Summer 2016 Student Update Memorandum for

Maine & Nguyen's

Intellectual Property Taxation: Problems and Materials

(2nd ed. 2015)

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CAROLINA ACADEMIC PRESS
Durham, North Carolina

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www.cap-press.com

Chapter 2
Overview of Intellectual Property

Page 13: In 2014, the Supreme Court addressed patentable subject matter again in a software patent case. *See* Alice Corp. Pty. Ltd. v. CLS Bank Int'l, 134 S. Ct. 2347 (2014).

Page 18: Absolute secrecy is not required for trade secret protection. *See* Hallmark Cards v. Monitor Clipper Partners, 758 F.3d 1051 (8th Cir. 2014).

Page 19: Statutory damages are available in copyright infringement cases. Reasonable royalties as a measure of damages (common in patent infringement cases but rarer in copyright infringement cases) were recently addressed in *Oracle Corp. v. SAT AG*, 765 F.3d 1081 (9th Cir. 2014) (reducing the $1.2 billion jury verdict in a copyright infringement case due to the speculative nature of the calculation of the damages).

Chapter 3
Overview of Traditional Principles of Federal Income Taxation

Page 60: In 2016, the AMT 28% rate begins at $186,300. For 2016, the exemption amounts are $53,900 for unmarried individuals and $83,800 for joint filers. Rev. Proc. 2015-53. These exemptions are phased out for high income taxpayers.

Chapter 4
Taxation of Intellectual Property Development

Page 79: The regulations under section 263A include licensing costs in the non-exclusive list of indirect costs that must be capitalized to the extent they are properly allocable to property produced. Treas. Reg. 1.263A-1(e)(3)(ii). Those costs include minimum annual payments and royalties that are incurred by a licensee. *See* IRS Field Attorney Advice 20145101F (May 8, 2014) (concluding that royalties paid under a patent license are indirect costs that are properly allocable to production of property and, thus, must be capitalized).

Page 80: The Protecting Americans from Tax Hikes (PATH) Act of 2015 recently extended the section 181 deduction for two years to qualified film and television productions commencing prior to January 1, 2017. It is worth emphasizing that an election must be made to allow the deduction of film production costs. *See* Kantchev v. Commissioner, T.C. Memo 2015-234 (Dec. 3, 2015).

Page 81: Tax cases involving book writing activities are not always easy to reconcile. *See* Ballard-Bey v. Commissioner, T.C. Summ Op. 2014-62 (concluding that although the taxpayer undertook his book writing activity with the honest intent to generate a profit, his profit-seeking activity was not functioning as a going concern in the years at issue); Pingel v. Commissioner, T.C. Summ Op. 2015-48 (disallowing expenses of a purported travel guide writer who trekked through Europe and Africa to write about his experiences).

Page 82: In July 2014, the IRS issued final regulations under section 174 that adopt, with some modifications, regulations that were proposed a year earlier. The final regulations provide:

- The ultimate success, failure, sale, or other use of the research or property resulting from research is not relevant to eligibility under section 174. Thus, taxpayers no longer need to be concerned about otherwise qualified expenses being disallowed because of an ultimate sale, which is often unforeseen.
- The "depreciable property rule" discussed below is an application of the general definition of research or experimental expenditures and should not be applied to exclude otherwise eligible expenditures.
- The term "pilot model" is defined as any representation or model of a product that is produced to evaluate and resolve uncertainty concerning the product during the development or implementation of the product. By redefining the definition of pilot model, issues that existed regarding the inclusive and exclusive nature of the term have been greatly resolved.
- The costs of producing a product after uncertainty concerning the development or improvement of a product is eliminated are not eligible under section 174.
- A shrinking-back rule applies when eligibility requirements are met with respect to only a component part of a larger product, but not the overall product itself. T.D. 9680 (eff. July 21, 2014). The shrinking back provision recognizes

situations in which component costs can qualify even though basic design specifications of the product are certain.

Page 85: It has been suggested that start-up businesses, which may be entitled to section 174 deductions, are not subject to the at-risk rules of section 465. *See* Daniel Willingham, How Start-Ups and Their Investors Can Avoid the At-Risk Rules, Tax Notes Today, Oct. 26, 2015, available at 2016 TNT 46-8. Do you agree?

