No. 19-1009

IN THE

Supreme Court of the United States

ALTERA CORPORATION & SUBSIDIARIES,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF OF FORMER FOREIGN TAX OFFICIALS AS *AMICI CURIAE* IN SUPPORT OF PETITIONER

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INTEREST OF *AMICI CURIAE*[1]

Amici curiae are 18 former tax officials of foreign jurisdictions who devoted significant parts of their government service to interpreting or administering domestic and international tax rules.[2] They are:

- Stefaan De Baets: Former First Attaché of Finance at Belgian Federal Public Service Finance; Vice-Chair of Committee on Fiscal Affairs Working Party 6 (Transfer Pricing), OECD; Vice-Chair of EU Transfer Pricing Forum;

- Eric Bonneaud: Former Director of Unit responsible for treaties, transfer pricing, and mutual agreement procedures, Directorate of Tax Legislation, French Ministry of Finance; Former French Competent Authority;

[1] The parties have consented to the filing of this *amicus* brief. No counsel for a party authored the brief in whole or in part. No party, counsel for a party, or any person other than counsel for *amici curiae* made a monetary contribution intended to fund the preparation or submission of the brief.

[2] *Amici* join this brief in their individual capacities as former government officials. Given the widespread implications of the decision below, many major U.S. and multinational corporations have a significant interest in the outcome of this case. That group includes the employers or firms of some *amici* and numerous clients of other *amici* or their firms. *Amici* do not, however, represent Altera, and neither they nor their employers or firms have been compensated for participation in this case. *Amici* join this brief solely because of their knowledge of the issues raised and their belief in the exceptional importance of this case.

- Carolina del Campo Azpiazu: Former Deputy Director-General for Non-Resident Taxation, Spanish Ministry of Economy and Finance;

- Blaise-Philippe Chaumont: Former Chief of Staff of French Budget Minister Valérie Pécresse; Former Deputy Chief of Staff to French Economy and Finance Minister François Baroin; Former Tax Policy Advisor to French Economy and Finance Minister Christine Lagarde; Former Director of Division responsible for treaties, transfer pricing, and mutual agreement procedures, Directorate of Tax Legislation, French Ministry of Finance; Former French Competent Authority; Former Head of Unit – International Tax Audit;

- Ricardo Escobar: Former Commissioner of the Internal Revenue Service of Chile;

- Bruno Gibert: Former Director, International Division, Tax Policy Department, and Competent Authority for Mutual Agreement Procedures, Ministry of Finance, France; Former Co-Chair of the OECD Forum on Harmful Tax Competition;

- Nishana Gosai: Former Head of Transfer Pricing, South African Revenue Service; Member of the UN Committee of Experts on International Cooperation in Tax Matters, Subcommittee on Transfer Pricing; Member of the African Tax Administrators' Forum Technical Tax Committee;

- Friedhelm Jacob: Former Associate International Tax Counsel, Federal Ministry of Finance, Bonn, Germany; Counselor (Fiscal), German Embassy, Washington, DC;

- Cezary Krysiak: Former Director, Tax Policy Department, Ministry of Finance of the Republic of Poland;

- Armando Lara Yaffar: Former Director-General for International Treaties, Tax Legislation Unit, Ministry of Finance and Public Credit, Mexico; Former Chairperson of the UN Committee of Experts on International Cooperation in Tax Matters; Former Vice-Chair of OECD Committee on Fiscal Affairs;

- Kyung Geun Lee: Former Director, International Tax Division, Tax & Customs Office, Ministry of Finance; Member of the UN Committee of Experts on International Cooperation in Tax Matters;

- Daniel Lüthi: Former Vice Director of the Federal Tax Administration, Ministry of Finance, Switzerland; Delegate of the Swiss Ministry of Finance for International Tax Matters; Chairman of Working Party No. I of the Committee on Fiscal Affairs, OECD;

- Yoshiyasu Okada: Former Deputy Commissioner (International) and Japanese Competent Authority, Director of the Office of

