FENWICK

International High Technology U.S. Tax Current Developments

Will Skinner, Kris Hatch



Agenda

1. Regulation packages
   - Section 987, FTCs, Pro Rata Share, FDII, GILTI/DEI Allocations, Section 4501, CAMT
2. Caselaw
   - *Varian*, *Siemens*, *Keysight*, *Liberty Global*, *Bruyea* and *Christensen*, *Continental Grand*, and others
3. Transfer pricing
   - Pending Cases, OECD Services Regulations, APA Report
4. Recent rulings and other guidance of interest

FENWICK

Regulation Packages

FENWICK

Section 987 Developments: Are we there yet?

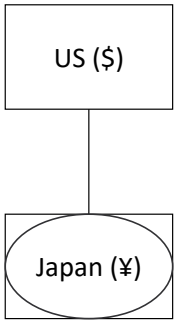
Notice 2026-17

- Released February 25, 2026.
- Intention to issue proposed regs. that will provide taxpayers opportunity to elect to use 1991 proposed regulation method, with some simplifying changes:
  - Taxpayers can elect, starting now, to use simplified "equity and basis pool" method for calculating § 987 FX gain or loss with respect to QBUs.

Notice 2026-17

- Equity and Basis Pool Method in the Notice:
  - Maintain equity pool in QBU's functional currency.
  - Basis pool in owner's functional currency.
  - Start with an opening balance sheet, then increase/decrease based on transactions between the QBU and its owner and gain/loss of QBU for the year.
  - Then recognize § 987 gain or loss on net remittances of year.
  - No more tracking historic and marked assets.
- Must have a current rate election in effect (as described in the 2024 Final Regulations) to elect the equity and basis pool method.

Notice 2026-17



- US forms Japan branch on July 1 of the year.

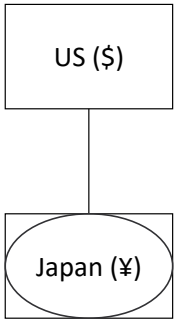
Annual Transactions

- July 1 - US transfers:
  - ¥100,000 to Japan branch with basis of $1,000.
  - Land with basis of $500.
- July 1 - Japan branch borrows ¥100,00 from a bank.
- During the year - Japan branch earns ¥12,000 for performing services and incurs 2,000¥ of deductible expenses.

Spot Rate

- July 1: $1 = ¥100
- December 31: $1 = ¥120
- Average rate during July 1 to December 31 period: $1 = ¥110

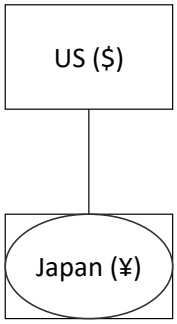
Notice 2026-17



987 Gain or Loss

- Net unrecognized gain or loss:
  - Equity Pool:
    - Opening balance = ¥0
      - Increased by transactions between QBU and Owner (contribution of (¥100,000 cash and land with basis of ¥50,000) translated into functional currency of QBU at time of contribution ($1 = ¥100): ¥150,000
      - Increased by Japan branch net income (12,000¥ - 2,000¥): ¥10,000
    - Ending balance = ¥160,000

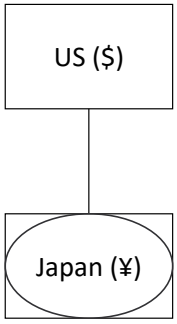
Notice 2026-17



987 Gain or Loss

- Net unrecognized gain or loss:
  - Basis Pool:
    - Opening Balance = $0
      - Increased by transactions between QBU and owner (land and cash): $1,500.
      - Increased by Japan branch net income translated at annual rate for year ($1 = ¥110).
    - Ending Balance = $1,590.91.

Notice 2026-17



987 Gain or Loss

- Net unrecognized gain or loss:
  - Equity pool on last day of year (¥160,000) translated into spot rate on last day of year ($1 = ¥120) = $1,333.33.
  - Basis pool on last day of year = $1,590.91.
  - Net Unrecognized 987 loss of ($257.58) = $1,333.33 - $1,590.91.
  - This section 987 loss would be recognized based on the fraction of the QBU's assets (measured in ¥) that it remits during the year.

Notice 2026-17 – Continued Nuances

- Equity and basis pool calculation must carry over prior unrecognized gain or loss from before the election takes effect. Transition rules under Reg. 1.987-10 will still apply.
- Section 987 losses on remittances from a QBU are subject to loss suspension rules of the 2024 regulations (see Reg. 1.987-11).
- Disregarded transactions are treated as giving rise to remittances.

Proposed CFC Exemption (REG-103844-26)

- Proposed Regulations were issued that generally permit taxpayers to elect to ignore § 987(3) with respect to QBUs owned by CFCs.
- Does *not* affect §§ 987(1) and (2) (translation of taxable income into the CFC's functional currency).
- Taxpayers can rely on the rules for tax years beginning after Dec. 31, 2024. Special rules to allow elections on an amended 2025 tax return filed by October 2027.

Proposed CFC Exemption (REG-103844-26)

- Consistency Requirement for all of the multinational's CFCs
- Pre-election 987 gain or loss: requirement to compute and amortize the 987 gain or loss over 10 years. Exemption for QBUs with <$50M average assets over 3-year prior period.
- Inbound reorganizations resulting recognition of section 987 gain (but not loss) on the CFC's QBUs.
  - $25M de minimis threshold for CFC owned QBUs with < $25 Million in asset basis.
  - Different methods to reconstruct the Section 987 pool on an inbound reorganization:
    - "Excess asset basis" rules under Section 367(b).
    - 6-year lookback to determine what Section 987 unrecognized gain or loss would have been under the 2024 final regulations

FENWICK

FTC Regulations

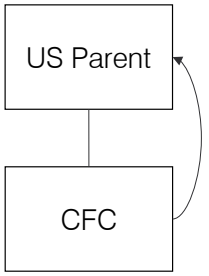
Notice 2025-77 and REG-115145-25

- Notable OBBBA Changes to GILTI:
  - Reduced the FTC haircut on GILTI from 20% to 10%.
  - Eliminated QBAI.
  - Increased effective rate (10.5% to 12.6%).
- Also, added § 960(d)(4) to *disallow* a credit for 10% of foreign income taxes paid or accrued on distributions of PTEP resulting from § 951A inclusions.
  - Applies to tax years of the US parent ending after June 28, 2025.

Notice 2025-77 and REG-115145-25

- Distinction between distributions out of PTEP (actual distribution) and § 951A (deemed distribution):
  - There was a question as to whether the FTC haircut on GILTI applied to pre-OBBBA PTEP.
  - Proposed § 960 regulations say no.
- Notice 2025-77 and the proposed regulations explain how the OBBBA's FTC disallowance under § 960(d)(4) applies to pre-OBBBA PTEP resulting from § 951A inclusions.
- The proposed regulations divide § 951A PTEP into:
  - Pre-June 28, 2025 tax year § 951A PTEP and
  - Post-June 28, 2025 year § 951A PTEP.
- Proposed regulations generally implement the Notice (proposed to apply for 951A inclusions occurring in tax years ending after June 28, 2025 and taxpayers can rely on them before finalization).

Notice 2025-77 and REG-115145-25



$150 § 951A PTEP Distribution

results in

$30 foreign country WHT

Year	§ 951A Inclusion
2024	$100
2025	$100

USP owns CFC which earns $100 of tested income in 2024 and 2025. USP has § 951A inclusion of $100 in each of 2024 and 2025. Country X imposes a 20% withholding tax on dividends.

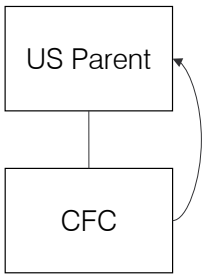
In 2026, CFC distributes $150 to USP.

- Under § 959 rules $100 is out of 2025 PTEP, $50 out of 2024 PTEP.

What PTEP amounts are subject to the 10% haircut under the § 960(d)(4) rules?

- $150? Or only $100 (excluding the distribution of $50 of pre-OBBBA PTEP from 2024).

Notice 2025-77 and REG-115145-25



$150 § 951A PTEP Distribution

results in

$30 foreign country WHT

Year	§ 951A Inclusion
2024	$100
2025	$100

Under the proposed regulations, $100 is assigned to the post-June 28, 2025 category; $50 to pre-June 28, 2025 category.

- So $20 of the $30 foreign country withholding tax on dividends is allocated to post-June 28, 2025 category, remaining $10 to pre-June 28, 2025 category.
- As a result, $2 (10% of $20) of the FTCs otherwise allowable as a credit are disallowed under § 960(d)(4).

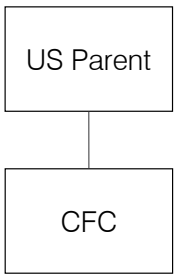
Notice 2025-72 and REG-115145-25

- Guidance where OBBBA repealed one-month deferral election under § 898(c)(2) for first tax year beginning after November 30, 2025.
  - CFCs could previously elect a tax year beginning one month earlier than a U.S. shareholder's year.
- Repeal of § 898(c)(2) creates issues for allocating foreign taxes paid or accrued in the first (short) "required" year and the "succeeding" year.
  - For example, a "required year" beginning December 1, 2025 and ending December 31, 2025 combined with credits applying to the domestic owner's tax year in which or with which the tax year of the foreign corporation ends could result in FTCs piling up in the one month "required" year.

Notice 2025-72 and REG-115145-25

- Notice 2025-72 provided a transition rule for allocating foreign income taxes for CFC's first short year based on portion of CFC taxes from 2025 calendar year attributable to that one-month period.
  - Taxes for the other 11 months are allocated to succeeding year based on relative amounts of CFC income derived in short month and the prior 11 months.
- Proposed regs. implemented the rules in Notice 2025-72 (and can be relied on before finalization), adding several helpful changes, including:
  - If a foreign corporation's foreign tax year (e.g. March 31) does not align with its succeeding tax year (e.g. Dec. 31), taxpayers may make irrevocable election to allocate succeeding year taxes between the required year and the succeeding tax year.
  - Election to apply a specific allocation percentage to the amount of a specified foreign income tax assigned to each income group of a corporation using a closing of the books method.
  - Election to allocate all foreign income taxes to the required year (and none to the succeeding year).

