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# US Court of Appeals affirms Tax Court decision in *Amazon*

## Global Transfer Pricing Alert 2019-024

A unanimous three-judge panel of the Ninth Circuit Court of Appeals on 16 August affirmed the Tax Court's decision in *Amazon.com, Inc. v. Commissioner*, 148 T.C. 108 (2017) that the definition of intangible assets under the Treasury regulations in effect in 2005 and 2006 does not include residual business assets such as the value of workforce in place, goodwill, and going concern value. The court concluded instead that the definition was limited to independently transferrable assets.

**Background**

At issue were the assets required to be included in a cost sharing buy-in payment in relation to a cost sharing arrangement (CSA) that was entered into as part of a 2004 restructuring by Amazon.com Inc. (Amazon) and its Luxembourg subsidiary. Amazon valued only the independently transferable intangible assets that it transferred to the European holding company under the CSA, including website technology, trademarks, and customer lists. The IRS valued the entire European business, other than preexisting tangible assets. The

valuation by the IRS included residual business assets such as workforce in place, goodwill, going concern value, and other unique business attributes such as growth options and Amazon's culture of innovation.

The Tax Court held in favor of Amazon in an opinion issued March 23, 2017.[1] The Tax Court concluded that the IRS`s buy-in payment included assets that were not included in the definition of intangible property and that therefore were not required to be included in the buy-in payment under the regulations applicable to 2005 and 2006.[2]

**Ninth Circuit opinion**

The Ninth Circuit upheld the Tax Court's opinion, holding that the definition of intangible assets in effect during the years at issue did not include residual business assets such as workforce in place, goodwill, going concern value, and other unique business attributes such as growth options. To reach this conclusion, the Ninth Circuit examined the regulatory definition of an intangible contained in the transfer pricing regulations, the overall transfer pricing regulatory framework, the rulemaking history of the regulations, and whether the IRS's position was entitled to deference under *Auer v. Robbins*, 519 U.S. 452 (1997).

*Regulatory definition of an "intangible"*

The Ninth Circuit first analyzed the regulatory text of Treas. Reg. §1.482-4(b) but determined that this alone did not definitively resolve the question.

That language defines an intangible as an asset that both has "substantial value independent of the services of any individual" and is one of the items listed in Treas. Reg. §1.482-4(b)(1) through (6). According to the court, each of the 28 specific items listed in subsections (b)(1) through (5) is independently transferrable, and none is a residual business asset.

The court also examined the catchall provision for "[o]ther similar items" under Treas. Reg. §1.482-4(b)(6), which is the provision the IRS relied on for its analysis. Concluding that such language was ambiguous, the court noted that concepts such as "growth options" and "culture of innovation" are amorphous and that it was not self-evident whether those assets have "substantial value independent of the services of any individual."

[1] For a discussion of the Tax Court opinion, see Global Transfer Pricing Alert 2017-008 (March 27, 2017).

[2] Also at issue in the Tax Court case was whether a claw-back provision for stock-based compensation in the CSA was operative and whether 100 percent of the costs attributable to certain costs centers were allocable to the CSA cost pool. Neither of those issues was subject to the appeal.

For these reasons, the court held that the regulatory definition of the term "intangible" was not dispositive.

*Overall transfer pricing regulatory framework*

The Ninth Circuit next looked at the transfer pricing regulatory scheme as a whole, viewing the definition of the term "intangible" in the context of the entire set of transfer pricing regulations.

The court noted that the provision requiring a "buy-in" incorporates rather than expands the meaning of an "intangible" given in Treas. Reg. §1.482-4(b). The court then noted that the cost sharing regulations in effect in 2005 and 2006 identified intangibles that were the product of research and development efforts. To the court, this indicated that the regulations contemplated a meaning of "intangible" that excluded items that are generated by earning income, not by incurring deductions, such as goodwill and going concern value.

Even though this analysis did not definitively resolve the issue, the court concluded that it favored Amazon's position more than the IRS's.

*Rulemaking history of the regulations*

The court then looked at the drafting history of the transfer pricing regulations, concluding that such history did not support the IRS's argument.

