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U.S. Tax Court Invalidates Cost Sharing Rule in *Altera* Decision



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The U.S. Tax Court on July 27 struck down the requirement in the 2003 cost sharing regulations that participants in a qualified cost sharing arrangement share stock-based compensation costs. The court granted petitioner Altera Corporation's motion for partial summary judgment and held that the regulation is invalid, because the U.S. Treasury failed to support its belief that unrelated parties would share stock-based costs with any evidence.

At issue in the *Altera* decision – a reviewed decision in which 14 judges agreed with Judge L. Paige Marvel's opinion, and only two did not participate in the case – was the IRS's assessed tax deficiency for tax years 2004-2007.

The Tax Court had already invalidated a previous version of the regulations that did not explicitly require controlled parties entering into qualified cost sharing agreements to share stock-based costs, and the Ninth Circuit had affirmed that decision. *Xilinx Inc. v. Commissioner*, 125 T.C. 37 (2005), *aff'd*, 598 F. 3d 1191 (9th Cir. 2010). In 2003, Treasury issued 1.482-7(d)(2), which requires participants in qualified cost sharing arrangements to share stock-based compensations costs to achieve an arm's length result. Thus, 1.482-7(d)(2) was in effect during the years at issue.

Judge Marvel wrote that the preamble to the regulation offered only Treasury's belief that unrelated parties entering into qualified cost sharing agreements would generally share stock-based compensation costs, but that Treasury failed to engage in any fact finding, and failed to examine the relevant data that had been provided by numerous commentators that parties operating at arm's length would not share stock-based compensation.

In finding that the regulation is invalid, the court concluded that "the final rule lacks a basis in fact, Treasury failed to rationally connect the choice it made with the facts found, Treasury failed to respond to significant comments when it issued the final rule, and Treasury's conclusion that the final rule is consistent with the arm's length standard is contrary to all of the evidence before it."

An in-depth analysis of the case and its repercussions will be distributed shortly.

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