Notice 2025-72 and REG-115145-25



Assume CFC's first required year is from December 1, 2025 to December 31, 2025.

Succeeding year is from Jan 1, 2026 to Dec. 31, 2026.

CFC taxable year end for foreign tax purposes is December 31.

Base Case

If CFC accrues $7,200 of Country X tax in its first required year:

- Allocate between required year (1-month period Dec. 1-Dec. 31, 2025), and succeeding year (2026).

Notice 2025-72 and REG-115145-25

Income Group Specific Allocation Method

If CFC accrues $7,200 of Country X tax in its first required year, and has taxable income of $45,000 for 2025:

- $3,750 of income is attributable to CFC's required year.

Assume The $7,200 of Country X tax is allocated and apportioned as follows:

- $5,400 to general category tentative gross tested income attributable to the CFC tested unit (CFC income group).
- $1,800 to the general category foreign base company services group (FBCServ income group).

Then for the required year:

- 1/12 of CFC income group ($5400/12 = $450) is allocated to the required year.
- 1/12 of FBCServ income group ($1800/12) is allocated to the required year.
- Remaining to the succeeding year.

Notice 2025-72 and REG-115145-25

Income Group Specific Allocation Method

- $33,750 of CFC's taxable income is assigned to the CFC income group.
  - And using a closing of the books, $2,250 of CFC's taxable income assigned to CFC income group for the first required year.
- $11,250 of CFC's taxable income is assigned to the FBCServ income group.
  - And using a closing of the books, $1,125 of CFC's taxable income is assigned to the FBCServ income group.

Then for the first required year:

- Amount of CFC taxable income assigned to CFC income group attributable to the firs required year ($2,250) is divided by total taxable income assigned to that group for the year ($33,750) resulting in a 6.66% allocation percentage and $360 of tax assigned to the CFC income group.
- $180 is similarly assigned to the FBCServ income group.

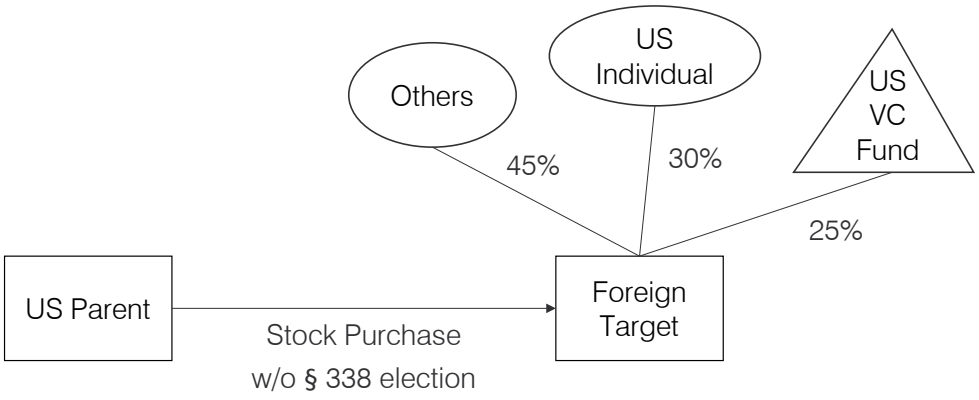
FENWICK

Pro Rata Share Regulations

Pro Rata Share Proposed Regs. (REG-115646-25)

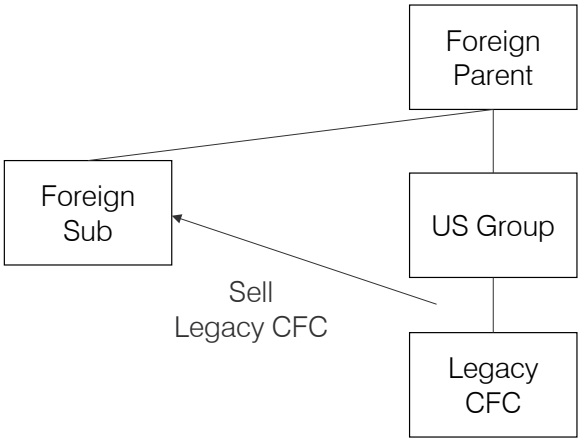
- Proposed regs. for pro rata share rules under § 951(a)(2)(B) under OBBBA (change from "last day" rule for GILTI and Subpart F inclusions to "any day" rule for tax years beginning before January 1, 2025).
- General rule is that subpart F income and GILTI are prorated on a daily basis.
- In certain circumstances, CFC's tax year for US tax purposes is required or permitted to be closed for tax purposes:
  - Foreign corporation's status as a CFC changes during the year (a "status change event") → mandatory closing of the tax year.
    - Partnerships are treated as aggregates in determining whether there is a status change event.
  - If there is a cumulative >50% change in ownership of CFC stock ("significant ownership variance"), the selling shareholder(s) can elect to close the CFC's tax year.
    - Related party transfers are disregarded.

Example 1 – Foreign Acquisition



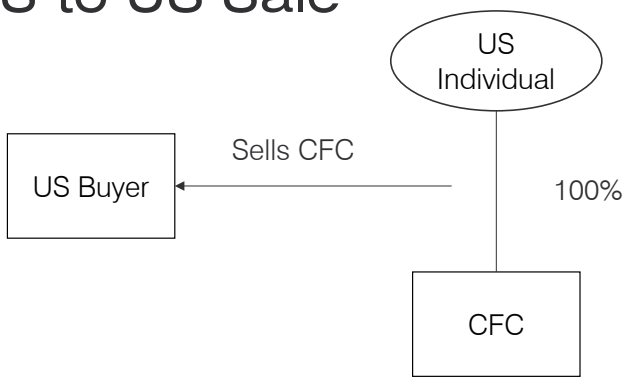
- Foreign Target's status as a CFC is determined without regard to Reg. 1.958-1(d)(2)(i) & (ii), which treat a domestic partnership as an entity for determining U.S. shareholder and CFC status.
- Therefore, this is a status change event that **requires** the closing of Foreign Target's tax year.

Example 2 – Sale to Foreign Parented Group



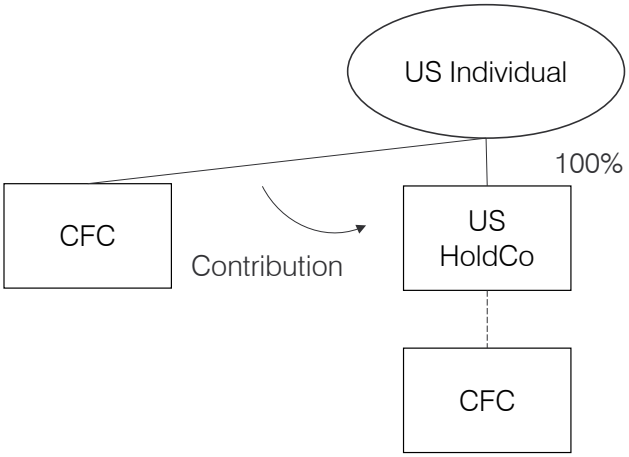
- Due to reinstatement of Section 958(b)(4), Legacy CFC will no longer be a CFC after the sale.
- Therefore, this is a status change event that **requires** closing of Legacy CFC's tax year.
- The extraordinary reduction rules of Sec. 1.245A-5(e) & (f) are no longer necessary and therefore, will no longer apply beginning in December 31, 2025.

Example 3 – US to US Sale



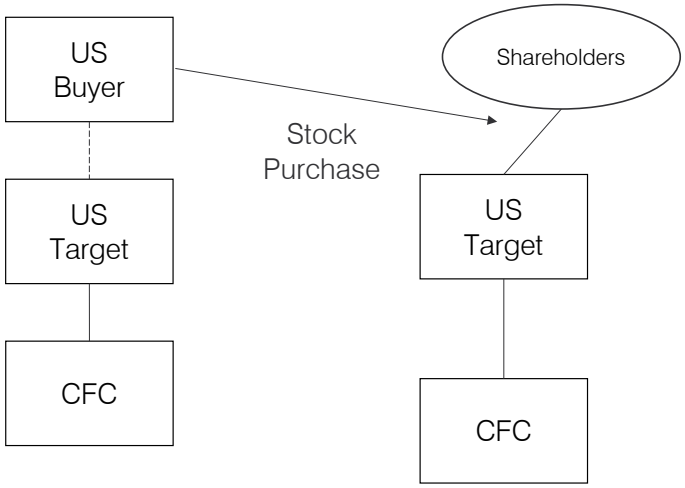
- This is not a status change event. However, since there is a >50% change in ownership of CFC during the year, this is a significant ownership variance that **permits** an election to close CFC's tax year.
- Election is made by the "controlling section 958(a) U.S. shareholder(s)" – the US shareholder(s) whose ownership decreases as a result of the variance – here U.S. individual.

Example 4 – Related Party Rule



- Transfers between related persons (within the meaning of Section 267(b), without regard to Section 267(c)(3)) are disregarded in determining a significant ownership variance.
- Therefore, daily proration of subpart F income and GILTI will apply.

Example 5 – Domestic Acquisition



- US Target's tax year ends under Reg. 1.1502-76. However, since there is no transfer of CFC's stock, US Target includes the full pro rata share of Subpart F income and GILTI.
- Conclusion: treatment is the same as under pre-OBBBA law.

FENWICK

FDII Regulations

Proposed FDDEI/DEI Regs.

