

US TAX COURT
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US TAX COURT
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JUN 18 2020

WESTERN DIGITAL CORPORATION AND
SUBSIDIARIES,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent

ELECTRONICALLY FILED

Docket No. 18984-18

PETITIONER'S REPLY TO AMENDMENT TO ANSWER

SERVED Jun 18 2020

UNITED STATES TAX COURT

WESTERN DIGITAL CORPORATION)	
AND SUBSIDIARIES,)	
)	
)	
Petitioner,)	
)	Docket No. 18984-18
v.)	
)	
COMMISSIONER OF INTERNAL)	
REVENUE,)	
)	Filed Electronically
Respondent)	

REPLY TO RESPONDENT’S FIRST AMENDMENT TO ANSWER

Petitioner replies to Respondent’s First Amendment to Answer as follows:

7. This paragraph does not contain an allegation that requires an admission or denial except as set forth in the subparagraphs below.

7.a. Admits.

7.b. Admits. Alleges that petitioner’s consent communicated petitioner’s disagreement with respondent’s assertion of penalties.

8. This paragraph does not contain an allegation that requires an admission or denial except as set forth in the subparagraphs below.

8.a. Denies.

8.b. Admits that respondent's proposed adjustment for petitioner's fiscal year ended June 27, 2008 ("FY 2008") exceeds \$20,000,000. Denies that respondent's proposed adjustment for FY 2008 is appropriate.

8.c. Denies.

8.c.i. Admits.

8.c.ii. Admits.

8.c.iii. Denies.

8.c.iv. First sentence. Denies that petitioner "concluded that \$140,900,000 was sufficient to cover anticipated royalties. . . ." Admits that petitioner relied on the KPMG Report, which determined that the four-year net present value of the licensed intangible property was \$140,900,000. The \$140,900,000 was a nonrefundable prepayment to be credited against actual unit sales. Additional per-unit royalties were due to the extent actual unit sales exceeded forecasts. Second sentence. Denies.

8.c.v. Admits that respondent's proposed net transfer-pricing adjustment for FY 2008 exceeds the \$140,900,000 prepayment. Alleges that respondent erroneously determined that he was authorized to adjust a prepayment. Further alleges that respondent's adjustment is erroneous irrespective of whether respondent is authorized to adjust a prepayment.

8.c.vi. Denies. Alleges that the KPMG Report's residual profit split method ("RPSM") allocated the anticipated profit attributable to the licensed intangible property. Further alleges that respondent does not define the term "related transactions," so petitioner can neither admit nor deny respondent's assertion with respect to that undefined term.

8.c.vii. Denies. Alleges that the KPMG Report explained why the RPSM was the best method and why the other methods were not suitable given the facts. Further alleges that respondent bases his adjustments in the notice of deficiency on an IRS economist's report that applies a form of the RPSM using a number of the same inputs and parameters used in the KPMG Report.

8.c.viii. First sentence. Denies. Second sentence. Admits.

8.d. Denies.

8.d.i. Denies.

8.d.ii. Denies.

8.d.iii. Admits. Alleges that KPMG provided the KPMG Report to petitioner on January 31, 2008.

8.d.iv. Denies. Alleges that the KPMG Report explained why the RPSM was the best method per Treas. Reg. § 1.482-1(c). Admits that the KPMG Report did not expressly state that it was prepared for section 6662

purposes but alleges that the KPMG Report satisfied the documentation requirement in Treas. Reg. § 1.6662-6(d)(2)(iii).

8.d.v. Denies. Alleges that the KPMG Report explained why the RPSM was the best method and why the other methods were not suitable given the facts. Further alleges that respondent bases his adjustments in the notice of deficiency on an IRS economist's report that applies a form of the RPSM using a number of the same inputs and parameters used in the KPMG Report.

9. First sentence. Admits that respondent made the referenced allegation. Alleges that the referenced allegation is erroneous. Second sentence. Denies that a penalty is appropriate for FY 2008.

9.a. Admits that respondent's proposed adjustment for FY 2008 exceeds \$5,000,000. Denies that respondent's proposed adjustment for FY 2008 is appropriate.

9.b. Denies.

9.b.i. This paragraph does not contain an allegation that requires an admission or denial. Respondent simply references paragraphs 8.c.i.–viii. of Respondent's First Amendment to Answer. Petitioner therefore refers respondent to petitioner's replies to the referenced paragraphs.

9.c. Denies.

9.c.i. This paragraph does not contain an allegation that requires an admission or denial. Respondent simply references paragraphs 8.d.i.–v. of Respondent’s First Amendment to Answer. Petitioner therefore refers respondent to petitioner’s replies to the referenced paragraphs.

10. First sentence. Admits that respondent made the referenced allegation. Alleges that the referenced allegation is erroneous. Second sentence. Denies that a penalty is appropriate for FY 2008.

10.a. Denies

10.b. Denies.

10.c. Denies.

10.c.i. This paragraph does not contain an allegation that requires an admission or denial. Respondent simply references paragraphs 8.c.i.–viii. of Respondent’s First Amendment to Answer. Petitioner therefore refers respondent to petitioner’s replies to the referenced paragraphs.

10.d. Denies.

10.d.i. This paragraph does not contain an allegation that requires an admission or denial. Respondent simply references paragraph 8.c.viii. of Respondent’s First Amendment to Answer. Petitioner therefore refers respondent to petitioner’s reply to the referenced paragraph.

11. First sentence. Admits that respondent made the referenced allegation. Alleges that the referenced allegation is erroneous. Second sentence. Denies that a penalty is appropriate for FY 2008.

11.a. Denies.

11.b. Denies.

11.c. Denies.

11.d. Denies.

12. First sentence. Admits. Alleges that respondent erroneously determined that he was authorized to adjust a prepayment. Further alleges that respondent's adjustments are erroneous irrespective of whether respondent is authorized to adjust a prepayment. Second sentence. Admits that respondent's Alternative Adjustment Position adjusts the royalties in the amounts indicated but denies that the proposed adjustments are appropriate.

13. First sentence. Admits that respondent made the referenced allegation. Alleges that the referenced allegation is erroneous. Second sentence. Admits that respondent made the referenced allegations. Alleges that the referenced allegations are erroneous. Third sentence. Admits. Alleges that no deficiencies or penalties are appropriate.

14. Admits that respondent and the IRS did not notify petitioner in any manner—formally or informally—of any intention to assess penalties until this

case had been docketed for over a year and a half, when respondent notified petitioner on April 30, 2020 that respondent intended to amend his answer to assert penalties. Alleges that the IRS extensively audited the transfer-pricing issue over the course of multiple years, including extensive audit follow up on the subject matter of the KPMG Report. Further alleges that at no time during the IRS administrative process did the IRS even suggest to petitioner that penalties might be appropriate. Further alleges that the asserted penalties constitute a new matter on which respondent bears the burden of proof.

15. First through third sentences. Denies for lack of knowledge or information sufficient to form a belief as to the truth of the allegations. Fourth sentence. Calls for a legal conclusion for which no reply is required. To the extent a reply is required, denies for lack of knowledge or information sufficient to form a belief as to the truth of the allegation.

16. Denies. Alleges that the Court has jurisdiction to consider the penalties under section 6214(a) of the Internal Revenue Code.

17. This paragraph does not contain an allegation that requires an admission or denial. And petitioner does not understand this paragraph given that respondent already filed an answer admitting, qualifying, or denying the allegations in the petition.

WHEREFORE, petitioner prays that this Court deny respondent's penalty assertions in Respondent's First Amendment to Answer.

Respectfully submitted,

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Dated: June 18, 2020