell between \$100 and \$200 million. The Service, on the other hand, derived a range of such intangibles to be between \$1.9 to \$4 billion, concluding that the intangibles should be valued at \$2.5 billion, but ultimately stating by trial that the intangibles should be valued at \$1.675 billion) *See also Veritas*, 133 T.C. at 329.

¹⁶⁷ *See* *Amazon.com, Inc. v. Comm'r.*, 148 T.C. 108, 152 (2017) (*Amazon*'s economic expert "assumed that the preexisting intangibles ha[d] a perpetual useful life . . .").

¹⁶⁸ *See* Kochman, *supra* note 14. *See also Veritas*, 133 T.C. at 313. The Tax Court in *Veritas*, however, found the Service's economic expert had "inflated the determination by valuing short-lived intangibles as if they have a perpetual useful life . . ." *Id.* at 315.

method rule.¹⁶⁹ The Tax Court in *Veritas* concluded that the CUT method was the best method for determining Veritas's Ireland subsidiary buy-in payment, and the Court further rejected the Service's contention that the transferred intangibles were substantially different from those addressed within Veritas's past OEM agreements.¹⁷⁰ The Court ultimately concluded that the Service abused its power and discretion under §482 because they were "arbitrary, capricious, and unreasonable, and VERITAS US' CUT method" was "the best method to determine the requisite buy-in payment."¹⁷¹

In response to the Tax Court's decision, although the Service did not appeal *Veritas*, an action on decision (AOD)¹⁷² was published where the Service refused to acquiesce the Tax Court's final ruling because both the "factual findings and legal assertions" are "erroneous."¹⁷³ A similar event occurred in *Xilinx, Inc. v. Commissioner*, where the Ninth Circuit U.S. Court of Appeals favored the taxpayer entirely on its transferred CSA with

¹⁶⁹ See Kochman, *supra* note 14 (The Service's economic expert based the buy-in payment on the forgone profits method (which is essentially a form of a Discounted Cash Flow (DCF) method), a market capitalization method, and an acquisition method). Ultimately, the Service's expert concluded the DCF method most accurately represented the arm's-length value of Veritas's transaction with its foreign subsidiary. *Id.* See also *Veritas*, 133 T.C. at 311–13.

¹⁷⁰ See Kochman, *supra* note 14. "Although VERITAS US' unbundled OEM agreements are certainly not identical to the controlled transaction, an analysis . . . establishes that the unbundled OEM agreements are sufficiently comparable to the controlled transaction and that the CUT method is the best method to determine the requisite buy-in payment." *Veritas*, 133 T.C. at 335.

¹⁷¹ *Veritas*, 133 T.C. at 316. The Tax Court did conclude, however, that certain adjustments need to be made to Veritas's CUT method. *Id.* at 335. Specifically, Judge Foley wrote that a 32% starting royalty rate was appropriate (rather than the 20 to 25% as used by Veritas), the preexisting intangibles had a four-year non-perpetual useful life, the royalty rate should drop down at 33% per year beginning in year two, and that a 20.47% discount rate should be used to determine the present value of the buy-in payment. *Id.* at 328, 336–38.

¹⁷² "An Action on Decision (AOD) is a formal memorandum prepared by the IRS Office of Chief Counsel that announces the future litigation position the IRS will take with regard to the court decision addressed by the AOD." *Actions on Decisions (AOD)*, IRS, <https://apps.irs.gov/app/picklist/list/actionsOnDecisions.html;jsessionid=tWX5FaRPCFI0dP3xB0b7766B64Pi6A55ZMnRBW51.-?indexOffirstRow=25&sortColumn=number&value=&criteria=&resultsPerPage=25&isDescending=true> [https://perma.cc/S47Z-RZVW].

¹⁷³ A.O.D. 2010-05, 2010-49 I.R.B. (Dec. 10, 2010) (According to the AOD's summary, "The Internal Revenue Service (Service) believes the Court's factual findings and legal assertions are erroneous. Therefore, it does not acquiesce in the result or the reasoning of the decision." See also Kochman, *supra* note 14 ("The major factual difference involved the nature of the intangibles to be valued.").

its European subsidiary.¹⁷⁴ According to the Service's argument, Veritas's CSA had two components of value: ongoing research and development value (R&D value);¹⁷⁵ and the value of the sale of the then already-existing intangibles transferred within the CSA (also referred to as an intangibles "make or sell" value).¹⁷⁶

The Court in *Veritas* rejected the Service's proposition that the intangibles have ongoing value, but instead concluded that the value associated with Veritas's preexisting intangibles was only its make or sell rights.¹⁷⁷ But this decision is "erroneous" because the Tax Court "fail[ed]" to recognize that, in circumstances where R&D rights in technology do

¹⁷⁴ A.O.D. 2010-03, 2010-33 I.R.B. (Aug. 16, 2010). In *Xilinx*, the parent MNE entered into a CSA with its Ireland subsidiary relating to the companies R&D (Research and Development) costs in proportion to its RAB (Reasonably Anticipated Benefits) from the technology to be later developed in the future pursuant to its CSA. However, it is important to note in this case that the Service specifically challenged the treatment of Xilinx's ESOs (Employee Stock Option Expenses) within the company's CSA, rather than the evaluation of its preexisting intangibles as seen in *Amazon* and *Veritas*. *See id.* "The Internal Revenue Service (Service) believes the Ninth Circuit's opinion is erroneous and acquiesces in the result, but not the reasoning, of the decision with respect to ESOs granted in taxable years governed by the section 482 regulations in effect prior to their amendment in 2003." *Id.*

¹⁷⁵ Research & Development ("R&D") refers to the "investigative activities" a business conducts "to improve existing products and procedures or to lead to the development of new products and procedures." *Research And Development—R&D*, INVESTOPEDIA, <https://www.investopedia.com/terms/r/randd.asp> [<https://perma.cc/B75R-Y8YA>]. R&D value "reflects the value of an intangible as a foundation for the development of new intangibles that will be used in future products . . ." Kochman, *supra* note 14. To give a modern example of R&D value, if Computer Company A has software X (an intangible product) located within its computers (in order for their computers to properly function and run as computers should when sold on the market), and this software gets transferred to A's European Subsidiary B so that B can then transform software X into a new and updated software program (now referred to as Software Y), this transfer of Software X has value because the subsidiary did not have to put forth all the effort, time, energy and work into completely re-programming Software Y from scratch. Software Y is essentially only a modification and updated version of Software X.

¹⁷⁶ Looking at the example given above in footnote 175, although Software X will eventually be turned and updated into Software Y, this does not stop Computer Company A from only selling Software Y. The Service views the transfer of Software X as having value in-and-of-itself because Software X can still be placed on the open market and sold for a profit in addition to the future-updated software Y. The value for the sale of existing products incorporated within the transferred intangible refers to "the make or sell rights." *See* Kochman, *supra* note 14.

¹⁷⁷ For an example of the value of an intangible with make or sell rights, *see supra* note 176. Because software tends to update frequently, the simple make or sell rights typically degrade in value as software becomes more outdated. *See* Kochman, *supra* note 14. In a field such as software development, the make or sell rights typically have a fairly short life. *Id.* Although such make or sell rights degrade over time, this does not mean "that an intangible ceases to have value as a platform for future [Research and Development]." *Id.*

have value, the economic life of that technology necessarily exceeds the useful life of the current generation product line or the make-sell rights.”¹⁷⁸ Although traditional tax law dictates that the term “income” generally means something along the lines of “value,”¹⁷⁹ the Service could not convince the Tax Court that Veritas’s R&D rights, derived from the transfer of its preexisting intangibles, “had value.”¹⁸⁰

*b. Amazon v. Veritas: Similarities, Differences, or just a Redux*¹⁸¹

The facts and arguments raised in both *Veritas* and *Amazon*, and the reasoning for the Service to use its §482 power to reallocate both parties’ buy-in payment within its CSA, is nearly identical.¹⁸² In fact, many tax professionals view *Amazon* “as the IRS’ attempt to re-litigate the findings

¹⁷⁸ See A.O.D. 2010-05, *supra* note 173, at 2 n.3. “The [Tax] court construes the buy-in to exclude any consideration of the *future income or value attributable to intangibles* to be developed under a CSA, apparently on the theory that *such future income stream is already paid for through the participants’ cost shares of ongoing R&D.*” *Id.* at 3 (emphasis added).

