

IRS Disagrees with *Veritas* But Won't Appeal**November 19, 2010**

On November 12, the Internal Revenue Service (IRS or Service) released an Action on Decision (AOD), AOD 2010-05, stating that it disagrees with the U.S. Tax Court's reasoning and decision in *Veritas Software Corp. v. Commissioner*, 113 T.C. No. 14 (2009).¹ However, the time period for filing an appeal of the *Veritas* decision expired on November 8, 2010. Indeed, the AOD confirms that the IRS will not appeal the Tax Court decision. An AOD such as this—in which the Service does not acquiesce in the decision or reasoning of a case—indicates that the Service disagrees with the court despite having tried the case and will continue to litigate with other taxpayers on the issue on similar facts. As we discuss below, the IRS's reasoning in the AOD rings hollow, given that the IRS chose not to test its position in the Ninth Circuit Court of Appeals. Regardless of the IRS's issuance of the AOD, *Veritas* remains the controlling authority in the Ninth Circuit and in Tax Court cases appealable to that circuit.

In the AOD, the IRS disagrees with important points decided by the Tax Court. Primarily, the Service disagrees with the Tax Court's rejection of its "platform rights" theory. The "platform rights" theory was at the core of the IRS's position in *Veritas* and is a foundation of the new regulations at Treasury Regulations Section 1.482-7T. The AOD reiterates the Service's position that platform rights are valuable and must be included in the buy-in: the value attributable to intangibles developed in a cost-sharing arrangement is due in large part to the "head start" provided by the existing intangibles. The Tax Court held that it was inappropriate to include any value attributable to developed intangibles in the buy-in, as these are a product of the cost-sharing arrangement and are paid for through the sharing of research and development costs.

The AOD indicates that the IRS also disagrees with the Tax Court's holding that "access to research and development team" and "access to marketing team" are not intangibles under Internal Revenue Code (IRC) Section 936(h)(3)(B) or Treasury Regulations Section 1.482-4(b). The IRS has a well-documented position² that workforce in place is an intangible for purposes of Sections 367(d) and 482. That position is without support in the current law. The controlling statutory and regulatory guidance addressing the definition of "intangible" clearly requires an item to "have substantial value independent of the services of any individual," thus excluding workforce in place from being treated as an intangible for purposes of Sections 367(d) and 482. The Tax Court in *Veritas* agreed with taxpayers on precisely this reasoning. The AOD's position—that the value of a workforce or team may be independent of the services of any *single*

¹ We discussed the decision in our December 16, 2009 LawFlash, "*Veritas v. Commissioner*: Tax Court Decision Exposes Flaws in Common IRS Cost-Sharing Buy-In Theories," at http://www.morganlewis.com/pubs/Tax_CostSharingBuyInTheories_LF_16dec09.pdf.

² Read more about the IRS's position in our October 9, 2009 LawFlash, "The IRS Continues to Assert Workforce in Place Constitutes an 'Intangible' for Purposes of Code Sections 367 and 482," at http://www.morganlewis.com/pubs/Tax_Sections367and482_LF_09oct09.pdf.

individual—represents, we believe, a misreading of statute and was correctly dismissed by the court. Should the IRS and Treasury wish to reverse this conclusion they should pursue such change via the legislative process, an avenue that they are currently pursuing.³

The vehemence with which the IRS disagreed in the AOD with the *Veritas* opinion is contradicted by the agency's decision not to appeal the case. Normally, parties to a losing case that believe the Tax Court was incorrect on both factual and legal issues (as indicated in the AOD) will seek redress in the Federal Court of Appeals. The fact that the IRS did not do so here is a strong indicator that it has serious concerns about whether its arguments would be accepted by the Ninth Circuit Court of Appeals or, further, by the U.S. Supreme Court.

The full AOD 2010-05 can be viewed at <http://www.irs.gov/pub/irs-aod/aod201005.pdf>.

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³ See, e.g., Obama Administration's Budget Proposals for fiscal years 2010 and 2011.