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TRANSFERS OF INTANGIBLE PROPERTY: REVISE §§ 482 AND 936(H) TO TAX TRANSFERS OF BUSINESS FUNCTIONS

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INTRODUCTION

Home-grown establishments like Burger King, Inc. are moving operations overseas in large part because of the international corporate tax system in the United States.[1] Like a conscientious objector fleeing across the border to our neighbors to the North, Burger King's merger with the Canadian-based Tim Horton's could mean that the company will move its headquarters from Florida to Canada to take advantage of lower corporate taxes.[2] Companies like Burger King use transfer pricing to shift income from higher tax countries to lower tax countries and obtain huge tax savings from doing so.[3] Even though a company like Google operates in mostly high-tax jurisdictions with corporate tax rates topping 20%, carefully planned transfer pricing strategies allow Google to enjoy an effective tax rate of merely 2.4%.[4]

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1. Andy J. Semotuik, *The Burger King Deal: What Happens if Your Job Moves Across the Border?*, FORBES, Sept. 2, 2014, http://www.forbes.com/sites/andyjsemotiuk/2014/09/02/the-burger-king-deal-what-happens-if-your-job-moves-across-the-border (describing Burger King as an "American icon"); *see also* Julie Hirschfeld Davis, *Obama Sidesteps Congress With Rules to Curb Corporate Flight*, N.Y. TIMES, Sept. 23, 2014, at B1. There are several examples of pending inversions. In a pending acquisition of a UK-based rival, Illinois-based pharmaceutical company AbbVie is considering a corporate inversion. *Id.* In another example, a Minneapolis-based medical manufacturer, Medtronic, is considering a corporate inversion with an Irish-based acquisition, Coviden. *Id.* The rates of similar inversion deals have accelerated. *Id.* Compare a U.S. corporate tax rate in 2014 of 40% to significantly lower corporate tax rates in Canada (26.5%), the Bahamas (0%), Switzerland (17.92%), and Ireland (12.5%). KPMG, *Corporate Tax Rates Table*, https://home.kpmg.com/xx/en/home/services/tax/tax-tools-and-resources/tax-rates-online/corporate-tax-rates-table.html (last visited Mar. 28, 2016).
2. Semotuik, *supra* note 1.
3. Jesse Drucker, *Google 2.4% Rate Shows How $60 Billion is Lost to Tax Loopholes*, BLOOMBERG (Oct. 21, 2010, 6:00 AM), http://www.bloomberg.com/news/2010-10-21/google-2-4-rate-shows-how-60-billion-u-s-revenue-lost-to-tax-loopholes.html.
4. *Id.*

In addition to changing tax residency in the context of a corporate inversion, moving income-producing assets and intangible property from a high-tax jurisdiction to a low-tax jurisdiction has the added advantage of reducing taxes going forward.[5] Section 482 of the U.S. IRS Tax Code (the Code) requires an arm's length consideration for transfers of tangible and intangible property between related parties.[6] To the extent that the company does not transfer its income producing intangibles (like the trademark, brand name, etc . . .) from the United States to Canada, moving the corporate headquarters taken by itself would, without additional steps, generally not reduce the corporation's United States tax bill.[7]

5. *See* H.R. Rep. No. 99-426, at 423 (1985).

> There is a strong incentive for taxpayers to transfer intangibles to related foreign corporations or possessions corporations in a low tax jurisdiction, particularly when the intangible has a high value relative to manufacturing or assembly costs. Such transfers can result in indefinite tax deferral or effective tax exemption on the earnings, while retaining the value of the earnings in the related group.

Id.

6. I.R.C. § 482 (2012) ("In the case of any transfer (or license) of intangible property (within the meaning of section 936(h)(3)(B)), the income with respect to such transfer or license shall be commensurate with the income attributable to the intangible."). Treasury regulation § 1.482-1(b)(1) further provides:

> In determining the true taxable income of a controlled taxpayer, the standard to be applied in every case is that of a taxpayer dealing at arm's length with an uncontrolled taxpayer. A controlled transaction meets the arm's length standard if the results of the transaction are consistent with the results that would have been realized if uncontrolled taxpayers had engaged in the same transaction under the same circumstances (arm's length result).

Treas. Reg. § 1.482-4(b)(1) (as amended in 2011); *see also* Treas. Reg. § 1.482-4(a) (as amended in 2011) (requiring an "arm's length amount charged in a controlled transfer of intangible property"); ALLISON CHRISTIANS ET AL., UNITED STATES INTERNATIONAL TAXATION 304 (2d ed. 2011) ("Known as the 'arm's length' standard, the idea is to achieve parity between controlled and uncontrolled taxpayers. In the United States, this is done by recasting for tax purposes the results of non-arm's-length transactions between controlled persons to reflect more accurately the 'true' taxable income derived by the related parties from the property or transaction.").

7. *Compare* I.R.C. § 482 (2012), *with* Treas. Reg. § 1.482-4(b)(1)–(6) (as amended in 2011) (workforce-in-place does not constitute an intangible). To this extent, if a company's management constitutes merely a "workforce," then the Commissioner may not adjust revenue to account for the value of the transferred "intangible" because no intangible within the meaning of the statute was transferred. *Compare* I.R.C. § 482 (2012) ("[T]he Secretary may distribute, apportion, or allocate gross income, deductions credits, or allowances between or among such organizations, trades, or businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent the evasion of taxes . . . ."), *with* Treas. Reg. § 1.482-4(b)(1)–(6) (as amended in 2011) (defining an intangible for the purposes of Section 482).

Every company adjusts its operations based on market changes or market changes that it seeks to bring about.[8] Companies make strategic decisions about the markets in which they will continue or establish a "presence."[9] In doing so, multinational companies continually change their activities and operations, and these changes "take the form of the establishment, replenishment, transfer, reduction and closing of more or less substantial activities."[10] Against this background, countries have enacted considerable legislation to appropriately tax transfers of intangible property and operations.[11]

In the United States, § 482 of the Code references § 936(h) to find a list of intangible property subject to taxation if transferred across international borders from one related enterprise to another.[12] This Note refers to such transfers as intercompany "cross-border" transfers. Section 936(h)(3)(B) appears to define "intangible property" by including a laundry list of items that constitute intangibles, but the list leaves out other intangibles like goodwill and going-concern value.[13] In spite of the statute's seemingly expansive wording, the Obama Administration proposes adding goodwill to clarify the definition of intangible property within the meaning of § 482.[14] The Department of the Treasury has encountered definitional

8. DR. ALEXANDER VÖGELE ET AL., VERRECHNUNGSPREISE [TRANSFER PRICING], ch. Q, ¶ 1 at 1611 (3d ed. 2011).

9. *Id.*

10. *Id.* at 1611–12.

11. *E.g.*, I.R.C. § 482 (2012); Außensteuergesetz (AStG) [Foreign Taxation Law], Sep. 8, 1972, BUNDESGESETZBLATT I [BGBl. I] [FEDERAL GAZETTE I] at 1713, §§ 1 (1)–(3), as amended, Dec. 22, 2014 BGBl I. at 2417.

12. I.R.C. § 482 (2012) ("In the case of any transfer (or license) of intangible property (within the meaning of section 936(h)(3)(B)), the income with respect to such transfer or license shall be commensurate with the income attributable to the intangible.").

13. I.R.C. § 936(h)(3)(B) defines an intangible as:

> [A]ny patent, invention, formula, process, design, pattern, or know-how; copyright, literary, musical, or artistic composition; trademark, trade name, or brand name; franchise, license, or contract; method, program, system, procedure, campaign, survey, study, forecast, estimate, customer list, or technical data; or any similar item, which has substantial value independent of the services of any individual.

I.R.C. § 936(h)(3)(B) (2012).