Page 88: Until recently, the research credit was continually renewed as a temporary provision. On December 18, 2015, President Obama signed into law a tax extenders bill making the research credit permanent for tax years starting in 2015. The Protecting Americans from Tax Hikes (PATH) Act (P.L. 114-113). The legislation also expanded the credit so that some start-up companies and small businesses can use it to offset payroll taxes or the alternative minimum tax. See, e.g., new IRC § 41(h). The expansions apply to tax years starting in 2016 and later. The expansion of the credit to the AMT applies to small businesses (those not publicly traded and that have annual gross receipts of less than $50 million over the past three years). The expansion of the credit to offset payroll taxes permits qualified small businesses 9those that are less than five years old and have less than $5 million of gross receipts for the year) to elect to use up to $250,000 of the credit to offset the employer portion of Social Security taxes (excluding the Medicare hospital insurance tax) in lieu of claiming it against the employer's income tax liability. The expansion should be of great benefit to many new and small businesses.

Page 88: It is worthy to note that wages account for nearly seventy percent of total qualified research expenses. *See* Joseph Rosenberg, *3 Facts About the Research Tax Credit*, TAX NOTES TODAY, July 22, 2015, available at 2015 TNT 143-56.

Pages 88–90: For a recent Tax Court case sending a message that the research tax credit is meant to cover a broad range of innovation (both applied and basic science research), *see* Suder v. Commissioner, TC Memo 2014-201.

Pages 90–91: In January 2015, the IRS issued a new set of proposed regulations with respect to internal use software. For tax years ending on or after January 20, 2015, taxpayers will generally be allowed to apply the new, favorable set of proposed regulations. Under the 2015 proposed regulations, internal use software is defined as software that is developed by the taxpayer for use in general and administrative functions that facilitate or support the conduct of the taxpayer's trade or business. Software is not developed primarily for internal use if it is developed to be commercially sold, leased, licensed, or otherwise marketed to third parties or if it is developed to enable a taxpayer to interact with third parties or to allow third parties to initiate functions or review data on the taxpayer's system. Thus, software developed to enable a taxpayer to interact with third parties or allow third parties to initiate functions or review data on the taxpayer's system does not have to satisfy the "high threshold of innovation test" discussed below. *See IRS, Proposed Regs Address Research Credit for Internal Use Software*, 2015 TNT 12-15 (Jan. 20, 2015). The 2015 proposed regulations also eliminate the distinction between software developed to deliver computer and non-computer services. They also

provide that "dual-function software—software that serves both general, administrative functions and third-party interaction functions—is presumed to be primarily internal-use software, although the portion of research expenditures allocable to the third-party subset may be eligible for the research credit." *Id.* (noting the 2015 proposed regulations provide a safe harbor so that a taxpayer can include 25% of the qualified research expenditures of the dual function software to simplify credit calculation).

Page 91: The 2015 proposed regulations incorporate the high threshold of innovation test, and elaborate on each of the three prongs above for software: (1) it must be innovative, (2) its development must involve significant economic risk, and (3) it is not commercially available for use by the taxpayer. In a positive development, the 2015 proposed regulations state that the first prong (innovative prong) "is not measured by the 'unique or novel nature' of the software but rather by 'a measurable objective standard' based on whether the software would result in substantially and economically significant cost or time savings." *See* Amy S. Elliott, *Favorable Internal-Use Software Research Credit Regs Issued*, 2015 TNT 12-6 (Jan. 20, 2015). The 2015 proposed regulations state the second prong (significant economic risk prong) "requires that, at the beginning of the taxpayer's activities, there be substantial uncertainty that the resources committed to the development of the software will be recovered within a reasonable period." *Id*.

Page 92: In February 2015, the IRS published final regulations that adopt, with changes, earlier proposed regulations allowing taxpayer to elect the alternative simplified credit under section 41(c)(5) on an amended return. T.D. 9712 (eff. Feb. 27, 2015).

Page 93: In a recent summary opinion, the Tax Court held that a taxpayer, who explained that his business was "a business of intangible assets," failed to adequately substantiate business expenses and deductions. Boring v. Commissioner, T.C. Summ Op. 2015-68.