- OBBBA excludes from DEI any income or gain from sale or other disposition of: (i) intangible property under section 367(d) or (ii) sale or disposition of other property that is subject to depreciation, amortization or depletion by the Seller.
- Recent proposed regulations issued on August 20, 2026 follow Notice 2025-78, with clarifying edits.
- New rule added that limits Foreign Derived Deduction Eligible Income ("FDDEI") to overall Deduction Eligible Income ("DEI"). Commentators are critical of this rule as going beyond the statutory text, which only contains a taxable income limitation.

FENWICK

Allocation of Deductions to GILTI/DEI

Allocation of deductions to GILTI/DEI (REG-117273-25)

- Prior to the OBBBA, § 250 defined deduction eligible income (DEI) as the excess of gross income determined without regard to 6 categories of income minus deductions "properly allocable" to such gross income.
- The OBBBA added a 7th category of income DEI is determined without regard to:
  - gain from the sale or disposition of IP or other property subject to depreciation, amortization, or depletion by the seller.
- The OBBBA also modified deductions "properly allocable" to gross income to exclude interest expense and R&E expense.

Allocation of deductions to GILTI/DEI (REG-117273-25)

- New § 904(b)(5) also gets rid of R&E, interest, stewardship expenses and other expenses previously allocated to foreign source GILTI for FTC limitation purposes.
- OBBBA added § 904(b)(5) such that for FTC limitation purposes, the following deductions are treated as allocable to foreign source GILTI:
  - any deduction allowed under § 250(a)(1)(B) (the 250 deduction for GILTI and § 78 gross up),
  - no amount of interest or R&E expense is allocated to GILTI,
  - any other deduction to such income only if such deduction is "directly allocable" to such income, and
  - any amount or deduction which would have been allocated or apportioned to such income shall only be allocated or apportioned to income which is from sources within the United States (re-sourcing provision).

Allocation of deductions to GILTI/DEI (REG-117273-25)

- The proposed regulations address OBBBA changes to § 250 expense allocation to DEI, and § 904(b)(5) expense allocation to GILTI for § 904 limitation purposes.
- The proposed regulations define interest expense as any amount deductible under § 163 (including OID), and R&E expenses as amounts deductible under §§ 174, 174A or 59(e)(2)(B).
- The proposed regulations also explain what deductions are not "directly allocable" to GILTI for § 904 purposes, generally including: stewardship expenses and supportive expenses (G&A) and may be reallocated to US source income for all § 904 purposes.
  - Certain deductions that would otherwise reduce foreign source GILTI instead reduce US source income. Can trigger ODL rules. See Prop. Reg. § 1.904(b)-4(d), example 2.
- Taxpayers can rely on proposed regs. before finalized (assuming consistency/applied in entirety).

FENWICK

4501 Regulations

Section 4501 Regulations

- On November 24, 2025, the IRS and Treasury issued final regulations under Section 4501. Most notable in the international tax area is the removal of the so-called "funding rule," under which the excise tax applied to certain repurchases of stock by a foreign parent corporation.

Section 4501 Regulations

- The Proposed Regulations would have extended these rules to situations where a domestic affiliate "funds by any means" a stock repurchase by the foreign parent corporation with a principal purpose of avoiding the excise tax. See Prop. Reg. sec. 58.4501-7(b)(2)(i).
- As summarized by the Preamble to the Final Section 4501 regulations, commentators objected to the funding rule on several grounds. One is that it would be burdensome to track and comply with, given that it could potentially apply to common business transactions. Second is that it was unclear when it would apply and whose purpose was relevant. Third was a lack of clarity in the examples of a prohibited "funding" in the Proposed Regulations. And fourth was that a special priority rule where a repurchase was funded from different sources was too narrow. Taking into account all of the comments, the IRS and Treasury decided not to adopt the funding rule. Generally, the final regulations (including the withdrawal of the funding rule) are effective for repurchases in taxable years beginning after December 31, 2022.

Section 4501 Regulations

- One other change in the Final Regulations with an international tax aspect relates to the so-called "dividend exception." Section 4501(e)(6) provides that the excise tax does not apply to a stock buyback to the extent that it is treated as a dividend for U.S. federal income tax purposes. The Proposed Regulations established a presumption that any repurchase was *not* treated as a dividend under section 302(d) or section 356. To rebut the presumption, the corporation was required to provide "sufficient evidence" that the shareholder treated the redemption as a dividend on the shareholder's own Federal income tax returns.
- Commentators suggested that the standard for "sufficient evidence" was too stringent, and the regulations should not require a shareholder certification. Especially, in the case of foreign shareholders that do not file U.S. tax returns, the required certification was too burdensome. Commentators also suggested that the dividend exception should be deemed satisfied if the corporation reports the redemption proceeds as a dividend on Form 1042-S.

Section 4501 Regulations

- In response to these comments, the IRS and Treasury modified the "sufficient evidence" standard.
- A shareholder certification is no longer required, although the shareholder certification remains as a safe harbor.
- Corporations can rely on the dividend exception if they establish through information known to the covered corporation that the redemption was substantially equivalent to a dividend under § 302(d) or § 356(a)(2), and the corporation does not know of any facts that would give it knowledge or reason to know that the redemption was not a dividend. The corporation also must treat the payment as a dividend for federal income tax purposes, including collecting FDAP withholding taxes, and demonstrate that it has sufficient E&P to cause the payment to be a dividend.
- The IRS and Treasury rejected the corporation's ability to rely on solely a Form 1042-S, because as stated by the IRS and Treasury, the Form 1042-S might prepared based on the assumption that the payment may be a dividend.

FENWICK

CAMT Notice

Notice 2026-7

- Intent to issue forthcoming CAMT proposed regulations.
  - Fixed book-tax discrepancies for § 197 intangibles (15-year amortization under § 197 for tax; goodwill remains until disposition for book purposes).
  - Aligned book and tax for purposes of § 174 acceleration of R&E under OBBBA (prior 5-year capitalization under TCJA; immediate expensing for book purposes).
  - Aligns § 367(d) royalty payments for book and tax purposes.
  - Also: Aligned book and tax for repairs to § 168 MACRS property, § 181 property, § 162 deductions for small dollar acquisitions.
- Future CAMT Guidance?
  - Deputy Assistant Secretary of the Treasury for Tax Policy Kevin Salinger stated at a tax conference that comprehensive proposed regs. will come in late 2026 to be finalized in 2027.

FENWICK

Case Law

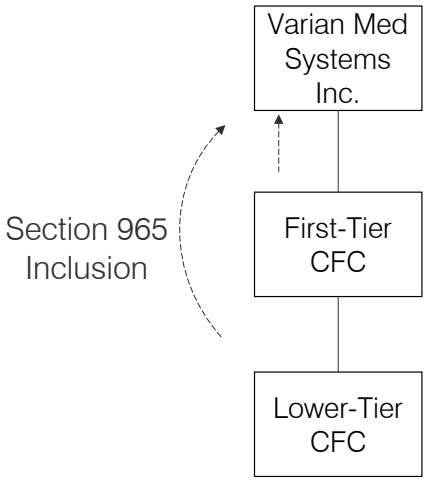
FENWICK

Varian and *Sysco*

History

- *Varian 1* (163 T.C. 76; 2024):
  - Varian and its subsidiaries use September 30 fiscal year.
  - For fiscal 2018, claimed § 245A DRD for § 78 gross-up due to § 965 inclusion.
  - TCJA effective dates allowed fiscal year taxpayers to claim a § 245A deduction (applying to *distributions* after December 31, 2017) for a § 78 gross-up.
    - Tax Court Held entitled to § 245A DRD.
      - Treasury's attempt to modify plain language of statute via regulation exceeded its authority and was invalid.

Fact Pattern Illustrated



Varian 2

- *Varian 2 (166 T.C. No. 8; 2026)*
  - Issue 1: can Varian claim § 245A deductions with respect to § 78 gross-up from lower-tier CFCs?
    - Held: holding period requirement not met under plain language of § 246(c). "Held" does not include indirect ownership for purposes of § 246(c).
    - Relied on *Dole Foods* (Foreign Sovereign Immunities Act case), Section 902 cases such as *First Chicago*, and canvassing the Internal Revenue Code's definition of "held"

Varian 2 – Foreign Tax Credit Reduction

- Issue 2: The other issue in Varian II was the FTC haircut under section 245A(d)(1)
  - Disallows FTC with respect to a dividend for which the DRD is available, to prevent both an exclusion and credit for the same income
    - Since the Section 78 gross up on the mandatory repatriation tax was partially eligible for a DRD, this implied that the deemed paid FTCs on the section 965 inclusion were reduced under section 245A(d)(1).
  - Parties disputed whether the disallowance should be based on the gross or net section 965 inclusion (i.e., after taking into account the Section 965(c) deductions).
  - In *Varian II*, the Court held that the FTC haircut was based on a fraction equal to the Section 78 gross-up eligible for the DRD divided by the ***net*** Section 965 inclusion.

Sysco Corp. v. Comm'r, T.C. Memo. 2026-84

- In a memorandum decision, the Tax Court revisited its analysis in Varian II to address additional arguments raised by the taxpayer in respect of the Section 245A DRD from lower-tier CFCs.
- This included that the key phrase "held by the taxpayer" in section 246(c)(1) can only mean "held by a U.S. shareholder within the meaning of section 951(b)," which encompasses indirect ownership. Section 246(c)(5)(B) requires United States shareholder status to be maintained to claim the DRD and, therefore, Section 246(c) contemplates indirect ownership.
- In reaffirming its conclusion in Varian II, the Court relied on the legislative history of section 246(c)(1) and the structure of the DRD provisions. Section 246(c)'s holding period requirement was enacted in 1958, before subpart F. Thus, the original meaning of section 246(c)(1) could not have been linked to subpart F's definition of U.S. shareholder. As Congress revised Section 246(c) to add new Code sections, it did not alter the original meaning of "held by the taxpayer" in Section 246(c).

