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Global Tax Alert

News from Transfer Pricing

US Supreme Court declines to hear *Altera* case

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On 22 June 2020, the United States (US) Supreme Court announced that it was denying the petition for certiorari for *Altera Corporation & Subsidiaries v. Commissioner*, 926 F.3d. 1061 (2019).

Altera filed the petition asking the Supreme Court to review a decision of the Ninth Circuit Court of Appeals upholding the 2003 version of Treas. Reg. Section 1.482-7 (2003 Regulations), which requires participants to include stock-based compensation costs in a cost-sharing arrangement. The denial to hear the case puts an end to the Altera's Ninth Circuit stock-based compensation challenge.

Case history

In 2003, the Internal Revenue Service (IRS) and Treasury issued the 2003 Regulations, which require stock-based compensation costs to be included in intangible development costs, which participants in a cost-sharing arrangement share. On 27 July 2015, the Tax Court ruled that the 2003 Regulations, were invalid under the *Administrative Procedure Act*. The Tax Court found that Treasury's conclusion that the final rule was consistent with the arm's-length standard was contrary to the evidence before it, namely that unrelated parties, acting at arm's length, would never agree to share each other's stock-based compensation costs.

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On 7 June 2019, in a 2-1 opinion, a Ninth Circuit panel reversed the Tax Court's holding and ruled that the 2003 Regulations complied with the *Administrative Procedure Act*. The Ninth Circuit found that the Government had adequately supported in the record that stock-based compensation should be treated as an intangible development cost in a cost-sharing arrangement and Treasury's position on the issue was not a policy change.

The Ninth Circuit observed that Altera's objection to the 2003 Regulations was based on them being "inconsistent with the traditional arm's length standard" because the evidence demonstrated that unrelated parties operating at arm's length never agreed to share stock-based compensation costs.

The Ninth Circuit applied the *Chevron* standard,[1] first finding that Internal Revenue Code Section 482 was ambiguous. The Ninth Circuit then addressed the second step in the *Chevron* analysis by considering whether Treasury's interpretation of the statute as applying the commensurate-with-income standard for any transfer (or license) of intangible property was reasonable. The Ninth Circuit stated the second step of *Chevron* was satisfied because "[t]hese internal allocation methods are reasonable methods for reaching the arm's length results required by statute. While interpreting the statute to do away with reliance on comparables may not have been 'the only possible interpretation' of Congress's intent, it proves a reasonable one."

In so finding, the Ninth Circuit held that the 2003 Regulations were valid under the *Administrative Procedure Act* and the Treasury Department's decision to forego the comparability analysis in determining the arm's-length standard and applying the commensurate-with-income standard was reasonable under *Chevron* (see EY Global Tax Alert, *US Ninth Circuit panel reverses Tax Court opinion in Altera, holding stock-based compensation to be a compensable cost under IRC Section 482*, dated 17 June 2019).

On 10 February 2020, Altera filed a petition for a writ of certiorari asking the Supreme Court to review the Ninth Circuit's decision. Altera contended that Treasury used an indefensible "bait-and-switch" by attempting to justify the 2003 Regulations using arguments that it advanced for the first time in the Ninth Circuit after the Tax Court held the regulation invalid.

After Treasury filed a petition opposing Altera's petition for Supreme Court review, Altera filed a reply brief arguing that the Ninth Circuit committed serious errors by "upholding an arbitrary and capricious regulation based on a rationale presented for the first time in litigation, and even giving the new rationale *Chevron* deference." Altera stressed that the Supreme Court should grant certiorari because the Ninth Circuit's decision has created uncertainty and confusion for international and domestic tax law. Altera rejected Treasury's argument that the Supreme Court should wait for a circuit split, saying most of the financial impact will be felt in the Ninth Circuit and there are no other cases in the pipeline.

Implications

The Supreme Court's denial of the petition for certiorari is important because the Ninth Circuit's decision stands. Companies within the Ninth Circuit must consider the Ninth Circuit decision concerning the inclusion of stock-based compensation in the cost-sharing agreement. Companies outside the Ninth Circuit must now consider how the Supreme Court's denial to hear the petition impacts their tax positions under the 2003 Regulations. To this end, the Tax Court decision, issued on 27 July 2015, holding that the 2003 Regulations were invalid, remains relevant precedent outside the Ninth Circuit.

Endnote

1. *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984). In *Chevron*, the Supreme Court set forth a legal test as to when the Court should defer to the agency's answer or interpretation, holding that such judicial deference is appropriate when the agency's answer was not unreasonable, so long as the Congress had not spoken directly to the precise issue at question.

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