International Operations, and Director of International Tax Examinations, National Tax Agency, Japan;

- Robin Oliver: Former Deputy Commissioner of Policy at Inland Revenue of New Zealand; Former Deputy Chair of OECD Committee on Fiscal Affairs;

- Maura Parsons: Former Deputy Director, Head of Transfer Pricing, HM Revenue & Customs, UK Competent Authority;

- Karina Perez Delgadillo: Former Central Administrator for Legal International Tax Issues and Internal Criteria for Large Taxpayers and Mexican Competent Authority, Tax Administration Service; Underdirector General for Treaty Negotiations, Underministry of Revenue, Ministry of Finance and Public Credit, Mexico;

- Carlos Pérez Gómez Serrano: Former Director of Transfer Pricing Examinations in the Mexican Tax Administration Service; Member of the UN Committee of Experts on International Cooperation in Tax Matters Subcommittee on Transfer Pricing; and

- Edwin Visser: Former Director, Direct Taxes and Former Deputy Director-General, Tax and Customs Policy and Legislation, Netherlands Ministry of Finance; Chairman of the Coordination Group on Transfer Pricing, Netherlands Tax and Customs Administration.

At issue here are the rules governing "transfer pricing." "[V]irtually every major industrial nation takes the arm's length standard as its frame of reference in transfer pricing cases." Study of Intercompany Pricing Rules, 53 Fed. Reg. 43,522-01, 43,539 & n.156 (Oct. 27, 1988) ("*White Paper*"). The heart of the arm's-length standard is consideration of what unrelated parties operating at arm's length actually do. In this case, however, the IRS decided to categorically disregard this evidence in favor of its own "internal" view of the transactions at issue.

As experts in foreign tax codes, *amici* have extensive experience using comparisons in real-world transactions when applying the arm's-length standard to related companies. Importantly, this standard allocates how much income should be attributed to each of two countries and thus how much tax revenue each country may collect. This helps avoid double taxation, where each country taxes the same income because each is applying a different set of transfer pricing rules, and minimizes cross-border conflicts that arise when different countries wish to tax the same significant income sources.

Based on their collective experience and expertise, *amici* believe the IRS's decision to disregard evidence of potential comparable transactions when determining the scope of cost-sharing payments is unique and troubling. The Ninth Circuit's decision below countenances a departure from the worldwide understanding of what the arm's-length standard means. *Amici* are not aware of any other taxing authority which categorically disregards relevant evidence presented in the form of comparable transactions among unrelated parties.

This isolationist ruling risks a tremendous increase in disputes between the United States and other countries over how much income should be attributed to each of two countries. The uncertainty caused by the Ninth Circuit's ruling warrants prompt resolution by the Court. The Court should grant review to preserve international comity.

STATEMENT OF THE CASE

In May 1997, Altera entered into a cost-sharing agreement with one of its foreign subsidiaries, Altera International, Inc., a foreign corporation ("Altera International"). Under a cost-sharing agreement, parties agree to share the costs of developing intangible property and thereby share its benefits (if any) following development. Cost-sharing agreements like the one Altera entered into with Altera International are common.

At issue in this case is whether it was appropriate for the IRS to require that the stock-based compensation paid to employees engaged in intangible development be included in the development costs Altera and Altera International share. The Ninth Circuit held that the IRS was entitled when adopting its requirement to categorically disregard evidence about whether unrelated parties share such costs when engaging in similar transactions.

The requirement at issue in this case was originally adopted in 2003. In that year, the U.S. Treasury Department ("Treasury") adopted Reg. § 1.482-7A(d)(2),[3] which provided that, with respect to the scope of payments under a cost-sharing agreement, parties must allocate stock-based compensation between themselves:

> [In a cost-sharing agreement], a controlled participant's operating expenses include all costs attributable to compensation, including stock-based compensation. As used in this section, the term stock-based compensation means any compensation provided by a controlled participant to an employee or independent contractor in the form of equity instruments, options to acquire stock (stock options), or rights with respect to (or determined by reference to) equity instruments or stock options, including but not limited to property to which section 83 applies and stock options to which section 421 applies, regardless of whether ultimately settled in the form of cash, stock, or other property.