Sysco Corp. v. Comm'r, T.C. Memo. 2026-84

- The Court noted that other parts of the DRD provisions (e.g., Section 243(c) addressing affiliated groups) explicitly incorporated indirect ownership, whereas Section 246(c) did not. It also found that Sysco's interpretation of section 246(c)(1) would leave section 246(c)(5)(B) with no work to do.
- Lastly, the Court rejected an argument based on Reg. section 1.245A-5(b)(1) provides that a "Section 245A shareholder" is allowed the DRD for *any* dividend received from a specified foreign corporation. Reg. section 1.245A-5(i)(21), in turn, defines the term "Section 245A shareholder" as a domestic corporation that is a U.S. shareholder and owns stock, "directly or indirectly." The Court credited the IRS's statements at oral argument that this was intended to apply to Section 964(e)(4), and not an indirect Section 78 gross-up.
- In sum, despite the taxpayer's "valiant efforts," the Court reached the same conclusion as in *Varian II.*
- The Court also reached the same conclusion on the FTC haircut.

FENWICK

Recent *Loper Bright* related decisions

Siemens

- July 15 Tax Court Opinion (167 T.C. No. 5) regarding § 245A and the extraordinary disposition rules in Temp. Reg. § 1.245A-5T to prevent fiscal-year taxpayers taking advantage of the effective date mismatch between §§ 965, 951A, and 245A.
- Siemens, a fiscal year taxpayer, restructured its foreign operations involving intercompany sales of foreign subsidiary stock for gain, increasing E&P, followed by a shareholder distribution to U.S. parent out of that E&P eligible for the full § 245A deduction (prior to the effective date of 951A such that 951A did not apply to the restructuring).
- Temp. Reg. § 1.245A-5T attempted to shut off restructurings that took advantage of the effective date mismatch for any non-ordinary course related party distributions during the gap period in effective dates.
- The full Tax Court in a 17-0 decision held in favor of the taxpayer, reasoning that Treasury cannot change the plain meaning of the statute through regs.
  - "Courts must presume that a legislature says in a statute what it means and means in a statute what it says there." (citing *Varian*).
  - Citing *Loper Bright*, role of reviewing court is to recognize constitutional delegations and ensure an agency has engaged in reasoned decision making within the boundary of those delegations.

Siemens

- IRS acquiesced in result only to the decision (AOD 2026-02). IRS accepts extraordinary disposition rules exceed Treasury's rulemaking authority when disposing of other cases.
  - Result only?
    - IRS disagrees with the reasoning of the opinion "including to the extent it implies that broadly worded delegations like those in §§ 245A(g) and 7805(a) do not include authority for narrowly tailored anti-abuse rules that preserve Congress's intent."
    - IRS will continue to assert other 245A regulations such as the extraordinary reduction rules.
    - Acquiescence does not extend to any other regulation.

Keysight

- Decision by the Court of Federal Claims issued July 2, 2026.
- Taxpayer argued it was entitled to § 197 amortization deductions related to Singapore and Delaware subsidiaries when computing GILTI inclusion.
- Keysight, a fiscal year taxpayer, engaged in internal restructuring, exchanging assets for intercompany debt of $8.5 billion, with recipient receiving a cost basis in assets with no corresponding GILTI inclusion as restructuring occurred during effective date mismatch where § 245A applied but § 951A did not.
  - Sought a refund to claim a § 197 amortization deduction in computing GILTI: permissible under the statute but not under disqualified basis regulations in § 1.951A-2(c)(5).

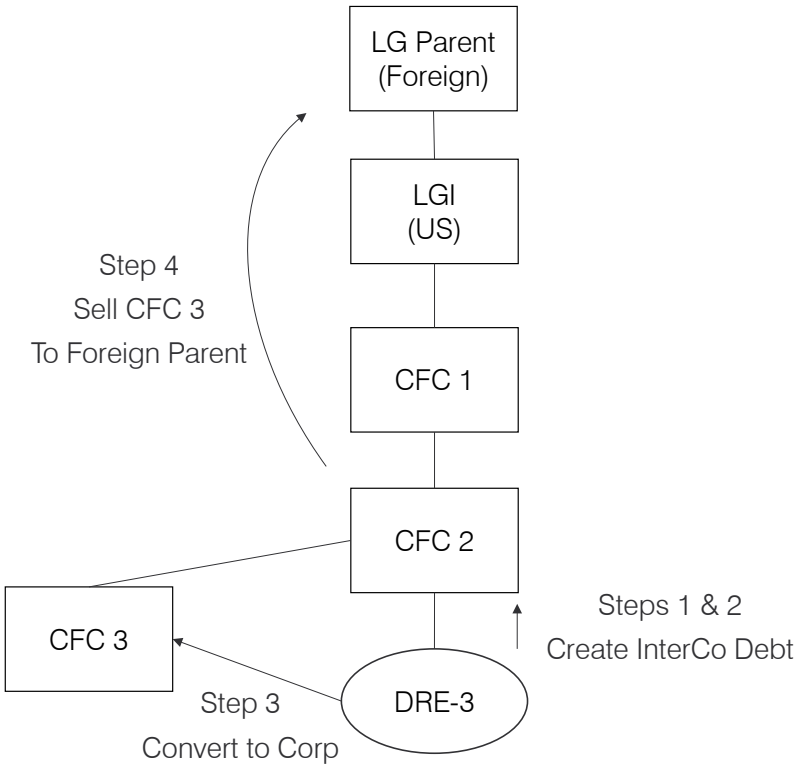
Keysight

- The IRS argued that § 951A incorporates the express delegation language in § 954(b)(5) which authorizes Treasury to determine which deductions are "properly allocable" to certain categories of Subpart F income.
  - According to the government, that delegated authority carried over to the GILTI regime through § 951A(c)(2)(A), which cross-references § 954(b)(5) such that deductions properly allocable to gross income would be determined "under rules similar to the rules of section 954(b)(5)."
- The Court of Federal Claims rejected the government's contention that the cross-reference to § 954(b)(5) includes an express delegation of rulemaking authority for purposes of § 951A, reasoning that § 954(b)(5)'s delegation applies only "[f]or purposes of subsection (a)," which concerns foreign base company income rather than GILTI.
  - Court rejected broad delegation of § 7805 stating it would contravene *Loper Bright*.
    - "When *Chevron* fell, so too did the presumption that statutory ambiguity favors the agency."
    - Under *Loper Bright*, there must be an express, specific delegation. Section 951A does not provide this delegation for the issue at hand.

FENWICK

Liberty Global

Liberty Global – Facts (simplified)



Liberty Global Economic Substance Decision

- The Tenth Circuit, in a 2-1 panel decision, affirmed the District of Colorado's ruling upholding the application of the codified economic substance doctrine in *Liberty Global v. United States*.
- The case concerned a Section 245A dividends-received deduction claimed in an internal restructuring named "Project Soy."
- The appeal turned on the follow narrow question: Is the codified economic substance doctrine "relevant" to Project Soy?
- The court described Project Soy as "a complex series of transactions" that Liberty Global undertook to exploit a "last day of the year rule/mismatch" in the international tax provisions of the 2017 TCJA.
- The majority answered the relevance question in the affirmative and rejected Liberty Global's assertion that the economic substance doctrine is an interpretive tool.
- As precedent, the Tenth Circuit cited its prior decisions in *Blum v. Commissioner* and *Sala v. Commissioner*, among other traditional "tax shelter" / listed transaction authorities.

Project Soy and the Majority's Analysis

- The Tenth Circuit stated that, in June 2018, Liberty Global "began to explore the possibility of exploiting a loophole in the international tax provisions of the TCJA to shelter profits."
- According to the Tenth Circuit, Liberty Global achieved this goal by generating "artificial" earnings that were used to offset its gain on step four of the transaction.
- The published opinion attaches the entirety of a January 2019 planning deck for Project Soy.
- The Tenth Circuit stated that Project Soy was "an elaborate tax-avoidance scheme" based on "economically meaningless transactions between closely related entities."
- The opinion stated that, for decades, transactions that comply with the literal terms of the tax code have been disregarded for tax purposes under federal common law if they have no economic substance.
- The court again cited *Blum* and *Sala*, as well as older Tenth Circuit cases.
- Under these cases, the court found itself bound to reject Liberty Global's assertion that the codified economic substance doctrine was not relevant in Project Soy.

Proper Unit of Measurement

- The Tenth Circuit held that the district court correctly found that the relevant transaction, or "**unit of measurement," was the entirety of Project Soy**, not its component parts.
- Project Soy as a whole was not a "basic business transaction," according to the Tenth Circuit.
- The court reasoned that, if it approved the rule advocated by Liberty Global, taxpayers and their advisers would quickly find ways to inoculate complex transactions by including basic business transactions in them.

Judge Eid's Dissent

- In a lengthy dissent, Judge Allison H. Eid stated that the relevance reference in Section 7701(o) makes it "clear that there exists a mandatory relevancy determination before the government may invoke the economic substance doctrine to disallow tax benefits."
- Judge Eid would have reversed and remanded because the district court's failure to engage in this threshold analysis constituted reversible error.
- She noted that the Section 245A deduction stemmed from the realization of a **real economic gain** in Liberty Global foreign subsidiary TGH's assets.
- As in *Cottage Savings*, it was the taxpayer's prerogative to decide when to realize the economic gain.
- The dissent concluded that Liberty Global's formal characterization of the transaction did not fail to capture economic reality, which it viewed as the proper scope for application of the economic substance doctrine.
- Nor did the dissent believe it was the court's job to rescue Congress from its drafting errors.