14. JOINT COMM. ON TAXATION, 112TH CONG., DESCRIPTION OF REVENUE PROVISIONS CONTAINED IN THE PRESIDENT'S FISCAL YEAR 2013 BUDGET PROPOSAL 364 (Comm. Print 2012) ("The proposal

issues both in the context of tax controversies as well as in the context of assessing the value of transferring intangible property. The definitional debate sets the stage for considering the extent to which the Administration's proposed changes address the definitional omissions in the Code in light of alternative approaches in use in other countries facing similar challenges.[15]

The primary purpose of this Note is to examine the need to address definitional and methodological holes in the interpretation of intangible property under § 482.[16] The second purpose of this Note is to propose actions that Congress should take.[17] In addressing the need to change the definition or approach of identifying intangible property, this Note begins with an introduction to the arm's length standard under international standards and national law.[18] This Note then considers the current state of the Code, as well as accompanying case law, and the definition of intangible property.[19] This Note also explores German law on transfers of intangible property.[20] Following a discussion of the relative merits of each system in accomplishing the goals of obtaining a more consistent application of tax law to business facts, this Note proposes changes to the Code that would

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states that it clarifies the definition of intangible property for purposes of sections 367(d) and 482 includes workforce in place, goodwill and going concern value."). In the Analysis of the proposal, the Joint Committee on Taxation notes that the proposal to modify the definition of intangible property does not fundamentally alter existing transfer pricing rules. *Id.* Instead, the proposal addresses "certain definitional and methodological issues that have arisen in controversies with respect to the value attributed to intangible property at the time it is transferred outside the United States." *Id.* The proposal to change the definition of intangibles to include goodwill and workforce in place has been a perennial proposal in the President Obama's budget since 2009. Veritas Software Corp. v. Comm'r, 133 T.C. 297, 316 (2009). The proposal to expand and clarify the definition of intangible property for purposes of §§ 482 and 367(d) remains in the Administration's 2014 budget proposal. JOINT COMM. ON TAXATION, 113TH CONG., DESCRIPTION OF CERTAIN REVENUE PROVISIONS CONTAINED IN THE PRESIDENT'S FISCAL YEAR 2014 BUDGET PROPOSAL 1 (Comm. Print 2013).

15. *See, e.g.*, *Veritas*, 133 T.C. at 316 (2009) (holding that the Commissioner did not have statutory authority to treat a transfer of a workforce in place as "akin" to a transfer of intangible property within the meaning of Section 482).

16. *See* discussion *infra* Part II.

17. *See* discussion *infra* Part III.

18. *See* discussion *infra* Part I.

19. *See* discussion *infra* Part II.A.

20. *See* discussion *infra* Part II.B.

incorporate elements from German law to achieve these tax goals.[21] First, this Note argues for the necessity of an expansive definition of intangible property. Next, this Note suggests taxing outbound transfers of tax-income-producing assets to lower tax jurisdictions by adopting a rule that makes the elements of a transfer of functions satisfied where the current law may leave it out.[22] In comparing the German example, this Note explains where the German definition substantively departs from the U.S. definition and seeks to reconcile the two with an aim toward strengthening the U.S. tax base.[23]

I. THE TAXATION OF TRANSFERS OF INTANGIBLE PROPERTY AND BUSINESS FUNCTIONS

A. Transfer Pricing and the International Arm's Length Standard

Most governments use the arm's length standard as the guiding principle for determining a multi-national enterprise's true taxable income and transfer prices.[24] The Organization for Economic Cooperation and Development (OECD) defines the arm's length standard as:

> [When] conditions are made or imposed between the two [associated] enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the

21. *See* discussion *infra* Part II.A.1.
22. *See* discussion *infra* Part III.A.
23. *See* discussion *infra* Part II.B.1.
24. Susan C. Morse, *The Transfer Pricing Regs Need a Good Edit*, 40 PEPP. L. REV. 1415, 1423 (2013). Treasury regulations define the arm's length standard as follows:

> In determining the true taxable income of a controlled taxpayer, the standard to be applied in every case is that of a taxpayer dealing at arm's length with an uncontrolled taxpayer. A controlled transaction meets the arm's length standard if the results of the transaction are consistent with the results that would have been realized if uncontrolled taxpayers had engaged in the same transaction under the same circumstances (arm's length result).

Treas. Reg. § 1.482-1(b)(1) (as amended in 2011).

> enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.[25]

In the context of transferring tangible or intangible property, the arm's length standard seeks to replicate the prices that would have been agreed upon between willing parties had the parties not had an incentive to artificially adjust pricing to save on taxes.[26]

B. U.S. Transfer Pricing Regulatory Regime

In the United States, § 482 of the Internal Revenue Code (the Code) grants the Commissioner of Internal Revenue (the Commissioner) authority to allocate income and deductions "between or among two or more organizations owned or controlled directly or indirectly by the same interests."[27] For transfers or licenses of intangible property, "the income with respect to such transfer or license shall be commensurate with the income attributable to that intangible."[28] Generally, § 482 is broad enough to allow the Commissioner substantial latitude in regulating and enforcing the text

25. Organization of Economic Cooperation and Development, Organization of Economic Cooperation and Development Model Tax Convention, art. 9, Apr. 22, 2010. The OECD's Model Tax Convention "forms the basis of bilateral tax treaties involving OECD member countries . . . ", including the United States and Germany." Organization of Economic Cooperation and Development, Organization of Economic Cooperation and Development Transfer Pricing Guidelines, Apr. 22, 2010, sec. 1.6.

26. Morse, *supra* note 24, at 1436.

27. *Id.* at 1423. Internal Revenue Code section 482 provides:

> In any case of two or more organizations, trades, or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Secretary may distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among such organizations, trades, or businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organizations, trades, or businesses. In the case of any transfer (or license) of intangible property (within the meaning of section 936(h)(3)(B)), the income with respect to such transfer or license shall be commensurate with the income attributable to the intangible.

I.R.C. § 482 (2012).

28. I.R.C. § 482.

of the statute.[29] Although extensive regulations interpret and enforce a taxpayer's ability to set its transfer prices, "[u]nder current U.S. tax law, U.S.-parented multinational corporations . . . have a lot of tax planning flexibility."[30] For example, the taxpayer himself has the most information about the nature of his operations, and the regulations give the taxpayer leeway in determining how to apply the regulations to his operations.[31] Accordingly, when intangibles are the subject of intercompany transfers, there are two main issues: (1) the Commissioner must overcome definitional hurdles to establish that an intangible was transferred and (2) the Commissioner must value that intangible.[32] Because both the existence of an intangible and the value of an intangible is often difficult to ascertain, taxpayers may engage in aggressive tax planning.[33] Under the U.S. transfer pricing statutes and regulations, Congress is primarily concerned with identifying valuable intangible property that may be transferred in the context of a business restructuring.[34] The OECD's new Chapter 9 in

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29. Morse, *supra* note 24, at 1423 (recognizing that "this broad statue supports considerable regulatory discretion . . . granted to the tax administrators by the very terms of the statute").

30. *Id.* at 1415.

31. *Id.* at 1416 (explaining that "taxpayers exploit information asymmetry and regulatory complexity advantage[ously] in their aggressive application of transfer pricing regulations.").

32. Yariv Brauner, *Value in the Eye of the Beholder: The Valuation of Intangibles for Transfer Pricing Purposes*, 28 VA. TAX REV. 79, 87–94 (2008) (noting the difficulties inherent in valuing intangible assets, particularly in the context of a vertically integrated firm).

33. Morse, *supra* note 24, at 1423 (noting that taxpayers can exploit U.S. transfer pricing, deduction, and allocation rules and "whipsaw the government at every turn by (1) choosing the most advantageous income and deduction assignment and sourcing methods for each particular set of taxpayer facts and (2) massaging the facts, for example through valuation analysis, to further improve the results").