26 C.F.R. § 1.482-7A(d)(2).[4] In other words, Treasury's regulation required that, when parties enter

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[3] Although the 2003 amendments are still in effect, the Tax Code has since been reorganized so that what was once § 1.482-7 in 2003 is now § 1.482-7A. This brief, like the decision below, uses the current citation to the regulation.

[4] This requirement impacts the tax U.S. companies engaging in cost-sharing agreements must pay. For instance, if a U.S. company enters into a cost-sharing agreement with a foreign

into a cost-sharing agreement, stock-based compensation must in all circumstances be included in the pool of costs they share.

Everyone agrees—and has agreed for most of a century—that 26 U.S.C. § 482, the statute on which Treasury relied for its authority to enact the 2003 regulation, establishes an "arm's-length" standard for allocation of income and deductions between related entities. *See* IRS C.A. Br. 31.[5] Under the arm's-length standard, the income attributed to related parties is determined based on what the parties' income *would* have been if they were unrelated entities dealing at arm's length. During the administrative process, Treasury repeatedly stated that its proposed rulemaking was consistent with the arm's-length standard. *See, e.g.,* 67 Fed. Reg. 48,997, 49,000 (July 29, 2002) ("The proposed regulations … clarify that § 1.482-7 provides the specific method to be used to evaluate whether a qualified cost sharing arrangement produces results consistent with an arm's

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subsidiary, under this regulation, the U.S. company's income would be calculated as if the subsidiary paid it a proportional share of stock-based compensation under the cost-sharing agreement, whether or not that was the agreement between the parties. The taxing authority in the country where the subsidiary is located also must determine whether to allow a deduction to that subsidiary for this purported payment. Inconsistency in approach can result in double taxation.

[5] Section 482 authorizes the U.S. Treasury to "distribute, apportion, or allocate gross income, deductions, credits, or allowances" between two related organizations if necessary "to prevent evasion of taxes or clearly to reflect the income of any of such organizations." 26 U.S.C. § 482.

length result….”). It is also well understood that evidence about comparable transactions engaged in by unrelated parties should be considered where available in determining what is an arm’s length result. *See, e.g.*, 26 C.F.R. § 1.482-1(a)-(c).

In the notice-and-comment period regarding the 2003 regulation, commentators pointed out that the IRS’s proposed approach was contrary to what parties would do at arm’s length and presented evidence that unrelated parties do not share stock-based compensation when engaged in similar co-development arrangements. Pet. App. 98a-101a; *see id.* at 229a-231a. Treasury adopted the regulation anyway, notwithstanding this significant evidence—and a lack of evidence showing unrelated parties sharing the costs of this compensation—all the while claiming that its approach comported with the arm’s-length standard. *See* 68 Fed. Reg. 51,171, 51,172-73 (Aug. 26, 2003) (“Treasury and the IRS do not agree with the comments that assert that taking stock-based compensation into account in the [cost-sharing] context would be inconsistent with the arm’s length standard in the absence of evidence that parties at arm’s length take stock-based compensation into account in similar circumstances.”).

Before the Ninth Circuit, the IRS asserted that it could ignore such evidence of potentially comparable transactions, stating that “comparability analysis plays no role in determining the costs that must be shared under a [cost-sharing agreement] in order to achieve an arm's length result." IRS C.A. Br. 30.[6] To support its position on appeal, the IRS argued that the second sentence of section 482—which provides that "[i]n 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"—allows it to take a purely "internal" view of cost-sharing arrangements, disregarding evidence about the behavior of unrelated parties. IRS C.A. Br. 31; *see also* Pet. App. 29a (characterizing IRS's approach as "[d]oing away with analysis of comparable transactions, and instead requiring an internal method of allocation"). This "commensurate with income" language has been in section 482 since 1986. *See* Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2085, 2563. The IRS appellate brief acknowledged that its new approach to comparables based on that language "changed the legal landscape." IRS C.A. Br. 30.

