

Federal Tax Cases To Watch In 2016

By **Eric Kroh**

Law360, New York (December 24, 2015, 8:38 PM ET) -- As 2016 gets underway, tax practitioners will be watching to see if the U.S. Supreme Court will review the economic substance doctrine, if the Internal Revenue Service will use outside litigators at the U.S. Tax Court, and if the government will prevail in a transfer pricing case against Amazon.com Inc., among other cases.

Here is the federal tax litigation to watch in 2016:

STARS Cases

The Second Circuit and the Federal Circuit both held in 2015 that transactions known as structured trust advantaged repackaged securities, or STARS, engaged in by Bank of New York Mellon Corp., American International Group Inc. and BB&T Corp. subsidiary Salem Financial Inc. were shams and that the companies could not claim the foreign tax credits associated with them.

The disputes could end up before the U.S. Supreme Court, as BB&T, AIG and BNY have urged the high court to take up their cases to resolve what they say is a conflict among the Second and Federal circuits on one hand and the Fifth and Eighth circuits on the other over the treatment of foreign taxes for purposes of the economic substance doctrine, which requires transactions to have a purpose other than tax avoidance.

In *Compaq Computer Corp. & Subsidiaries v. Commissioner*, the Fifth Circuit in 2001 held that foreign taxes and tax credits should not be considered in an analysis of the profitability of a transaction for purposes of the economic substance doctrine. The Eighth Circuit came to the same conclusion the same year in *IES Industries Inc. v. U.S.*

Some tax practitioners, however, question whether the cases are ripe for Supreme Court review. There is no true circuit split on the issue, as the cases in the Fifth and Eighth circuits involved transactions that were entirely different from the STARS transactions considered by the Second and Federal circuits, they say.

The issue may also be dated, as Congress has enacted a statute to codify the economic substance doctrine since the time of the STARS transactions, Julie Bradlow of Moore & Van Allen PLLC said.

"I wonder if perhaps the Supreme Court thinks they've already sufficiently spoken" on the economic substance doctrine, Bradlow said. "It'll be interesting to see if the Supreme Court grants review of any of

these cases.”

The cases are Salem Financial Inc. v. U.S., case number 15-380, Bank of New York Mellon Corp v. Commissioner of Internal Revenue, case number 15-572, and American International Group Inc. v. United States, case number 15-478, in the U.S. Supreme Court.

United States v. Clarke

While U.S. v. Clarke is known for the Supreme Court’s 2014 ruling in the case that set a new standard for obtaining evidentiary hearings in summons enforcement cases against the Internal Revenue Service, experts said the case could still yield important legal precedent in the summons enforcement area.

The controversy stemmed from an IRS audit of Dynamo Holdings LLP’s 2005 through 2007 tax years. After Dynamo agreed to two extensions of the statute of limitations, it refused to grant a third, and the IRS issued summonses to four individuals associated with the company in 2010.

When the respondents didn’t comply, the IRS instituted enforcement proceedings in the district court. Dynamo questioned the agency’s motives in issuing the summonses and sought to question the responsible agents in a summons enforcement hearing. After the district court denied the request, the Eleventh Circuit reversed and the Supreme Court agreed, saying a taxpayer has the right to question IRS officials about a summons “when he points to specific facts or circumstances plausibly raising an inference of bad faith.”

Miller & Chevalier Chtd.’s Alan Horowitz said the case raises important questions about the IRS’ ability to use its summons power to aid in Tax Court litigation that were not addressed by the Supreme Court and will now be considered by the Eleventh Circuit on remand.

“If the summoned parties are able to successfully challenge the summonses on these grounds, that’s going to be a concern to the IRS going forward,” Horowitz said.

Oral arguments in the case will likely be scheduled for the last week of February, Horowitz said.

The case is U.S. v. Clarke, case number 12-13190, in the U.S. Court of Appeals for the Eleventh Circuit.

Amazon.com Inc. v. Commissioner

Tax attorneys are still waiting for a ruling from the Tax Court in a transfer pricing case involving Amazon.com Inc.

Amazon’s suit against the IRS seeks to resolve notices of proposed adjustments the agency issued for a seven-year period, starting in 2005, relating to the company’s transfer pricing with foreign subsidiaries, which the retailer estimates could result in a tax liability of \$1.5 billion plus interest.

The case centers on a cost-sharing agreement that Amazon made with Luxembourg affiliate Amazon Europe Holdings Technologies SCS. The IRS disputes the value of so-called buy-in payments that the subsidiary made to Amazon in exchange for intangibles. The case is particularly important for the IRS after it lost a similar transfer pricing dispute with Veritas U.S. in 2009.

The Amazon suit is likely to provide a benchmark for how the government is going to proceed with

transfer pricing cases, which many predict will constitute the next major wave of IRS litigation in the years to come as the agency looks for targets for additional revenue.

The trial in the Amazon case wrapped up in late 2014, and tax practitioners are expecting a decision soon.

The case is Amazon.com Inc. and Subsidiaries v. Commissioner of Internal Revenue, case number 31197-12, in the U.S. Tax Court.

Eaton Corp. v. Commissioner

Another case with transfer pricing implications is a challenge in the Tax Court by global energy parts supplier Eaton Corp. to the IRS' assessment of more than \$400 million in tax deficiencies relating to transactions with its Caribbean subsidiaries.

Eaton alleged in its 2012 petition that the IRS was wrong to cancel an advanced pricing agreement it made regarding manufacturing plants in Puerto Rico and the Dominican Republic owned by Eaton subsidiaries.

The IRS claims Eaton withheld information that, if revealed, would have caused the agency to opt out of the deal. The APA was formally canceled in December 2011.

Peter J. Connors of Orrick Herrington & Sutcliffe LLP said the IRS' unilateral revocation of the APA was a "pretty extreme measure."

Tax practitioners will be watching to see to what extent the APAs are binding agreements and if the Tax Court grants the IRS the broad authority to revoke them.

The case is Eaton Corp. v. Commissioner, case number 5576-12, in the U.S. Tax Court.

EU State Aid Cases

The European Commission is investigating tax deals made by American multinationals with European countries, and the cases could have implications for the companies' U.S. tax obligations. The EC has already determined that Starbucks Corp. owes up to €30 million (\$33 million) in back taxes because of a deal it made with the Netherlands.

Under the European Union's unique state aid system, national governments are not allowed to grant companies selective benefits that put them in a better competitive position compared with other players in the European market.

The commission has been investigating EU members' tax ruling practices since 2013 and disclosed investigations into the arrangement between Starbucks and the Netherlands in July 2014. An investigation into a deal between Apple and Ireland is also pending, and in December the commission said it was probing whether McDonald's Corp. was the recipient of an unfair tax deal with Luxembourg.

At a congressional hearing in December, Robert B. Stack, Treasury deputy assistant secretary for international tax affairs, said there is a question about whether the retroactive taxes would result in the companies being able to claim U.S. foreign tax credits, and the Treasury has not yet analyzed whether

that would, in fact, be the case.

“In the event that the state aid investigations succeed in clawing back taxes from those companies, there is a question as to what the tax impact will be in the U.S.,” David J. Fischer of Crowell & Moring LLP said.

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