Rehearing Denied

- The Tenth Circuit denied Liberty Global's petition for rehearing en banc in a 9–3 decision.
- Judge Eid, joined by two other judges, filed a brief dissent from the denial of rehearing.
- Judge Eid stated that the case presented an important and straightforward question of statutory interpretation regarding how and when to apply the economic substance doctrine.
- Section 7701(o) states that the economic substance doctrine applies in any case to which the doctrine is relevant, determined in the same manner as if Section 7701(o) had never been enacted.
- Judge Eid stated that the panel majority's standard, under which the doctrine is relevant if taxpayers "attempt to obtain a benefit not intended by Congress," gives too much discretion to courts and the government and does not provide necessary clarity to taxpayers.
- In line with *Patel*, Judge Eid would interpret Section 7701(o) to require a meaningful threshold relevance determination that is not coextensive with the two-part test in Section 7701(o).

FENWICK

Christensen and *Bruyea*

Christensen and Bruyea

- Two recent cases in the Federal Circuit held that the NIIT is not creditable under the relief/elimination from double taxation sections of the relevant tax treaties.
  - *Bruyea* (No. 2025-1563, Fed. Cir. Aug. 31, 2026) involved a Canadian-resident U.S. citizen who sold real estate in Canada and owed NIIT on the sale.
  - *Christensen* (No. 2024-1284, Fed. Cir. Aug. 31, 2026) involved French-resident U.S. citizens who sold stock in a French company and owed NIIT on the sale.
  - Both cases reversed prior taxpayer-favorable decisions in the Court of Federal Claims.
- The Federal Circuit read all meaning out of the treaty and interpreted the relevant "U.S. law limitation" in each treaty ("subject to the limitations of the law of the United States") to mean that the NIIT is creditable under the treaty only if it is otherwise creditable under the Code.

Christensen and Bruyea

- Section 901 restricts FTCs only to apply against taxes imposed by Chapter 1 of the Code. The NIIT is imposed under Chapter 2A.
- Treaties however can provide another avenue for a credit.
  - Generally, the approach is to give effect to both the language of a treaty and the Code "without violating the language of either." See e.g. *Whitney v. Robertson*, 124 U.S. 190 (1888).
- The U.S.-France Treaty in particular has two potential avenues for a credit:
  - Article 24(2)(a) of U.S.-France Treaty provides that, in accordance with the provisions and subject to the limitations of the law of the United States, the US should allow a citizen of the US a credit against the US income tax for French income tax paid by or on behalf of such citizen or resident.
    - Technical explanation to the treaty provides that this "limitations" language generally refers to the FTC limitations under § 904.
  - Article 24(2)(b) provides that a dual resident is allowed a credit against US tax for French tax paid and does not have the same "limitations" language as in 24(2)(a).

Christensen and Bruyea

- Federal Circuit:
  - Held that "limitations" language in treaty means that because the Code does not give a credit for the NIIT, the treaty cannot either (any other reading would render the "limitations" language superfluous).
  - Also raises fairness argument (windfall to Americans living in Ontario).
  - In the case of the U.S.-French treaty, argued that the "limitations" language which appears in the first part of paragraph 2, serves as an overarching qualifier to both subparagraphs (a) and (b).

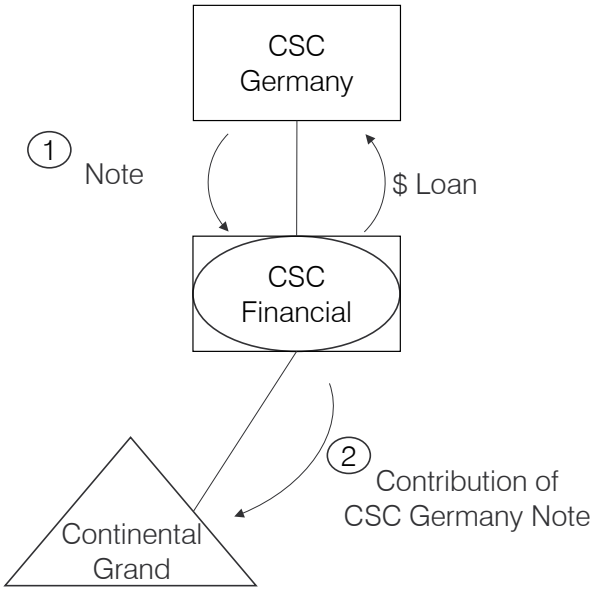
FENWICK

Continental Grand

Continental Grand: Background and Transaction

- In *Continental Grand Limited Partnership*, 166 T.C. No. 3, the Tax Court analyzed the interaction of the check-the-box regulations with the partnership rules.
- Continental Grand was a Nevada partnership engaged in leasing equipment to affiliates in the Computer Sciences Corp ("CSC") consolidated group.
- CSC Germany wholly owned CSC Financial GmbH ("CSC Financial").
- In March 2001, CSC Germany issued CSC Financial a promissory note with an issue price and fair market value of approximately **$610 million**.
- The Note entitled the holder to receive approximately **$1.1 billion of principal and deferred interest** at maturity in 2009.
- CSC Financial contributed the Note to Continental Grand in exchange for partnership units.

Continental Grand



Tax Court's Analysis

- Reg. sec. 301.7701-2(a) provides that a disregarded entity's activities **"are treated in the same manner as a sole proprietorship, branch or division of the owner."**
- A disregarded entity is not invisible for all federal tax purposes, but the check-the-box regulations disregarded the original loan between CSC Financial and CSC Germany.
- CSC Germany was therefore viewed as contributing its own Note to a partnership in which CSC Germany, through CSC Financial, was a partner.
- The state-law property rights between CSC Germany and CSC Financial were not relevant because the check-the-box regulations disregarded those rights for federal income tax purposes.

Tax Court's Analysis - Continued

- The Tax Court held that the Note had **no tax basis** when contributed to the Partnership.
- Even if the Note were "property" under section 721, its basis was its cost under section 1012(a), and the Note had no cost to its maker, CSC Germany.
- The Court distinguished:
  - *Tufts*, because it involved a taxable acquisition.
  - *Perracchi* and *Lessinger*, because they involved sections 351 and 357(c), rather than the partnership rules.
- The basis issue was central to whether CSC Germany recognized a section 987 foreign currency loss when the Partnership dissolved in 2009, but the Court did not reach the section 987 issue.
- The Court also did not decide the consequences of repayment of the zero-basis Note.

FENWICK

Other Cases

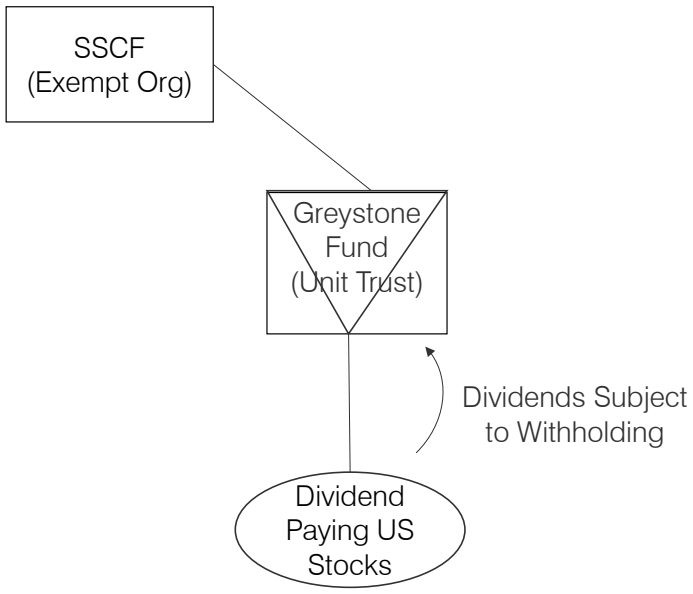
SIH LLLP v. Commissioner – Facts and Background

- The taxpayer, a Susquehanna International Group affiliate, was an options and futures market maker that held unhedged short index positions (the Firm Hedge) to mitigate equity market downturns.
- SIH claimed about $170 million of qualified dividend income and roughly $25 million of FTCs after a treaty reclaim of the 35% Swiss withholding; the IRS disallowed the credits and recharacterized the dividends as ordinary income.
- Section 246(c) denies qualified dividend income treatment under § 1(h)(11) unless the stock is held at market risk for the minimum holding period; § 901(k) applies the same discipline to credits for dividend withholding tax.
- Both rules trace to the American Jobs Creation Act of 2004, enacted to overturn the taxpayer-favorable results in Compaq and IES.

SIH LLLP – Holding and Takeaways

- Substance over form rejected: the court refused to disaggregate the portfolio swap into individual short positions, holding the highly technical reg. § 1.246-5 rules control. IRS was not allowed to argue based on the Code and contrary to its regulations.
- Notably, the court observed that no case holds tax avoidance alone nullifies an otherwise code-compliant, substantive set of transactions.
- The Court sustained the IRS's position under the antiabuse rule of reg. § 1.246-5(c)(1)(vi), holding among other things that tax savings significantly exceeded expected pretax profit.
- Contrary to Compaq and IES, Swiss withholding tax reduced pretax economic profit while the credit for the same tax counted as a benefit – about $25 million of tax savings against $0 to $2.4 million of expected profit.

South Saskatchewan Community Foundation (SSCF)



SSCF Investment Structure and Treaty Claim

- In *South Saskatchewan Community Foundation v. United States*, the Court of Federal Claims interpreted the U.S. Canada income tax treaty and the regulations governing hybrid entities under Reg. Sec. 1.894-1(d).
- The taxpayer, South Saskatchewan Community Foundation ("SSCF"), was a Canadian charitable organization.
- It invested in U.S. dividend paying stocks through the TD Greystone Global Equity Fund (the "Greystone Fund"), a unit trust organized under Canadian law.
- Both parties agreed that SSCF would be entitled to an exemption from U.S. withholding taxes if it invested directly in the U.S. securities held by the Greystone Fund.
- However, this exemption was not met because Greystone Fund had beneficiaries that were not exempt organizations.
- Thus, SSCF argued that, under the fiscally transparent entities ("FTE") provision of Article IV(6) that it was entitled to treaty benefits on a look-through basis.

