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HIGHLIGHTS

IN THIS ISSUE

IRS Announces Intention to Issue Regulations That Could Dampen Use of IP Partnerships

In Notice 2015-54, IRS announced its intent to issue regulations under section 721(c) to tax certain transfers of appreciated property by a U.S. taxpayer to a partnership in which foreign related persons are also partners. While the Notice was drafted to cover a broader class of property, its focus clearly is to curb the use of partnerships to shift intellectual property offshore. The Notice provides an exception to up-front taxation for partnerships that: (i) adopt the "remedial allocation" method under section 704(c); (ii) agree to accelerate built-in gain upon the occurrence of certain events (e.g., the contributor sells its partnership interest); and (iii) allocate all partnership items with respect to contributed property in the same proportion. These proposed rules leave room for multinationals to continue to restructure their ownership of IP using partnerships, though it is not clear whether a partnership with a preferred return would be able to meet the last requirement under the Notice.

Two Recent Cases Involve the Ability of Taxpayers to Challenge Regulations

In *Altera Corp. v. Commissioner*, the full Tax Court unanimously invalidated under the Administrative Procedure Act a provision in 2003 cost-sharing regulations. This is the first time the Tax Court has applied the "arbitrary and capricious" standard to a tax regulation. The Tax Court chastised the Government for failing to take into account or adequately address the extensive and persuasive commentary of taxpayers opposed to the rule. Many other tax regulations are

vulnerable to challenge under the arbitrary and capricious standard for failing to adequately explain the reasons behind the rules adopted in the regulations.

In *Florida Bankers Ass'n v. Treasury*, a divided panel of the D.C. Circuit held the plaintiffs' challenge to a regulation was barred by the Anti-Injunction Act in the Internal Revenue Code, based on reasoning that is clearly inconsistent with the Supreme Court's decision in *Direct Marketing Ass'n v. Brohl* earlier this year. Contrary to the majority opinion in *Florida Bankers*, *Direct Marketing* opens up an avenue for taxpayers to challenge regulations without needing to file a return with a position contrary to the regulation. Taking into account the very weak reasoning in the majority opinion in *Florida Bankers* and a strong dissent, it is very likely the panel opinion will be subject to a rehearing en banc by the full D.C. Circuit.

Proposed Section 199 Regulations Eschew Benefits-and-Burdens Ownership Test

Long-awaited proposed regulations under section 199 include an unexpected provision involving who can take the section 199 domestic production deduction. Current regulations limit the section 199 deduction to the person that has the benefits and burdens of ownership of the qualified production property. The proposed regulations, if finalized, would instead treat contract manufacturers as the taxpayer entitled to the deduction with respect to qualifying activities performed by them, regardless of who has the benefits and burdens of ownership of the property. The stated reasons for this change are to reduce administrative complexity and to ensure that two taxpayers do not claim the same deduction. This proposed rule has already drawn criticism for its arbitrary creation of new winners and losers, and taxpayers should not rely on this rule unless and until it becomes finalized. Currently, in many circumstances, LB&I permits the two parties to enter into an agreement with the IRS whereby only one of the two parties agrees to claim the section 199 deduction. Such agreements are presumably still available.

New Section 355 Item on 2015-2016 Priority Guidance Plan

As part of an effort to keep the scope of the Government's priority guidance plan realistic in the face of declining resources, the Corporate Tax section of the guidance plan includes only a single, albeit broadly worded, new item – guidance relating to the requirements under section 355, including the active trade or business requirement and the device requirement. While the parameters of this guidance plan project are ambiguous, wording of the item suggests that the project will grapple with the issues of whether a trade or business can be too small to qualify and whether a REIT election following a spinoff should be considered antithetical to the device requirement.

IRS Denies Ruling under Section 367 Safe Harbor PLR to Avago and Broadcom

Avago Technologies and Broadcom Corp. jointly announced that the IRS rejected Broadcom's request for a private letter ruling under Treas. Reg. § 1.367(a)-3(c)(9). If granted, the PLR would have provided assurance that Avago's acquisition of similarly-sized Broadcom would not trigger a section 367 toll charge. Treas. Reg. § 1.367(a)-3(c)(9) gives the IRS discretion to relax the substantiality requirement of Treas. Reg. § 1.367(a)-3(c), and IRS's decision not to exercise such discretion was likely motivated by an aversion to abetting inversion transactions. The parties planned for the contingency of failing to obtain a PLR by inserting a Cayman partnership into the structure, providing Broadcom shareholders the option to receive an interest in the partnership rather than in the Singapore holding company.

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Relevant IP&B Articles

IP&B's Pat Smith, a leading expert on the intersection of tax and administrative law, has written on both *Altera* and *Florida Bankers*:

http://www.proceduralltaxing.com/a-massive-loss-and-a-huge-rebuke-for-the-irs-from-the-tax-court-in-altera-decision/

http://www.proceduralltaxing.com/d-c-circuit-majority-opinion-in-florida-bankers-not-consistent-with-supreme-courts-direct-marketing-decision-part-1/

http://www.proceduralltaxing.com/d-c-circuit-majority-opinion-in-florida-bankers-not-consistent-with-supreme-courts-direct-marketing-decision-part-2/