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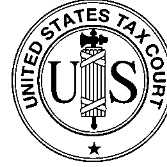

US TAX COURT
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JUN 15 2020

WESTERN DIGITAL CORPORATION AND
SUBSIDIARIES, ET AL.,
Petitioners,

ELECTRONICALLY FILED

v. Docket No. 18984-18, 4818-19

COMMISSIONER OF INTERNAL REVENUE,
Respondent

PETITIONERS' RESPONSE TO MOTION FOR PARTIAL SUMMARY JUDGMENT

SERVED Jun 15 2020

UNITED STATES TAX COURT

WESTERN DIGITAL CORPORATION AND SUBSIDIARIES,	)	
Petitioner,	)	Docket Nos. 18984-18, 4818-19
v.	)	
COMMISSIONER OF INTERNAL REVENUE,	)	
Respondent	)	Filed Electronically

PETITIONER'S RESPONSE TO RESPONDENT'S MOTION FOR PARTIAL SUMMARY JUDGMENT

Respondent filed a motion for partial summary judgment ("Respondent's MPSJ") and related memorandum ("Respondent's Memorandum") on April 29, 2020. Respondent seeks a ruling that Treas. Reg. § 1.482-2(a)(1)(iii)(B) "does not apply" to section 956(c)(2)(C).[1] Petitioner files this response in accordance with the Court's May 1, 2020 order, which set deadlines for a response and reply.

As explained below, Respondent's MPSJ has fatal procedural and substantive flaws. Procedurally, Respondent's MPSJ frustrates the purpose of

[1]"Section" references are to the Internal Revenue Code, as amended and in effect for the years in issue. "Treas. Reg." references are to the Federal income tax regulations in effect for the years in issue. "Rule" references are to the Tax Court Rules of Practice and Procedure.

summary judgment, seeks a premature and potentially advisory opinion, and does not seek to dispose of any of the issues in the case. Substantively, Respondent's MPSJ miscasts as clear an ambiguous, facts-and-circumstances-dependent statutory exception and tells a distorted narrative that frustrates Congress's intent to exclude from income inclusion under section 956 normal commercial transactions (trade receivables) reflecting common payment practices.

I. RESPONDENT'S MPSJ IS PROCEDURALLY DEFECTIVE.

Summary judgment is a device for expediting the resolution of litigation; it is intended to avoid unnecessary and expensive trials. Shiosaki v. Commissioner, 61 T.C. 861, 862 (1974). The Court should deny Respondent's MPSJ because it does not serve the purpose of summary judgment.

A trial on the section 956 issue will involve the same scope and evidence regardless of how the Court rules on Respondent's MPSJ. Respondent's statement to the contrary—that "[t]he granting of this motion will narrow the issues for trial . . ." at ¶ 17 of Respondent's MPSJ—is simply false. It is therefore not surprising that respondent provides no basis for (or explanation in support of) that statement.

Respondent's MPSJ is the kind of piecemeal-litigation tactic that courts disfavor. This Court said it best in denying a taxpayer's motion for partial summary judgment *at respondent's request*:

> Our opinion would not dispense with the need for a trial to resolve any dispute between the parties about operative facts in this case. Accordingly, petitioners' Motion for Partial Summary Judgement does not serve the above objective of the summary judgment procedure. In fact, it would do the opposite because it would tend to foster piece-meal adjudication.

Mazzocchi Bus. Co., Inc. v Commissioner, T.C. Memo. 1990-292; see also Garisto v. Geico Ins. Co., No. 3:10-CV-00261-TMB, 2011 WL 13152057, at *2 (D. Alaska Aug. 2, 2011) (noting that courts can decline to rule on an MPSJ "where it would result in inefficient, piecemeal litigation"); Tenn. Valley Auth. v. Westinghouse Elec. Co., 69 F.R.D. 5, 9 (E.D. Tenn. 1975) (equating "the well-settled rule that the materials presented by the moving party in support of its motion must be viewed in the light most favorable to the opposing party" with the "rule of equal importance . . . that a court should avoid piecemeal litigation").

The procedural problems with Respondent's MPSJ do not end there. Respondent essentially asks the Court to order itself not to consider Treas. Reg. § 1.482-2 *if* petitioner relies on that regulation in a post-trial brief or otherwise. This raises questions such as: Would such an order bind the Court in the ultimate opinion in the case (or could the Court reconsider its position after it hears the evidence and arguments)? If the Court could reconsider its position, then would such an order have any effect at all? Would such an order foreclose other judges from considering the regulation in other cases even if the parties ultimately settle the section 956 issue in this case? Would the Court even have to consider the

applicability of the regulation in this case, or could it decide the case without doing so? The answers to those questions suggest that Respondent's MPSJ could amount to an improper request for an advisory opinion. See Nickert v. Puget Sound Tug & Barge Co., 480 F.2d 1039, 1041 (9th Cir. 1973) (characterizing a trial court's ruling on a question of law on partial summary judgment as a hypothetical, advisory opinion subject to later revision or reversal by the trial judge); Mazzocchi Bus. Co., Inc., T.C. Memo. 1990-292 (denying a taxpayer's motion for partial summary judgment at respondent's request because the motion sought "an advisory opinion as to a question of law, and such relief is outside of the intended scope of Rule 121"); id. ("[O]ur opinion on the question posed by petitioners' motion might prove to be extraneous when the facts are known.").

