Nos. 06-74246 & 06-74269

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

XILINX, INC., AND CONSOLIDATED SUBSIDIARIES,
Petitioner – Appellee,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent – Appellant.

Appeal from the United States Tax Court

BRIEF OF *AMICI CURIAE* UNITED STATES COUNCIL FOR INTERNATIONAL BUSINESS, CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA, APPLE INC., ALTERA CORPORATION, CYPRESS SEMICONDUCTOR CORPORATION, AND YAHOO! INC. IN SUPPORT OF PETITION FOR REHEARING OR REHEARING *EN BANC*

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CORPORATE DISCLOSURE STATEMENT

No *amicus* has a parent corporation, and no publicly held corporation owns 10% of more of the stock of any *amicus*.

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INTEREST OF THE AMICI CURIAE

The members of the United States Council for International Business (USCIB) include top U.S.-based global companies and professional services firms from every sector of our economy, with operations in every region of the world. The USCIB is the sole U.S. affiliate of the Business and Industry Advisory Committee to the Organisation for Economic Cooperation and Development (OECD), a 30-nation group that helps governments formulate policies that contribute to growth in world trade on a multilateral, non-discriminatory basis. In that capacity, the USCIB provides business views to policy makers and regulatory authorities worldwide, and works to facilitate international trade and investment.

The Chamber of Commerce of the United States of America is the world's largest business federation. It represents an underlying membership of more than three million businesses, state and local chambers of commerce, and professional organizations of every size, in every industry sector, and from every region of the country. The Chamber routinely advocates the interests of the national business community in courts across the nation by filing *amicus curiae* briefs in cases involving issues of national concern to American business.

The corporate *amici* listed below, all headquartered in California, have affiliates in foreign countries that have tax treaties with the United States.

Apple Inc. and its wholly owned subsidiaries design, manufacture (or have manufactured), and market personal computers, portable digital music players, and mobile communication devices and sell a variety of related software, services, peripherals, and networking solutions.

Altera Corporation designs and manufactures programmable logic devices and related software development tools.

Cypress Semiconductor Corporation designs, manufactures and sells high-performance, mixed-signal, programmable systems, controllers, clocks and memories. Cypress also offers wired and wireless connectivity technologies.

Yahoo! Inc. is a leading global consumer brand and one of the most trafficked Internet destinations worldwide.

The interests of the *amici* are further described in the accompanying motion for leave to file this brief.

INTRODUCTION

The divided panel decision in this case should be reheard *en banc* because it creates profound uncertainty in international trade and taxation. The decision undermines the arm's length standard that provides the international benchmark for transfer pricing (*i.e.*, allocating tax consequences for transactions between related parties)—a standard designed to prevent variations in tax treatment from impeding international trade and economic development. Under that standard, income and

deductions associated with transactions between companies that are under common control, yet subject to different taxing authorities, may be adjusted to reflect the allocations that would have resulted had independent companies engaged in the same transaction. The majority's conclusion that the arm's length standard is optional under Internal Revenue Code section 482—a result that the Commissioner did not seek—brings U.S. tax law into conflict with treaty provisions that are premised on the reciprocal application of the standard.

Rehearing is warranted to reinstate the "internationally comprehensible standard" (slip op. 6185 (Noonan, J., dissenting)) that was incorporated in U.S. bilateral income tax treaties explicitly to reflect the Treasury Department's longstanding interpretation of Section 482. In reliance on that universal principle of transfer pricing, thousands of U.S. companies and their overseas affiliates engage in transactions valued in the trillions of dollars. The panel decision has disrupted the settled expectations of those businesses and U.S. treaty partners alike.

As Judge Noonan observed, the panel majority "ignore[d] the international context" (*id.* at 6179) of the arm's length standard. The United States pioneered the development of the arm's length standard and forged the consensus that has resulted in the standard's inclusion in a wide network of treaties aimed at promoting international trade by avoiding double taxation.

The majority nonetheless decided that the arm's length standard is a matter of administrative grace rather than statutory command. Although the United States long has assured its treaty partners that Section 482 (and its predecessor) embodied the arm's length standard, and binding IRS regulations construe the statute that way, the panel held that the standard is a mere, non-binding "regulatory gloss" (slip op. 6169 n.9).

