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International Tax Cases To Watch In The 2nd Half Of 2020

By **Natalie Olivo**

Law360 (July 10, 2020, 7:57 PM EDT) -- Courts this year will continue grappling with several high-stakes cross-border tax issues, including questions of whether some European countries gave U.S. tech giants an unfair advantage and how to calculate potentially steep penalties for Americans who didn't report their offshore bank accounts.

In two closely watched cases overseas, Apple and Amazon are challenging the European Commission's conclusion that the companies received favorable tax treatment — Apple from Ireland, Amazon from Luxembourg — amounting to illegal state aid. Specialists say these disputes have prompted some to question whether the commission is using its state aid enforcement powers to set tax policy.

Practitioners are also tracking major transfer pricing litigation in the U.S., where the Internal Revenue Service has contended that several multinational corporations undervalued the intangible property they licensed to foreign affiliates. Some of these companies, including Coca-Cola and Facebook, are fighting billions of dollars in tax bills.

As for individual taxpayers, a handful of contested issues have been raised by people who failed to file foreign bank and financial account forms with the IRS, including disputes over how to calculate penalties. Whether penalties are tallied per account or per FBAR, for example, could significantly change the total amount a person owes.

Here, Law360 reports on key international tax cases to watch in the second half of 2020.

U.S. Tech Giants' State Aid Cases

In separate disputes playing out in the General Court of the European Union, Amazon and Apple have appealed the European Commission's determinations of illegal state aid.

The commission, which is the EU's competition watchdog, made international headlines in August 2016 when it ordered California-based Apple to pay up to €13 billion ($14.7 billion) in back taxes to Ireland. According to the commission, Ireland issued two tax rulings to Apple in 1991 and 2007 that allowed the company to allocate almost all of its sales profits to so-called head offices that existed only on paper.

Apple and Ireland have pushed back against the finding, telling the EU General Court in September that the commission was wrong to conclude the company's Irish affiliates had no capacity to perform "crucial

functions" regarding the management of Apple's intellectual property.

The court is expected to rule July 15, according to a recent statement from Ireland's Department of Finance.

In a similar case, Amazon is challenging the commission's conclusion that the Seattle-based tech giant owes Luxembourg €250 million in corporate income taxes. The commission concluded in October 2017 that the country approved a transfer pricing arrangement that allowed Amazon to record most of its profits there without being taxed, amounting to an unfair advantage.

For Amazon's part, the company told the EU General Court in March that the commission misapplied a well-established transfer pricing method and disregarded guidance from the Organization for Economic Cooperation and Development.

After the commission was dealt a partial defeat at the EU General Court in Starbucks' challenge to a state aid finding, specialists said the ruling showed the limits of case-by-case investigations as a way to pursue tax policy.

"The difficulty here is that usually member states are given a lot of autonomy in terms of how they organize their internal tax affairs in the absence of any EU-wide harmonization laws," according to Suzanne Rab, a professor and a barrister at Serle Court in London.

Without pan-European rules in the relevant areas, Rab said, then the question is, "What are member states allowed to do in terms of organizing their tax affairs consistent with the level playing field that the state aid rules require?"

In Rab's view, it comes down to the fundamental principle of whether companies would be in a comparable legal and factual situation regarding the measure in question and if a multinational is "any different from a standalone company established in one member state."

Apple's cases are Ireland v. Commission and Apple Sales International and Apple Operations Europe v. Commission, case numbers T-778/16 and T-892/16, in the General Court of the European Union.

Amazon's cases are Amazon EU and Amazon.com v. Commission and Luxembourg v. Commission, case numbers T-318/18 and T-816/17, in the General Court of the European Union.

Transfer Pricing Fights With the IRS

At their cores, four closely watched transfer pricing cases — involving Coca-Cola, Medtronic, Facebook and 3M — concern whether the IRS abused its discretion in reallocating income to the U.S. companies from their foreign affiliates. Each dispute, however, wrestles with this question in a different way.

Coca-Cola's case centers on a transfer pricing method the company used to license intangibles, such as trademarks and drink formulas, to foreign affiliates. The Atlanta-based company said that for years it has followed the same method the IRS accepted in a 1996 closing agreement. Then, for 2007 to 2009, the agency changed its stance and reallocated income to the U.S. from units in seven countries, creating tax deficiencies of $3.3 billion, the company said in its 2015 U.S. Tax Court petition.

Even though the closing agreement wasn't binding for later tax years, there's a question of whether the

IRS' decision to deviate from it without communicating this change will affect the Tax Court's analysis, according to Amanda Leon, an associate at Caplin & Drysdale. She raised the question while moderating a webinar hosted by the American Bar Association's Section of Taxation on July 2.

Sean Akins, a partner at Covington & Burling LLP, said during the webinar that he didn't think the IRS' new position required a heightened level of explanation.

"I'm not sure that I'd go that far personally, if only because it's a closing agreement with one individual taxpayer as opposed to … stated public policy," he said.