SUMMARY OF ARGUMENT

The international taxation system relies on countries working together to develop consistent and stable understandings of important tax concepts. The IRS's significant departure from the common worldwide understanding of the arm's-length standard, validated by the Ninth Circuit below, threatens this cooperation. The underlying taxation question is how

[6] *Amici* understand that Altera and other *amici* are addressing the appropriateness of the IRS's change of position under U.S. administrative law. This brief does not address that topic, instead focusing on the significance of the IRS's appellate position to international taxation.

much income should be attributed to each of two countries. This issue is of great practical importance to the functioning of the worldwide tax system. The uncertainty around this question needs to be resolved now. *Amici* urge this Court to grant Altera's petition for certiorari.

ARGUMENT

I. International Tax Treaties Are Based On The Arm's-Length Standard.

International taxation is a complex system. While each country has its own tax code and rules, because taxation often has international consequences, countries enter into tax treaties in an effort to apply the tax law consistently across borders, with the goal of ensuring that transactions are taxed once and only once. *See* U.S. Treasury Dep't, Preamble to 2016 U.S. Model Income Tax Convention, at 1 (Feb. 17, 2016), https://tinyurl.com/y6b4ss93 (citing "the Treasury Department's longstanding policy that tax treaties should eliminate double taxation"); *Pending Income Tax Agreements, Hearing Before the S. Comm. on Foreign Relations* (Feb. 25, 2004) (testimony of Barbara Angus, Int'l Tax Counsel, U.S. Dep't of Treas.), https://tinyurl.com/yxea26yo (noting that avoiding double taxation is a goal of tax treaties) ("*Angus Statement*").

Tax treaties work best when they employ well-understood and well-established concepts that each country can attempt to apply in the same manner to minimize disputes. As explained by counsel for Treasury itself, testifying before a Senate committee:

> Tax treaties provide benefits to both taxpayers and governments by setting out clear ground rules that will govern tax matters relating to trade and investment between the two countries. A tax treaty is intended to mesh the tax systems of the two countries in such a way that there is little potential for dispute regarding the amount of tax that should be paid to each country…. A treaty with clear rules addressing the most likely areas of disagreement minimizes the time the two governments (and taxpayers) spend in resolving individual disputes.

Angus Statement. Countries expend significant resources negotiating tax treaties, and implementing their provisions, to achieve these important benefits.

In addition, a great deal of effort is spent internationally attempting to harmonize understandings of tax law among nations. Substantial undertakings like the Organisation for Economic Cooperation and Development's ("OECD") Base Erosion and Profit Sharing project are directly aimed at creating common understandings across countries of how to create and apply tax laws with cross-border consequences.[7]

These treaties and common understandings promote consistency and stability and diminish conflict between nations, which may each have a claim to tax

[7] OECD, *Inclusive Framework on Base Erosion and Profit Shifting*, https://tinyurl.com/y4berw7q (last visited July 26, 2019).

the same income. Cross-border tax disputes are time- and resource-intensive not only for taxpayers but also for governments, and uncertainty in the tax law can impede free flow of business activity across borders. *See Angus Statement*. In some cases, unresolved disagreements between countries about taxation can lead to high-level political conflict.[8] Maintaining common understandings of significant tax principles is therefore important to international comity and trade.[9]

Cost-sharing arrangements, whereby two entities share the costs and risks of developing new intangibles, are common among related and unrelated parties worldwide. *See* Pet. App. 99a-100a. In determining the scope of required payments under these arrangements, both the United States and its treaty partners have looked to the arm's-length standard. This standard forms the basis not only for U.S. tax law but also for scores of tax treaties. *White*

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[8] *See, e.g.*, William Mauldin, *U.S. Launches Probe of French Digital Tax*, Wall St. J. (July 10, 2019), https://tinyurl.com/y5l6jfqt; Diane Bartz, *U.S. Government Seeks to Intervene in Apple's EU Tax Appeal: Source*, Reuters (July 4, 2017), https://tinyurl.com/y6kxhrf4.