Chapter 5
Taxation of Intellectual Property Acquisitions

Page 145: Neither the Internal Revenue Code nor the Treasury Regulations specifically address the tax treatment of domain name purchase costs. In a recent legal memorandum, however, the IRS did provide administrative guidance. In Chief Counsel Advice 201543014 (Sept. 10, 2015), the IRS first clarified that the cost of purchasing a domain name cannot be expensed under Section 162, but must be capitalized under Section 263. The IRS then addressed whether such capitalized purchase costs could be recovered over time through an amortization allowance.

The IRS concluded that a *non-generic domain name that functions as a trademark* is a Section 197 intangible amortizable over 15 years. [For purposes of Section 197, the term "trademark" "includes any word, name, symbol, or device, or any combination thereof, adopted and used to identify goods or services and distinguish them from those provided by others." Domain names have dual functions. In addition to the technical function of locating a site on the Web, a domain name can function as a trademark if it is used to identify the source of goods or services.] The IRS also concluded that a *purchased generic domain name* does not meet the definition of a trademark under Treas. Reg. 1.197-2(b)(10), but is a "customer-based intangible" as defined in Treas. Reg. 1.197-2(b)(6) if: (a) the generic domain name is associated with a website that is already constructed and will be maintained by the acquiring taxpayer, and (b) such taxpayer acquired the generic domain name for use in its trade or business either to generate advertising revenue by selling space on the website or to increase its market share by providing goods or services through the website. Accordingly, such a generic domain name is a section 197 intangible amortizable over 15 years regardless of whether acquired as a separate asset or as part of the acquisition of a trade or business.

Chief Counsel Advice 201543014 assumes that the taxpayer is acquiring an already existing site but does not describe the tax results if the domain name was purchased from one that merely owned the name but was not using it. What if a taxpayer purchases a domain name outside of the secondary market or for reasons other than those discussed in the Chief Counsel Advice? What if a taxpayer purchases a generic domain name even though a website has not been constructed and no goods or services have been offered? The IRS should provide further guidance on the tax treatment of generic domain names.

Page 146: The section 179 expense deduction for off-the-shelf computer software has been made permanent by the Protecting Americans from Tax Hikes Act of 2015 (PATH Act).

Chapter 6
Taxation of Intellectual Property Sales and Licenses

Page 176: A recent example of the difficulty in distinguishing a sale from a license is the case of Myland, Inc. v. Commissioner, T.C. Memo 2016-45, which involved a transfer of intellectual property rights in a chemical compound called nebivolol to a third party. The IRS argued that the proceeds from the transaction should be characterized as ordinary income from a license, whereas the taxpayer asserted that the proceeds resulted in capital gain from a sale. Because of substantial unresolved questions of fact, the court denied the IRS's motion for summary judgement.

Page 186: It should be cautioned that proscribed control might be found even in the absence of a 25% stock ownership interest in the transferee. *See* Cooper v. Commissioner, 143 T.C. No. 10 (Sept. 23, 2014) (stating "retention of control by a holder over an unrelated corporation can defeat capital gain treatment under section 1235 because the retention prevents the transfer of 'all substantial rights'").

Page 191: Similar to the *abandonment* loss deduction described in the main text, section 165 permits a deduction for loss arising from *theft*. In *Sheridan v. Commissioner*, T.C. Memo 2015-25 (Feb. 18, 2015), the taxpayer claimed a large deduction for theft losses that occurred when "pirates" stole the intellectual property underlying a patent that he held. The IRS disallowed the deduction because there was no evidence that patent infringement had occurred or that the taxpayer has incurred actual damages. The Tax Court upheld the IRS's decision disallowing the theft loss deduction, finding that the taxpayer had failed to establish the section 165(e) theft loss requirements.

Chapter 7
Taxation of Intellectual Property Litigation

Page 230: In a recent Private Letter Ruling, the taxpayer licensed a certain patent from its affiliate for the manufacture and distribution of products based on the patent. Pursuant to the license agreement, the taxpayer was required to notify the affiliate about any third party violating the patent and the affiliates had complete control of the defense and related settlement negotiation with the third party. The taxpayer and the affiliate also agreed that they would share the expenses incurred in defending the patent, as well as proceeds recovered from the litigation. Later, the taxpayer filed a patent infringement against a company for infringing the patent. The company moved for a declaratory judgment of non-infringement and patent invalidity. None of the claims asserted that the affiliate did not have legal title to the patent. The taxpayer and the affiliate incurred expenses in legal costs. The Service concluded that the litigation costs incurred by the taxpayer are deductible as ordinary and necessary business expenses under Section 162(a) of the Code. According to the Service, the costs were incurred to protect against infringement of the patent by a competitor and not for the defense or perfection of title to the patent. Priv. Ltr. Rul. 201536006 (Sept. 4, 2015).