¹⁷⁹ See *U.S. v. Drescher*, 179 F.2d 863, 866 (1950). In *Drescher*, the taxpayer was an employee of Bausch & Lomb where the employee was given an annuity “in ‘recognition of prior services rendered,’” which was non-transferable and would not begin to pay until the taxpayer reached the age of sixty-five (this was eighteen to nineteen years after the premium was initially paid). *Id.* at 863–64. The Court held that the taxpayer had received income when the \$5,000 premium was initially paid, rather than when the taxpayer would begin receiving monthly annuitant payments at the age of sixty-five. *Id.* at 866–67. The taxpayer “relied upon the terms of the contract to prove that it had no present value whatever.” *Id.* at 866. However, the Court ruled “we are satisfied that the 1939 policy [(the date the premium was paid)] *had some present value* and since he [(the taxpayer)] did not prove that such value was less than \$5,000, the judgement in his favor cannot stand.” *Id.* (emphasis added).

¹⁸⁰ See *Veritas Software Corp. v. Comm’r.*, 133 T.C. 297, 322–23 (2009). “In short, there is insufficient evidence that access to VERITAS US’ R&D . . . was transferred to VERITAS Ireland or *had value.*” *Id.* at 323 (emphasis added).

¹⁸¹ See Kochman, *supra* note 14 (discussing the similarities and differences between *Amazon* and *Veritas* and whether *Amazon* is an independent case in-and-of itself, or simply just a *Veritas* redux).

¹⁸² Compare Julie Martin, *Amazon wins \$1.5 billion transfer pricing dispute in US Tax Court*, MNE TAX (Mar. 24, 2017), <https://mnetax.com/amazon-wins-transfer-pricing-case-tax-court-20243-20243> [<https://perma.cc/PV4X-WQWA>], with Kochman, *supra* note 14. Both *Amazon* and *Veritas* applied the CUT method for allocating their buy-in payment for the transfer of its preexisting intangibles while using a CSA (while the Service initially argued that some form of a DCF method is the proper method to use under the Best Method Rule for the transfer); both Tax Courts found the preexisting intangibles do not have a perpetual useful life, as argued both times by the Service; both opinions were governed under the pre-2009 CSA regulations; and finally, both judges for the Tax Court concluded that the Service’s recalculation of the buy-in payment was arbitrary, capricious, and unreasonable, and that the taxpayers CUT method is instead the best method to use to calculate the CSA buy-in payment for each parent’s preexisting intangibles.

in the *Veritas* case.”¹⁸³ Even Judge Lauber, writing on behalf of the Tax Court in *Amazon*, explains “[o]ne does not need a Ph.D. in economics to appreciate the essential similarity between the DCF methodology that Dr. Hatch employed in *Veritas* and the DCF methodology that Dr. Frisch employed [in the instant case].”¹⁸⁴ Like *Veritas*, the Tax Court in *Amazon* found that the Service’s approach to reallocating both parties income to be “fatally flawed because it treated the buy-in transaction as being ‘akin to the sale’¹⁸⁵ of the business and did not give appropriate considerations to the environment of rapid innovation”¹⁸⁶ “[B]y valuing short-lived intangibles as if they have a perpetual life, the [Internal Revenue Service] improperly took into account intangibles *that were subsequently developed*, rather than pre-existing.”¹⁸⁷

¹⁸³ Mike Heimert & Jill Weise, *Transfer Pricing Times: U.S. Tax Court Rules in Favor of Amazon in Latest Transfer Pricing Case*, DUFF & PHELPS (Mar. 31, 2017), <https://www.duffandphelps.com/insights/publications/transfer-pricing/transfer-pricing-times-march-2017-issue> [<https://perma.cc/4877-UVJL>] (“[T]he core issues in [*Amazon*] are very similar to those in the *Veritas* case”).

¹⁸⁴ *Amazon.com, Inc. v. Comm’r.*, 148 T.C. 108, 155 (2017). Both economic experts within *Veritas* and *Amazon*

assumed that the preexisting intangibles transferred under the QCSA [Qualified Cost Sharing Agreement] had a perpetual useful life; both determined the buy-in payment by valuing into perpetuity the cash flows supposedly attributable to these pre-existing intangibles; and both in effect treated the transfer of pre-existing intangibles as economically equivalent to the sale of an entire business.

Id.

¹⁸⁵ *See id.* at 152, 156.

The Commissioner’s expert [from *Veritas*], Dr. Hatch, “assumed that the preexisting intangibles ha[d] a perpetual useful life” and “characterized the CSA as ‘akin’ to a sale or geographic spinoff” of the U.S. parent’s international business operations.

[The Service’s expert within *Amazon* uses a] DCF methodology [that] resembles Dr. Hatch’s in another respect: It is based in essence on an “akin to a sale” theory.

Id. (citing *Veritas Software Corp. v. Comm’r.*, 133 T.C. 297, 313 (2009)). Essentially, the Service argues that the transfer of such intangibles should be treated as if there is a complete sale of all the rights and obligations associated with the transferred preexisting intangibles.

¹⁸⁶ Heimert & Weise, *supra* note 183 (There was additionally no consideration given by the Service “to the current and future contributions of Amazon’s European operations to the projected profits of that business.”).

¹⁸⁷ Vidya Kauri, *Tax Court Backs Amazon In \$1.5B Transfer Pricing Dispute*, LAW360 (Mar. 23, 2017, 3:52 PM), available at <https://www.law360.com/articles/905586/tax-court>

(continued)

3. *Evaluating Preexisting Intangibles under a CSA While still Dealing at Arm's Length with a Controlled Subsidiary*

Although there are valid arguments that the evaluation of intangibles cannot have a perpetual useful life, it is unreasonable to believe that such intangibles transferred within *Veritas* and *Amazon* only contain make or sell value, but hold no R&D value.¹⁸⁸ Generally, the idea of giving preexisting intangibles a perpetual useful life in-and-of-itself is extremely difficult to argue—whether evaluating an intangibles make-sell value or R&D value independently.¹⁸⁹ However, the fact that the Tax Court held in both *Veritas*¹⁹⁰ and *Amazon*¹⁹¹ that a parent's preexisting intangibles

backs-amazon-in-1-5b-transfer-pricing-dispute (emphasis added) (“The IRS’ valuation expert . . . treated the buy-in payment transaction like a sale by determining an enterprise value for Amazon’s entire business, but this assumption calculates values for assets that were not transferred under the [CSA] as well as assets that were not compensable intangibles to begin with . . .”).

¹⁸⁸ *Id.* See also Kochman, *supra* note 14. (“There is little question that in a rapidly changing field such as software development, the make or sell rights have a fairly short useful life and the value of those rights degrades as the software becomes dated. *That does not necessarily mean, however, that an intangible ceases to have value as a platform for future R&D.*”) (emphasis added).

¹⁸⁹ See *Finite Lived vs Indefinite Lived Intangible Assets—How to test for impairment?*, POPULARACCOUNTING (Jan. 11, 2016), <http://www.popularaccounting.com/2016/01/11/finite-lived-vs-indefinite-lived-intangible-assets-how-to-test-for-impairment/> [<https://perma.cc/X4K4-RTJP>] (“[T]he number of intangible assets that are considered to be indefinite lived (other than Goodwill) is VERY limited.”).

¹⁹⁰ See *Veritas Software Corp. v. Comm’r.*, 133 T.C. 297, 323–24 (2009).