[9] *Cf. F. Hoffmann-La Roche Ltd. v. Empagran S.A.*, 542 U.S. 155, 164-65 (2004) (noting that ensuring that "the potentially conflicting laws of different nations work together in harmony" is "particularly needed in today's highly interdependent commercial world"); *EEOC v. Arabian Am. Oil Co.*, 499 U.S. 244, 248 (1991) (highlighting the importance of "protect[ing] against unintended clashes between our laws and those of other nations which could result in international discord").

Paper, 53 Fed. Reg. at 43,539 & n.156 (explaining that the "arm's length standard is embodied in all U.S. tax treaties" and "is incorporated into most tax treaties to which the United States is not a party"). The IRS White Paper further explained that the arm's-length standard is in every "major model treaty, including the U.S. Model Convention" and the model conventions of the OECD and United Nations. *Id.* at 43,539 & n.158. Indeed, "virtually every major industrial nation takes the arm's length standard as its frame of reference in transfer pricing cases." *Id.* The application of the arm's-length standard is thus reflected in the "Associated Enterprises" article of tax treaties to which the United States is a party.

For example, the income tax treaty with the United Kingdom provides for application of the arm's-length standard in Article 9, as follows:

> Where a Contracting State includes in the profits of an enterprise of that State, and taxes accordingly, profits on which an enterprise of the other Contracting State has been charged to tax in that other State, and the other Contracting State agrees that *the profits so included are profits that would have accrued to the enterprise of the first-mentioned State if the conditions made between the two enterprises had been those that would have been made between independent enterprises*, then that other State shall make an appropriate adjustment to the amount of the tax charged therein on those profits.

2001 U.S.-United Kingdom Income Tax Treaty, art. 9 (July 24, 2001), https://tinyurl.com/yxthmttr (emphasis added). Article 9 of the U.S. Model Tax Treaty "incorporates … the arm's-length principle reflected in the U.S. domestic transfer pricing provisions, particularly Code section 482." Pet. App. 86a (quoting 1996 Technical Explanation, 1 Tax Treaties (CCH) ¶ 216, at 10,691-26).

Further showing the importance of the arm's-length standard to transfer pricing treaties, the United States has thus far refrained from entering into a tax treaty with Brazil, which instead conducts transfer pricing on the basis of certain statutory profit percentages. Brazil-U.S. Business Council, *A Roadmap to a U.S.-Brazil Tax Treaty*, at 7-8 (March 2019), https://tinyurl.com/y4goy2hp (noting that the countries' disparate treatments of transfer pricing is a "key negotiation point[]"). In fact, Brazil's transfer pricing policies have also prevented it from joining the OECD. Recently, however, Brazil initiated an effort to join this elite group of countries. This triggered an assessment of the Brazilian transfer pricing rules conducted by the OECD and Brazil's tax authorities aimed at enabling its rules to achieve convergence with the arm's-length standard. *See* OECD, *Transfer Pricing in Brazil: Towards Convergence with the OECD Standard* (2019), https://tinyurl.com/ubpcxlb; *see id.* at 25 ("Ensuring the primacy of the arm's length principle as set out in the OECD Transfer Pricing Guidelines is required of OECD member countries as one of the OECD Committee on Fiscal Affairs' Core Principles.")

II. The Ninth Circuit's Decision Allowing The IRS To Abandon The Traditional Arm's-Length Standard Has Dangerous Consequences For The Global Tax System.