34. *Compare* I.R.C. § 482 (2012), *with* I.R.C. § 936(h) (2012) (defining the meaning of intangible property for the purposes of I.R.C. § 482). In addition, extensive Treasury regulations further define intangible property. For instance, Treasury Regulation section1.482-4(b) provides:

> For purposes of section 482, an intangible is an asset that comprises any of the following items and has substantial value independent of the services of any individual —
>
> (1) Patents, inventions, formulae, processes, designs, patterns, or know-how;
> (2) Copyrights and literary, musical, or artistic compositions;
> (3) Trademarks, trade names, or brand names;
> (4) Franchises, licenses, or contracts;
> (5) Methods, programs, systems, procedures, campaigns, surveys, studies, forecasts, estimates, customer lists, or technical data; and
> (6) Other similar items. For purposes of section 482, an item is considered similar to those listed in paragraph (b)(1) through (5) of this section if it derives its value not from its physical attributes but from its intellectual content or other intangible

the Transfer Pricing Guidelines "encourages the use of transfer pricing guidelines to analyze business restructurings . . . [with] [p]articular emphasis . . . placed on pre- and post-restructuring risk allocation, taking into consideration the arm's length principle."[35]

C. German Law on Transfers of Business Functions

In contrast to § 482's focus on taxing the transfer of intangibles, German law provides a much broader starting point, evaluating a business restructuring by taxing transfers of functions.[36] The Foreign Transactions Tax Act, as amended in 2008, allowed for the first time the evaluation and taxation of a transfer of business functions.[37] According to the administrative principles enforcing the provisions of the Foreign Tax Act, "a function is a business activity that consists of a combination of similar business tasks performed by a certain position or department."[38] According to the German rules, "the transfer of functions and risks . . . is considered to have occurred only when the assets acquired for profit-making are shifted along with the risks and opportunities, and the transferring party experiences a contraction of its functional capabilities as a result of the shift."[39] The

properties.

Treas. Reg. § 1.482-4(b) (as amended in 2011).

35. Bob Ackerman et al., *Readdressing Transfer Pricing in a Down Economy*, DAILY REP. EXEC. (BNA), Mar. 12, 2010, at 5.

36. Außensteuergesetz (AStG) [Foreign Taxation Law], Sep. 8, 1972, BUNDESGESETZBLATT I [BGBl. I] [FEDERAL GAZETTE I] at 1713, §§ 1 (1)–(3), as amended, Dec. 22, 2014 BGBl I. at 2417.

37. *Id.*

38. Robert Ackerman, Diana Organista, & Carlos M. Mallo, *Intangible Property Migration: Germany's Recent Draft Administration Principles on Transfer of Business Function*, TAX MGMT. TRANSFER PRICING REP., Apr. 8, 2010, at 1.

39. Ackerman et al., *supra* note 35, at 5 (*citing* Verordnung zur Anwendung des Fremdvergleichsgrundsatzes nach § 1 Abs. 1 des Außensteuergesetzes in Fällen grenzüberschreitender Funktionsverlagerungen [Funktionsverlagerungsverordnung - FVerlV] [Regulation on the Application of the Arm's Length Principle under § 1 (1) of the Foreign Transactions Tax Law in Instances of Cross-Border Transfers of Function] [Transfer of Function Regulation], as amended, June 26, 2013 BUNDESGESETZBLATT I [BGBl I] [FEDERAL GAZETTE I] at 1809) (defining a function as "(1) [a] function is a business activity consisting of an aggregation of operational tasks of the same kind that are performed by certain units or departments of an enterprise. It is an organic part of an enterprise, but need not constitute a branch of activity for tax purposes. (2) Except as otherwise provided in paragraphs 6 and 7, a transfer of function within the meaning of § 1 (3) sent. 9 of the Foreign Transactions Tax Law occurs where an enterprise (transferring enterprise) conveys assets and other benefits to a different,

threshold for taxing the transfer of business functions is lower than the threshold under § 482 because the focus on a company's operations allows a much broader starting point for tax authorities to tax a transaction.[40]

A transfer of functions can occur when a company moves the production of a product line from one country to another country if there is no corresponding drop in overall revenues.[41] A transfer of functions may take place under the rules where the "transferor remains in a legal or economic position to continue the performance of the function, and it is irrelevant to consider whether the receiving entity performs the function in the same manner as the transferring company."[42]

Nevertheless, the German rules on transfers of functions seek to accomplish the same goals as § 482—taxing transfers of intangible property—because the German rules exempt transfers of functions from exit taxation where no significant intangibles are transferred.[43] For example, under the German rules, a parent company taking on routine service provider activities for subsidiary companies in exchange for an arm's length cost-plus remuneration would not meet the definition of having transferred functions.[44]

related enterprise (receiving enterprise) together with the associated opportunities and risks, or provides these for use by the receiving enterprise, so that the receiving enterprise can exercise a function that was previously exercised by the transferring enterprise, thereby restricting the transferring enterprise's exercise of the function in question. A transfer of functions can also occur where the receiving enterprise assumes the function only for a limited period of time. Transactions realized within five fiscal years shall be combined to form a single transfer of function as of the time at which, by reason of their collective realization, the requirements of sentence 1 are fulfilled as an economic matter. (3) A transfer package within the meaning of § 1 (3) sent. 9 of the Foreign Transactions Tax Law consists of a function and the opportunities and risks associated with this function as well as the assets and benefits that the transferring enterprise conveys to the receiving enterprise together with the function or provides for its use and the services rendered in this connection").

40. Ackerman et al., *supra* note 35, at 5.

41. Ackerman, Organista, & Mallo, *supra* note 38, at 1 (explaining the hypothetical where "transferring [the production of] a product has taken place, then a limitation of the function has taken place, regardless of whether the decrease in revenues is offset by new products.").

42. *Id.* at 1–2.

43. *Id.* at 4.

44. *Id.* at 2 (stating "[a] transfer of functions [under German rules] does not exist where a parent company, acting as a service provider for the subsidiary production entities, undertakes the centralized production control for the entire group, or when the transferee exclusively carries out the transferred

II. ANALYSIS

A. *Current U.S. Law Regulating Transfers of Intangible Property and Transfers of Business Functions*

1. *Current U.S. Transfer Pricing Statutes and Regulations Narrowly Define Intangible Property to the Detriment of the U.S. Tax Base*

Although U.S. regulations require arm's length compensation for transfers of identified intangibles, the regulations leave out many transfers of profitable components of a business.[45] In this context, "transfer of intangibles" refers to any buying, selling, licensing, or sharing of the costs of developing an intangible asset.[46] In other words, there are profitable parts of a business that are transferred, which fall outside the purview of existing U.S. statutory law, because it is unlikely that the U.S. regulations would reach far enough to tax the transfer of goodwill along with other identifiable intangibles.[47] Depending on how the single identifiable intangible is valued in relation to the overall nexus of similar business activities, the value of "goodwill" could be extremely high but nonetheless out of tax authority reach.[48]

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function on behalf of the transferor and receives a cost-plus remuneration.").

45. *See, e.g.*, I.R.C. § 936(h) (2012). Excluding goodwill and going concern value from the definition of intangible property means that the taxpayer need not value those components when transferring a business from the United States to another country. *Cf.* I.R.C. § 482 (2012) (defining the scenarios under which the Commissioner may adjust a taxpayer's profits).

46. *See* Treas. Reg. § 1.482-4 (as amended in 2011) (referring to the sale or disposition of intangible property).

47. *See, e.g.*, I.R.C. § 936(h).