Page 230: In Chief Counsel Attorney Memorandum, AM 2014-006, 2014 WL 4495163, a generic drug manufacturer sought approval from the Food and Drug Administration for an Abbreviated New Drug Application (ANDA) with Paragraph IV Certification that allows for the testing and development of a generic drug prior to patent expiration. While making or using a patented drug in order to complete an ANDA is not an act of patent infringement, the act of filing an ANDA with Paragraph IV certification constitutes an act of patent infringement, providing courts with jurisdiction to resolve patent issues before actual sale of the generic drug. According to the IRS, the legal fees incurred in defense against patent infringement in relation to the ANDA application process are required to be capitalized under section 263 and Treas. Reg. § 1.263(a)-4(b)(1)(v), -4(d)(5). Capitalization is necessary because the infringement suit pursuant to an ANDA with Paragraph IV Certification is "so integral to the process by which generic drug manufacturers obtain approval to market and sell a generic version of a drug that the litigation costs to defend the suit are incurred 'in the process of pursuing' such approval." The patent defense originates in a capital transaction—the application for FDA approval to market and sell a generic drug—and the costs of such litigation facilitate the transaction and must be capitalized under Treas. Reg. § 1.263(a)-4(e)(1). [Note: Where a drug manufacturer holds a patent on a drug for which an ANA with Paragraph IV certification is filed, the legal fees incurred by the drug manufacturer to establish the manufacture, use, or sale of the drug subject to the ANDA would infringe the drug manufacturer's patent are generally not required to be capitalized under Treas. Reg. § 1.263(a)-4(d)(9).] Query: Do you agree with IRS's position? Will it make it more costly for brand name and generic pharmaceutical companies to engage in patent litigation? In a more recent Field Attorney Advice, the IRS concluded that a drug manufacturer that filed an ANDA with the FDA must capitalize legal fees incurred in defending a patent infringement suit; the Service also concluded that FDA-approved ANDAs are section 197

intangibles that are amortizable ratably over 15 years. IRS Field Attorney Advice 20154502F (July 24, 2015).

Chapter 10
Taxation of Intellectual Property Held by Non-Profit Organizations

Page 342: Priv. Ltr. Rul. 201545028 (Aug. 12, 2015) (denying tax-exempt status to an organization established to fund the R&D of certain energy efficient devices because it operated for the private interest of its founder and his for-profit business); Priv. Ltr. Rul. 201538025 (June 25, 2015) (rejecting the exempt status of an organization whose activities are devoted to a non-exempt purpose of identification, development, promotion and sales of medical devices, in addition to serving the private interests of businesses and development partners); Priv. Ltr. Rul. 201545030 (June 22, 2015) (denying tax-exempt status to a record producer that would own rights to intellectual property pertaining to its projects).

For recent rulings denying tax exempt status to software organizations, see Priv. Ltr. Rul. 201514013 (Jan. 6, 2015) (denying tax exempt status to a company that provides software to businesses and nonprofit organizations as well as managerial and consulting services for a fee, because taxpayer's activities are commercial in nature and further the private interests of the founders); Priv. Ltr. Rul. 201507025 (Nov. 18, 2014) (denying tax-exempt status to a computer software developer that sought tax exempt status as a social welfare organization because developing and distributing open-source software does not promote the social welfare of a community and the developer's primary activity is selling software services at cost, similar to a for-profit company); Priv. Ltr. Rul. 201505040 (Nov. 6, 2014) (rejecting the exempt application submitted by an open source software organization that was formed for the purpose of creating, developing, and publishing open source software products for software programmers; such activities "do not serve a charitable class, further an educational purpose, or further a scientific purpose.")