SSCF Analysis and Holding

- The parties agreed that since the Greystone Fund was a resident of Canada, Article IV(6)(a) was satisfied, but disputed whether the Greystone Fund was "fiscally transparent."
- Thus, the Court found that the Greystone Trust met the requirements of the income inclusion rule and was fiscally transparent under Reg. sec. 1.894-1(d).
- However, the Court found that the Treasury Regulation was not decisive because the Tax Treaty itself and extrinsic evidence demonstrate that the signatories intended for Article XXI(3) to be the exclusive provision governing this sort of investment through a collective investment vehicle.
- It is a standard rule of statutory construction that a specific provision controls over a more general one.
- Applying this principle, the Court concluded that Article XXI(3), rather than Article IV(6), was the sole treaty provision to exempt SSCF's dividends from tax.
- Permitting SSCF to rely on Article IV(6) would allow SSCF to bypass the specific provisions that the contracting states agreed to in Article XXI(3) and read out the limitations on those vehicles.

FENWICK

Pending Transfer Pricing Cases

Pending Cases: Challenges to SBC Regulations

- In *McKesson*, a refund case filed in the U.S. District Court for the Northern District of Texas, the taxpayer is challenging Reg. sec. 1.482-7's requirement that taxpayers share stock-based compensation ("SBC") expense in a qualified cost-sharing arrangement.
- McKesson argues that:
  - Section 482 and its regulations consistently require application of the arm's-length standard.
  - Unrelated parties do not share SBC costs.
  - Requiring controlled parties to share SBC costs does not clearly reflect income and is therefore invalid.

Challenges to SBC Regulations, cont.

- McKesson relies on:
  - *Seagate*, in which the IRS conceded that it lacked evidence of an arm's-length transaction where SBC was shared.
  - *Xilinx*, in which the Ninth Circuit held that the IRS could not require SBC cost sharing under the arm's-length standard and the 1995 cost-sharing regulations.
  - *Altera*, in which a divided Ninth Circuit panel upheld the SBC rule under "step two" of *Chevron*.
- McKesson argues that *Loper Bright* forecloses the use of *Chevron* deference and requires courts independently to determine the best reading of section 482.
- McKesson also relies on *3M v. Commissioner*, in which the Eighth Circuit invalidated the blocked-income regulations for failure to clearly reflect income.

SBC Regulations: Government's Response

- The Government argues that the first sentence of section 482 delegates authority to the IRS to adjust related-party transactions when necessary to prevent tax evasion or clearly reflect income.
- In the Government's view, section 482:
  - Does not prescribe a specific adjustment method.
  - Does not require the IRS to consider evidence from unrelated-party transactions.
  - Authorizes the SBC regulations independently of the arm's-length standard.
- The Government also argues that cost-sharing arrangements involve the transfer of "future distribution rights to intangibles," bringing them within the commensurate-with-income standard in the second sentence of section 482.
- Responding to McKesson's Administrative Procedure Act challenge, the Government asserts that Treasury was required to consider only "relevant and significant" comments under *Huawei Technologies USA, Inc. v. FCC*.
- Treasury's assertion that unrelated parties would share SBC was characterized as "conjecture" that was not material to its adoption of the regulations.

Government's Alternative Section 162 Argument

- The Government separately argues that McKesson's SBC deductions are not deductible under section 162.
- Section 162 requires expenses to be incurred in the taxpayer's own trade or business; a subsidiary's trade or business is different from its parent's trade or business.
- The Government asserts that McKesson did not directly and proximately benefit from the Irish CFC's share of the SBC expense.
- The Government relies principally on:
  - *Young & Rubicam, Inc. v. United States*
  - *OTM Corp. v. United States*
  - *R.T. French Co.*
- According to the Government, sections 482 and 162 provide independent grounds for disallowing McKesson's deduction.
- Even if the section 482 adjustment was erroneous, McKesson retains the burden of proving its entitlement to the deduction under section 162(a).

Eaton: Implicit Support and Section 482

- Following a Tax Court trial, Eaton and the IRS filed opening briefs concerning:
  - Interest expense under an intercompany loan with Eaton ROW.
  - Guarantee fees paid by Eaton US to Eaton ROW for guaranteeing third-party debt.
- The IRS disallowed approximately:
  - $296 million of interest expense
  - $237 million of guarantee-fee deductions
- The dispute concerns whether Eaton ROW's relationship with Eaton US should be considered in determining Eaton US's credit rating and the arm's-length result.

Eaton: Implicit Support and Section 482, cont.

- Eaton argues that:
  - The parties must be treated consistently as unrelated parties.
  - Section 482 rests on the separate-entity principle of *Moline Properties*.
  - Reg. sec. 1.482-1(a)(1) places controlled taxpayers on parity with uncontrolled taxpayers acting at arm's length.
  - Reg. sec. 1.482-2(a)(2)'s reference to the "credit standing of the borrower" means the borrower considered as an unrelated party.
- The IRS argues that its Credit Rating Method and Yield Spread Method appropriately account for "implicit support" because major credit-rating agencies would consider Eaton ROW's relationship with Eaton US.
- The IRS also argues that its section 482 adjustments were not an abuse of discretion.

3M and Coca-Cola: Blocked-Income Regulations

- In *3M Co. v. Commissioner*, the Eighth Circuit invalidated the blocked-income regulation under *Loper Bright*.
- The court held that the IRS could not allocate unpaid royalties that Brazilian law prevented 3M Brazil from paying.
- The Eighth Circuit concluded that section 482 permits allocation of income only when the taxpayer has "dominion or control" over it.
- The Government's rehearing petition argued that:
  - The court misread *Commissioner v. First Security Bank of Utah*.
  - "Income" may include economic gain even when the taxpayer cannot force its distribution, presently receive it, or repatriate it.
  - 3M had sufficient dominion and control because it could have caused the funds to be distributed.
- The Eighth Circuit denied rehearing, finalizing the decision barring Supreme Court review.

3M and Coca-Cola: Blocked-Income Regulations

- The application of the blocked-income regulations to Brazilian royalties is also pending before the Eleventh Circuit in *Coca-Cola*.
- The Government argues that:
  - Brazilian law did not bar payment of dividends or treatment of those dividends as royalties for U.S. tax purposes.
  - *3M* adopted an overly narrow definition of "income."
  - Because Coca-Cola could have paid a dividend, the income was not "blocked."
- Coca-Cola argues that its case is the same as *3M* and that the Eleventh Circuit should follow *3M* rather than create a circuit split.
- During oral argument, members of the panel questioned the notice and due-process implications of the IRS's adjustments and how the Government selected the affiliates whose use of the 10-50-50 method would be adjusted.

FENWICK

Other Transfer Pricing Developments

2025 APA Report overview

2025 APA Report: Staffing and Case Activity

- The IRS Advance Pricing and Mutual Agreement ("APMA") program released its 2025 report.
- APMA staffing at the end of 2025 consisted of:
  - 63 team leaders
  - 30 economists
  - 12 managers
  - 3 assistant directors
- This represented a decrease of 13 team leaders and five economists from 2024.
- The number of executed APAs decreased:
  - 110 in 2025
  - 142 in 2024
  - 156 in 2023

2025 APA Report overview

- APA applications increased:
  - 178 in 2025
  - 169 in 2024
  - 167 in 2023
- The median completion time increased to 41.6 months, from 33.5 months in 2024.
- The average completion time for a new bilateral APA increased to 50 months.

2025 APA Report: Countries, Transactions, & Methods

- India represented **35% of executed bilateral APAs**, followed by Japan at 25% and Canada at 11%.
- Of the APAs executed in 2025:
  - 45% involved non-U.S. parents and U.S. subsidiaries.
  - 45% involved U.S. parents and non-U.S. subsidiaries.
  - 10% involved sister companies.
- Most APAs involved services:
  - 30% involved services provided by a non-U.S. entity.
  - 23% involved services provided by a U.S. entity.
- Non-U.S. service providers represented **41% of tested parties**.
- CPM/TNMM remained the most common transfer-pricing method:
  - Used in 86% of tangible- and intangible-property transactions.
  - Used in 83% of services transactions.

2025 APA Report: Countries, Transactions, & Methods, cont.

- For North American tested parties using CPM/TNMM, the most widely used comparable-company data source was Standard & Poor's Compustat/Capital IQ.
- Most APAs covered a five-year term; only 23% included rollback years.
- No APAs were revoked or cancelled in 2025; 10 APAs were withdrawn.

OECD Services Guidance

OECD Guidance on Intra-Group Services

- On June 1, 2026, the OECD released a public consultation document on intra-group services.
- The revisions are not intended to change the underlying arm's-length principles, but to improve alignment, clarity, and the availability of examples.
- Tax administrations should not dictate how a business operates; their role is to determine the tax consequences of the transaction.
- Labels do not determine the transfer-pricing analysis:
  - Calling a payment a "service fee" does not establish the existence of a service.
  - The absence of an agreement or payment does not establish that services were not rendered.
- Accurate delineation requires a functional analysis and consideration of assumption of risk.
- A provider that owns relevant assets, makes non-routine contributions and key decisions, and assumes economically significant risks is materially different from a provider performing routine activities under close supervision

OECD Services Guidance
Benefit Test and Excluded Activities

Benefit Test

- The benefit test asks whether an activity provides another group member with economic or commercial value that enhances or maintains its business position.
- If an independent enterprise would not have been willing to pay for the activity or perform it for itself, the activity should not be treated as an intra-group service.
- A benefit:
  - May increase profitability, reduce expenses or losses, or improve operations.
  - May arise during or after the period in which the activity occurs.
  - Must be factually possible and reasonably expected when the transaction is entered into.
- The benefit test is separate from determining the arm's-length remuneration for the service.
- Where an activity benefits multiple group members, the test must be applied at the subsidiary level.