In the court's view, the only reference in the drafting history to any residual business assets suggests that such items were actually *excluded* from the definition of intangible assets. The court noted that Notice 88-123, 1988-2 C.B. 458 (the White Paper), which laid the groundwork for what would ultimately become the final regulations at issue in *Amazon*, proposed including "going concern value" of a research facility in the buy-in payment. Nevertheless, the Treasury Department's final regulations kept essentially the same definition of the term "intangible" as was used in prior versions of the regulations before the White Paper.

Significantly, the final regulations did not refer to "going concern value" or any other residual business asset.

The court also focused on two statements made by Treasury during the drafting process of the final regulations. First, in 1993, the Treasury Department asked for comments on whether the definition of intangibles should be expanded to include items not normally considered intangible property, such as workforce in place, goodwill, or going concern value. When doing this, the Treasury Department

stated that the then-existing definition of "intangible" did not include such residual business assets. Second, a year later, Treasury opted against such an expansion and explained that the final 1994 regulations merely "clarified" when an item would be deemed similar to the 28 items listed in the definition.

The court also focused on another statement from the drafting history of Treas. Reg. §1.482-4 that lent further support for Amazon's position that the term "intangible" has always been understood to be limited to assets that are independently transferrable. Specifically, the 1993 temporary regulations defined "intangible" as "any commercially transferrable interest" in the intangibles listed in IRC §936(h)(3)(B) that had "substantial value independent of the services of any individual." The court observed that Treasury, when it left out the "commercially transferrable" language from the final 1994 regulations, explained that such language was superfluous.

Finally, as part of its analysis, the court examined the legislative history of the term "intangible property" under IRC §936(h)(3)(B). The IRS had argued that the 2017 amendment supported its interpretation of Treas. Reg. §1.482-4(b) – that is, that residual business assets such as goodwill, going concern, and workforce in place were intangible assets. Dismissing this argument, the Ninth Circuit, in footnote 16 of the opinion, maintained:
Congress stated that the amendment should not be "construed to create any inference" as to the definition of intangibles for taxable years occurring before the amendment's effective date. 131 Stat. at 2219. Congress said nothing to indicate that the amendment was meant only as a clarification.

The court concluded, therefore, that the drafting history of Treas. Reg. §1.482-4(b) strongly supported Amazon's position that the definition of "intangible" was limited to independently transferrable assets.

*Whether IRS's position is entitled to Auer deference*

The IRS's final argument rested on a legal doctrine known as *Auer* deference, which states that, under certain circumstances, an agency's interpretation of its own regulations must be given controlling weight as long as it is not plainly erroneous or inconsistent with the regulation. Looking at the text of the regulatory definition of "intangible," the definition's place within the transfer pricing regulations generally, and the rulemaking history, the court concluded that *Auer* deference was not warranted.

**Observations**

This case is governed by regulations promulgated in 1994 and 1995. In 2009, the Treasury Department issued temporary cost sharing regulations to replace the 1994 and 1995 regulations, and in 2017 Congress amended the definition of "intangible property" as part of the Tax Cuts and Jobs Act. See 74 Fed. Reg. 340 (Jan. 5, 2009) and Pub. L. 115-97, § 14221(a), 131 Stat. 2054, 2218 (2017), respectively.

The Ninth Circuit's opinion is limited to issues arising under the 1995 cost sharing regulations. The subsequent cost sharing regulations replaced the reference to buy-in payment with the concept of a platform contribution transaction, which includes any resource, capability, or right that is reasonably anticipated to contribute to developing cost-shared intangibles. In addition, as noted above, the Tax Cuts and Jobs Act amended the definition of intangible property to include workforce in place, goodwill, and going concern value.

In analyzing these changes, the court stated in footnote 1 of the opinion that, "[i]f this case were governed by the 2009 regulations or by the 2017 statutory amendment, there is no doubt the Commissioner's position would be correct." This language, along with the language in footnote 16 of the opinion, may impact consideration of this issue in years governed by the 2009 temporary regulations and before the effective date of the TCJA.

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