



IPB Attorney Pat Smith Quoted in Tax Notes re: Altera Makes Its Mark

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Ivins attorney Pat Smith was quoted in *Tax Notes* about the Ninth Circuit oral argument in the *Altera* case. *Altera Makes Its Mark*.

The panel didn't suggest the outcome it was considering for *Altera*, but the questions about the arbitrary and capricious standard and *Chevron* raise the potential for mischief. The questions focused on the breadth of authority that the IRS and Treasury have to issue regulations under section 482, and one implied that because the Tax Court has no authority to issue a nationwide injunction like a district court does, the arbitrary and capricious standard shouldn't necessarily apply in a Tax Court case, said Patrick J. Smith of Ivins, Phillips & Barker Chtd. "That would be a surprising outcome," he said, adding that the government did not contend that the Tax Court shouldn't apply the arbitrary and capricious standard in its brief. However, O'Malley asked the IRS why the regulations requiring the cost sharing didn't represent a change under *FCC v. Fox Television Stations Inc.*, 556 U.S. 502 (2009). "The premise for that question is that an arbitrary and capricious challenge can work in the Tax Court," Smith said.

Still, the focus on *Chevron* is surprising because the only question the Tax Court decided was whether the regulation was invalid under the arbitrary and capricious standard, Smith said. "The Tax Court didn't reach the *Chevron* argument," he noted. "It seems to me that the taxpayer has a good position that the argument that the Justice Department is making on appeal is different than the one in the regulations."



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Even if the taxpayer loses on appeal because the court finds that the regulation was not arbitrary and capricious, it seems unlikely that there will be much of an alteration in practice either at Treasury or in the Tax Court. "I think if the Tax Court [decision] is reversed, it would say This is one decision by a circuit that is frequently reversed by the Supreme Court," Smith said. Given that the Tax Court's decision was 15 to 0, the effect of a Ninth Circuit reversal may have little impact on how the court proceeds in other cases. And the IRS and Treasury have already demonstrated in response to comments on the final regulations under section 385 that they adopted the practices outlined by the Tax Court in *Altera*, Smith noted. "When you have 15 judges in the Tax Court without any concurrences or dissents basically sending a message to the IRS and Treasury that things have to change, the fact that a particular case might be reversed isn't going to be viewed as encouragement for less careful procedures for issuing regulations," he said.

The substantive issue is also susceptible to a problematic outcome if it significantly alters the commensurate with income concept, but the government's insistence that the IRS and Treasury didn't have the authority to eliminate consideration of the arm's-length standard in applying section 482 is encouraging. However, the IRS relied heavily in its briefing and arguments on the 1986 amendments to section 482 that added the commensurate with income rule and argued that the change authorizes it and Treasury to sometimes look beyond the narrow inquiry of what happens in uncontrolled transactions. "There are a lot of questions about whether that is correct," Smith said. The taxpayer noted that the IRS and Treasury maintained that the commensurate with income rule is a way of applying the arm's-length standard, and not inconsistent with it.

If the IRS manages to eke out a win on the procedural question, the likelihood of significant changes to the regulatory process seems remote. "Obviously, it depends on what the opinion says, but the Tax Court opinion was so extremely strong and totally unanimous that I wouldn't expect this to have a big effect," Smith said. "*Altera* has already made its mark procedurally."