The [pre-2009 CSA] regulation[s] unequivocally requires a buy-in payment to be made with respect to transfers of “pre-existing intangible property[.]” No buy-in payment is required for subsequently developed intangibles. Yet [the Service’s expert] unabashedly took such items into account in calculating the requisite buy-in payment rather than limiting the valuation to preexisting intangibles as prescribed by section [1.482-7A(g)(2)], Income Tax Regs. In fact, [the Service’] readily and repeatedly acknowledged that his valuation took into account income relating to items other than the preexisting intangibles. Accordingly, [the Service’s] allocation violates section [1.482-7A(g)(2)], Income Tax Regs.

Id.

¹⁹¹ See Kochman *supra* note 14. See also *Amazon.com, Inc. v. Comm’r.*, 148 T.C. 108, 156 (2017).

[I]t is clear that [the Service] improperly included in the buy-in payment the value of “subsequently developed intangibles”. . . . Management’s projections for the European business were based on the (extremely high) growth rates that Amazon had

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transferred to its subsidiary hold absolutely no R&D value is completely absurd. Current technology today is not developed solely from scratch:¹⁹² a movie today is not developed without the use of Adobe Premiere®;¹⁹³ music is not produced without the computer software of Pro Tools®;¹⁹⁴ and the current Microsoft Word® version sixteen certainly would not have been produced without the creation and development of Microsoft Word version fifteen (or Microsoft Word version one for that matter).¹⁹⁵ Does this mean that (although these past or present preexisting intangibles cannot be sold for much value today, or within the near future because they

achieved in the past. Such growth rates could be sustained only through the constant innovation, including innovations concerning products and services that did not yet exist in marketable form. Projects that would contribute to high future growth rates, some of which were in early development as of January 2005, included the Kindle, Amazon Prime, the Fire smartphone, Fire TV, digital music/video offerings, cloud computing and storage, and the EFN, which implemented standardized and improved fulfillment operations across Europe.

These new products and services, as well as the next generation of Amazon's website platform, would be created thanks to massive projected IDC investments by Amazon in years after 2004. But [Amazon Luxembourg] would have paid, via cost sharing, its ratable share of these future ICDs, and it would thus co-own these subsequently-developed intangibles. Because [Amazon Luxembourg] would pay for these assets via cost sharing, it was not required to pay for them through the upfront buy-in payment.”).

Id. (internal citation omitted).

¹⁹² See Chris Scholz, *How is a Facebook-Like Site Actually Created from Scratch?*, FORBES (May 20, 2013, 10:09 AM), <https://www.forbes.com/sites/quora/2013/05/20/how-is-a-facebook-like-site-actually-created-from-scratch/#7189c081dd2d> [<https://perma.cc/4YJW-S54A>] (discussing how, in theory and generally speaking, Facebook was developed “from scratch”).

¹⁹³ See *Overview of Adobe Premiere Pro*, MEDIA COLLEGE, <https://www.mediacollege.com/adobe/premiere/pro/intro.html> [<https://perma.cc/G89A-JV2J>] (“Adobe Premiere is a video editing software package suitable for both amateur enthusiasts and professionals. It can be purchased and used alone, or alongside other applications such as Adobe Photoshop, After Effects, etc.”).

¹⁹⁴ See Dave Roos, *How Pro Tools Software and Hardware Works*, HOWSTUFFWORKS, <https://entertainment.howstuffworks.com/pro-tools-software-hardware.htm> [<https://perma.cc/MZ63-7FPL>] (“Pro Tools is a rare example of a technology that absolutely dominates an industry. Every single professional audio production facility—from recording studios to audio post-production houses—uses a Pro Tools system.”).

¹⁹⁵ See *Microsoft Word*, *supra* note 93; Martin Hendriks, *Learn About Updating Microsoft Office Word*, LIFEWIRE (Jan. 18, 2018), <https://www.lifewire.com/updating-microsoft-office-word-3539910> [<https://perma.cc/E2FR-PGYZ>] (“Microsoft frequently issues updates that improve the functionality, performance, stability, and security of all their office tools, including MS Word.”).

will eventually be periodically updated) these intangibles contribute no other value to future products or intangibles subsequently developed because of the original intangibles creation?

The Tax courts have held under the pre-2009 CSA regulations that the R&D value cannot be taxed in addition to the make or sell value because subsequent IDCs¹⁹⁶ will be made by the subsidiary to the parent as the intangibles subsequently develop over time.¹⁹⁷ But this reasoning is again absurd. An intangible can still hold R&D value even if a controlled entity makes IDCs because of the *potential value* those preexisting intangibles hold with respect to the subsequently-developed intangibles the originally-transferred intangibles expect to produce. In today's current technological market, subsequently developing intangibles is how businesses continue to compete with other technological competition (and how many businesses continue to stay "afloat" and in business today).¹⁹⁸ By saying that an IDC

¹⁹⁶ See Treas. Reg. § 1.482-7A(a)(1) (2009) (explaining intangible development costs (IDCs) refers to the costs associated with the "development of one or more intangibles . . ."; and explaining, under a CSA, the parties to the CSA share the costs associated with the development of an intangible, which is why a parent must transfer its preexisting intangibles to its subsidiary in exchange for a buy-in payment so that both the parent and subsidiary can subsequently develop its intangibles and share the costs of such development as provided within the entities' CSA). See also Treas. Reg. § 1.482-7A(g)(1) (2009) & Treas. Reg. § 1.482-7(d) (2013) (showing the pre and post-2009 CSA regulations regarding IDCs).

¹⁹⁷ See Kochman, *supra* note 14; Amazon.com, Inc. v. Comm'r., 148 T.C. 108, 156 (2017). See also *supra* note 191 ("But [Amazon Luxembourg] would have paid, via cost sharing, its ratable share of these future IDCs, and it would thus co-own these subsequently-developed intangibles.").

¹⁹⁸ See *The Importance of Upgrading Business Technology*, CLASSIC FUNDING GROUP (April 17, 2015), <https://www.classicfg.com.au/blog/the-importance-of-upgrading-business-technology/> [<https://perma.cc/WGZ8-JHYX>].

The prevalence of technology in business has its distinct advantages, from operational efficiency to customer satisfaction and marketing. While reliable staff, a great product range and an overarching set of goals and objectives, are the driving factors behind a company's success, businesses also need to keep up with the ever-changing advancements in technology.

Maintaining a solid IT [Information Technology] infrastructure can help a company go through the day-to-day motions of doing business more efficiently - and can even reduce costs. Falling out of step with the digital environment, however, can disadvantage operational effectiveness.

Id.

is the “near equivalent” of an intangible’s R&D value,¹⁹⁹ but instead paid over time rather than at the time of the subsidiary’s buy-in payment,²⁰⁰ the Tax courts are essentially allowing a controlled participant’s subsidiary to obtain the parent’s preexisting intangibles for a lot less than the intangibles present and potential value: this includes an intangible’s R&D value. IDCs cannot be included based on this argument because IDCs are simply a burden imposed on MNEs and a cost associated with doing business in the intangible industry.²⁰¹

In the end, the transfer of these intangibles under a CSA is meant to facilitate development of future products or to subsequently develop future intangibles.²⁰² But this future product or intangible still holds many aspects of the original transferred intangible.²⁰³ Therefore, this creates value within the original transferred intangible because of the future products, or subsequently-developed intangibles, created over time from the original transferred intangible. It is not until a certain time has passed, where a product or intangible has been developed or updated so many times, that the subsequently-developed intangibles begin to show very few

¹⁹⁹ See *Amazon*, 148 T.C. at 156 (Judge Lauber, writing for the Tax Court, determined that Amazon would not have to pay for the R&D value of the transfer of Amazon U.S.’s preexisting intangibles because Amazon Luxembourg “would pay for these assets via cost sharing.”).

²⁰⁰ See *id.* (Amazon Luxembourg “would have paid, via cost sharing, its ratable share of these future IDCs” and was therefore “not required to pay for [the subsequently-developed intangibles] through the upfront buy-in payment.”).