48. *E.g.*, Facebook, Inc., Annual Report (Form 10–K), at 72 (Dec. 31, 2012), http://www.sec.gov/Archives/edgar/data/1326801/000132680113000003/fb-12312012x10k.htm. In accounting for the value of the acquired assets in Facebook, Inc.'s acquisition of Instagram, Inc., Facebook attributed $433 million to goodwill of the total fair value of the acquired assets of $521 million, representing 83% of the total purchase price. *Id.* Although financial accounting standards will differ from tax regulations, the point is clear—leaving out goodwill leaves out important and valuable parts of a business. *Compare* Deloitte, *ASC 805—Business Combinations*, http://www.iasplus.com/en-us/standards/fasb/broad-transactions/asc805 (last visited Mar. 28, 2016) (describing financial accounting standards for valuing goodwill in the context of a business combination), *with* Treas. Reg. § 1.263(c) (as amended in 2011) (listing examples of acquired intangibles and setting out the rules for which these are classified).

The definitional problem in § 482 goes beyond not including intercompany transfers of goodwill—the U.S. focus on intangible transfers may fail to appropriately capture the substantive facts and circumstances of a transfer.[49] The operations moved from one country to another may not constitute an identifiable intangible under § 482 but nevertheless generate profits for the enterprise.[50] In Germany, the classic example is moving a factory from Germany to another country.[51] Without question, moving an entire production line along with know-how and associated patents will trigger a valuation of the property and exit taxation under both §§ 482 and 1 of the German Foreign Tax Act.[52]

On the other hand, reducing a fully-fledged manufacturer to an agent of a principal would also trigger § 482 with respect to any defined intangibles transferred in the context of the restructuring.[53]

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49. BUNDESMINISTERIUM DER FINANZEN [FEDERAL MINISTRY OF FINANCE], Grundsätze für die Prüfung der Einkunftsabgrenzung zwischen nahe stehenden Personen in Fällen von grenzüberschreiteten Funktionsverlagerungen (Verwaltungsgrundsätze Funktionsverlagerung) [Administrative Principles for Determining Income for Cross-Border Transfers of Functions (Administrative Principles)], Oct. 13, 2010, at 10 (demonstrating the facts and circumstances that would lead to the identification of a transfer of business functions as including management activities).

50. Veritas Software Corp. v. Comm'r, 133 T.C. 297, 316–18 (2009) (holding that a workforce in place is not an intangible within the meaning of Section 482 where the operations of that workforce moved from the United States to Ireland).

51. BUNDESMINISTERIUM DER FINANZEN [FEDERAL MINISTRY OF FINANCE], Grundsätze für die Prüfung der Einkunftsabgrenzung zwischen nahe stehenden Personen in Fällen von grenzüberschreiteten Funktionsverlagerungen (Verwaltungsgrundsätze Funktionsverlagerung) [Administrative Principles for Determining Income for Cross-Border Transfers of Functions (Administrative Principles)], Oct. 13, 2010, at 12 (presenting the example of the German-based manufacturer that manufactured Product A and then transferred the future production to a subsidiary company located in another country).

52. *Compare id.* (concluding that transferring the product line along with tangible and intangible assets constitutes a taxable transfer of business functions under the meaning of § 1 Foreign Tax Act and the FVerlV), *with* Eli Lily & Co. v. Comm'r, 856 F.2d 855, 860 (7th Cir. 1988) (describing a pharmaceutical company's production shift from the United States to a Puerto Rican affiliate constituted a transfer of patent and know-how intangibles).

53. Dr. Dirk Brüninghaus & Dr. Ralph Bodenmüller, *Tatbestandsvorausetzung der Funktionsverlagerung* [*Elements of a Transfer of Business Functions*], 2009 DEUTSCHES STEUERRECHT (DSTR) [GERMAN TAX LAW] 1285 (2009), at 4–5 (providing an example of reducing a fully-fledged manufacturer to a routine contract manufacturer). In a simplified example, converting a fully-fledged manufacturer to a mere agent of a principal begins an analysis of the functions, assets, and risks of the taxpayer before and after the transfers. *See id.* Typically, a fully-fledged manufacturer performs all of the functions of a producer and marketer of a product. *Id.* It owns the production facilities, directs marketing and distribution activities, owns the requisite intangible property (including any relevant patents or manufacturing know-how as well as customer lists), and controls the final sale of the product.

Anything else of value, whether attributed to goodwill, going-concern value, or otherwise would be excluded.[54] The taxpayer may transfer these assets free of charge and free of exit taxation to any country in the world.[55]

2. *A Narrow Definition of Intangible Property is Inconsistent with Other Tax Statutes, Treasury Regulations, and Applicable Case Law.*

The Obama Administration suggests that no change in law would be required to effectuate changes in how the Internal Revenue Service (the IRS) identifies and values transfers of intangible property under § 482.[56] Instead, the Administration argues that including goodwill as an intangible asset under § 482 is nothing more than a clarification of the law.[57] Ample authority supports the idea that goodwill is an intangible asset, including numerous areas of the Code, as well as case law.[58] Unfortunately for the Administration's position, the absence of the words "goodwill" or "going-concern"

Id. If some of these activities (like marketing and ownership of IP) were transferred to a related party leaving only a contract manufacturer performing that function only for the principal, then a conversion exists. *See* Ackerman, Organista, & Mallo, *supra* note 38, at 2. In this simplified example, section 482 clearly catches the taxation of the transferred intangible property, but it probably does not capture the "marketing function" independent of any specified intangible (like the brand name). *Id.* at 3. By contrast, the German regulations would capture the whole of the transfer. *See* Brüninghaus & Bodenmüller, *supra*, at 4–5.

54. *See* I.R.C. § 482 (2012).

55. *Veritas*, 133 T.C. at 316.

56. JOINT COMM. ON TAXATION, 112TH CONG., DESCRIPTION OF REVENUE PROVISIONS CONTAINED IN THE PRESIDENT'S FISCAL YEAR 2013 BUDGET PROPOSAL 364 (Comm. Print 2012).

57. *Id.* ("The proposal states that it clarifies the definition of intangible property for purposes of sections 367(d) and 482 includes workforce in place, goodwill and going concern value."). With regard to workforce in place, the IRS "takes the position that any identifiable intangible with substantial value independent of the services of any particular individual is, by definition, not goodwill or going concern value." *Id.* at 366 (citing Treas. Reg. § 1.482-4(b)(6)). In an example, the Administration argues that a research and development team "that has substantial value independent of the services of any individual member of that workforce also has an intangible component that is distinct from goodwill and going concern value and is compensable by the person for whose benefit it is used." *Id.*

58. *E.g.*, I.R.C. § 865(d)(2) (2012) (defining intangible assets as including goodwill); Welch v. Helvering, 290 U.S. 111, 115 (1933) ("Reputation and learning are akin to capital assets, like the good will of an old partnership.").Under section 865(d), goodwill is "sourced in the country in which it was generated," and "in cases involving multi-jurisdictional business, an allocation of the gain among various jurisdictions may be required." CHRISTIANS ET AL., *supra* note 6, at 32.

under § 482's definitions of intangible property is conspicuous.[59] Following the canon of construction *expressio unius est exclusio alterius*,[60] one can quickly conclude that Congress's exclusion of "goodwill" from § 936(h) is an intentional omission where other sections of the Code, and the regulations promulgated thereunder, expressly include goodwill and going-concern value as an intangible asset.[61]

Adding goodwill to the list of intangibles under § 936(h) may go a long way to aligning the international transfers of intangibles to purely domestic transactions.[62] However, changes to the statutes beyond those the Obama Administration has proposed may be warranted because even including goodwill leaves open a factual analysis of the taxpayer's operations in the period before and after the transfer of the function.[63]

The current law simply does not require that type of before-and-after analysis, an analysis which is necessary to ascertain the extent to which valuable business functions moved across borders.[64] In

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59. I.R.C. § 197 (2012) (expressly including goodwill with intangibles).