Chapter 11
Use of Domestic Intellectual Property Holding Companies

Page 381: The Maryland Court of Appeals in *NIHC, Inc. v. Comptroller of Treasury*, 97 A.3d 1092 (Md. App. 2014), offered the following observation about the modern day holding company scheme to avoid state taxation by comparing the scheme to the basketball maneuver known as the "four corners offense":

> Once upon a time, before the advent of the shot clock, some basketball teams employed a maneuver known as the "four corners offense." This strategy involved a series of passes among team members that seemingly did not advance the ultimate purpose of putting the ball in the hoop, but had the separate purpose of depriving the opposing team of possession of the ball. In a somewhat analogous enterprise, corporate tax consultants devised a strategy that involved a series of transactions passing licensing rights between related corporations and that was motivated by a desire, not to directly enhance corporate profits, but to keep a portion of those profits out of the hands of state tax collectors. Much as the shot clock led to the demise of the four corners offense, judicial decisions during the past two decades have limited the utility of this tax avoidance strategy.

Chapter 12
Overview of International Taxation

Page 421: The United States has the highest corporate income tax rate among OECD nations. It has been suggested that the United States adopt a so-called "patent box," which would provide a lower tax rate solely on income generated by patents and/or other types of intellectual property. Several countries in the European Union (e.g., Belgium, France, Hungary, Luxembourg, the Netherlands, and Spain) have some form of patent or innovation box.

Chapter 13
Use of Foreign Intellectual Property Holding Subsidiaries

Page 461: *See* Gabe B. Gartner, *(Ir)recoverable Basis in Outbound Intangible Transfers*, 2015 TNT 91-15 (May 12, 2015) (arguing that until the tax treatment of tax basis in outbound transfers of intangible property is clarified by regulations or other guidance, taxpayers should not assume that their tax basis is irrecoverable).

Page 461: Under an earlier rule, the useful life of intangible property was limited to 20 years. Treas. Reg. §1.367(d)-1T(c)(1), (3). However, recently proposed regulations now provide that the useful life of intangible property is the entire period during which the exploitation of the intangible property is reasonably anticipated to occur, as of the time of transfer. REG-139483-13. According to the government, the 20-year life provision was an arbitrary cap on the life of an intangible, and its elimination allows for a better measure of the value of intangibles. *See* David D. Stewart, *ABA Meeting: Outbound Transfer Regs Eliminate Arbitrary Useful Life*, TAX NOTES TODAY, Sept. 21, 2015, *available at* 2015 TNT 182-11.

Pages 462–464: It should be noted that Ireland, under pressure from European countries, recently changed its tax residency rules as of January 2015, so that all Irish-registered companies must be tax residents in Ireland within the next six years. More specifically, although new companies can no longer use the "Double Irish" structure, existing companies have until the end of 2020 to come into compliance with the new law. Thus, the material that follows remains relevant for some time for a good number of existing schemes. Ireland has retained its low 12.5% corporate tax rate, so it remains to be seen whether Ireland will remain attractive for companies. In addition to the grandfathering exception discussed above (applicable to existing companies incorporated in Ireland and resident in a non-treaty jurisdiction, like Bermuda), there is a treaty based exception as well. Companies incorporated in Ireland and managed and controlled in a treaty jurisdiction, like Malta or Hong Kong, are not deemed to be tax residents of Ireland IF a treaty tie-breaker rule enforces the other country as place of tax residency. This treaty exception to the revised residency rule opens up several possibilities to achieve similar results by moving the managerial headquarters of a controlled subsidiary into a county with a treaty with Ireland.

Page 462–464: The main text describes several anti-deferral provisions applicable to U.S. companies that use foreign corporations to avoid or defer U.S. tax. Many of these anti-deferral provisions, however, can be avoided with careful tax planning.

The U.S. *controlled foreign corporation rules (subpart F)* impose current taxation on passive income (e.g., dividends and royalties from lower tiered CFCs to higher-tiered CFCs) and on certain active income. But multiple exceptions and loopholes are available that undercut the intended application of subpart F. Importantly, the check-the-box regulations enable U.S. multinational companies to have lower-tiered CFCs disregarded for U.S. tax purposes, so passive income paid to higher-tiered CFCs is ignored by the United States (not subpart F income). [Note that a temporary CFC look-through rule was enacted in 2006, which provides "look through" treatment for payments between related

CFCs; the provision has been temporary, so multinational companies still rely heavily on check-the-box.] In addition, the CFC rules themselves contain important statutory exceptions. For example, the "same country" exception excludes payments from one related CFC to another in the same country. [Note that, in addition, a manufacturing exception exists that excludes income if the CFC itself manufactures the goods it sells; regulations make it easy to claim this exception.]