²⁰¹ There is a general cost associated with tech companies similar to *Amazon* and *Veritas* where the costs to develop these companies’ technologies is simply a cost of doing business and keeping the business flowing. See David Pogue, *Why the Upgrade Cycle Will Never End*, SCIENTIFIC AMERICAN (June 1, 2015), <https://www.scientificamerican.com/article/why-the-upgrade-cycle-will-never-end/> [<https://perma.cc/CK5R-2B9Q>] (“[T]ech companies have only one big tool to entice you to upgrade each year: *piling on new features*. More, more features. Microsoft Word was once a word processor. Today it’s a database, and a Web-layout program, and a floor wax.”) (emphasis in original).

²⁰² See *Cost Sharing Agreements an Effective Tax Planning Tool*, *supra* note 62 (A CSA “allows the companies to share the costs and risks of developing, producing, or obtaining assets. Typically, companies with R&D or technology-related assets, such as pharmaceutical or software companies, have entered into this type of agreement.”).

²⁰³ See Alison E. Berman & Jason Dorrier, *Technology Feels Like It’s Accelerating—Because It Actually Is*, SINGULARITY HUB (Mar. 22, 2016), <https://singularityhub.com/2016/03/22/technology-feels-like-its-accelerating-because-it-actually-is/#sm.0001nbrecaxv7er7se51gnzilryj6> [<https://perma.cc/UHX7-K7ZK>] (discussing how technology is accelerating exponential over time because of the law of acceleration. “Technology goes beyond mere tool making; it is a process of creating ever more powerful technology using the tools from the previous round of innovation.”).

aspects of the original transferred intangible.²⁰⁴ Until that time, however, future products developed from the original-transferred intangibles retain the same or very similar aspects of the original transferred intangible.²⁰⁵

IV. SIGNIFICANCE

Although *Amazon v. Commissioner* could be reversed because it is pending appeal,²⁰⁶ there is, because of *Amazon* and *Veritas*, one aspect that remains certain regarding the buy-in payment of preexisting intangibles when transferred through a CSA under the pre-2009 CSA regulations: the transfer of such preexisting intangibles have only make or sell rights, with a non-perpetual useful life, that will likely be short.²⁰⁷ Yet this idea is deeply flawed because intangibles can hold R&D value that theoretically exceeds that of a simple short and useful life, as found in the case of *Amazon* and *Veritas*.²⁰⁸ The computers currently used today were at one time 1800 square feet in size.²⁰⁹ Although computers have significantly changed since the original first generation of computers,²¹⁰ original

²⁰⁴ As an intangible develops over time, the original intangible may show some aspects of that intangible within future or subsequently developed intangibles, but such features begin to fade away as it continues to develop. For an article regarding how Apple's IOS software has developed and changed over time, see Verge Staff, *iOS: A Visual History*, THE VERGE (Sept. 16, 2013, 2:43 PM), <https://www.theverge.com/2011/12/13/2612736/ios-history-iphone-ipad> [<https://perma.cc/6QKK-CPD2>].

²⁰⁵ See Berman & Dorrier, *supra* note 203 (“[E]ach new generation of technology stands on the shoulders of its predecessors . . .”).

²⁰⁶ See *IRS filed notice of appeal in Amazon case*, *supra* note 12. See also *IRS appealing Tax Court loss in Amazon transfer pricing case*, MNE TAX (Oct. 5, 2017), <https://mnetax.com/irs-appeals-amazon-transfer-pricing-loss-ninth-circuit-23903> [<https://perma.cc/PYD9-UT5W>] (“The IRS’s appeal, filed on September 29, will challenge a March Tax Court ruling concerning Amazon’s cost-sharing agreement buy-in payment. The case is important because it is expected to provide fundamental guidance on the arm’s length pricing of transfers of intangibles.”).

²⁰⁷ See *supra* notes 177, 182 & 187; Kochman, *supra* note 14 (Indeed, “[t]here is little question that in a rapidly changing field such as software development, the make or sell rights have a fairly useful life and the value of those rights degrades as the software becomes dated.”).

²⁰⁸ See Kochman, *supra* note 14 (Although make or sell rights of an intangible can have a fairly short life, “[t]hat does not necessarily mean, however, that an intangible ceases to have value as a platform for future R&D.”).

²⁰⁹ See *How have computers developed and changed?*, THE WORKPLACE DEPOT (Mar. 22, 2013), <https://www.theworkplacedepot.co.uk/news/2013/03/22/how-have-computers-developed-and-changed/> [<https://perma.cc/2D2Y-AM7E>] (The first computers took weeks to re-program and required continuous maintenance 24 hours a day).

²¹⁰ See Vangie Beal, *The Five Generations of Computers*, WEBOPEDIA (Jan. 10, 2010), https://www.webopedia.com/DidYouKnow/Hardware_Software/FiveGenerations.asp [<https://perma.cc/K2J5-MP6F>] (“The first computer systems used vacuum tubes for

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computers still hold some form of value because of their original significance or creation, and because of the need for subsequently-developed computers that do not yet exist today.²¹¹ But for the creation of the original computer—and its further research and development—computers may not have the same high-capacity and efficient functions available in the current generation of computers in existence today.²¹² Computers today still hold many aspects and products found within first-generation computer technology,²¹³ and the same holds true with the intangibles located within technology similar to that of computers.

Broadly speaking, the overall influence of *Amazon* and *Veritas* may be limited because both holdings are analyzed under the pre-2009 CSA regulations.²¹⁴ But it is not entirely certain which side the tax courts will favor if *Amazon* is governed under the current post-2009 CSA regulations.²¹⁵ The current final regulations imposed, after the release of the temporary regulations in January 2009, changed drastically.²¹⁶ A

circuitry and magnetic drums for memory, and were often enormous . . . These computers were very expensive to operate and in addition to using a great deal of electricity, [they] generated a lot of heat, which was often the cause of malfunctions.”)

²¹¹ See Emma Kavanagh, *The Evolution of Computers, 1st, 2nd, 3rd, 4th Generation, and More to Come*, NORTON SECURITY, <https://www.nortonsecurityonline.com/security-center/evolution-of-computers.html> [<https://perma.cc/LK9B-9PFS>] (“The first full-sized digital computer in history was developed in 1944. Called the Mark I, this computer was used only for calculations and weighed five tons. Despite its size and limited ability it was the first of many that would start off generations of computer development and growth.”).

²¹² For a general history in the development of technology to what is currently in existence and available today, see *History of Technology*, BRITANNICA, <https://www.britannica.com/technology/history-of-technology/The-20th-century> [<https://perma.cc/TEZ9-EMER>].

²¹³ For a detailed analysis comparing the early computer and the modern computer, see Zobair Ullah, *Early Computer VS Modern Computer: A Comparative Study and an Approach to Advance Computer*, 12 GLOBAL J. OF COMPUTER SCI. AND TECH. INTERDISC. 11, (2012), available at https://globaljournals.org/GJCST_Volume12/1-Early-Computer-VS-Modern.pdf [<https://perma.cc/V4QT-6Z24>].

²¹⁴ See Kochman *supra* note 14 (“Although at one time the IRS had a huge inventory of buy-in cases under the 1995 cost sharing regulations, it appears that the bulk of those cases have been resolved through the IRS administrative appeals process.”).

²¹⁵ As of February 2018, a Court has not yet held a decision regarding the current CSA regulations that have been in effect since December of 2011. See *supra* note 22. The most recent pre-2009 CSA disputes with the Service include *Amazon.com, Inc. v. C.I.R., Altera Corp. and Subsidiaries v. C.I.R., Veritas Software Corp. v. C.I.R., and Xilinx, Inc. v. C.I.R.* See *Amazon.com, Inc. v. Comm’r.*, 148 T.C. 108 (2017), *Altera Corp. and Subsidiaries v. Comm’r.*, 145 T.C. 91 (2015), *Veritas Software Corp. v. Comm’r.*, 133 T.C. 297 (2009) & *Xilinx, Inc. v. Comm’r.*, 567 F.3d 482 (9th Cir. 2009).