60. *Expressio Unius Est Exclusio Alterius*, BLACK'S LAW DICTIONARY (10th ed. 2014) ("A canon of construction holding that to express or include one thing implies the exclusion of the other, or of the alternative.").

61. *See, e.g.*, I.R.C. § 197(d). Internal Revenue Code § 197(d) provides:

> (1) In general.—Except as otherwise provided in this section, the term "section 197 intangible" means—(A) goodwill, (B) going concern value, (C) any of the following intangible items: (i) workforce in place including its composition and terms and conditions (contractual or otherwise) of its employment, (ii) business books and records, operating systems, or any other information base (including lists or other information with respect to current or prospective customers), (iii) any patent, copyright, formula, process, design, pattern, knowhow, format, or other similar item, (iv) any customer-based intangible,(v) any supplier-based intangible, and (vi) any other similar item.

Id.

62. *See* discussion *supra* Part II.A.

63. BUNDESMINISTERIUM DER FINANZEN [FEDERAL MINISTRY OF FINANCE], Grundsätze für die Prüfung der Einkunftsabgrenzung zwischen nahe stehenden Personen in Fällen von grenzüberschreiteten Funktionsverlagerungen (Verwaltungsgrundsätze Funktionsverlagerung) [Administrative Principles for Determining Income for Cross-Border Transfers of Functions (Administrative Principles)], Oct. 13, 2010, at 16, 35, 54–55 (requiring an analysis of the circumstances surrounding the transfer of functions before and after the transfer).

64. I.R.C. § 482 (2012).

addition, were the IRS to engage in a before and after functional analysis, the IRS would lack the authority to tax anything beyond those separately identifiable intangibles and not goodwill.[65]

B. German Statutes and Regulations Regarding Transfers of Business Functions Offer an Alternative Approach to Taxing Intercompany Transfers of Intangible Property

1. German Regulations Broadly Define Business Functions as the Touchstone of Analyzing Transfers of Profit

German transfer pricing rules provide a broader starting point in evaluating a business restructuring by taxing transfers of business functions.[66] The German parliament amended many provisions of the corporate tax code in connection with the *Unternehmensteuerreformgesetz* of 2008 (Corporate Tax Reform Act of 2008).[67] The Corporate Tax Reform Act of 2008 amended the Foreign Tax Code, and it included additional language authorizing the taxation of transfers of functions with the accompanying chances and risks.[68]

The statute itself does not define the term "function."[69] The *Funktionsverlagerungverordnung* (Executive Decree on Transfers of Business Functions) defines a function as a "business activity that consists of an amalgamation of similar business duties which are carried out by particular positions or departments in a company."[70]

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65. *Accord* Comm'r v. Lincoln Sav. & Loan Ass'n, 403 U.S. 345, 354 (1971) (noting that goodwill is a "a separate and distinct . . . asset").

66. Außensteuergesetz (AStG) [Foreign Taxation Law], Sep. 8, 1972, BUNDESGESETZBLATT I [BGBl. I] [FEDERAL GAZETTE I] at 1713, §§ 1 (1)–(3), as amended, Dec. 22, 2014 BGBl I. at 2417.

67. Unternehmenssteuerreformgesetz 2008 [UStRG 2008] [Corporate Tax Reform Act of 2008], May 25, 2007, BUNDESGESETZBLATT I [BGBL I] [FEDERAL GAZETTE I], art. 7.

68. *Id.* (codifying the changes to the Foreign Tax Code to include transfers of business functions).

69. GERHARD KRAFT, AUßENSTEUERGESETZ (ASTG) [FOREIGN TAX ACT], *AStG § 1 Berichtigung von Einkommen [Income Adjustments]* ¶ 360 (2009) ("A legal definition of the term function does not exist. Nevertheless, § 1 para. 1. FVerlV indicates that a function . . . consists of a combination of similar business activities carried out by specific positions or departments of a company.").

70. §§ 1 (1)–(3) Verordnung zur Anwendung des Fremdvergleichsgrundsatzes nach § 1 Abs. 1 des Außensteuergesetzes in Fällen grenzüberschreitender Funktionsverlagerungen [Funktionsverlagerungsverordnung - FVerlV] [Regulation on the Application of the Arm's Length

The Executive Decree on Transfers of Business Functions further defines a transfer of functions as one where the related transferee can now perform a function that had been previously performed by the transferor.[71]

A function consists of chances, risks, and assets.[72] These chances, risks, and assets represent business activities consisting of a combination of similar business tasks that are performed by certain positions or departments of an entity.[73] Generally, all types of operating activities are considered functions, such as research and development, purchasing, production, distribution, financing, and management activities.[74]

A transfer of functions occurs when an entity transfers assets and other advantages as well as the associated opportunities and risks to another related party so that the receiving entity may exercise a function which was formerly carried out by the transferring entity.[75] If the function in the transferring entity is limited by this transfer, this constitutes a transfer of functions.[76] A limitation of functions occurs when, for example, transferring the production of a particular transfer leads to a reduction of revenues in Germany. [77] Note that the criteria have been met for the limitation of a function even where new

Principle under § 1 (1) of the Foreign Transactions Tax Law in Instances of Cross-Border Transfers of Function] [Transfer of Function Regulation], as amended, June 26, 2013 BUNDESGESETZBLATT I [BGBl I] [FEDERAL GAZETTE I] at 1809.

71. Brüninghaus & Bodenmüller, *supra* note 53, at 6.

72. *Id.* at 1.

73. §§ 1 (1)–(3) Verordnung zur Anwendung des Fremdvergleichsgrundsatzes nach § 1 Abs. 1 des Außensteuergesetzes in Fällen grenzüberschreitender Funktionsverlagerungen [Funktionsverlagerungsverordnung - FVerlV] [Regulation on the Application of the Arm's Length Principle under § 1 (1) of the Foreign Transactions Tax Law in Instances of Cross-Border Transfers of Function] [Transfer of Function Regulation], as amended, June 26, 2013 BUNDESGESETZBLATT I [BGBl I] [FEDERAL GAZETTE I] at 1809.

74. Brüninghaus & Bodenmüller, *supra* note 53, at 8 (listing typical practical examples of transfers of functions including differing types of business activities).

75. *Id.* at 5; *see also* Ackerman et al., *supra* note 35, at 4.

76. Brüninghaus & Bodenmüller, *supra* note 53, at 3.

77. BUNDESMINISTERIUM DER FINANZEN [FEDERAL MINISTRY OF FINANCE], Grundsätze für die Prüfung der Einkunftsabgrenzung zwischen nahe stehenden Personen in Fällen von grenzüberschreiteten Funktionsverlagerungen (Verwaltungsgrundsätze Funktionsverlagerung) [Administrative Principles for Determining Income for Cross-Border Transfers of Functions (Administrative Principles)], Oct. 13, 2010, at 11.

product lines offset the decline in revenues from the departure of existing product lines.[78]

Once the elements of a transfer of functions have been met, the taxpayer is required to value the function according to the specifications of German law, which require an arm's length compensation for the intercompany transfer of functions.[79] Germany requires a payment for the transferred function, typically based on the net present value of the function transferred.[80]

In administrative guidance, the German tax authorities employ an "output-oriented approach" in defining a function.[81] Under this approach, the production of a certain product is accordingly a stand-alone function; the production of another product is, on the other hand considered another function, notwithstanding any comparability of the individual products.[82] Commonly occurring "transfers of products" would each be, according to the Ministry of Finance, a separate transfer of functions.[83] This applies even if the production of the transferred product is replaced with the production of another comparable product.[84]

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78. *Id.*

79. *Id.* at 25–30.