As for the United States' treaty obligations, the panel concluded that the explicit arm's length standard in the U.S.-Ireland treaty also is optional because a saving clause, common to U.S. tax treaties, allows signatories to apply domestic tax law to their residents. That novel approach would permit each treaty signatory to depart from the arm's length standard as to its own resident when a transaction involves companies from each nation—thwarting the goal of consistent transfer pricing to avoid double taxation.

Perhaps recognizing the international repercussions, the Commissioner did not contend that Section 482 permits divergence from the arm's length standard as a matter of regulatory discretion. Rather, he argued that his reallocation here reached an arm's length result—not because companies operating at arm's length would share employee stock option values as "costs," but as a matter of administrative fiat. The panel declined to permit the Commissioner to satisfy the arm's length standard by *ipse dixit*.

Yet rather than reject the non-arm's length reallocation as arbitrary and capricious—*see*, *e.g.*, *DHL v. Comm'r*, 285 F.3d 1210, 1223-24 (9th Cir. 2002); *Bausch & Lomb Inc. v. Comm'r*, 933 F.2d 1084, 1091-92 (2d Cir. 1991)—the majority changed the rules and placed worldwide transfer pricing in disarray. The statutory text did not command that result. Rather, the majority had to strain to read Section 482 as a boundless grant of allocation authority. The majority first had to construe Treasury regulations as conflicting rather than complementary, and then had to depart from the Commissioner's contentions by interpreting Section 482 as independent of the arm's length standard—all the while disregarding the interpretive context provided by treaty provisions reflecting the very arm's length standard that U.S. negotiators told the world was embodied in Section 482.

The panel's statutory interpretation undermines the fundamental premise of the international transfer pricing regime. It impairs trust in the United States as a treaty partner that convinced the world to adopt the arm's length analysis. The decision virtually guarantees double taxation by permitting related corporations to be taxed differently from unrelated corporations. The decision therefore should be reheard.

BACKGROUND

A. The Arm's Length Standard Is A Guiding Principle For International Tax Treaties.

The IRS has acknowledged that "the arm's length standard" is the "international norm for making transfer pricing adjustments." White Paper, SER82. As the IRS explained, "[t]he arm's length standard is embodied in all U.S. tax treaties," and "is incorporated into most tax treaties to which the United States is not a party." *Id.*[1] It "is in each major model treaty, including the U.S. Model Convention" and the model conventions of the OECD and United Nations. *Id.* & n.156. And "virtually every major industrial nation takes the arm's length standard as its frame of reference in transfer pricing cases." *Id.* The network of treaties applying the arm's length standard has provided a predictable means for allocating taxing authority among the different sovereign governments touched by cross-border commerce among related parties.

The 1996 and 2006 U.S. Model Conventions both provide in Article 9 that the arm's length standard based on the conduct of "independent enterprises" governs transfer pricing issues. The Technical Explanations equate this standard with "the arm's length principle reflected in U.S. domestic transfer pricing provisions, particularly Code section 482." 2006 USMCTE art. 9, at CCH 10,640;

[1] The U.S. is a party to 67 U.S. tax treaties. *See* http://www.irs.gov/businesses/international/article/0,,id=96739,00.html.

1996 USMCTE art. 9, at CCH 10,691-26. Article 9 of the OECD Model Convention uses the same "independent enterprises" standard; the Commentary makes clear that "the arm's length principle ... underlies the Article." 1992 OECD Commentaries art. 9, ¶ 3.

B. The United States Forged The International Consensus On The Arm's Length Standard.

The prevalence of arm's length treaty provisions is no coincidence. The U.S. has negotiated their inclusion for decades, pointing to Section 482 (and its predecessor) as the model. Mitchell Carroll, the primary U.S. tax treaty negotiator in the 1930s and 1940s, explained that the independent enterprise language in the first U.S. double taxation treaty (in 1932)—"was modeled on … Section 45 of the United States Revenue Act, presently Section 482 I.R.C." Carroll, *Evolution of U.S. Treaties to Avoid Double Taxation of Income Part II*, 3 INT'L LAW. 129, 150 (1968). Reworded to "deal[] specifically with rectification of accounts on an arm's length basis," the provision "served as a model in subsequent Conventions." *Id.* A later U.S. negotiator, Assistant Secretary Stanley Surrey—Harvard professor and author of a leading treatise—commented on "intensified efforts to achieve appropriate international techniques" so that Section 482 allocations could "be appropriately meshed with other rules and procedures of the other countries involved." Surrey, *The United States Tax System and International Tax Relationships*, 43 TAXES 1, 28 (1965). These U.S. "proponents of 'arm's length'