²¹⁶ See *IRS Issues Temporary and Proposed Cost Sharing Regulations*, ROPES & GRAY (Jan. 6, 2009), <https://www.ropesgray.com/en/newsroom/alerts/2009/01/irs-issues-tempo>

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general overviewing of the long and current CSA regulations, which generally follow the 2009 temporary regulations,²¹⁷ reveals that the new regulations more closely follow the Service's position as argued in *Veritas* and *Amazon*.²¹⁸

One difference between the current and pre-2009 CSA regulations is the Treasury's decision to get rid of a Qualified Cost Sharing Arrangement.²¹⁹ However, the largest change made by the Treasury within the post-2009 CSA regulations is the use of a "platform contribution transaction" (PCT), which replaces the general idea of a "buy-in payment."²²⁰ A PCT is similar in nature, but broader in language, as to how the Treasury refers to the need of a "buy-in payment" for the transfer of preexisting intangibles within the pre-2009 CSA regulations.²²¹

"A platform contribution is any resource, capability, or right that a controlled participant has developed, maintained, or acquired externally to the intangible development activity (whether prior to or during the course of the CSA) that is reasonably anticipated to contribute to developing cost

rary-and-proposed-cost-sharing-regulations ("The [2009] temporary regulations . . . ma[d]e numerous changes to proposed regulations issued in August 2005.").

²¹⁷ See *IRS adopts final cost sharing regulations*, INT'L TAX ALERT (Dec. 22, 2011), [http://www.ey.com/Publication/vwLUAssets/International_Tax_Alert_-_22_December_2011_-_IRS_adopts_final_cost_sharing_regulations/\\$FILE/EY_Tax_news_2012010301.pdf](http://www.ey.com/Publication/vwLUAssets/International_Tax_Alert_-_22_December_2011_-_IRS_adopts_final_cost_sharing_regulations/$FILE/EY_Tax_news_2012010301.pdf) [<https://perma.cc/TL7R-LYKB>] ("Generally, the final regulations closely follow the 2009 temporary regulations.").

²¹⁸ See Kochman *supra* note 14 ("The new cost sharing regulations . . . are much more in line with the IRS position in *Veritas* and the AOD.").

²¹⁹ See *supra* note 150 (for a discussion on the post-2009 CSA regulations getting rid of the concept of a QCSA). Compare Treas. Reg. § 1.482-7A(b) (2009), with Treas. Reg. § 1.482-7 (2013) (The finalized regulations do not even acknowledge the existence of a qualified cost sharing arrangement).

²²⁰ See *IRS Issues Temporary and Proposed Cost Sharing Regulations*, *supra* note 216.

The temporary regulations [which have now been finalized,] use a new term, "platform contributions," to describe the scope of pre-existing assets that will contribute to development of the cost shared intangibles. All participants must commit to platform contribution transactions (PCTs), which are also known as buy-ins, to the extent that there are platform contributions. A platform contribution is any resource, capability, or right that a participant possesses, separately from the intangible development activity, whether developed or acquired prior to or during the course of the CSA, that is reasonably anticipated to contribute to developing cost shared intangibles.

Id.

²²¹ See *id.* "The subsequent cost sharing regulations replaced the concept of a 'buy-in' payment with the concept of a platform contribution transaction . . ." *US Tax Court sides with Amazon in intangibles transfer case*, *supra* note 150.

shared intangibles.”²²² This language is drafted to cover a very broad spectrum of what the pre-2009 CSA regulations refer to as an MNE’s “preexisting intangibles.”²²³ The post-2009 CSA regulations also refer to the amount charged within a PCT to be the arm’s-length amount²²⁴ which, of course, is similarly found within the pre-2009 CSA regulations.²²⁵

While the post-2009 CSA regulations, like the pre-2009 regulations, allow for many different types of methods to calculate a buy-in payment for the transfer of preexisting intangibles through a CSA,²²⁶ “Each method 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.”²²⁷ This added language is quite different from the pre-2009 CSA regulations.²²⁸ However, such language

²²² Treas. Reg. § 1.482-7(c)(1) (2013) (“The determination whether a resource, capability, or right is reasonably anticipated to contribute to developing cost shared intangibles is ongoing and based on the best available information.”).

²²³ A PCT “has a much more expansive definition of what is compensable compared to just the preexisting IRC §936(h)(3)(B) intangibles at issue under the 1995 regulations.” *US Tax Court sides with Amazon in intangibles transfer case*, *supra* note 150.

²²⁴ “In a PCT, each other controlled participant (PCT Payor) is obligated to, and must in fact, make arm’s length payments (PCT Payments) to each controlled participant (PCT Payee) that provides a platform contribution.” Treas. Reg. § 1.482-7(b)(1)(ii) (2013).

²²⁵ “The buy-in payment by each such other controlled participant is the arm’s length charge for the use of the intangible . . . multiplied by the controlled participant’s share of reasonably anticipated benefits . . .” Treas. Reg. § 1.482-7A(g)(2) (2009).

²²⁶ “The arm’s length amount charged in a platform contribution transaction (PCT) . . . must be determined under the method or methods applicable under the other section or sections of the section 482 regulations . . .” Treas. Reg. § 1.482-7(a)(2) (2013). The pre-2009 CSA regulations provide that the buy-in payment “is the arm’s length charge for the use of the intangible under the rules of §§1.482-1 and 1.482-4 through 1.482-6 . . .” Treas. Reg. § 1.482-7A(g)(2) (2009). Section 1.482-4 gives the various methods an MNE may use for evaluating intangibles. *See generally* Treas. Reg. § 1.482-4 (2011). For a brief explanation on the different methods available for evaluating intangibles under §1.482-4, *see supra* at 458.

²²⁷ Treas. Reg. § 1.482-7(g)(1) (2013) (The regulations further provide that “[e]ach method will yield a value for the compensation obligation of each PCT Payor consistent with the product of the combined pre-tax value to all controlled participants of the platform contribution that is the subject of the PCT and the PCT Payor’s RAB share.”).

²²⁸ Under the pre-2009 CSA regulations, the buy-in payment “is the arm’s length charge for the use of the intangible . . . multiplied by the controlled participant’s share of reasonably anticipated benefits . . .” Treas. Reg. § 1.482-7A(g)(2) (2009). “[A] controlled participant’s reasonably anticipated benefits are the aggregate benefits that it reasonably anticipates that it will derive from covered intangibles.” *Id.* § 1.482-7A(e)(2).

The pre-2009 CSA regulations specifically refer to the buy-in payment as only being a subsidiary’s RAB in order to obtain an arm’s-length value for the transferred preexisting intangibles. The post-2009 CSA regulations force MNEs to find this value, as they “must”

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does resemble a similar concept within the pre-2009 CSA regulations, where an intangible must be evaluated under one of the specified methods “multiplied by the controlled participant’s share of reasonably anticipated benefits”²²⁹

In what way can the use of a buy-in payment for the transfer of an MNE’s preexisting intangibles be the value of a subsidiary’s anticipated “future income” (as used in the current CSA regulations) versus the value of a subsidiary’s RABs (as required in the pre-2009 CSA regulations)? To start, the language is explicit in (essentially) forcing an MNE to evaluate intangibles from a subsidiary’s anticipated “income” versus the subsidiary’s anticipated “benefits.”²³⁰ This change in the current CSA regulations implies a higher standard and burden imposed on MNEs that use CSAs to transfer its intangibles to a controlled subsidiary.²³¹ Can this amended language change a tax courts’ future decision and allow the Service to collect from an MNE the present value of an intangible’s make-sell rights, and an MNE’s R&D value rights, based on the anticipation of a controlled participant’s “future income” when transferring a preexisting intangible through a CSA?²³²

specifically reference within their PCT “to the future income anticipated to be generated by the resulting cost shared intangibles.” Treas. Reg. § 1.482-7(g)(1) (2013).