80. VÖGELE ET AL., *supra* note 8, ch. Q, ¶ 11 at 1614. Section 1 AStG imposes several valuation requirements that are not found in the U.S. regulations. While the purpose of this note is to explore the definitional shortfalls of the section 482 compared to the German system, a few notes on the valuation mechanism bear mentioning. First, the German regulations require the valuation of the function from the perspective of both the transferring company (the company selling the function) and the company acquiring the function (the transferee). *See id.* This double-sided valuation leads to several direct consequences. *Id.* First, the valuation occurs on a discounted net present value basis of after-tax profits. *Id.* Secondly, goodwill and going concern value are part of the valuation on the side of the transferring company. *Id.*, ch. Q, ¶ 99, at 1637 (noting that the valuation of goodwill comes into play when assets of "closed organizational unit" create a value that exceeds the book value of the assets). Lastly, any synergy effects that the acquiring company may realize would be included in the profit expectations of the transferring company. *See id.*, ch. Q, ¶ 97–100, at 1637.

81. Brüninghaus & Bodenmüller, *supra* note 53, at 3.

82. Ackerman et al., *supra* note 35, at 4.

83. *Id.*

84. BUNDESMINISTERIUM DER FINANZEN [FEDERAL MINISTRY OF FINANCE], Grundsätze für die Prüfung der Einkunftsabgrenzung zwischen nahe stehenden Personen in Fällen von grenzüberschreiteten Funktionsverlagerungen (Verwaltungsgrundsätze Funktionsverlagerung) [Administrative Principles for Determining Income for Cross-Border Transfers of Functions (Administrative Principles)], Oct. 13, 2010, at 66–72.

2. *Expanding § 482 or § 936(h) to Include Transfers of Business Functions Offers a Workable Solution*

The German example provides a potential model for the U.S. to implement similar rules. First, the German definition encompasses all tangible and intangible assets included in the definitions of intangible property under §§ 482 and 936(h).[85] In addition to encompassing the same listed intangibles covered in relevant U.S. transfer pricing law, the German definition also includes goodwill.[86] Furthermore, Germany's definition of "function," by including a combination of business activities, clearly captures concepts such as "workforce in place" because the definition of function includes individual positions and departments within a company conducting business activities.[87] In addition, German valuation methods capture the synergy values, or the value created from combining two operations together as opposed to operating independently.[88]

Contrasting the German method with a U.S. analysis in a domestic context captures some of the failures of current U.S. law and how the German approach remedies these failures. In *Selig v. United States*, the Seventh Circuit recognized the bulk sale of a baseball team as an

85. *Compare* §§ 1 (3) Außensteuergesetz (AStG) [Foreign Taxation Law], Sept. 8, 1972, BUNDESGESETZBLATT I [BGBl. I] [FEDERAL GAZETTE I] at 1713, as amended, Dec. 22, 2014 BGBl I. at 2417 (including all tangible and intangible assets), *with* I.R.C. §§ 482, 936(h) (2012) (excluding certain intangibles).

86. §§ 1 (1)–(3) Verordnung zur Anwendung des Fremdvergleichsgrundsatzes nach § 1 Abs. 1 des Außensteuergesetzes in Fällen grenzüberschreitender Funktionsverlagerungen [Funktionsverlagerungsverordnung - FVerlV] [Regulation on the Application of the Arm's Length Principle under § 1 (1) of the Foreign Transactions Tax Law in Instances of Cross-Border Transfers of Function] [Transfer of Function Regulation], as amended, June 26, 2013 BUNDESGESETZBLATT I [BGBl I] [FEDERAL GAZETTE I] at 1809.

87. *Id.* (recognizing that a function consists of the activities of departments within a company that are distinct parts of a legal entity).

88. BUNDESMINISTERIUM DER FINANZEN [FEDERAL MINISTRY OF FINANCE], Grundsätze für die Prüfung der Einkunftsabgrenzung zwischen nahe stehenden Personen in Fällen von grenzüberschreiteten Funktionsverlagerungen (Verwaltungsgrundsätze Funktionsverlagerung) [Administrative Principles for Determining Income for Cross-Border Transfers of Functions (Administrative Principles)], Oct. 13, 2010, at 34 (including synergy effects in the valuation of a transfer of business functions). Under current law, the U.S. may not consider synergy effects an appropriate intangible. *See* Weinberger v. UOP, Inc., 457 A.2d 701, 713 (Del. 1983) (holding, in a shareholder dispute context, that fair value measurements are required to include all relevant factors, and "[o]nly the speculative elements of value that may arise from the 'accomplishment or expectation' of the merger are excluded.").

identifiable asset, holding that the value of the combined contracts was worth more than the sum of the individual contracts.[89] If an analogous transfer were to occur across borders within a corporate group, § 482 would give no authority to value and tax this intercompany transaction.[90] The German method leaves no stone unturned in the factual analysis of a transfer of business functions from one country to another.[91]

III. THE U.S. SHOULD INCORPORATE GERMAN REGULATIONS IN EVALUATING AND TAXING TRANSFERS OF BUSINESS FUNCTIONS TO RELATED PARTIES

A. Change § 482 to Tax Intercompany Transfers of Business Functions

Whether or not the current trend of U.S. companies engaging in inversion transactions continues at the present pace, U.S. companies moving intangible property overseas creates an important area of scrutiny for the IRS.[92] Changing the law would create statutory authority to allow the IRS to adjust a taxpayer's income to reflect results "commensurate with the income" of the intangibles and business operations transferred.[93]

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89. Selig v. United States, 740 F.2d 572, 578 (7th Cir. 1984) ("[A] sale in the player market or free agent market is a different transaction economically, subject to different restrictions, and may result in attaining values for the players substantially different from those attained in a bulk sale in the club market. . . . [W]e find no error in the district court's decision to rely on data derived from analyses of that market.").

90. I.R.C. § 936(h)(3)(B) (2012).

91. BUNDESMINISTERIUM DER FINANZEN [FEDERAL MINISTRY OF FINANCE], Grundsätze für die Prüfung der Einkunftsabgrenzung zwischen nahe stehenden Personen in Fällen von grenzüberschreiteten Funktionsverlagerungen (Verwaltungsgrundsätze Funktionsverlagerung) [Administrative Principles for Determining Income for Cross-Border Transfers of Functions (Administrative Principles)], Oct. 13, 2010, at 16, 35, 54–55 (requiring a factual analysis of the circumstances surrounding the transfer of functions, both before and after the transfer for both the transferor and the transferee).

92. Noah Buhayar, Richard Rubin & Zachary Tracer Jesse Drucker, *Buffett Seen Saving More Than $ 1 Billion on Taxes in Swap*, BLOOMBERG BUS. (Nov. 13, 2014, 12:50 PM), https://www.bloomberg.com/news/2014-11-13/buffett-seen-saving-more-than-1-billion-on-taxes-in-swap.html.

93. JOINT COMM. ON TAXATION, 112TH CONG., DESCRIPTION OF REVENUE PROVISIONS CONTAINED IN THE PRESIDENT'S FISCAL YEAR 2013 BUDGET PROPOSAL 357 (Comm. Print 2012).

If one takes the Obama Administration's proposal to modify the definition as little more than a clarification of present law, then Congress need not act.[94] In that vein, if §§ 482 and the cross-referenced 936(h)(3)(B) are already broad enough to encompass both goodwill or business functions within the definition of intangible property, then Congress need not take any additional action.[95] If the existing regulations are sufficient, then taxing the intercompany transfer of business functions or goodwill in the context of an overall corporate inversion becomes little more than a matter of enforcement.

