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Tax Court Déjà Vu – IRS Tried, and Failed, to Overturn *Veritas*

In a recent decision (*Amazon Inc. v. Commissioner*, March 23, 2017), the Tax Court handed the IRS an unsurprising loss when it attempted to relitigate many of the same issues it unsuccessfully raised before the Tax Court in *Veritas v. Commissioner* in 2009.

The IRS took issue with Amazon's determination of the amount of a buy-in payment related to a cost sharing agreement (CSA) Amazon entered into with its Luxembourg subsidiary, AEHT. Over the course of 2005 and 2006, Amazon and AEHT formed a CSA that transferred to AEHT the preexisting technology and marketing intangibles associated with the group's European operations. In return, AEHT made a buy-in payment of $255 million for rights to the transferred intangibles and agreed to share the intangible development costs associated with the CSA in proportion to its share of projected sales.

The IRS later audited the arrangement and, using a discounted cash flow (DCF) analysis, determined that the arm's-length buy-in was $3.6 billion (later reduced to $3.468 billion). According to the IRS, the $255 million buy-in payment undervalued the intangibles contributed by Amazon and overvalued the contributions of AEHT since it did not participate in any intangible development activities. Amazon petitioned the Tax Court for a redetermination, arguing that the IRS's method for determining the buy-in payment was similar to the method previously rejected by the Tax Court in *Veritas*.

The Tax Court must have experienced déjà vu when hearing this case, given the striking similarities between the IRS's arguments in this case and its arguments in *Veritas*. Back in 2009, the IRS also attempted to use a DCF analysis to argue that the $166 million buy-in payment made by Veritas's Irish subsidiary to Veritas for intangibles should have been $2.6 billion. The court in *Veritas* found that the IRS's determinations were arbitrary, capricious, and unreasonable, and that, instead, Veritas's method with appropriate adjustments was the best method to determine the requisite buy-in payment. The similarities between the two cases did not go unnoticed by the court, which stated in its opinion: "One does not need a Ph.D. in economics to appreciate the essential similarity between the DCF methodology that [the IRS expert witness] employed in *Veritas* and the DCF methodology that [another IRS expert witness] employed here. . . ."

Just as it did in *Veritas*, the Tax Court determined that the comparable uncontrolled transaction (CUT) method used by Amazon with appropriate adjustments is the best method to determine the requisite buy-in payment. The court found that the IRS's expert improperly assumed a perpetual useful life for the intangibles rather than restricting his valuation to the preexisting intangible property, some of which had a useful life of only about seven years. The court also found that the expert improperly included the value of subsequently developed intangibles that would be covered in future cost-sharing payments. Additionally, the court took issue with the expert's use of the aggregation principle. The court determined that aggregation was inappropriate because it combined preexisting intangibles that were subject to the buy-in with subsequently developed intangibles and also combined compensable intangibles with residual business assets.

The court concluded that the IRS expert's approach violated the cost-sharing regulations because he treated the transaction as "akin to a sale" of an entire business and did not limit his buy-in payment to the value of the preexisting intangibles transferred under the qualified CSA, and therefore, his approach must be rejected.

In an effort to avoid similar problems in the future, the IRS expanded the scope of the buy-in, now referred to as a "platform contribution," and introduced detailed valuation methods for valuing platform contribution transactions in its 2009 temporary, and 2011 final, cost-sharing regulations. The regulations take a broad view of what constitutes a platform contribution and provide that an approach like the DCF analysis used by the IRS in this case and in *Veritas* may be appropriate to determine the value of a platform contribution transaction. Under the 2011 regulations, the IRS positions in this case and in *Veritas* would have been bolstered. However, the 2011 regulations could be considered overreaching, and the Tax Court could view that the regulations fall outside the purview of the statute. The 2011 regulations did not apply in either case, since the years at issue were before 2009. And so the Tax Court's holding in this case and in *Veritas* apply only to transactions in years before 2009.

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