²²⁹ Treas. Reg. § 1.482-7A(g)(2) (2009). See also Treas. Reg. § 1.482-7(g)(1) (2013). The current CSA regulations do not get rid of the idea of RABs entirely. However, the current regulations specifically require taxpayers to refer to their anticipated “future income” in order for its PCT to be consistent with the idea of obtaining an arm’s-length result for such transfers. See *id.*

²³⁰ See *supra* note 229. Additionally, “the IRS has introduced three new methods—the income method, the acquisition price method, and the market capitalization method—to ensure arm’s-length pricing in all cost-sharing transactions. The comparable uncontrolled transaction (CUT) method and a revised residual profit split (RPS) method are also included as specified methods.” Jeffrey B. Kaufman, *Transfer Pricing: The New Temporary Cost-Sharing Regs.*, THE TAX ADVISER (Apr. 1, 2009), <https://www.thetaxadviser.com/issues/2009/apr/transferpricingthenewtemporarycost-sharingregs.html> [<https://perma.cc/AKL5-E4AH>].

²³¹ By using language that the evaluation of an intangible “*must* yield results consistent” to the PCT “*by reference* to the future income anticipated,” taxpayers must now specifically prove by reference to a transferred intangibles “future income anticipated” in order to obtain an arm’s length result. See Treas. Reg. § 1.482-7(g)(1) (2013) (emphasis added). This added language is much stronger and more favorable to the Service than the pre-2009 CSA regulations, and it imposes a higher burden upon MNEs who transfer intangibles through a CSA to a foreign subsidiary.

²³² With the amendment of §482 following the Tax Cuts and Jobs Act, there is clearly work being performed by Congress, and the Treasury, from abusing the transfer of intangibles under a CSA. For a discussion on how the TCJA changed §482, see *supra* Section V.

Because the current CSA regulations state that “each method must yield results consistent” with “the future income anticipated to be generated by the resulting cost shared intangible,” it is extremely difficult to argue that these transferred preexisting intangibles—which are transferred to develop the future “cost-shared intangibles”—hold no R&D “future income” that is “anticipated” to come from any subsequently developed intangibles.²³³ This is especially true when an MNE’s intangibles have contributed to the growth of the MNE’s business as a whole; such growth is anticipated and even expected as the MNE’s intangibles continue to develop over time.²³⁴ Although R&D value cannot exist where a taxpayer obtains transferred preexisting intangibles for the sole purpose of using or selling them independently,²³⁵ CSAs are specifically made to research and develop future intangibles²³⁶ between two controlled participants;²³⁷ this makes it nearly impossible to argue that a transferred preexisting intangible holds no R&D value.

It could be argued that it is difficult to determine whether a future intangible will actually be developed or contain “future value” from these transferred preexisting intangibles, and this therefore should not be evaluated as having any form of R&D value.²³⁸ But this argument should

²³³ See Treas. Reg. § 1.482-7(g)(1) (2013). The definition, and entire purpose for the creation of a CSA, is for “controlled participants [to] share the costs and risks of developing cost shared intangibles . . .” Treas. Reg. § 1.482-7(b) (2013).

²³⁴ The regulations specifically provide that the evaluation of such transferred preexisting intangibles must be “consistent” with a “reference to the future income anticipated . . .” Treas. Reg. § 1.482-7(g)(1). This can again help mitigate certain abusive practices and favor (at least more than the pre-2009 CSA regulations) the Service’s position.

²³⁵ This would be the equivalent of an MNE using the intangibles solely for making or selling. Because there is no R&D, there can be no R&D value in the transferred intangible. For information regarding make or sell value, see *supra* note 176.

²³⁶ See *supra* note 233. But see *Cost Sharing Agreements an Effective Tax Planning Tool*, *supra* note 62 (Creating a CSA can have other benefits or purposes beyond just developing intangibles. CSAs “are particularly beneficial when global development activities would otherwise require global cross-licensing arrangements which are difficult to administer . . .”).

²³⁷ In traditional U.S. contract law, contracts can be freely negotiated and the law will not evaluate the adequacy of the parties consideration. See Edmund Polubinski, Jr., *The Peppercorn Theory and the Restatement of Contracts*, 10 WM. & MARY L. REV. 201, 201 (1968). However, because CSAs are created and entered into between commonly controlled entities, this basic contract theory cannot apply as these parties would give either no consideration, or simply just “nominal consideration,” for the transfer because of their relationship. See *id.* at 202–03 (describing “[t]he doctrine of nominal consideration”).

²³⁸ See Avi-Yonah, *supra* note 7.

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fail and is again deeply flawed. Executing a CSA is a business decision that involves taking certain inherent risks, including whether the intangibles transferred within a CSA will actually create some form of a future profit or value. Additionally, MNEs typically only “enter into cost-sharing agreements . . . when they know the intangible will be profitable”²³⁹ There is nothing within the U.S. corporate law structure that guarantees some type of repayment when a corporation forms or when a shareholder invests.

The idea behind cost-sharing was that the multinational cannot know whether the development will be successful This, it was thought, would inhibit the multinationals from taking too aggressive a position in their cost-sharing agreements.

But this idea is deeply flawed for two reasons. First, successful intangibles result in profits that far outweigh the costs of development. . . . [I]mmense sums . . . can be earned from the successful exploitation of intangibles.

Second, for cost-sharing to work the multinational cannot know whether the intangible will be successful or not. But multinationals are in the best position to know precisely that, and it is very hard for the IRS to second-guess their knowledge or lack thereof. Multinationals typically enter into cost-sharing agreements only when they know the intangible will be profitable, and while in theory this requires a “buy-in” payment[,] . . . in practice this becomes a valuation issue and the IRS has not been successful in litigation over buy-in payments (*Veritas* and now *Amazon*).

Id.

²³⁹ *Id.* Under a CSA, an MNE

risks losing 80% of the R&D deduction if it is unsuccessful because this deduction is shifted to the [controlled foreign corporation], which does not have U.S. source income. This, it was thought, would inhibit the multinationals from taking too aggressive a position in their cost-sharing agreements Thus, it makes sense for a multinational that develops an intangible for \$100 million with a profit potential of \$1 billion to risk losing \$80 million in deductions, if there is a good chance that this will shield \$800 million or more in profits from current U.S. taxation.

Id.

V. THE AMENDMENT OF §482 THROUGH THE TAX CUTS AND JOBS ACT OF 2017²⁴⁰

Recently, §482 was amended following the Tax Cuts and Jobs Act of 2017.²⁴¹ The amendment, which adds a sentence at the end of the pre-TCJA²⁴² §482 statute, states the following:

For purposes of this section, the Secretary shall 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 determines that such basis is the most reliable means of valuation of such transfers.²⁴³

²⁴⁰ During the creation and editing process of this Note, §482 was amended in the Tax Cuts and Jobs Act of 2017. Unfortunately, because of how recent this amendment is, it is very difficult to determine the extensiveness and scope on how this amendment will affect similar transactions (as discussed throughout this Note). Because of the relevancy of this amendment to the concepts discussed throughout, it will be discussed in brief detail within the section below. However, additional and extensive research and analysis will be required for a more fully comprehensive view, and it is recommended to the active reader to seek out further research on how this amendment may affect similar future transactions.

²⁴¹ Compare I.R.C. § 482 (2017), with I.R.C. § 482 (2018) (the statute is nearly the same in terms of the language from the pre-TCJA §482, but there is an added amended sentence and the definition of “intangible” as used in the statute has now been changed).

²⁴² The Tax Cuts and Jobs Act of 2017 was a large Tax Act that amended the Internal Revenue Code of 1986. See *2018 Tax Cuts & Jobs Act Overview*, SMITH&HOWARD (Mar. 2018), <https://www.smith-howard.com/2018-tax-cuts-jobs-act-overview/> [<https://perma.cc/L8BV-D3Y3>]. The Act made significant changes, including reducing the corporate tax rate from 35% to 21%, allowing a new business income deduction with pass-through entities, and a new limit on a business loss with pass-through entities. See *How did the Tax Cuts and Jobs Act change business taxes?*, TAXPOLICYCENTER, <https://www.taxpolicycenter.org/briefing-book/how-did-tax-cuts-and-jobs-act-change-business-taxes> [<https://perma.cc/5RZ5-V66V>].