Transfers of business functions cannot be taxed without first identifying specific, identifiable, and intangible assets listed in the statute. Thus, the inability to identify statutorily listed assets presents a hurdle to enforcement because the IRS is not permitted to act outside of its statutory authority.[96] This allows certain intercompany transfers of valuable business functions to go untaxed.[97]

B. Incorporate Language Similar to Germany's Transfer of Functions Rules

Congress should enact a statute that vests the Treasury with the authority to ascertain, value and ultimately tax intercompany transfers of business functions. The German statutory, regulatory, and guidance regime presents a workable model that could be incorporated in the United States' own statutory and regulatory structures.[98]

Specifically, Congress should expand the definition of intangibles in § 482 to include business functions along with the related chances and risks.[99] A business function is the aggregation of tasks, people, and assets employed in a commercial activity.[100] Assets in the

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94. *Id.* at 364.
95. *Id.*
96. Chevron U.S.A., Inc. v. Nat. Res. Def. Council, Inc., 467 U. S. 837, 841 (1984).
97. I.R.C. § 936(h)(3)(B) (2012).
98. Oliver Wehnert & Cornelia Wolff, *German Transfer Pricing Regulations—Tax Authorities Further Tighten the Belt*, 18 J. INT'L TAX. 22, 24–25 (2007).
99. *Id.* at 26.
100. §§ 1 (1)–(3) Verordnung zur Anwendung des Fremdvergleichsgrundsatzes nach § 1 Abs. 1 des

context of a business function would include both tangible and intangible assets so long as they are related to the identified business function. Chances and risks refer to the profit associated with the activity.[101]

Congress could choose, as German statutes do, to leave the definition of business function to the regulations.[102] Business functions would include workforce in place, management functions, production, distribution, research and development, etc. . .[103] To the extent that a U.S. entity transfers these functions to a related party, the Treasury would have the authority to value and tax the transaction.[104]

A transfer pricing analysis generally involves the identification of functions, risks, and assets.[105] Tying the business function to associate chances and risks ensures that the intercompany transfer of valuable, risk-taking parts of a business are subject to taxation.[106] Lowering the threshold allows a much broader start for tax authorities to tax a transaction.[107]

Außensteuergesetzes in Fällen grenzüberschreitender Funktionsverlagerungen [Funktionsverlagerungsverordnung - FVerlV] [Regulation on the Application of the Arm's Length Principle under § 1 (1) of the Foreign Transactions Tax Law in Instances of Cross-Border Transfers of Function] [Transfer of Function Regulation], as amended, June 26, 2013 BUNDESGESETZBLATT I [BGBl I] [FEDERAL GAZETTE I] at 1809.

101. Brüninghaus & Bodenmüller, *supra* note 53, at 6.

102. KRAFT, *supra* note 69.

103. Brüninghaus & Bodenmüller, *supra* note 53, at 8.

104. Verordnung zur Anwendung des Fremdvergleichsgrundsatzes nach § 1 Abs. 1 des Außensteuergesetzes in Fällen grenzüberschreitender Funktionsverlagerungen [Funktionsverlagerungsverordnung - FVerlV] [Regulation on the Application of the Arm's Length Principle under § 1 (1) of the Foreign Transactions Tax Law in Instances of Cross-Border Transfers of Function] [Transfer of Function Regulation], as amended, June 26, 2013 BUNDESGESETZBLATT I [BGBl I] [FEDERAL GAZETTE I] at 1809.

105. ORGANIZATION OF ECONOMIC COOPERATION AND DEVELOPMENT, ORGANIZATION OF ECONOMIC COOPERATION AND DEVELOPMENT TRANSFER PRICING GUIDELINES 253 (2010), http://www.oecd-ilibrary.org/docserver/download/2314291e.pdf?expires=1460042237&id=id&accname=guest&checksum=60EE64583B6D2734A8F0144BC3528933.

106. Verordnung zur Anwendung des Fremdvergleichsgrundsatzes nach § 1 Abs. 1 des Außensteuergesetzes in Fällen grenzüberschreitender Funktionsverlagerungen [Funktionsverlagerungsverordnung - FVerlV] [Regulation on the Application of the Arm's Length Principle under § 1 (1) of the Foreign Transactions Tax Law in Instances of Cross-Border Transfers of Function] [Transfer of Function Regulation], as amended, June 26, 2013 BUNDESGESETZBLATT I [BGBl I] [FEDERAL GAZETTE I] at 1809.

107. *See* Wehnert & Wolff, *supra* note 98, at 26.

The German example provides an alternative model for U.S. rules on taxing intercompany transfers of intangible property. The German definition of intangible property overlaps with the U.S.'s definition of intangible property.[108] But the German definition is more expansive because it includes goodwill.[109] Furthermore, adopting a definition of "business function" in line with German statutes captures concepts like "workforce-in-place" because the definition of function includes individual positions and departments within a company conducting business activities.[110] German valuation rules capture any synergy values generated from combining the operations in the context of an intercompany, cross-border merger.[111]

Modifying the definition of intangible property to include business function in line with the German definition remedies a key shortcoming in existing U.S. law. Intangible property includes workforce-in-place in other areas of the Code, so modifying the definition of intangible to include workforce-in-place as a part of a business function would be in line with existing precedent.[112] Changing the definition in § 482 would allow the Treasury to value and tax this intercompany transaction if a transfer were to occur across borders within a corporate group.[113] Changing the law allows the Treasury to overcome limitations on considering synergistic

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108. *Compare* § 1 (3) Außensteuergesetz (AStG) [Foreign Taxation Law], Sep. 8, 1972, BUNDESGESETZBLATT I [BGBl. I] [FEDERAL GAZETTE I] at 1713, as amended, Dec. 22, 2014 BGBl I. at 2417 (including all tangible and intangible assets), *with* I.R.C. §§ 482, 936(h) (2012) (excluding certain intangibles).

109. Verordnung zur Anwendung des Fremdvergleichsgrundsatzes nach § 1 Abs. 1 des Außensteuergesetzes in Fällen grenzüberschreitender Funktionsverlagerungen [Funktionsverlagerungsverordnung - FVerlV] [Regulation on the Application of the Arm's Length Principle under § 1 (1) of the Foreign Transactions Tax Law in Instances of Cross-Border Transfers of Function] [Transfer of Function Regulation], as amended, June 26, 2013 BUNDESGESETZBLATT I [BGBl I] [FEDERAL GAZETTE I] at 1809.

110. *Id.* (recognizing that a function consists of the activities of departments within a company that are distinct parts of a legal entity).

111. BUNDESMINISTERIUM DER FINANZEN [FEDERAL MINISTRY OF FINANCE], Grundsätze für die Prüfung der Einkunftsabgrenzung zwischen nahe stehenden Personen in Fällen von grenzüberschreiteten Funktionsverlagerungen (Verwaltungsgrundsätze Funktionsverlagerung) [Administrative Principles for Determining Income for Cross-Border Transfers of Functions (Administrative Principles)], Oct. 13, 2010, at 34 (including synergy effects in the valuation of a transfer of business functions).

112. *See* Selig v. United States, 740 F.2d 572, 578 (7th Cir. 1984).

113. I.R.C. § 936(h)(3)(B) (2012).

effects as an intangible.[114] Aligning with the German method would leave no stone unturned in the factual analysis of a transfer of business functions from one country to another.[115]

An expansive definition of "business function" would also include goodwill and going-concern value because all assets associated with the business function would form part of the analysis.[116] Importantly, making the business functions the threshold question in an analysis of cross-border transfers provides a more complete solution than merely extending the definition of intangible to goodwill and going-concern value. For example, to the extent that a Burger King inversion to Tim Horton's requires a management team's activities to move from one country to the other, this Note's proposed statutory additions would authorize the Commissioner to determine the extent to which entrepreneurial risks and opportunities transferred in connection with that inversion.[117] This hook would allow the Treasury to ascertain, value, and ultimately collect income taxes due in an arm's length sale of such a business function.[118]

Meeting the elements of a transfer of business functions requires the taxpayer to value the business functions in order to calculate an arm's length payment for the function, risks, and assets for the intercompany transfer of functions.[119] German regulations require a payment for the transferred function calculated on the net present

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114. Weinberger v. UOP, Inc., 457 A.2d 701, 713 (Del. 1983).