The IRS's position that it can categorically ignore relevant facts is not consistent with the arm's-length standard as it is understood worldwide. That global standard is instead a fact-intensive inquiry. Multiple U.S. courts have also recognized this fact. *See, e.g.*, *Eli Lilly & Co. v. Comm'r*, 84 T.C. 996, 1134 (1985), *aff'd in relevant part*, 856 F.2d 855, 860 (7th Cir. 1988); *see also Philipp Bros. Chems., Inc. (N.Y.) v. Comm'r*, 435 F.2d 53, 57 (2d Cir. 1970) (§ 482 determination is "essentially one of fact"); *Local Fin. Corp. v. Comm'r*, 407 F.2d 629, 632 (7th Cir. 1969) (same); *Procacci v. Comm'r*, 94 T.C. 397, 412 (1990) ("[T]he determination under section 482 is essentially and intensely factual."). Today, the § 482 regulations contain 90 references to "facts and circumstances" or "factors" in addressing the application of the arm's-length standard. *See, e.g.*, 26 C.F.R. § 1.482-1(d)(1) (comparability of transactions "must be evaluated considering *all factors* that could affect prices or profits in arm's length dealings" (emphasis added)); 26 C.F.R. § 1.482-5(c)(2) (the "degree of comparability between the tested party and the uncontrolled taxpayer depends upon *all the relevant facts and circumstances*" (emphasis added)).

While application of the arm's-length standard can be difficult, and examination of comparable transactions may require additional economic analysis (or such transactions may be lacking entirely in a particular case), *amici* are not aware of any other taxing authority which purports to apply that standard while categorically disregarding relevant evidence presented in the form of comparable transactions among unrelated parties. *Accord White Paper*, 53 Fed. Reg. 43,522-01 ("Transfer prices must be determined on the basis of true comparables if they in fact exist"). The IRS's new "purely internal" approach to defining the scope of cost-sharing payments, relying on its own incompletely informed belief about how parties would behave instead of analyzing the available evidence of what unrelated parties actually do, is inconsistent with the arm's-length standard.

The 1986 inclusion of the "commensurate with income" language in 26 U.S.C. § 482 did not change the common understanding of the role of the arm's-length standard in determining the scope of cost-sharing payments. In all the years this language has been in the U.S. statute, neither the IRS nor foreign taxing authorities have ever before deemed it to categorically dispense with comparability analysis. In fact, as Judge O'Malley wrote in her dissent from the panel opinion, the U.S. "commensurate with income" standard has been applied only to circumstances where comparable transactions do not provide guidance. Pet. App. 59a (quoting *White Paper*, 53 Fed. Reg. at 43,537-38). Under Article 9 of the U.S. Model Tax Treaty, "[i]t is understood that the 'commensurate with income' standard for determining appropriate transfer prices for intangibles, added to Code section 482 by the Tax Reform Act of 1986, was designed to operate consistently with the arm's length standard." Pet. App. 92a (quoting 1996 Technical Explanation, 1 Tax Treaties (CCH) ¶ 216, at 10,691-26 and citing

2006 Technical Explanation, 1 Tax Treaties (CCH) ¶ 215, at 10,641).

The IRS's position in this appeal, endorsed by the Ninth Circuit below, is not consistent with the arm's-length standard as it is understood worldwide. Indeed, it is fair to say that such an approach is simply *not* the application of the arm's-length standard at all. Pet. App. 72a (characterizing the IRS's decision to abandon comparability as an impermissible "exception that swallows a rule").

The Ninth Circuit concluded that the tax treaties to which the United States is a party are not relevant because "there is no evidence that our treaty obligations bind us to the analysis of comparable transactions." Pet. App. 31a. But U.S. treaty obligations do bind the IRS to application of the arm's-length standard, which requires consideration of comparable transactions where they are available.

As a result, the approach the IRS supports in this appeal is a dangerous one. The goal of the United States and its treaty partners has been to agree on standards for transfer pricing to help ensure that income is taxed once and only once, minimizing disagreement and confusion. *See supra* at 11-13. Coordination is particularly important for transfer pricing, as the underlying taxation question is how much income should be attributed to each of two countries. Consideration of third-party evidence is an important part of the arm's-length standard, grounding countries in facts that can be referenced and discussed where disagreements arise. If instead "arm's length" can be anything one country declares it to be, then there is no way to fairly resolve disputes or mitigate double taxation.

CONCLUSION

This Court should grant the petition for certiorari in light of the exceptional importance of the question posed in this case.

Respectfully submitted,

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