The *transfer pricing rules of Section 482* use an "arm's-length" approach to transfer pricing concerns. As described earlier, the United States requires royalties be "commensurate with the income" attributable to transferred intellectual property, and the IRS is allowed to make periodic royalty adjustments years after the intellectual property transfer, even if the initial royalty was reasonable when set. U.S. multinational companies have found ways to avoid transfer pricing adjustments by entering into cost sharing agreements with their foreign subsidiary corporations. Cost sharing arrangements are expressly authorized by the regulations. Under a cost sharing agreement, a U.S. multinational company and its foreign subsidiary share R&D costs and risks of co-developing products for a global market in exchange for rights to intellectual property for their respective markets. Because the economic ownership of newly developed intangibles is split, no arm's-length royalty payments are needed for the use of intellectual property. It should be noted that an arm's-length buy-in payment is required for platform contributions made by U.S. multinationals.

Techniques used by multinational companies to circumvent anti-deferral rules (e.g., utilization of check-the-box regulations to create hybrid entities, the use of cost sharing arrangements to avoid transfer pricing adjustments) may be legal but they are circumventing the purposes of the laws. Many governments, including the United States, have taken note of these intellectual property income shifting techniques and their impact on domestic revenue bases. According to one analysis, income shifting from the United States to low tax jurisdictions drains as much as $100 billion in corporate revenue from the United States every year. Kimberly A. Clausing, *The Effect of Profit Shifting on the Corporate Tax Base in the United States and Beyond*, Jan. 2016, *available at* SSRN-id2685442.pdf. The Joint Committee on Taxation itself estimates the loss for FY 2016 to be $108.9 billion. Joint Committee on Taxation, *Estimates of Federal Tax Expenditure*, JCS-141R-15, Dec. 7, 2015, *available at* www.jct.gov/publications.html?func=select &id=5. It is also estimated that U.S. multinationals have now accumulated nearly $2.3 trillion of un-repatriated earnings in 2014. Audit Analytics, *Untaxed Foreign Earnings Top $2.3 Trillion in 2014*, Apr. 2015, *available at* www.auditanalystics.com/blog/untaxe d-foreign earnings-toop-2-3-trillion-iin-2014/.

In the United States, members of Congress from both parties have put forth various tax reform proposals. The White House and the Treasury Department have released "The President's Framework for Business Tax Reform," which targets income shifting. *The President's Framework for Business Tax Reform: An Update*, Apr. 2016, *available at* www.treasury.gov/resource-center/tax-policy/Documents/The-Presents-Framework-for-Business-Tax-Reform-An-Update-04-04-2016.pdf.

Other countries around the world are also looking hard at what multinationals are doing and discussing measures to close tax loopholes. Most notably, at the request of the G-20 nations, the Organization for Economic Cooperation and Development (OECD) in 2015 delivered a number of recommendations on how to deal with base erosion and profit shifting (BEPS Project). *See* OECD, BEPS 2015 Final Reports, Oct. 5, 2015, *available at* www.oecd.org/tax/beps-2015-final-reports.htm. The final BEPS Project reports, issued in October 2015, make concrete action plan recommendations to help nations address the problems of income shifting. Most recommendations attempt to tax profits where value is added and to promote greater tax transparency with increased information exchange between tax authorities.

The OECD points out the advantages of a multilateral approach to international tax reform. It will be interesting to see how countries address the OECD's recommendations, as countries have different goals and face different constraints. There are signs that the United States intends to meet the multilateral commitment it made in the OECD's BEPS Project. For example, the Treasury and the IRS have recently released proposed regulations that, if finalized, would require country-by-country reporting as recommended in BEPS Action Plan #13 (transfer pricing documentation).