were determined to 'internationalize' the system, principally to provide scope for the operation of the United States rules." Langbein, *The Unitary Method and the Myth of Arm's Length*, 30 TAX NOTES 625, 650 (1986). And they not only convinced international bodies to follow the "method of the section 482 regulations," but also persuaded other nations to adopt arm's length principles in their domestic transfer pricing laws. *Id.* at 651 (emphasis deleted).

Similarly, Surrey suggested that the arm's length transfer pricing methods used under Section 482 should become the basis of an OECD consensus on the principle, *Secretary Surrey Reports on Developments in Treasury's Foreign Tax Program*, 24 J. TAX'N 54, 56 (1966); the OECD's 1979 report on *Transfer Pricing and Multinational Enterprises* reflected this approach. The United States later joined with the U.K., France, and Germany to "reaffirm[] each country's commitment to the arm's length principle." IRS, *Report on the Application and Administration of Section 482*, 92 Tax Notes Today 77-19, App. E (Apr. 10, 1992).

The IRS then participated in the "common elaboration of the arm's length principle in the 1995 OECD Transfer Pricing Guidelines." IRS, *Report on the Application and Administration of Section 482*, 99 Tax Notes Today 108–10 (Apr. 21, 1999). Those Guidelines identify "the arm's length principle" as "the international transfer pricing standard that OECD Member countries have agreed should be used for tax purposes by MNE [multinational enterprise] groups and tax

administrations." OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*, at I-1 (1995; 2001 rev.).

ARGUMENT

I. Rehearing Is Warranted To Ensure That Section 482 And Associated Regulations Are Construed In Accord With U.S. Tax Treaties Adopting An Arm's Length Standard.

The panel majority construed Section 482 to provide the Commissioner with unconstrained discretion to reallocate income and deductions among related companies, characterizing the arm's length standard as a nonbinding "regulatory gloss." Slip op. 6169 n.9. That conception conflicts with the Commissioner's contentions in this case and with the longstanding view of Section 482 that Treasury repeatedly expressed in the context of tax treaties.

A. Section 482 Should Be Construed To Accord With Treaty Provisions Requiring That Arm's Length Principles Govern Intercompany Adjustments.

1. The U.S.-Ireland Treaties Incorporate The Arm's Length Standard.

In construing the statute, the panel scarcely acknowledged the two international tax treaties bearing on this transfer pricing issue between a U.S. parent and its Irish subsidiary. The earlier two tax years at issue fall within the 1949 U.S.-Ireland Treaty, TIAS 2356. Article IV of that treaty permits an adjustment if a transaction between related companies reflects "conditions different from those which would be made with an independent enterprise." Likewise,

Article 9 of the 1997 U.S.-Ireland Treaty (which covers the third year at issue) permits adjustments for conditions that "differ from those that would be made between independent enterprises." Pet. Addendum C-3–4. These tax treaties are self-executing and therefore have the status of federal statutes. *See* KLAUS VOGEL ON DOUBLE TAXATION CONVENTIONS 24 (3d ed. 1997); *Medellin v. Texas*, 128 S. Ct. 1346, 1356 (2008).

Because treaties are in "full parity" with federal statutes, *Breard v. Greene*, 523 U.S. 371, 376 (1998) (quoting *Reid v. Covert*, 354 U.S. 1, 18 (1957)), Section 482 should be construed to harmonize rather than conflict with the tax treaties. The statute and treaties are fully "capable of co-existence," *Morton v. Mancari,* 417 U.S. 535, 551 (1974); there is no need to construe one to derogate from the other.