²⁴³ I.R.C. § 482 (2018). The new amendment now explicitly states by statute a requirement for the MNE to provide either (1) an evaluation based on an aggregate basis, or (2) an evaluation based on realistic alternatives, *if* the Secretary determines it is the most reliable means of evaluation. Evaluating intangibles on an aggregate basis has previously been required in the pre-2009 CSA regulations. See Treas. Reg. § 1.482-7A(e)(2) (2009) (“[A] controlled participant’s reasonably anticipated benefits are the aggregate benefits that it reasonably anticipates that it will derive from covered intangibles.”). Additionally, requiring realistic alternatives has also previously been required through regulations in the transfer of intangibles. See *id.* § 1.482-4(d) (2011). These concepts are by no means new ideas in the transfer pricing arena.

In addition to this amendment, the new statute also replaced and re-defined the definition of “intangible.”²⁴⁴ This new definition explicitly includes: goodwill, going concern value, and workforce in place.²⁴⁵ In theory, this extended definition should help the Service’s argument as found in *Amazon*,²⁴⁶ considering the Tax Court ruled that the Service cannot take into account these properties as being considered “intangibles.”²⁴⁷ However, the Tax Court in both *Amazon* and *Veritas* did not directly turn to the definition of an intangible as found by the statute. Rather, both courts suggested a buy-in payment is required for the transfer

²⁴⁴ Compare I.R.C. § 482 (2017), with I.R.C. § 482 (2018). The pre-TCJA definition of intangible has officially been repealed. See I.R.C. § 936 (2018).

[T]he term “intangible property” means any—(A) patent, invention, formula, process, design, pattern, or know-how, (B) copyright, literary, musical, or artistic composition, (C) trademark, trade name, or brand name, (D) franchise, license, or contract, (E) method, program, system, procedure, campaign, survey, study, forecast, estimate, customer list, or technical data, (F) *goodwill, going concern value, or workforce in place (including its composition and terms and conditions (contractual or otherwise) of its employment, or (G) other item the value or potential value of which is not attributable to tangible property or the services of any individual.*

I.R.C. § 367(d)(4) (emphasizing the new language that now fall within the definition of intangible within the meaning of §482, that did not previously before the TCJA). The pre-TCJA definition of intangible had a “catch all” provision stating that intangible property includes “any similar item.” See I.R.C. § 936(h)(3)(B)(vi) (2017). Additionally, the pre-TCJA definition was only considered an intangible if it had “a substantial value independent of the services of any individual.” See *id.*

²⁴⁵ I.R.C. § 367(d)(4)(F). The new definition also includes a “catch all” provision, but it only qualifies as an intangible if the item has “value or *potential value* of which is not attributable to tangible property or the services of any individual.” *Id.* § 367(d)(4)(G) (emphasis added). For an analysis on how transferred intangibles hold more than just its make/sell rights, but also its R&D rights and subsequently developed intangible property rights (or the “potential value” of the intangible when transferred), see *supra* Section IV.

²⁴⁶ See *Amazon.com, Inc. v. Comm’r.*, 148 T.C. 108, 157–158 (2017) (citing *Veritas Software Corp. v. Comm’r.*, 133 T.C. 297, 316 (2009)) (“Thus, as we concluded in *Veritas*, there was for the tax years at issue ‘no explicit authorization’ in the cost sharing regulations for ‘respondent’s “akin” to a sale theory or * * * [his] inclusion of workforce in place, goodwill, or going concern value’ in determining the buy-in payment . . .”).

²⁴⁷ It is important to note, however, that although the definition of goodwill, going concern value, or workforce in place is not specifically defined in the pre-TCJA definition of intangible, these properties could arguably be covered under the “any similar item” of §936(h)(3)(B)(vi). See Ryan Finley, *Big Decisions Loom as IRS Updates Transfer Pricing Rules*, TAXNOTES (FEB. 21, 2019), <https://www.taxnotes.com/editors-pick/big-decisions-loom-irs-updates-transfer-pricing-rules> [<https://perma.cc/9MGE-8LRN>].

because it is stated by cross-reference in the regulations.²⁴⁸ “Because the *Amazon* and *Veritas* decisions contain no analysis of the section 482 commensurate with income standard, which cross-references section 936(h)(3)(B) instead of reproducing it, the only definition directly relevant to the court’s assessment was the nearly identical definition that still appears in reg. section 1.482-4(b).”²⁴⁹

Regardless, this new amendment can only further help the Service’s position as argued in *Amazon*, considering goodwill and going concern value was not included within Amazon’s evaluation.²⁵⁰ Additionally, because the definition of an intangible now also includes “other item[s] the value or potential value of which is not attributable to tangible property,” the Service’s position in *Amazon* should stand—at least partly—corrected.²⁵¹ Although it may be difficult to argue that the “potential value” of a transferred intangible has a perpetual useful life,²⁵² because the new definition of an intangible includes a broader range of assets, this should certainly include further values beyond the restrictions imposed within the *Amazon* Tax Court at evaluation.²⁵³

²⁴⁸ See Finley, *supra* note 247 (however, the regulations defining intangibles was “taken almost verbatim from the then-section 936(h)(3)(B).”).

²⁴⁹ *Id.* (“Under this interpretation, intangible transfers structured other than as cost-sharing arrangements could theoretically benefit from the same ‘artificial valuation limitation’ until conforming changes are made to reg. section 1.482-4.”).

²⁵⁰ See *Amazon*, 148 T.C. at 157.

In 1993 the IRS considered updating the 1968 transfer pricing regulations. Via temporary and proposed regulations, the Secretary requested comments specifically 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. 5312 (Jan. 21, 1993). After receiving numerous comments opposing such an expansion, the IRS decided not to change the definition of intangible property. See T.D. 8552, 1994-2 C.B. 93 (explaining that the revised regulations merely clarified the 1968 definition).

Id. at 157 n.18 (emphasis added).

²⁵¹ See *supra* Section IV (discussing how the Tax Court in *Amazon* should have also considered factors, such as Amazon’s “potential value,” when evaluating its intangibles).

²⁵² See *Amazon*, 148 T.C. at 153 (rejecting the Service’s position that Amazon’s intangibles have a perpetual useful life).

²⁵³ In *Amazon*, the Service attempted to include the value of “subsequently developed intangibles” during evaluation. *Id.* at 156. Whether this value will also be included within the now broader definition of an intangible remains to be seen, but it certainly could not hurt the Service’s case as argued in *Amazon*.

The new amended statute also gives explicit authority for the Secretary to require an evaluation based on either an aggregate basis, or based on a comparison of realistic alternatives, if the Secretary determines it is the most reliable means of valuation.²⁵⁴ Similar to the post-2009 CSA regulations, this amendment now just explicitly places the burden on the MNE through statutory, rather than by regulatory authority.²⁵⁵

Looking at the the transfer pricing issue in *Amazon* as a whole, we now have a statutory amendment with primary authority that is trying to at least help change the outcomes of cases like *Amazon and Veritas*.²⁵⁶ However, we also have precedent that continues to state the commensurate with income standard must be consistent with the arm's length standard,²⁵⁷ and because precedent dictates that the arm's length standard does not include subsequently developed intangibles,²⁵⁸ it is hard to determine with certainty whether this amendment will additionally include further value at evaluation.

Further, although the §482 amendment now explicitly authorizes the Secretary to evaluate intangibles based on an aggregate basis, a similar rule

²⁵⁴ See I.R.C. § 482 (2018). As explained below, a temporary regulation requiring similar actions was also put in place at the time of *Amazon*, but the Service allowed its September 2018 deadline to pass for extending the regulation. See *infra* note 259; Finley, *supra* note 247.