Finally, it is questionable whether the potential interpretive argument on which respondent seeks a summary-judgment ruling[2] even constitutes an "issue" for purposes of Rule 121. Rule 121(b) permits "a partial summary adjudication . . . which does not dispose of *all* the issues in the case" (emphasis added).

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[2]Respondent describes that argument inconsistently. Respondent's MPSJ ultimately rests on a strawman position of respondent's imagining—that petitioner "seeks to inappropriately create a new safe harbor rule." Respondent's Memorandum at 10. But tucked away in Respondent's MPSJ and Respondent's Memorandum is respondent's acknowledgment that petitioner merely contends that the referenced regulation is relevant to the Court's interpretive inquiry and that the Court should ultimately consider it in ruling on the section 956 issue. Respondent's MPSJ at ¶ 14(f); Respondent's Memorandum at 5.

Respondent's MPSJ would not dispose of *any* issues in the case. Respondent defines the issues in the case (e.g., "Transfer pricing under I.R.C. § 482" and "I.R.C. § 956") in paragraph 10 of Respondent's MPSJ—the relevancy (or lack thereof) of Treas. Reg. § 1.482-2 to respondent's section 956 adjustments is not one of them. Consistent with Rule 34(b)(4), which equates assignments of error and issues, respondent himself defines the relevant issue as the propriety of his section 956 adjustments rather than the merits of potential legal arguments—such as those regarding Treas. Reg. § 1.482-2's relevancy—relating to those adjustments.[3] In any event, the Court should deny Respondent's MPSJ on the procedural grounds noted above regardless of whether Treas. Reg. § 1.482-2's relevancy constitutes an "issue" for purposes of Rule 121 or merely concerns potential arguments relating to an issue.

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[3]Respondent does not (and cannot) request partial summary judgment on the section 956 issue because the question of what is ordinary and necessary depends on the facts and circumstances "and thus will require trial." Crestek, Inc. v. Commissioner, 149 T.C. 112, 133 (2017); see also Seagate Technology, Inc. v. Commissioner, T.C. Memo. 2000-388 ("Summary judgment is a device used to expedite litigation, but it is not a substitute for a trial in that disputes over factual issues are not to be resolved in such proceedings.").

II. RESPONDENT'S MPSJ RESTS ON THE FALSE PREMISE THAT SECTION 956(c)(2)(C) IS CLEAR AND UNAMBIGUOUS AND FAILS TO RECOGNIZE THAT RESPONDENT'S ADJUSTMENTS FLOUT CONGRESSIONAL PURPOSE.

A controlled foreign corporation's ("CFC's") foreign-source income is not generally subject to U.S. taxation until repatriated to the CFC's shareholders via dividend or other distribution.[4] SIH Partners LLLP v. Commissioner, 150 T.C. 28, 34 (2018). Congress enacted sections 951 and 956 in 1962 as part of subpart F of part III, subchapter N, chapter 1 of the Internal Revenue Code. Id. at 38. Those provisions subject certain U.S. shareholders to current income inclusions (i.e., U.S. Federal income tax on a CFC's earnings even when the CFC does not distribute those earnings to its shareholders) based on the U.S. shareholders' pro rata shares of the average amounts of "United States property" held by the CFC at the close of each quarter of the tax year. Section 956(a).[5]

Section 956(c)(1) defines "United States property" generally. The list of items that constitute "United States property" includes "an obligation of a United States person." Section 956(c)(1)(C). Section 956(c)(2) lists exceptions (i.e., items that are excluded from the definition of United States property). The listed

[4]The Tax Cuts and Jobs Act of 2017, Pub. L. No. 115-97, sec. 14101 et seq., altered this longstanding regime for tax years after those in issue in this litigation.

[5]The intricacies and mechanics of sections 951 and 956 (and the subpart F provisions generally) are beyond the scope of this response.

exceptions include the following exception that is the subject of the parties' dispute:

> any obligation of a United States person arising in connection with the sale or processing of property if the amount of such obligation outstanding at no time during the taxable year exceeds the amount which would be ordinary and necessary to carry on the trade or business of both the other party to the sale or processing transaction and the United States person had the sale or processing transaction been made between unrelated persons . . . .

Section 956(c)(2)(C).