Like Coca-Cola's case, a dispute between medical device maker Medtronic and the IRS raises questions about which transfer pricing method best reflects a foreign affiliate's contributions to a U.S. company. The case is back in the Tax Court after the Eighth Circuit remanded the dispute in August 2018, finding the trial court had to justify more extensively the method it said Medtronic could use.

In a separate case, California-based Facebook is embroiled in a dispute with the IRS involving license agreements between the tech giant and its Irish subsidiary. At issue is the value of intangible property such as trademarks and copyrights, with billions of dollars on the line.

Meanwhile, Minnesota-based 3M Co. is challenging the IRS' decision to reallocate nearly $24 million from the company's Brazilian affiliate — income the company says is blocked by Brazil's restrictions on royalty payments. The IRS has cited regulations enacted in 1994 that disregard a foreign legal restriction to the extent it "generates an economic outcome that is inconsistent with an arm's-length result."

The regulation essentially went unenforced until the 3M case came up in 2013, Akins said during the ABA webinar. He said there's a question of whether the enforcement issue has any implication on the deference granted to the IRS' interpretation of the rule "or the deference that we grant to the regulation itself."

The cases are Coca-Cola Co. v. Commissioner, docket number 31183-15, in the U.S. Tax Court; Medtronic Inc. et al. v. Commissioner of Internal Revenue, docket number 6944-11, in the U.S. Tax Court; Facebook Inc. and Subsidiaries v. Commissioner of Internal Revenue, docket number 21959-16, in the U.S. Tax Court; and 3M Co. et al. v. Commissioner of Internal Revenue, docket number 5816-13, in the U.S. Tax Court.

FBAR Penalty Disputes

A key contested FBAR reporting issue centers on whether the statutory penalty cap of $10,000 for nonwillful violations applies per bank account, or per form.

In a case on appeal before the Ninth Circuit, a California federal judge found in April 2019 that Jane Boyd owed penalties for the nonwillful failure to report each of her 14 U.K. bank accounts. The judge rejected her contention that penalties shouldn't exceed $10,000 per year and that Congress could have been explicit if it had wanted penalties to apply per account.

Meanwhile, a Texas federal judge reached the opposite conclusion in a separate case in June. Siding with Texas resident Alexandru Bittner, U.S. District Judge Amos L. Mazzant found that "Congress knew how to make the nonwillful FBAR penalty vary with the number of foreign financial accounts maintained, but it did not do so."

The question of whether nonwillful penalties are computed per account or per form is "clearly one of the hot issues in this area," said Barbara Kaplan, co-chairwoman of Greenberg Traurig LLP's global tax practice.

Because the Texas judge ruled differently in the Bittner case from the California judge's decision in Boyd, there's a chance the government may appeal the Bittner ruling, she said.

Jeffrey Neiman, a partner at Marcus Neiman & Rashbaum LLP, said the U.S. government "talks out of both sides of their mouth" on this issue. In the criminal context, the government says penalties should be calculated per form, but in the civil nonwillful context, it's per account, per year, he said.

A newly disputed area involves situations in which the IRS uses the foreign account balance on a date other than June 30, the deadline to submit an FBAR on the year that it's due, to calculate the penalty.

In a case involving a Florida resident, Isac Schwarzbaum, the agency didn't look at the June 30 account balance but instead used the highest aggregate balance to calculate penalties for willful nondisclosure, according to court papers. U.S. District Judge Beth Bloom trimmed the IRS' penalty assessment in May, and the case is on appeal before the Eleventh Circuit.

The calculation issue is at stake in a few other cases, including one involving the estate of a dead Florida resident, Marie Green, according to Neiman, an attorney involved in the dispute.

Beyond computation cases, there's a question concerning how people facing FBAR penalties can get to court in the first place.

In a complaint filed in a New York federal court last month, a former Manhattan resident, Jonathan Zuhovitzky, challenged over $5 million in civil willful penalties assessed by the IRS. He contended that his only options were to pay the penalty and file a refund suit or wait for the government to sue and collect.

It's worth following issues concerning what people must do to get into court to defend against penalties, according to Kaplan, of Greenberg Traurig.

"You want to find a way to get there without having to pay the $2 million that's been assessed against you when you think liability should be $20,000," she said.

Neiman noted that in many civil penalty cases, "it's very hard to find a way to get judicial review."

He added, "This has been giving the IRS a license to take some pretty harsh positions, and the courts very rarely have a chance to weigh in."

The cases are U.S. v. Jane Boyd, case number 19-55585, in the U.S. Court of Appeals for the Ninth Circuit; USA v. Bittner, case number 4:19-cv-00415, in the U.S. District Court for the Eastern District of Texas; USA v. Isac Schwarzbaum, case number 20-12061, in the U.S. Court of Appeals for the Eleventh Circuit; U.S. v. Jacqueline D. Green et al., case number 1:19-cv-24026, in the U.S. District Court for the Southern District of Florida; and Jonathan Zuhovitzky v. U.S. et al., case number 1:20-cv-04937, in the U.S. District Court for the Southern District of New York.

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