Page 465: Recent years have seen numerous corporate inversions. For an explanation for the recent tide of inversions*, see* Robert Holo & Devin J. Heckman, *Inversions Inside Out*, 2014 TNT 241-7 (Dec. 2, 2014) (describing the benefits and risks associated with modern inversion transactions, and discussing recent proposals to address inversion strategies). The U.S. government has taken several steps in recent years to prevent corporate inversions. Specifically, the IRS issued an IRS Notice in 2014, an IRS Notice in 2015, and Treasury Regulations in 2016. In large part, these measures shut down the ability to "skinny down" the U.S. company or "fatten up" the foreign company to clear statutory hurdles.

Chapter 14
Transfer Pricing and Cost Sharing Arrangements

Page 477: A number of high profile transfer pricing disputes under section 482 continue to arise. For example, Medtronic, Inc., is involved in a high-profile dispute in Tax Court involving more than $2 billion in proposed section 482 transfer pricing adjustments. Medtronic, Inc. v. Commissioner, T.C. No. 6944-11 (2014). *See also* Margaret Burow, *Company Challenges IRS Pricing of Alleged Intangibles Transfers*, 2014 TNT 161-3 (Aug. 20, 2014) (noting Zimmer Holdings, Inc., a manufacturer and seller of medical devices, filed a Tax Court petition challenging the IRS's assessment of $79 million of tax deficiencies, arguing that the IRS ignored contractual terms of transactions involving intangibles between the taxpayer and its foreign subsidiary).

Page 486: *See* Mark J. Silverman, et. al, *Considering Veritas and Future Transfer Pricing Litigation*, 2014 TNT 200-6 (Oct. 16, 2014) (examining the IRS's continued efforts in litigation despite the Tax Court's rejection of the IRS's position in *Veritas*).

Page 487: The IRS completed 101 APAs in 2014, a decrease from the 145 completed in 2013. IRS Announcement 2015-11, 2015 I.R.B. 1 (Mar. 30, 2015).

Page 484: The saga of stock-based compensation in cost sharing arrangements has continued. After the Tax Court's 2010 decision in *Xilinx* (which held that under the 1995 cost-sharing regulations, stock-based compensation costs need not be shared between controlled entities entering into cost sharing arrangements), the Tax Court in 2015 addressed the 2003 regulations (which required participants in a cost sharing arrangement to share stock-based compensation costs). In *Altera Corp. v. Commissioner*, the Tax Court invalidated, as arbitrary and capricious, the 2003 regulation that required participants in a cost sharing agreement to share the costs of stock-based compensation in order to achieve an arm's-length result. 145 T.C. No. 3 (July 27, 2015). The issue in the case was whether the U.S. taxpayer, under its cost sharing arrangement with its foreign subsidiary, failed to include stock-based compensation in its cost-share pool, resulting in insufficient income allocated to the United States. The IRS increased the foreign subsidiary's cost-sharing payments, allocating more income to the U.S. taxpayer. According to the court, the government could not have rationally adopted the regulation based on its consistency with the arm's-length standard, and the government did not contend that that the regulation had been adopted solely based on the "commensurate with income" standard. *See* Michael L. Schler, *The Arm's-Length Standard After Altera and BEPS*, TAX NOTES TODAY, Dec. 1, 2015, *available at* 2015 TNT 230-9. The government has appealed its loss in *Altera* to the Ninth Circuit.

Chapter 15
Estate Planning for Intellectual Property

Page 543: With the recent death of several celebrities, the valuation of postmortem rights of publicity for estate tax purposes has gained particular attention. *See, e.g.*, Marie Sapirie, *But Honey I'm Rich on Personality: Publicity Rights and Estate Taxes*, TAX NOTES TODAY, May 5, 2016, *available at* 2016 TNT 89-2.

Page 543: In 2016, an unmarried decedent's estate of less than $5,450,000 escapes any federal estate tax if the decedent made no lifetime taxable gifts.

Page 546: The IRS has recently published proposed regulations that require an heir's basis in property acquired from a decedent to be consistent with the value of the property as finally determined for estate tax purposes. REG-127923-15; 81 Fed. Reg. 11486-11496 (Mar. 4, 2016).

Page 548: One option for a client is to securitize future royalty income. Securitizing royalty income can provide funds for the decedent's estate to pay estate taxes without the estate having to sell the intellectual property rights. *See* Ajay Gupta, David Bowie: *Rock Star of Tax Planning*, TAX NOTES TODAY, Jan. 14, 2016, *available at* 2016 TNT 11-4.