Congress's stated purpose in enacting section 956 was to "to prevent the repatriation of income to the United States in a manner which does not subject it to U.S. taxation." H.R. Rept. No. 87-1447, at 58 (1962). That is, Congress sought to tax U.S. shareholders on earnings brought back to the United States on the basis that "this is substantially the equivalent of a dividend being paid to them." S. Rept. No. 87-1881, at 88 (1962). Given the regime's purpose, it should come as no surprise that Congress included the aforementioned exception. Congress did not view "normal commercial transactions without intention to permit the funds to remain in the United States indefinitely" as substantially equivalent to a dividend to U.S. shareholders. Id.

Respondent declares section 956(c)(2)(C) "clear and unambiguous on its face," Respondent's Memorandum at 11, and argues that "[p]etitioner is ignoring

the most basic cannon [sic] of statutory construction—the plain meaning of the [sic] Section 956(c)(2)(C)," id. at 13. Respondent is simply incorrect.

Section 956(c)(2)(C) does not define or explain the term "the amount which would be ordinary and necessary." And the Supreme Court itself has recognized on more than one occasion that the term "ordinary and necessary" is ambiguous. See, e.g., Textile Mills Sec. Corp. v. Commissioner, 314 U.S. 326, 338 (1941) (characterizing the words "ordinary and necessary" as "not so clear and unambiguous in their meaning and application as to leave no room for an interpretative regulation. The numerous cases which have come to this Court on that issue bear witness to that."); Welch v. Helvering, 290 U.S. 111, 115 (1933) (characterizing what is "ordinary" as "not a rule of law; it is rather a way of life. Life in all its fullness must supply the answer to the riddle.").[6]

Under these circumstances, it is critical to remember Congress's goal in enacting the exception the parties now dispute—to spare from current U.S. taxation normal commercial transactions and obligations without intention to permit the funds to remain in the United States *indefinitely*. See Green v. Bock Laundry Mach. Co., 490 U.S. 504, 508–509 (1989) ("We begin by considering the extent to

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[6]The relevant Treasury regulation serves only to emphasize the statute's ambiguous nature, largely repeating the statute before adding that "[w]hether the amount of an obligation described in this subdivision is ordinary and necessary is to be determined from all the facts and circumstances in each case." Treas. Reg. § 1.956-2(b)(1)(v).

which the text of [the disputed provision] answers the question before us. Concluding that the text is ambiguous with respect to [that question], we then seek guidance from legislative history . . . .").

Respondent's MPSJ paints a warped narrative in which respondent provides no factual support for any of his statements of fact and fails to apprise the Court of numerous relevant facts.[7] Among the relevant facts respondent neglects to mention is the fact that Western Digital (Malaysia) Sdn. Bhd. and Western Digital (Thailand) Co. Ltd.—the relevant CFCs—regularly paid third-party vendors 90 days or more from an invoice date. Respondent also fails to note the instances in which Western Digital's customers paid Western Digital 90 days or more from an invoice date. Nor does respondent apprise the Court that payment of invoices 90 days or more after issuance is evident in petitioner's industry (as respondent defines it). Respondent's failure to mention these facts obscures that respondent is seeking to apply section 956 in a draconian manner that defies (rather than furthers) Congress's goals.

Under these circumstances, the Court should retain all of the interpretative tools in its arsenal, including the ability to look to the transfer-pricing regulations to the extent the Court deems them relevant after considering the evidence. See C.

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[7]A prime example of an improper statement of fact is respondent's naked allegation that "the industry standard for paying invoices was approximately 60 days Net." Respondent's Memorandum at 4.

Lowell and M. Martin, U.S. International Transfer Pricing ¶ 17.04[3][d][iii] ("Relationship of Section 956 to Section 482") (Thomson Reuters/Tax & Accounting) (2020) ("In situations where it is not completely clear whether the period of a receivable is ordinary and necessary, it may be that the appropriate approach would be to impose the interest charge of the Section 482 Regulations, rather than a complete termination of the deferral under Section 956, which seems harsh in an ambiguous situation (inevitably present when an ordinary and necessary inquiry is to be made)."). And there is good reason for the Court to deem the transfer-pricing regulations relevant to the section 956 inquiry in this case. Section 956(c)(2)(C)—the crux of the parties' dispute—looks to transactions "between unrelated persons." As the Court of Appeals for the Ninth Circuit (to which an appeal of the Court's decision in this case would lie) recognized: "The purpose of the [transfer-pricing] regulations is parity between taxpayers in uncontrolled transactions and taxpayers in controlled transactions." Xilinx, Inc., v. Commissioner, 598 F.3d 1191, 1196 (9th Cir. 2010). Where better for the Court to look for relevant guidance on a novel legal question that looks to transactions between unrelated parties than to a well-developed transfer-pricing regime that speaks to that very subject?

III. CONCLUSION

For the reasons explained above, petitioner respectfully requests that the Court deny Respondent's MPSJ.

Respectfully submitted,

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