

# Cooley

November 22, 2010

In December 2009, the United States Tax Court soundly rejected the current IRS theories for valuating the "buy in" payment required for intangible property transferred to a foreign related corporation upon entering into a cost sharing arrangement (CSA) in its decision in *Veritas Software Corp.* (see [Cooley Alert December 15, 2009](#)). On November 10, 2010, after electing not to appeal the adverse decision in *Veritas*, the IRS announced that it believes both the factual findings and the legal assertions by the Tax Court were erroneous. The IRS announcement, in the form of an Action on Decision (AOD), means that the IRS will continue to assert its position in *Veritas*, rejected by the Tax Court, in other CSA buy-in cases.

*Veritas* involved a common pattern for technology companies. Veritas Software Corp. (Veritas US) and its wholly-owned Irish subsidiary (Veritas Ireland) entered into a CSA to develop software. Veritas US transferred certain existing intangible property rights to Veritas Ireland as part of the arrangement. In such circumstances, the tax rules require a "buy-in" payment from Veritas Ireland to Veritas US. The amount of that payment is a highly disputed issue, currently on the IRS Tier I list of issues that warrant close examination.

In *Veritas*, the IRS determined the buy-in payment under the uniform audit and litigation position set forth in an IRS Coordinated Issue Paper: "Section 482 CSA Buy-In Adjustments" issued September 27, 2007 (the "CIP") and Temporary Regulations § 1.482-7T (modified by new Temporary and Proposed Regulations in 2009, which apply a consistent theory). In general, the IRS valuation of the buy-in payment is based on an income method that assumes (i) that all intangible property owned by the US taxpayer at the time of entering into the CSA is subject to the buy-in payment, (ii) that future intangible property developed under the CSA evolves from and adds to the value of the existing intangible property, and (iii) that the existing intangible property has a perpetual (or extremely long) useful life. As a result, the IRS method commonly results in the buy-in payment being substantially all of the value of the entire business line that is the subject of the CSA.

The Tax Court rejected the IRS valuation in *Veritas*, holding that a proper income method would (i) not necessarily take into account all intangible property owned by the US taxpayer, (ii) not include significant value properly attributable to intangible property developed under the CSA, and (iii) reflect the reality that intangible property in the software business has a short (in this case 4-year) useful life.

In the AOD, the IRS has indicated that it intends to continue to assert that its income method is the proper method to value CSA buy-in payments in other cases, even before the new 2009 Temporary and Proposed Regulations. By not appealing the *Veritas* decision, the IRS legally is permitted to continue to assert that position, even in cases in the Ninth Circuit (which includes California), where *Veritas* would have been appealed. The AOD sets forth the IRS argument, to be followed on audit, that the legal issues decided in *Veritas* were mere *dicta*, not necessary to the decision under the Tax Court's factual findings (erroneous in the eyes of the IRS), and therefore the IRS need not follow the *Veritas* decision in any future case.

The AOD implies that the IRS may adopt a slightly more moderate position concerning its income method. The AOD seems to concede that intangible property transferred at the time of entering into a CSA has a limited useful life, although that life may still be long, and perhaps that some of the future income from the business line is attributable to intangible property developed under the CSA. Whether this will result in any change in IRS buy-in valuations on audit or in litigation remains to be seen.

The IRS processing of cost sharing buy-in cases slowed to a crawl while the IRS was considering how to react to *Veritas*. Now that the IRS has decided to continue the fight, taxpayers with CSAs under audit should expect those cases to proceed once again.

This content is provided for general informational purposes only, and your access or use of the content does not create an attorney-client relationship between you or your organization and Cooley LLP, Cooley (UK) LLP, or any other affiliated practice or entity (collectively referred to as “Cooley”). By accessing this content, you agree that the information provided does not constitute legal or other professional advice. This content is not a substitute for obtaining legal advice from a qualified attorney licensed in your jurisdiction and you should not act or refrain from acting based on this content. This content may be changed without notice. It is not guaranteed to be complete, correct or up to date, and it may not reflect the most current legal developments. Prior results do not guarantee a similar outcome. Do not send any confidential information to Cooley, as we do not have any duty to keep any information you provide to us confidential. This content may be considered **Attorney Advertising** and is subject to our [legal notices](#).

---

This information is a general description of the law; it is not intended to provide specific legal advice nor is it intended to create an attorney-client relationship with Cooley LLP. Before taking any action on this information you should seek professional counsel.

Copyright © 2023 Cooley LLP, 3175 Hanover Street, Palo Alto, CA 94304; Cooley (UK) LLP, 22 Bishopsgate, London, UK EC2N 4BQ. Permission is granted to make and redistribute, without charge, copies of this entire document provided that such copies are complete and unaltered and identify Cooley LLP as the author. All other rights reserved.