

Ninth Circuit denies petition for rehearing en banc in ‘Altera’

November 21, 2019

In brief

The US Court of Appeals for the Ninth Circuit on November 12 issued an order denying Altera’s petition for rehearing en banc in the case of *Altera Corp. v. Commissioner*. The order means that the Ninth Circuit will not reconsider its June 7, 2019 decision upholding the validity of Treas. Reg. sec. 1.482-7A(d)(2), requiring stock-based compensation costs to be included in the costs shared in a cost-sharing agreement. The June 7 decision is not yet final, however, because Altera may file a petition requesting the US Supreme Court to review the decision.

In detail

Background

Factual Background

Altera Corporation (Altera) is a US company that had entered into a research and development cost sharing agreement (R&D CSA) with a foreign subsidiary. For tax years 2004 through 2007, Altera granted stock options and other stock-based compensation (SBC) to certain employees, but did not include any SBC expenses in the pool of costs shared under the R&D CSA. The IRS asserted that Altera’s failure to share SBC costs violated a regulatory provision, issued in 2003, requiring that SBC costs be included in the costs shared under a CSA (the SBC rule).

Procedural Background

On July 27, 2015, the US Tax Court in *Altera Corp. v. Commissioner*, 145 T.C. 91 (2015), held that the regulatory SBC rule was invalid. In a unanimous en banc opinion, the court held that Treasury and the IRS had failed to provide a reasoned basis for the SBC rule that was consistent with the arm’s-length standard. For a summary of the Tax Court’s decision, see the previous [PwC Tax Insight issued August 6, 2015](#).

The Ninth Circuit on July 24, 2018, issued an opinion overturning the 2015 Tax Court decision, but then withdrew the opinion on its own motion on August 7, 2018. One of the judges on the three-judge panel who had heard the appeal died before the July 24 opinion was issued, and thus a reconstituted panel of judges was assigned to hear the case. On June 7, 2019, the reconstituted Ninth Circuit panel issued a majority opinion that once again determined that the disputed SBC rule was valid both procedurally and substantively. For details regarding the Ninth Circuit opinion, please see our [Tax Insight dated June 17, 2019](#).

On July 22, 2019, Altera filed a petition for a rehearing en banc in the Ninth Circuit.

The November 2019 Order and Dissenting Opinion

On November 12, the Ninth Circuit issued an order denying Altera's petition for rehearing en banc. The order means that the Ninth Circuit will not reconsider its June 7, 2019 decision upholding the validity of the SBC rule in Reg. sec. 1.482-7A(d)(2).

The order was not accompanied by a majority opinion. Three Ninth Circuit judges dissented from the order and joined in a dissenting opinion authored by Judge Milan D. Smith. The dissenting opinion provided several reasons why the SBC rule should be held invalid.

First, Judge Smith pointed out that Treasury's original justification for issuing the SBC rule—that it was consistent with the arm's-length standard—ran counter to the evidence in the administrative record, and the justification offered on appeal—that the commensurate-with-income standard permits Treasury to disregard arm's-length evidence—was merely a post-hoc rationalization. Second, Judge Smith reasoned that Treasury's suggested interpretation on appeal was contrary to its long-standing public position that the commensurate-with-income standard was intended to operate consistently with the arm's-length standard and failed to recognize that CSAs do not constitute "transfers of intangible property" within the meaning of the commensurate-with-income statute in any event.

Finally, Judge Smith noted a number of deleterious practical consequences of the majority decision. The dissenting opinion pointed out that, given the unanimous opinion by the US Tax Court in *Altera* holding the regulation invalid (which remains US Tax Court precedent outside of cases appealable to the Ninth Circuit), the Ninth Circuit decision creates disuniformity in the national application of the tax laws, akin to a circuit split. The opinion also noted that the majority decision would trample the long-standing reliance interests of American businesses and upset the international application of the arm's-length standard, which is relied upon to avoid double taxation between countries.

The June 7 decision is not yet final because Altera may file a petition requesting the US Supreme Court to review the decision. Under US Supreme Court rules, Altera has 90 days to petition the Court for review of the decision (and may apply for a 60-day extension of that deadline for good cause).

Observation: The dissenting opinion offered several interesting reasons why the majority decision could be questioned: "It invites an effective circuit split, ignores the reasonable reliance of businesses on the well-settled arm's length standard, subjects those businesses to double taxation, and sows uncertainty over the fate of billions of dollars...[and] sends a signal that executive agencies can bypass proper notice-and-comment procedures." The US Supreme Court rules cite, as an example of a case that may merit Supreme Court review, a circuit court decision that creates a circuit conflict and involves an important federal question.

The takeaway

The Ninth Circuit will not reconsider its June 7, 2019 decision upholding the validity of Reg. sec. 1.482-7A(d)(2), requiring stock-based compensation costs to be included in the costs shared in a cost-sharing arrangement. The November 12 order thus ends the Ninth Circuit's consideration of this issue. However, Altera may file a petition requesting the US Supreme Court to review the decision.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

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