



January 2010

Tax Law

Alert

Xilinx, Inc. v. Commissioner — Ninth Circuit to Revisit its Controversial Ruling on Cost Sharing Agreements

BY SEAN M. KING AND
MATTHEW C. MARSHALL

In a one sentence order dated Jan. 13, 2010, the U.S. Court of Appeals for the Ninth Circuit withdrew its much criticized 2009 opinion and dissent in *Xilinx, Inc. v. Commissioner*. Brief as it is, the January order does not provide a hint of what the Ninth Circuit plans to do next.

Tax practitioners roundly criticized the *Xilinx* opinion due to its implications for cost-sharing agreements and transfer pricing under Code § 482. Specifically, tax practitioners criticized the Ninth Circuit for deviating from the universally accepted “arm’s-length principle.” The Ninth Circuit ruled that parties must share employees’ stock-based compensation under cost-sharing agreements. The Ninth Circuit ruled that parties must share stock-based compensation even where taxpayers could show that parties dealing at arm’s length would not share stock-based compensation. It is likely that the Ninth Circuit will attempt to address this criticism.

To recap, multinational enterprises often use cost-sharing agreements in lieu of licensing intangible property between related companies or branches. The related parties that enter into a cost-sharing agreement each contribute to the costs of developing the intangible property and obtain the right to use it. In early 2009, the Treasury and IRS released temporary regulations in Treasury Decision 9441 (01/06/09). The temporary regulations note that intangible development costs the

parties are to share include stock-based compensation paid to employees participating in the intangible development activity.

Prior to *Xilinx*, taxpayers had debated whether they had to share stock-based compensation as an intangible development cost. In *Xilinx*, the Ninth Circuit addressed this issue. *Xilinx*, a California headquartered multinational, had allocated to its Irish subsidiary some of its research and development costs, but not stock-based compensation of employees participating in the intangible development activity. *Xilinx* argued that including stock-based compensation as an intangible development cost violated the arm’s-length principle because unrelated enterprises negotiating at arm’s length would not agree to share stock-based compensation costs. *Xilinx* obtained a favorable ruling in the Tax Court. The Ninth Circuit reversed the Tax Court and ruled for the IRS. The Ninth Circuit ruled that the relevant Treasury Regulations required the parties to share “all costs,” a different standard than the arm’s-length principle.

The Ninth Circuit’s ruling focuses only on the Treasury Regulations. It does not focus on the long history of the arm’s-length principle in preventing multinationals from shifting profits to tax-favorable jurisdiction. The Ninth Circuit’s ruling is significant because the arm’s-length principle has always been the norm for multinational



Williams Mullen Tax Law Alert. Copyright 2010. Editorial inquiries should be directed to Craig L. Rascoe at 804.783.6472 or crascoe@williamsmullen.com

The Tax Law Alert is provided as an educational service and is not meant to be and should not be construed as legal advice. Readers with particular needs on specific issues should retain the services of competent counsel.

Please visit www.williamsmullen.com for more information about the Williams Mullen Tax Law Team.

enterprises. Deviating from the arm's-length principle would set the U.S. apart from its major trading partners.

If the Ninth Circuit upholds its *Xilinx* opinion, it is not certain whether other U.S. appellate courts and the Tax Court would apply the all-costs standard to cost-sharing agreements. However, it is certain that "all costs" and "arm's length" are irreconcilable. Assuming the worst-case scenario, for U.S. tax purposes, a multinational enterprise would allocate stock-based compensation costs globally to satisfy the all-costs standard, but other jurisdictions would apply the arm's-length principle to reject the allocation of stock-based compensation costs because independent enterprises would not share those costs.

The IRS has not tried to deviate from the arm's-length principle for intra-group transactions performed outside of cost-sharing agreements. Even the newest Treasury Regulations on transfer pricing still hold intra-group transactions to the arm's-length principle. The U.S. cannot deviate far from the arm's-length principle if it wants to remain an attractive country for multinational enterprises to operate. The Ninth Circuit may have had this in mind when it decided to withdraw its criticized *Xilinx* opinion and reconsider the matter.

For more information about this topic and Williams Mullen's International Tax practice, please contact Sean M. King at sking@williamsmullen.com or 804.644.9812.

Tax Law Team

Craig L. Rascoe

Chair, Tax Law Team
804.783.6472
crascoe@williamsmullen.com

Farhad Aghdami

Vice-Chair, Tax Law Team
804.783.6440
aghdami@williamsmullen.com

Jenny L. Connors

jconnors@williamsmullen.com

Thomas R. Frantz

tfrantz@williamsmullen.com

J. Conrad Garcia

cgarcia@williamsmullen.com

James Philip Head

jhead@williamsmullen.com

Sean M. King

sking@williamsmullen.com

Montgomery Knight, Jr.

mknight@williamsmullen.com

Steven B. Long

slong@williamsmullen.com

Matthew C. Marshall

mmarshall@williamsmullen.com

Charles B. Neely, Jr.

cneely@williamsmullen.com

Nancy S. Rendleman

nrendleman@williamsmullen.com

Robert W. Shaw

rshaw@williamsmullen.com

Charles L. Steel, IV

csteel@williamsmullen.com

Maria S. Stefanis

mstefanis@williamsmullen.com

Heather Hoch Szajda

hszajda@williamsmullen.com

John H. Turner

jturner@williamsmullen.com

Please visit

www.williamsmullen.com
for more information about
the Williams Mullen Tax Law
Team.



WILLIAMS MULLEN
Where Every Client is a Partner®