Indeed, Treasury itself has confirmed that Section 482 reflects the same arm's length standard expressed in the treaties. As Judge Noonan pointed out, Treasury's Technical Explanation of the 1997 Treaty asserted that Article 9 "incorporates in the Convention *the arm's length principle in the U.S. domestic transfer pricing provision, particularly Code section 482*." Slip op. 6183 (Noonan, J., dissenting) (emphasis added) (quoting 1997 USITE). Moreover, for the 1997 Treaty and the U.S. Model Conventions, Treasury has made clear that "cost sharing arrangements," "as with any other kind of transaction" between related

parties, must be evaluated under the arm's length standard. 1997 USITE (SER236-37); 2006 USMCTE art. 9(1), at CCH 10,641; 1996 USMCTE art. 9(1), at CCH 10,691-26. The technical explanation of a treaty offered by the "Government agencies charged with their negotiation and enforcement is entitled to great weight." *Sumitomo Shoji America, Inc. v. Avagliano*, 457 U.S. 176, 184-185 (1982); *see also United States v. Stuart*, 489 U.S. 353, 368 n.8 (1989) (considering technical explanation to U.S.-Canada tax treaty). That is due, in part, to the Senate's reliance on that explanation in providing its advice and consent. *See* R. ANDERSEN, ANALYSIS OF UNITED STATES INCOME TAX TREATIES ¶ 1.04[1][a][iii] (2009). And private parties also rely on Treasury treaty guidance in ordering their affairs.

2. The Saving Clause Does Not Diminish The Importance Of The Issue Or Render The Treaty Obligations Irrelevant To Interpreting Section 482.

The saving clause in the 1997 U.S.-Ireland treaty (Art. 1(4)) and similar treaties—permitting each nation to tax its residents and citizens under domestic law—does not limit the exceptional importance of the panel decision or make it unnecessary to interpret Section 482 consistently with the treaty provisions based on it. The saving clause was intended to permit Treasury to tax U.S. citizens' income earned in other countries, not to give either party *carte blanche* to disregard the arm's length standard in taxing the local half of a cross-border

transaction. *See*, *e.g.*, Patrick, *A Comparison of the United States and OECD Model Income Tax Conventions*, 10 L. & POL'Y INT'L BUS. 613, 618 (1978).

Yet even if the saving clause were read to preclude a treaty provision from literally *superseding* Section 482 with respect to a U.S. taxpayer, that Section should be construed to accord with rather than nullify the treaties' transfer pricing provisions. Those provisions rest on the premise that each treaty partner will apply the arm's length standard, leaving only disputes over particular applications of that standard to be resolved by the "competent authority" process.[2] That is how Treasury sees the issue: the Technical Explanation for the 1997 Treaty (like those for the U.S. Model Conventions) explains that any adjustments under domestic law are permitted only if they "accord with [the treaty's] general principles" and "reflect[] what would have transpired had the related parties been acting at arm's length." 1997 USITE (SER237); 1996 USMCTE art. 9(1), at CCH 10,691-27; *see also* 2006 USMCTE art. 9(1) at CCH 10,641. And that is what has been communicated to our treaty partners. *See* Pet. Addendum E–2.

The statute and treaty should not be construed to make the IRS's use of the arm's length standard optional for U.S. residents but mandatory for their foreign

[2] When disparities between taxing authorities' adjustments arise, the treaties "call[] for negotiation between the competent tax authorities of the involved countries." Clark, Comment, *Transfer Pricing, Section 482, and International Tax Conflict: Getting Harmonized Income Allocation Measures from Multinational Cacophony*, 42 AM. U. L. REV. 1155, 1199 & nn. 292-93 (1993).

affiliates covered by a tax treaty. The Supreme Court has counseled against interpreting treaties to provide aliens with advantages over U.S. residents. "While treaties, in safeguarding important rights in the interest of reciprocal beneficial relations, may by their express terms afford a measure of protection to aliens which citizens of one or both of the parties may not be able to demand against their own government, the general purpose of treaties of amity and commerce is to avoid injurious discrimination in either country against the citizens of the other." *Todok v. Union State Bank*, 281 U.S. 449, 454-55 (1930). The treaty and statute should not be construed to produce a fun-house maze in which a U.S. company, in order to seek the benefit of the arm's length standard available to its foreign counterpart, might have to "intentionally violate the arm's-length dealing standard" so that the *other* nation made an arm's length adjustment, and then "invoke competent authority relief" to induce the United States to respect the arm's length standard—rather than pursuing the matter directly in the U.S. courts. Tremblay, Xilinx—*Canadian Competent Authority Conundrum*, 55 TAX NOTES INT'L 203, 206 (2009).

