

United States

Amazon beats the IRS in US intangibles case

Amazon defeated the US Internal Revenue Service (IRS) in an appeal case over assets moved to Luxembourg more than a decade ago. However, other companies may not be so fortunate to win.



By Josh White

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The US Ninth Circuit Court of Appeals [upheld](#) the Tax Court's 2017 ruling in Amazon's favour and rejected the revenue service's claim to charge the platform for its transfer of an estimated \$2.2 billion worth of intangible assets to Luxembourg in 2005 and 2006.

Amazon moved assets like lists of customers, intellectual property (IP) rights and software to Luxembourg. The US company reportedly chose Luxembourg as its European headquarters because of its central location and corporate tax advantages.

The IRS tried to make the case that the US definition of intangible assets extended to the company's "more nebulous" assets. This would have covered residual-business assets, including Amazon's goodwill, the workforce in place and its "culture of innovation". However, this argument was rejected.

"Although the language of the definition is ambiguous, the drafting history of the regulations shows that 'intangible' was understood to be limited to independently transferable assets," Judge Consuelo Callahan said. "We thus affirm."

At the same time, Judge Callahan acknowledged that the implications of the Amazon case are only relevant for longstanding arrangements. As such, the IRS has a much stronger position since the US tax reform was enacted and future cases may not favour the taxpayer.

"This case is governed by regulations promulgated in 1994 and 1995," Judge Callahan explained. "If this case were governed by the 2009 regulations or by the 2017 statutory amendment, there is no doubt the commissioner's position would be correct."

The post-1994 transfer pricing regime allowed companies to shift intangibles to foreign affiliates and make tax savings. These transactions were non-taxable under US law so long as the transfers were at arm's-length and the units paid their share of research and development (R&D) costs.

The US Treasury Department expanded the definition of intangibles in the US Tax Cuts and Jobs Act (TCJA) to cover contributions for which compensation must be made as part of the buy-in payment. So, US companies seeking a similar Luxembourg structure today should think again.

Conflicting TP methodologies

The Seattle-based tech company restructured its European operations in 2005 and 2006 to shift income from US-based entities to a string of subsidiaries.

However, US law required the European subsidiaries to compensate Amazon for the use of intangible assets developed in the US.

Compensation was provided through a qualified cost-sharing arrangement between the parent company and the holding company for its European subsidiaries. The holding company made the buy-in payment for the pre-existing intangibles and cost-sharing payments for its share of future R&D.

As a result, Amazon had to pay taxes on the buy-in payment and take a smaller tax deduction for R&D costs. The platform reported a buy-in payment of around \$255 million, but the IRS argued this was not the arm's-length price and recalculated the payment.

The IRS reached a figure of \$3.6 billion through its methodology. The company had used the comparable uncontrolled transaction (CUT) method to calculate its rate, whereas the revenue service used a discounted cash flow (DCF) method.

One in-house tax consultant at a biotech company expects the US to see more disputes over methodology when it comes to intangible assets.

"Normally the CUT would be the best TP method you could have in most situations," the consultant said. "However, it gets harder when you're comparing arrangements in real-time and, after many years, the fact pattern changes."

"This is why the IRS is taking a harder look at taxpayer arrangements going back 15 or even 20 years in some cases," he told *TP Week*.

Soon after the reassessment, Amazon filed a petition with the US Tax Court disputing the valuation. The company argued the TP regulations allowed for a much narrower definition of intangible assets than the IRS was applying.

Intangible implications

The Amazon case is just the latest in a slew of high-stakes battles the IRS has waged to fight taxpayers on historic agreements. It will rank alongside the recent court decisions in [Altera](#) and [Medtronic](#).

The case has widespread implications for IP-rich industries and many platforms with arrangements going back more than a decade. Many US companies with similar TP structures set up between 1994 and 2009 will be relieved after the court's decision. However, the risks larger than just legal.

"Reputational risk is huge in the US," said one tax director at a chemical company. "You can't just brush it off and you have to provide for the worst-case scenario."

The court has drawn a thick border between the regulatory landscape of the past and the existing framework. There may be more certainty about past arrangements, but US companies looking to make in-roads into Europe might have to rethink their strategy.

"A lot of companies see the need to align tax and commercial strategy," said one head of tax at a pharmaceutical company. "In the past, you could have both strategies going in different directions and you would be fine."

"Now companies are realising it's important to not let the tax guys drive the bus," the head of tax continued. "The tax guys have to be upfront with commercial to see where they're going, but the commercial strategy has to come first."

The definition of intangible property has changed and this means certain IP structures face greater scrutiny than in the past. Not only will the IRS be emboldened, but the US courts will likely be less forgiving for post-2017 structures.

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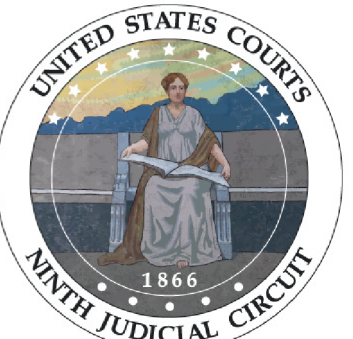


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