OECD Services Guidance
Activities Generally Not Satisfying the Benefit Test

Activities Generally Not Satisfying the Benefit Test

- **Shareholder activities:** Activities undertaken solely because of the ownership interest and benefiting only the shareholder, including certain shareholder meetings, stock-exchange listings, consolidated reporting, investor relations, and parent-company tax compliance.
- **Duplicative activities:** Activities duplicating services performed by another group member, subject to exceptions such as temporary duplication during a reorganization, required local and consolidated functions, or obtaining a second legal opinion.
- **Incidental benefits:** Indirect or remote benefits for which an independent enterprise would not be willing to pay.
- **On-call services:** May constitute services where an independent enterprise would reasonably pay a standby charge to ensure availability.

OECD Services Guidance
Methods and Arm's-Length Pricing

Direct-Charge Approach

- Appropriate where a service is rendered to a specific group member and the provider can identify the work performed, costs, personnel time, and related resources without disproportionate compliance costs.

Indirect-Charge Approach

- Must:
  - Reflect an identifiable, reasonably expected benefit.
  - Be sensitive to the commercial features.
  - Include safeguards against manipulation.
  - Follow sound accounting principles.
  - Produce allocations proportionate to expected benefits.
- Allocation keys must be measurable, relevant, verifiable, and, where possible, readily available.
- Multiple allocation keys may be used for a single cost base if they do not result in double-counting or under-counting.

OECD Services Guidance
Methods and Arm's-Length Pricing, cont.

Selection of Method

- No transfer-pricing method, including a cost-based method, should be assumed to be preferred in every case.
- The analysis should consider:
  - Economically relevant characteristics.
  - Unique or valuable intangibles.
  - Risk profiles.
  - The provider's and recipient's realistically available alternatives.
- The CUP method may be appropriate where comparable services exist.
- Cost-plus and TNMM may be appropriate, but the cost base must not be materially distorted.
- A transactional profit-split method may apply when both parties make unique and valuable contributions, have highly integrated operations, or share economically significant risks.
- Pass-through costs may be recharged without a markup when the provider is merely acting as a paying agent; a markup may be appropriate when the provider contributes value.

OECD Services Guidance
Low-Value-Adding Services

- The OECD discussion draft provides a simplified approach for low-value-adding services.
- Tax administrations generally should refrain from challenging the benefit test when the simplified approach is properly applied.
- Qualifying services generally:
  - Are supportive in nature.
  - Are not part of the group's core business.
  - Do not use or create unique and valuable intangibles.
  - Do not involve substantial or economically significant risk.
- Core business activities, including R&D, manufacturing, product services, sales, and marketing, are not eligible.
- The same allocation key must be applied consistently to costs relating to the same category of service.

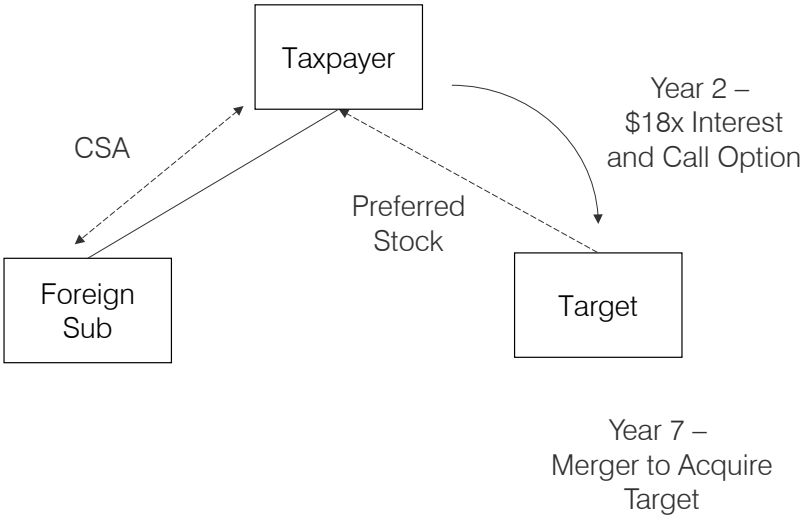
OECD Services Guidance
Low-Value-Adding Services, cont.

- Potential allocation keys include:
  - Headcount for people-related services.
  - Number of users for IT services.
  - Transactions or assets for accounting services.
  - Turnover where appropriate.
- The simplified approach applies a 5% markup to the relevant costs without requiring a benchmarking study.
- The OECD intends to hold a public consultation in November 2026 at the OECD Conference Centre in Paris.

CCA 202618011

- IRS permitted taxpayer to change cost allocation key method under comparable profits method (CPM) in a setoff situation, contrary to taxpayer's § 6662(e) documentation.
- Taxpayer (US) priced certain controlled services transactions with affiliates using a CPM with a markup on costs (MOC) as the profit level indicator (PLI).
- Initially used allocation key to allocate costs to regional operating companies based on shares of worldwide revenue.
- Wanted to switch to more precise method, first allocating costs to business divisions then based on revenue share, and claim the adjustment as a "setoff" under Treas. Reg. § 1.482-1(h)(4)(i) (which is allowable only to reduce other 482 adjustments in the same tax year).
- IRS allowed setoff due to the more reliable allocation key. Noted that in determining appropriate method for cost allocation, consideration should be given to all factors, including practices used by the taxpayer to apportion costs for business management purposes.

ILM on Use of PCT Valuation



IRS Rejects APM Based on Call Option Formula

- In ILM 202643014 the IRS concluded that the Taxpayer's use of the acquisition price method (APM) to value a platform contribution transaction (PCT) under its cost-sharing arrangement (CSA) was unreliable and not the best method.
- The IRS stated that the best method was the income method using a discounted cash flow (DCF) valuation analysis that was presented to the board of directors (Board) prior to the acquisition.
- Although the acquisition and PCT were close in time, the acquisition price was effectively set five years earlier by a formula in the call option agreement.
- The call option agreement granted Taxpayer a right to acquire the remaining equity in Target through a compelled merger.

DCF Analyses and PCT Payment

- The Board presentation deck stated that the purchase window was closing and discussed the financial projections underlying two DCF analyses.
- The first DCF analysis calculated the enterprise value based on Target's financial projections as a standalone enterprise ("Standalone Valuation").
- The second DCF analysis was based on Target's financial results considering synergies from combining Target and Taxpayer's businesses ("Pro Forma Valuation").
- In the acquisition the Target's shareholders collectively received $720x, the same amount as the option exercise price presented to the Board.
- Two months later, the Taxpayer contributed certain Target resources, capabilities, and rights ("RCRs") to the Taxpayer CSA.
- Taxpayer calculated the Target PCT Payment as $30x, the product of (i) the percentage reflecting Foreign CSA Participants' aggregate shares of reasonably anticipated benefits ("RAB") under the Taxpayer CSA, and (ii) an adjusted acquisition price for Target of $130x.

IRS Conclusion

- The IRS stated that the acquisition transaction was not subject to a meaningful, arm's length negotiation at the time of the acquisition.
- The parameters of the exercise price formula were negotiated five years before the acquisition date when the circumstances were not the same.
- The stage of development of the intangible was materially different. Moreover, Target's revenue increased over the five-year period, and this resulted in a much higher enterprise value.
- The IRS stated that the call option agreement is an unreliable CUT for the application of the acquisition price method.

FENWICK

OECD Work from Home PE

OECD Model Treaty Update: Work-from-Home PE

- On November 18, 2025, the OECD released an update to the Commentary to the Model Income Tax Convention.
- New paragraph 44 of the Commentary to Article 5 provides an analytical framework, together with examples, for determining when an employee working from home creates a permanent establishment ("PE") of the employer.
- A home office typically differs from other places of business used by an enterprise because it generally is not accessible to other employees or personnel.
- The mere fact that an employee uses a home office for work does **not** automatically make the home a PE of the employer.
- For a home office to constitute a PE:
  - It must satisfy the general requirement of permanence.
  - It must serve a commercial purpose of the employer.

Working-Time Threshold and Commercial Reason

- If an employee spends **less than 50% of working time** at the home office, the home generally will not be considered a PE of the employer.
- If the employee spends **more than 50% of working time** at the home office, a facts-and-circumstances analysis applies.
- A "prominent consideration" is whether the employer has a commercial reason for the employee to perform activities in the country where the home office is located.
- A commercial reason may exist where the employee's physical presence facilitates the employer's business, including:
  - Meetings with customers.
  - Cultivation of a new customer base or identification of business opportunities.
  - Relationships with suppliers.
  - Real-time interactions across time zones.
  - Access to business-relevant expertise.
  - Services requiring physical presence in the country.
  - Interaction with personnel of the enterprise or associated enterprises.
- Allowing an employee to work from home solely to obtain or retain that employee's services is **not** a commercial reason.

OECD Examples

- **Example A:** An employee works from a rental home in another country for three months to care for a sick relative. The duration is too short to satisfy the permanence requirement.
- **Example B:** An employee works from home one or two days per week, totaling 30% of working time. Although the home is a fixed place, it generally is not a PE.
- **Example C:** An employee works from home 80% of the time and regularly visits local clients to provide services. The home serves a commercial purpose and generally constitutes a PE.
- **Example D:** An employee works from home 60% of the time and provides services remotely to clients in several countries, with quarterly local client visits. The presence of local clients does not, by itself, establish a commercial reason; the home generally is not a PE.
- **Example E:** An employee provides services virtually, but the employee's location allows the employer to better serve clients in that time zone. The home generally constitutes a PE.

FENWICK

Pillar 2 Side-by-Side

SbS Package

- Side-by-Side Safe Harbor (Jan 5., 2026) exempts U.S. parented multinationals and all their constituent entities in the group from IIR and UTPR.
- Doesn't fix prior year issues (only applies beginning Jan 1, 2026).
- Section 899 still a threat.