More fundamentally, if the saving clause excused each signatory from applying the arm's length standard to its own residents, the treaty would fail at one of its central purposes, consistent taxation of cross-border transactions. The Supreme Court has instructed that "[c]onsiderations which should govern the diplomatic relations between nations, and the good faith of treaties, as well, require

that their obligations should be liberally construed so as to effect the apparent intention of the parties to secure equality and reciprocity between them." *Factor v. Laubenheimer*, 290 U.S. 276, 293 (1933). Construing the treaties' saving clause to permit an interpretation of Section 482 that allows discretionary departures from the arm's length standard for domestic taxpayers in multinational enterprises—but not for their foreign affiliates—would turn "equality and reciprocity" upside down.

B. Construing Section 482 To Be Limited By The Arm's Length Principle Avoids Unnecessary Conflict With Treaty Commitments.

The pertinent question here is whether, in light of the context provided by the treaties, Section 482 authorizes a departure from the arm's length standard. For decades, Treasury regulations have interpreted the statutory authority to adjust transactions among related corporations "clearly to reflect income" as authorizing only arm's length adjustment. Treas. Reg. § 1.482-1(b). As for the statute's second sentence, which permits the use of a "commensurate with income" formula for licenses and transfers of intangibles, the panel recognized that no such license or transfer is at issue here (slip op. 6165 n.5). And in this case the Commissioner has acknowledged (Supp. Br. 9-10) that the commensurate-with-income standard "was designed to operate consistently with the arm's-length standard ... in accordance with the general principles of paragraph 1 of Article 9 of the Convention, as interpreted by the OECD Transfer Pricing Guidelines." In short,

there is no statutory authority for an allocation that contradicts arm's length practice.

II. The Panel's Interpretation Of Section 482 Impairs The International Tax Treaty Network And Injures The Credibility Of The United States As A Treaty Partner.

By authorizing non-arm's length allocations under the statute that provided the model for the international arm's length standard, the panel decision undermines the international tax treaty regime and impairs the reputation of the United States as a trustworthy treaty partner. The panel decision encourages actual and potential treaty partners to pick and choose how and when to apply the arm's length standard. Such flexible unilateral action, if broadly countenanced, would deprive the international norm of any substance, while making it impossible for multinational companies to anticipate their tax obligations. That is why the IRS has long acknowledged that continued domestic adherence to the arm's length standard helps "avoid[] extreme positions by other jurisdictions and minimiz[e] the incidence of disputes over primary taxing jurisdiction in international transactions." White Paper, SER82.

More important, in light of the United States' role in developing and propagating the arm's length standard as an international norm, the holding that Section 482 permits abandonment of the standard "undermine[s] the United States' credibility in the international tax community." Peroni, *Back to the Future: A Path*

to Progressive Reform of the U.S. International Income Tax Rules, 51 U. MIAMI L. REV. 975, 1003 (1997). As a prominent Canadian commentator recently observed, under the panel decision "the United States is not bound to its obligations concerning arm's-length treatment." Tremblay, *supra*, 55 TAX NOTES INT'L at 204. As a consequence, "other countries should carefully consider whether it is at all worthwhile entering into tax treaties with the United States." *Id.* At a minimum, as the former foreign tax officials who appear in Addendum E to the Petition explain, the panel decision "calls into question the ability of the United States to honor its international tax treaty obligations" as those obligations are perceived overseas. Pet. Addendum E–2.