115. BUNDESMINISTERIUM DER FINANZEN [FEDERAL MINISTRY OF FINANCE], Grundsätze für die Prüfung der Einkunftsabgrenzung zwischen nahe stehenden Personen in Fällen von grenzüberschreiteten Funktionsverlagerungen (Verwaltungsgrundsätze Funktionsverlagerung) [Administrative Principles for Determining Income for Cross-Border Transfers of Functions (Administrative Principles)], Oct. 13, 2010, at 16, 35, 54–55 (requiring a factual analysis of the circumstances surrounding the transfer of functions, both before and after the transfer for both the transferor and the transferee).

116. Brüninghaus & Bodenmüller, *supra* note 53, at 4–5. Adding "and risks" may be superfluous because risk and reward are two sides of the same coin. Aswath Damodaran, *Applied Corporate Finance*, at 21 (2007), http://people.stern.nyu.edu/adamodar/pdfiles/execs/cf2day2007notes.pdf.

117. Wehnert & Wolff, *supra* note 98, at 6, 25.

118. *Id.* at 27.

119. BUNDESMINISTERIUM DER FINANZEN [FEDERAL MINISTRY OF FINANCE], Grundsätze für die Prüfung der Einkunftsabgrenzung zwischen nahe stehenden Personen in Fällen von grenzüberschreiteten Funktionsverlagerungen (Verwaltungsgrundsätze Funktionsverlagerung) [Administrative Principles for Determining Income for Cross-Border Transfers of Functions (Administrative Principles)], Oct. 13, 2010, at 25–30.

value of the cash flows derived from the transferred function.[120] Changing the definition of intangible property would not require the Treasury to issue or amend its regulation on valuing intangible property because the Treasury's regulatory guidance would be sufficient.[121]

Multi-national enterprises adjust their operations primarily for business purposes unrelated to taxation.[122] Moving operations from one country to another is part of a globalized economy.[123] Moving operations from one country to another may lead to taxable events that require regulation in the event that a company transfers its operations and assets to a related party to ensure an arm's length remuneration.[124] Under a more expansive view of intangible property, companies like Google would still be able to organize their overseas operations as their business demands and take advantage of better corporate tax rates.[125] The proposed rules would merely require an arm's length payment for the intercompany transfer of valuable business functions.[126]

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120. VÖGELE ET AL., *supra* note 8, ch. Q, ¶ 11, at 1614.

121. Treas. Reg. § 1.482-7 (2012). The final cost sharing regulations contain the "income method" as an available method for the taxpayer to value the transfer of intangible property in the contest of a cost sharing arrangement. *See id.* The income method, along with the methods contained in Treasury Regulation § 1.482-4 related to intangible property could serve as the basis for taxing business functions. *See id.* Changing the subject matter of the valuation of intercompany transfers of intangible property would probably not require significant changes to the regulations. *Compare* §§ 1 (1)–(3) Verordnung zur Anwendung des Fremdvergleichsgrundsatzes nach § 1 Abs. 1 des Außensteuergesetzes in Fällen grenzüberschreitender Funktionsverlagerungen [Funktionsverlagerungsverordnung - FVerlV] [Regulation on the Application of the Arm's Length Principle under § 1 (1) of the Foreign Transactions Tax Law in Instances of Cross-Border Transfers of Function] [Transfer of Function Regulation], as amended, June 26, 2013 BUNDESGESETZBLATT I [BGBl I] [FEDERAL GAZETTE I] at 1809, *with* Treas. Reg. § 1.482-7 (2012) (where both the German and U.S. regulations refer to an income method and discounted cash flow valuation methodologies).

122. VÖGELE ET AL., *supra* note 8, ch. Q, ¶ 1, at 1611.

123. *Id.*

124. I.R.C. § 482 (2012).

125. Drucker, *supra* note 3.

126. Treas. Reg. § 1.482-1(b)(1) (as amended in 2011).

C. Add Goodwill as an Alternative to Statutory and Regulatory Overhaul

Recognizing that Congress may be reluctant to introduce an entirely new statutory and regulatory regime, Congress could—and should—opt for a minimum addition of goodwill to the list of intangible property, either directly under§ 482 or indirectly to incorporate it by reference under § 936(h)(3)(B). Some profitable business portions fall outside the purview of existing U.S. statutory law because U.S. regulations do not tax the transfer of goodwill along with other identifiable intangibles.[127] Depending on how the single identifiable intangible is valued in relation to the overall nexus of similar business activities, the value of "goodwill" could be high but nonetheless out of tax authority reach.[128] If §§ 482 and 936(h)(3)(B) are insufficient to cover goodwill or business functions, then Congress should amend § 482 to incorporate these concepts.

Section 482 fails to appropriately capture the substantive facts and circumstances of a transfer, so merely including intercompany goodwill may not address some valuable transfers of property. Moving operations from one country to another may not constitute goodwill attached to a specific intangible asset under § 482 but nevertheless generate profits for the enterprise.[129] Although this approach does not appear to allow an inquiry into the nature of the functions, assets, and risks transferred for a hypothetical management team, it would allow inquiry as to whether that management team's activities constitute goodwill, a workforce-in-place, or other identifiable intangible.[130] Although the thorny definitional problem of

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127. *See, e.g.*, I.R.C. § 936(h) (2012).

128. *E.g.*, Facebook, Inc., Annual Report (Form 10–K), at 118 (Dec. 31, 2012), http://www.sec.gov/Archives/edgar/data/1326801/000132680113000003/fb-12312012x10k.htm.

129. Veritas Software Corp. v. Comm'r, 133 T.C. 297, 316–18 (2009) (holding that a workforce in place is not an intangible within the meaning of § 482 where the operations of that workforce moved from the United States to Ireland).

130. Verordnung zur Anwendung des Fremdvergleichsgrundsatzes nach § 1 Abs. 1 des Außensteuergesetzes in Fällen grenzüberschreitender Funktionsverlagerungen [Funktionsverlagerungsverordnung - FVerlV] [Regulation on the Application of the Arm's Length Principle under § 1 (1) of the Foreign Transactions Tax Law in Instances of Cross-Border Transfers of Function] [Transfer of Function Regulation], as amended, June 26, 2013 BUNDESGESETZBLATT I [BGBl

what constitutes an intangible asset is still present, widening the definition to include more categories accomplishes the revenue raising and consistency goals of tax policy.

CONCLUSION

Multi-national enterprises avoiding taxes through legal transfer pricing means represents a cost to the United States in the form of foregone tax revenue and inequitable taxation of similarly situated domestic taxpayers. Furthermore, this inequity encourages companies to reorganize with a tax motivation as the primary force. Fortunately, this type of behavior represents an opportunity for Congress to change the law and fall in line with how other countries have dealt with these issues. Although Germany provides a prime example, the OECD's working group in Base Entity Profit Shifting—of which the United States takes part—is continuing to investigate and generate workable solutions.[131] German methods appear to underpin much of the language in Chapter IX of the OECD guidelines. In addition, the German approach appears consistent with the well-established arm's length principle because it mirrors how unrelated third parties would, or could, view these intercompany transactions.

Therefore, Congress should amend § 482 to tax transfers of business functions, incorporating much of the German language and regulatory guidance. If a larger overhaul is not desired, then Congress should, at a minimum, amend § 936(h) to include goodwill and going-concern value in the definition of intangible property.

I] [FEDERAL GAZETTE I] at 1809.

131. THE ORGANIZATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD), BASE EROSION AND PROFIT SHIFTING PROJECT: EXPLANATORY STATEMENT 3 (2014), http://www.oecd.org/ctp/beps-2014-deliverables-explanatory-statement.pdf.