SbS Package

- SbS Safe Harbour can be applied if the UPE is located in a jurisdiction that meets four criteria:
  - An eligible domestic tax system, which includes:
    - a statutory corporate income tax rate of at least 20%
    - a QDMTT or corporate alternative minimum tax at a nominal rate of at least 15%; and
    - no material risk that in-scope MNEs will face an ETR below 15% on domestic operations.
  - An eligible worldwide tax system, which includes:
    - a comprehensive foreign income inclusion regime covering both active and passive CFC and branch income;
    - substantial unilateral mechanisms to address BEPS risks; and
    - no material risk that in-scope MNEs will face an ETR below 15% on foreign operations.
  - A foreign tax credit for QDMTTs, available on the same terms as creditable Covered Taxes.
  - Timing of enactment: the domestic and worldwide regimes must have been enacted before Jan 1, 2026 (or a later date permitted under the IF's review process).

SbS Package

- Jurisdictions meeting these criteria are listed in a Central Record.
  - The U.S. is already in the Central Record as having a Qualified SbS Regime.
- QDMTTs remain fully applicable.

FENWICK

Branch profits tax through hybrid entities

LTR 202547011 / 202607002

- Foreign corporation (country A) can rely on zero rate of branch profit tax under its treaty for ECI earned in part through a U.S. LLC.
  - U.S. LLC treated as a corporation for Country A purposes, transparent for U.S. purposes.
  - Country A does not tax profits of U.S. LLC (also eligible for zero rate dividends under the Country A participation exemption).
- Article 24(4) of the U.S.-Country A Treaty provides as follows:
  - In the case of an item of income, profit or gain derived through a person that is fiscally transparent under the laws of either State, such item shall be considered to be derived by a resident of a State to the extent that the item is treated for the purposes of the taxation law of such State as the income, profit or gain of a resident.
- Ruling concludes that the "dividend equivalent amount" for branch profits tax purposes is not "derived through" the LLCs.
  - Thus, while Article 24(4) of the Treaty conditions entitlement to treaty benefits with respect to income, profits or gain earned through a fiscally transparent entity on the treatment of the income in the other Contracting State, it does not apply here with respect to Taxpayer's DEA because it is not "derived through" the U.S. LLCs.

FENWICK

Section 1059 PLR

Section 1059A PLR

Section 1059A and Customs Valuation

- LTR 202552012 addresses the coordination of customs valuation and transfer pricing under section 1059A.
- The importance of section 1059A has increased with the expanded use of tariffs.
- Although section 1059A ordinarily is a "no-rule issue," the IRS found that facilitating the **"timely liquidation and payment of customs duties"** justified granting the ruling. See Rev. Proc. 2025-7, sec. 4.01(22).
- The taxpayer was a U.S. subsidiary of a foreign parent that manufactured finished goods and components and imported goods from the foreign parent and other affiliates for resale in the United States.
- The taxpayer's transfer pricing was determined using the residual profit-split method ("RPSM").
- The taxpayer and foreign parent each earned an arm's-length profit on routine functions and divided residual profits based on their contributions to manufacturing and distribution operations in North America.
- The taxpayer had an advance pricing agreement ("APA") covering Years 1 and 2 and was renewing the APA for Years 3 and 4.

Deductive Value Method

- For customs purposes, the taxpayer used the **deductive value method** under 19 U.S.C. sec. 1401a(d), pursuant to a customs ruling.
- The deductive value method begins with the taxpayer's resale price and subtracts certain post-importation expenses, including:
  - Advertising.
  - Sales and general and administrative expenses.
  - Sales commissions.
  - Transportation and insurance costs.
  - Customs duties and federal excise taxes.
  - Value added through post-importation processing.
- This differs from transaction-based methods, which begin with the foreign party's sale price and add certain costs incurred by the buyer.
- Customs law establishes a hierarchy of valuation methods:
  - Transaction value.
  - Value of identical or similar merchandise.
  - Computed value, if requested by the importer.
  - Deductive value.

Section 1059A Framework

- Section 1059A was enacted as part of the Tax Reform Act of 1986 to coordinate customs values with the tax basis of inventory imported from related parties.
- Where property is imported from a related party, costs used to determine the inventory's tax basis and also used to determine customs value are limited to the costs taken into account for customs purposes.
- The provision prevents taxpayers from taking inconsistent factual positions for customs and federal income tax purposes, as occurred in *Brittingham v. Commissioner*.
- Section 1059A's purpose is to prevent a taxpayer from claiming a transfer price for federal income tax purposes that exceeds the amount consistent with the customs value.
- Appropriate adjustments may be made where the customs valuation method differs from the income-tax method.
- Section 1059A places a ceiling on costs considered for both customs and income-tax purposes, but does not apply to costs that are not considered for customs purposes.

IRS Ruling and Conclusion

- Section 1059A did **not** limit the taxpayer's inventory basis to the customs value determined under the deductive value method.
- Although section 1059A requires consistent treatment of the same costs, it does not impose a ceiling by reference to the final customs value itself.
- The deductive value method:
  - Begins with the importer's resale price, rather than the amount paid by the importer.
  - Produces customs value by subtracting various adjustments.
  - Includes adjustments that may consist of both notional and actual costs.
- To the extent the adjustments reflect actual costs considered for both customs and income-tax purposes, those costs must be reported consistently.
- The taxpayer represented that the actual costs were reported consistently.
- The final customs value was a **derived amount** and therefore did not impose a section 1059A ceiling on the taxpayer's inventory basis.

FENWICK

Section 865(h) treaty-resourcing PLR

LTRs 202611004

- 9100 Relief to file § 865(h) election to apply resourcing under an applicable income tax treaty (treat items as foreign source income for FTC purposes when a foreign country has a right to tax that item of income).
- Article 25(3) of relevant U.S.-Country X treaty would allow a US corporation to treat gain from sale of stock in a Country X corporation as foreign source income.
- US corporation sold shares of Country X corporation realizing gain and was subject to tax in country X but failed to make timely § 865(h) election.
  - In a later tax year, sold more shares, and timely made an § 865(h) election.

FENWICK

Attorney Bios



+1 650-335-7669

wrskinner@fenwick.com

Link to bio

Practices
Tax

Industries
Life Sciences
Software
Fintech

William R. Skinner

Partner, Tax

Will Skinner focuses his practice on corporate tax planning and transactions, including mergers and acquisitions, financings, spins, restructurings, partnerships, and licensing matters. Will draws on extensive experience with technology and life sciences transactions to shape tax structures in pursuit of clients' business goals. Will also provides corporations with standalone tax advice, including formal and informal opinions on technically challenging tax issues in Subchapter C, U.S. international tax and other areas.

During his 20 years in practice, Will has handled dozens of complex, multibillion-dollar transactions, and worked with leading software, fintech, and life sciences companies on their internal tax planning. Willing to cross silos, Will's reach spans different areas of federal income tax in order to provide clients with effective tax advice. In his recognition from Chambers, one multinational client described Will as a "highly sophisticated professional with a broad tax vision."

Will is a lifelong resident of the San Francisco Bay Area, having attended both UC Berkeley and Stanford for undergrad and law school, respectively. Before entering private practice, Will clerked for the Honorable Carlos T. Bea on the U.S. Court of Appeals for the Ninth Circuit in San Francisco.

Selected Transactional Experience

Sellside Transactions:

- **Smartsheet** in its $8.4 billion acquisition by Blackstone and Vista Equity Partners
- **Redfin** in its pending $1.75 billion stock for stock merger with Rocket Companies
- **Niantic** in its pending $3.5 billion acquisition by Scopely and PIF
- **Cupertino Electric** in its $1.54 billion acquisition by Quanta Services
- **Figma** in its proposed $20 billion acquisition by Adobe for stock and cash (transaction mutually abandoned by both parties)
- **DX** in its $1 billion acquisition by Atlassian

Buyside Transactions:

- **Stripe** in acquisitions of Metronome and Privvy
- **Gusto** in its acquisition of Guideline
- **CareDx** in its acquisition of Naveris
- **DayOne** in its acquisition of Mersana
- **Symantec** in the $10.7 billion sale of its enterprise security assets to Broadcom
- **Etsy** in its pending $1.2 billion sale of DePop to eBay

Life Sciences

- **Morphic Holdings** in its $3.2 billion acquisition by Eli Lilly
- **Day One Biopharmaceuticals** in its $2.5 billion acquisition by Servier
- **Stoke** in its strategic collaboration with BioGen

Financings

- **Coinbase Global** in its $1.1 billion convertible debt offering and Bill.com in its $1.4 billion convertible debt offering
- **CoreWeave** in its $650 million and $642 million minority investment transactions
- **Metropolis Technologies Inc.** in its $1.7 billion financing for its acquisition of SP Plus and $1.65 billion debt and equity financing transaction



+1 650-335-7882

khatch@fenwick.com

Associate

Practices
Tax

Focus
International Tax
Tax Structuring and Planning
Corporate Tax

Kris Hatch

- Kris advises on a broad variety of domestic and international tax matters.

Speaking Engagements and Publications

- "CFC, Subpart F, and GILTI," Tax Executives Institute.
- "GILTI"; "PFIC," Strafford.
- "Intellectual Property: Tax Issues," and "Cross-Border Intellectual Property Transactions: US Tax Issues," Westlaw.
- "Transaction Tax Deductions," Journal of Corporate Tax.
- "Treas. Reg. § 1.861-20"; "2020 final and proposed PFIC regulations"; "2021 PLRs of interest." International Tax Journal.
- "Pillar Two Side-by-Side Safe Harbor"; "LB&I Update"; "Proposed and Final Cloud Computing Regulations"; "Notice 2023-63"; "PFIC for U.S. Investors." Client Alerts.