The OECD has pointedly warned that "[a] move away from the arm's length principle would ... threaten the international consensus, thereby substantially increasing the risk of double taxation." *Transfer Pricing Guidelines* § 1.14. Indeed, Lawrence Summers, when Deputy Treasury Secretary, warned that such a departure would "destroy the U.S. network of tax treaties." Fernandez, *Dorgan Blasts Arm's Length Transfer Pricing Method*, 96 Tax Notes Today 249-4 (Dec. 24, 1996). And representatives of six large European nations cautioned that a unilateral departure from a treaty standard "undermines the basis of trust existing between the two countries involved, erodes the certainty and security intended by international agreements and ultimately poses the question as to whether an

international convention for the avoidance of double taxation serves any purpose at all if it can be altered at will by one of the contracting parties." Letter from European Econ. Cmty. Group of Six to James Baker, U.S. Sec'y of the Treasury (1986) (quoted in Vagts, *The United States and its Treaties: Observance and Breach*, 95 AM. J. INT'L L. 313, 319-20 (2001)).

By calling into question a fundamental principle of the international transfer pricing regime, the panel decision impedes its future expansion—notably through the OECD—to include China, India, Brazil, Russia, and Indonesia, among other quickly growing economies. If U.S. domestic law undercuts the arm's length standard at the core of the tax treaties, there are few reasons for other major economies either to agree to that standard, or to apply it even-handedly if they do. *See* Tremblay, 55 TAX NOTES INT'L at 207. Rehearing is warranted to foreclose these ill effects.

III. The Uncertainty Created By The Panel Decision May Have Broad And Harmful Effects On Global Trade.

A departure from the arm's length standard, like that effected by the panel decision, could "severely affect world trade," as Secretary Summers warned. *See* Fernandez, *supra*, 96 TAX NOTES TODAY 249-4. The OECD *Transfer Pricing Guidelines* explain (at ¶ 1.7), "the arm's length principle promotes the growth of international trade and investment" by "removing … tax considerations from economic decisions" that are based on "the relative competitive positions" of

related and unrelated enterprises. The IRS has told Congress the same thing: "One primary purpose of tax treaties is to encourage international trade by mitigating the impact of inconsistent international taxation … through consistent treatment of transactions globally … , in accordance with the internationally accepted arm's length standard." *IRS Report*, *supra*, 92 Tax Notes Today 77-19 ch. 5, ¶ I.B. By contrast, the panel decision discourages trade by creating uncertainty about the formerly unquestioned international norm. According to the IRS, the volume of cross-border transactions between related parties exceeds $4 trillion. IRS, *Current Trends in the Administration of International Transfer Pricing by the Internal Revenue Service*, IRS Ref. No. 2003-30-174, at 37 (September 2003), available at http://treas.gov/tigta/auditreports/2003reports/200330174fr.pdf. Yet the absence of a consistent global arm's length standard risks creating de facto trade barriers that will disrupt global commerce and the efficient allocation of resources.

Finally, the panel's sudden, unilateral departure from a norm created and sponsored by the United States may impair the Nation's ability to conclude and maintain a broader range of trade-related treaties. The Transportation Department recently criticized a Justice Department approach seeking similarly fundamental changes in U.S. law with respect to airline regulation: "Were we to suddenly change our antitrust immunity and public interest approach, as DOJ suggests, the credibility of the U.S. Government with its international aviation partners would be

significantly compromised and our ability not only to reach new Open-Skies agreements but also to maintain those agreements that we have already achieved would be undermined." U.S. Dep't of Transp., *Joint Application of Air Canada et al.*, Dkt. OST-2008-0234, at 11 (July 10, 2009). The departure from the arm's length standard here could cause similar harms, and should not be lightly taken.

CONCLUSION

The panel decision should be reheard and the decision of the United States Tax Court affirmed.

Respectfully submitted,

Dated: August 24, 2009 /s/ Donald M. Falk

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CERTIFICATE OF COMPLIANCE

1. Pursuant to Fed. R. App. P. 29(d) and 9th Cir. R. 32-1, the undersigned hereby certifies that the attached brief is proportionally spaced, has a typeface of 14 points or more, and contains 4,103 words, exclusive of the exempted portions of the brief, as provided in Fed. R. App. P. 32(a)(7)(B).

2. The brief has been prepared in proportionally-spaced typeface using Microsoft Word 2007 in 14-point Times New Roman font. As permitted by Fed. R. App. P. 32(a)(7)(C), the undersigned has relied upon the word-count feature of this word-processing system in preparing this certificate.

August 24, 2009

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STATEMENT OF RELATED CASES

Counsel for the *amici curiae* are not aware of any related cases pending in this Court.