²⁵⁵ See *supra* notes 228–231 and accompanying text (discussing how the post-2009 CSA regulation concept with using a “platform contribution transaction” forces the taxpayer to specifically prove by reference to a transferred intangibles “future income anticipated” in order to obtain an arm's length result). See *cf.* Treas. Reg. § 1.482-7(g)(1) (2013).

²⁵⁶ See MINDY HERZFELD & RICHARD L. DOERNBERG, INTERNATIONAL TAXATION IN A NUTSHELL 393 (11th ed. 2018).

Recognizing that the courts have not been treating the IRS kindly in its attempt to prevent taxpayers from transferring valuable intangible assets outbound with minimal tax paid, Congress joined in the attempt by adding a new sentence to I.R.C. § 482 in the TCJA that permits aggregation and the consideration of realistic alternatives if this produces the most reliable means of valuation. . . .

Id.

²⁵⁷ See *supra* notes 145–146 and accompanying text (discussing that uncertainty once existed as to if the commensurate with income standard conformed with the arm's length principle).

²⁵⁸ See *Amazon*, 148 T.C. at 156 (citing *Veritas*, 133 T.C. at 323) (As held in *Veritas*, “No buy-in payment is required for subsequently developed intangibles.”).

applied in the issued 2015 temporary regulations.²⁵⁹ Considering the Tax Court continues to reject cases where the Service attempts to require taxpayers to use an aggregate approach, even after the issuance of the 2015 temporary regulations, what suggests that there may a different outcome with the post-TCJA amendment of §482? The good news is, at least from the Service's position, we now have statutory authority, versus simply regulatory authority, on this amendment (which should, in theory, give some greater weight).²⁶⁰ It is extremely difficult to tell the possible outcomes that may come with this amendment, but with time, these issues should certainly create more certainty.

VI. CONCLUSION

A 207-page tax court decision with thirty documented attorneys between *Amazon* and the Service is something to put MNEs and multinational tax professionals on notice.²⁶¹ At a minimum, MNEs and tax professionals should realize that the Service is not going to rest until it obtains a more favorable security in the transfer pricing war between MNEs and its foreign subsidiaries.²⁶² The Service should additionally continue to go after these MNEs who choose to abuse the transfer pricing system by moving assets and income rather easily through low-tax jurisdictions via a CSA.²⁶³

²⁵⁹ See Treas. Regs. § 1-482-1T(f)(2)(i)(B) (2015) (providing that where synergies exist among transferred intangibles, evaluating them in the aggregate may be a more reliable method than valuing them separately).

²⁶⁰ *But see* Finley, *supra* note 247.

Government officials have been *ambiguous* on whether the updated regulations will ultimately retain the temporary regulations' explicit assertions of *broad aggregation authority* or simply defer to the new statutes. The IRS did not immediately abandon its plan to finalize the temporary regulations and in mid-2018 officials still predicted final regulations before the September sunset deadline. However, after the deadline passed, officials said the project was delayed by *the need to align the final regulations with the amended statute*.

Id. (emphasis added).

²⁶¹ See generally *Amazon.com, Inc. v. Comm'r.*, 148 T.C. 108 (2017) (Amazon held eighteen attorneys on record for this case while the Service held twelve).

²⁶² See Gregory Ossi & Mike Shepherd, *The IRS's Renewed Emphasis on Transfer Pricing*, CORP. TAX'N (July/Aug. 2010), <https://www.pwc.com/us/en/tax-services/assets/irs-transfer-pricing.pdf> [<https://perma.cc/3MSN-DUPT>] ("The IRS has designated transfer pricing as a key focus of its international compliance initiatives.").

²⁶³ See Avi-Yonah, *supra* note 7 ("US multinationals have . . . been able to shift trillions of dollars of profits attributable largely to US developed intangibles to low tax jurisdictions.

(continued)

Although *Amazon* and *Veritas* have both shown that a CSA governed under the pre-2009 CSA regulations includes evaluation methodologies of only make-sell value, R&D value—and subsequently developed intangible value—will likely also be included under the post-2009 CSA regulations for similar transactions.²⁶⁴ The substantial changes in the post-2009 CSA regulations, and the requirement that MNEs “must yield results consistent with measuring the value of a platform contribution by reference to the future income anticipated [from] the . . . cost shared intangibles,” will include evaluations by MNEs to include an intangible’s R&D value.²⁶⁵ Further, such transactions will continue to be seen by the tax courts as technology continues to develop, and as the evaluations of transferred preexisting intangibles through a CSA continue to expand both in theory and in law.²⁶⁶

The concept of a CSA began in the 1970s, but it became extremely important following the adoption of the super-royalty rule in 1986.²⁶⁷ If the Treasury continues to allow MNEs to use CSAs, the Service must have a favorable security with MNEs and their evaluation methodologies with the transfer of its preexisting intangibles through a CSA.²⁶⁸ By tax courts not allowing to include certain values, such as R&D or subsequently developed intangible value, for the transfers of preexisting intangibles

The explanation is mostly the cost sharing rule . . . Importantly, nothing actually happens in the [controlled foreign corporation]: The entire development takes place in the U.S.”)

²⁶⁴ See Hochman, *supra* note 14. See also *supra* note 233 (The new regulations require taxpayers to “specifically” prove the evaluation of the transferred intangibles in order to obtain an arm’s-length result).

²⁶⁵ Treas. Reg. § 1.482-7(g)(1) (2013). The added language in the post-2009 CSA regulations imposes an additional burden on MNE taxpayers who participate in such CSA transactions. See *supra* note 231.

²⁶⁶ See John Henshall, *Transfer Pricing and Intellectual Property*, BUILDING IP VALUE, http://www.buildingipvalue.com/06KTI/038_041.htm [<https://perma.cc/K6U5-CDU5>].

Transfer pricing is increasingly of interest to the tax authorities, particularly in the more developed nations as they struggle to retain taxing rights over businesses that are moving to exploit the cheaper labour and materials and lower taxes offered in those countries. Over the next five years intellectual property will continue to grow in importance as it forms the battleground on which arguments are fought—and these will be very expensive battles.

Id.

²⁶⁷ See Avi-Yonah, *supra* note 7. For a brief history on the creation and development of §482 and the super-royalty rule, see *supra* Section III.B.1.a.

²⁶⁸ See Avi-Yonah, *supra* note 7 (“These IRS defeats . . . have been a major contributing factor to the ability of US-based multinationals to amass over \$2.5 trillion of profits in offshore low-tax jurisdictions.”).

executed under a CSA, the United States as a nation fails to obtain “immense sums [of taxes] that can be earned from the successful exploitation of intangibles” by MNEs.²⁶⁹ Thus, although the Service has been unable to obtain a favorable security in transfer pricing agreements under a CSA with the pre-2009 CSA regulations, the Service has the ability and potential to obtain a more favorable security with CSA transactions governed under the post-2009 CSA regulations.²⁷⁰ For this reason, the Service should forget about the old regulations and focus on the new regulations when §482 disputes arise.²⁷¹ Such regulations may finally give the Service a favorable security in the transfer pricing war between MNEs and its foreign subsidiaries.²⁷²

²⁶⁹ *Id.* (Cost sharing “enables multinationals to shift the profits from intangibles developed in the U.S. offshore without incurring any serious risk of losing the R&D deductions.”).

²⁷⁰ Additionally, the Service may also gain an advantage under the amendments made following the TCJA. *See supra* Section V.

²⁷¹ *See* Treas. Reg. § 1.482-7A (2009). Because the post-2009 CSA transactions apply to transactions occurring after the date of January 4, 2009, it is very likely that future CSA litigation will be governed under the current CSA regulations.

²⁷² *See* Avi-Yonah, *supra* note 7 (“[T]he IRS has not won a major transfer pricing case outright since 1979.” That will soon change—especially after the amendments made following the TCJA.).