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

ELECTRONICALLY FILED

v.

Docket No. 18984-18, 4818-19

COMMISSIONER OF INTERNAL REVENUE,
Respondent

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

UNITED STATES TAX COURT

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

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

On April 29, 2020, Respondent filed a motion for partial summary judgment and related memorandum seeking judgment as a matter of law on the applicability of Treas. Reg. § 1.482-2(a)(1)(iii)(B) to determinations under Section 956(c)(2(C) and Treas. Reg. § 1.956-2(b)(1)(v)[1] (collectively, "Respondent's MPSJ"). On May 1, 2020, the Court ordered Petitioner to respond to Respondent's MPSJ by June 15, 2020 ("Petitioner's Response") and Respondent to respond to Petitioner's Response by July 15, 2020.

Petitioner's Response, argues, *inter alia*, that: 1) "Respondent's MPSJ is procedurally defective"; and, 2) "Respondent's adjustments flout congressional

[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.

purpose." Petitioner's Response, pages 2 and 6. Petitioner's procedural claims are unfounded. Furthermore, Respondent's MPSJ is consistent with Congressional purpose.

I. PETITIONER'S PROCEDURAL CLAIMS ARE UNFOUNDED

A. Respondent's MPSJ is appropriate under Tax Court Rule 121 and F.R.C.P. Rule 56.

As discussed in Respondent's MPSJ, statutory or rule construction begins with the plain meaning of the text. Respondent's MPSJ is governed by Tax Court Rule 121. Tax Court Rule 121(a) unequivocally states that "[e]ither party may move, with or without supporting affidavits or declarations, for a summary adjudication in the moving party's favor upon all or any part of the legal issues in controversy" (emphasis added).

Tax Court Rule 121 does not require that Respondent's MPSJ dispose of the Section 956 adjustments in total for it to be appropriate. Rather, as this Court has repeatedly stated, a motion for partial summary judgment is appropriate to dispose of any part of the legal issues. See, e.g., Naftel v. Commissioner, 85 T.C. 527, 528-29 (1985); Shepherd v. Commissioner, T.C. Memo. 2020-45; Yarish v. Commissioner, 139 T.C. 290, 293 (2012); N. Cal. Small Bus. Assistants, Inc. v. Commissioner, 153 T.C. 65, 67 (2019); Countryside, Ltd. P'ship v. Commissioner,

T.C. Memo. 2008-3 (collectively standing for the premise that Tax Court Rule 121 allows a party to move for summary judgment upon any part of the legal issues in controversy so long as there is no genuine issue of material fact).

The applicability of the 482 Interest Free Exception[2] to Section 956 is part of an issue in controversy—Respondent's Section 956 adjustments. Moreover, this question, whether the 482 Interest Free Exception applies to Section 956, is a purely legal issue and not dependent on any specific facts.[3] It is exactly the type of issue motions for partial summary judgment are intended to resolve.

Tax Court Rule 121 "is derived from F.R.C.P. Rule 56. Hence, in any question turning on the interpretation of Rule 121, the history of F.R.C.P. Rule 56, and the authorities interpreting such rule, are considered by the Tax Court. See Hoeme v. Commissioner, 63 T.C. 18, 21 (1974); Shiosaki v. Commissioner, 61 T.C. 861, 862 (1974)." Boyce v. Commissioner, T.C. Memo. 1990-555, n.3. In 2010, Congress amended F.R.C.P. 56 to clarify that motions for summary

---

[2] The "482 Interest Free Exception" means the period under Treas. Reg. § 1.482-2(a)(1)(iii)(B). See Respondent's MPSJ, Memorandum page 3 and Motion ¶ 11.

[3] Petitioner's Response, page 9, alleges that Respondent painted "a warped narrative" of the facts. Respondent maintains that the facts set forth in Respondent's MPSJ are accurate. Regardless, any factual disputes do not impact whether the 482 Interest Free Exception applies to Section 956.

judgment on "part of each claim or defense" are appropriate. In making this amendment, the Advisory Committee stated that this language was:

> added to make clear at the beginning that summary judgment may be requested not only as to an entire case but also as to a claim, defense, or part of a claim or defense. The subdivision caption adopts the common phrase 'partial summary judgment' to describe disposition of less than the whole action, whether or not the order grants all the relief requested by the motion (emphasis added).

F.R.C.P. 56, Advisory Committee Notes, 2010 Amendment.

In addition, Moore's Federal Practice explains F.R.C.P. 56 and its history. In doing so, it disproves Petitioner's procedural argument. This treatise encourages practitioners to use motions for partial summary judgment to manage their cases:

> The freedom to use summary judgment procedure to address particular issues or elements of a claim is an important feature of Rule 56, making it a much more useful case management device (see § 56.121.[5] [series of partial summary judgment motions directed to controlling issues may be used to shape litigation process]).

11 Moore's Federal Practice – Civil § 56.122. Accordingly, Respondent's motion is consistent with Tax Court Rule 121.

B. Granting Respondent's MPSJ will save the parties and the Court considerable time and resources.

Petitioner contends that granting Respondent's MPSJ will not save the parties or the Court time and effort. Petitioner's opposition overlooks that granting Respondent's MPSJ will eliminate extremely detailed informal (and perhaps formal) discovery and spare the Court the burden of reviewing hundreds of thousands of pages of invoices. Furthermore, granting Respondent's MPSJ will avoid the parties and the Court from having to determine which, if any, of Petitioner's accounts payable owed to its foreign subsidiaries fall within the 482 Interest Free Exception. Otherwise, the parties and this Court will have to expend an enormous amount of resources to determine which if any of Petitioner's accounts payable owed to its foreign subsidiaries fall within the 482 Interest Free Exception.

As set forth in Respondent's MPSJ, Memorandum page 12, the 482 Interest Free Exception states that for intercompany transactions in the ordinary course of business, "[i]nterest is not required to be charged on an intercompany trade receivable *until the first day of the third calendar month following the month in which the intercompany trade receivable arises*." (Emphasis added). Thus, the 482 Interest Free Exception can range from 59 days (sales occurring on January

31st in non-leap years), to 91 days (sales occurring on June 1st). Therefore, the 482 Interest Free Exception depends on individual sales dates. Applying it requires analyzing every intercompany "trade receivable" for the tax years at issue to determine which, if any, fall within or exceed the interest free period. To do this accurately, every invoice must be reviewed to determine if it falls within the 482 Interest Free Exception.

Performing this analysis would be incredibly labor intensive. Respondent's Section 956 adjustments cover FY2009 and FY2010. During these years, WDT maintained 90 days net payment terms with WDM and WDTh. Respondent's MPSJ at ¶ 14(c). WDM reported approximately $1.786 billion and $2.817 billion of intercompany sales for FY2009 and FY2010, respectively. WDTh reported approximately $5.339 billion and $7.017 billion of intercompany sales for FY2009 and FY2010, respectively. Thus, nearly $17 billion in intercompany sales are potentially subject to the 482 Interest Free Exception. The amount of time and money to locate, produce and review the invoices underlying these sales would likely be significant. Further, one can only shudder in horror at the thought of actually having to look at every one of these invoices.

To be sure, an accurate analysis would consist of the following steps:

(a) First, Petitioner would have to collect all the intercompany invoices for FY2009 and FY2010, as well as all intercompany invoices that were outstanding at the beginning of FY2009, as some of these invoices may also exceed the 482 Interest Free Exception during FY2009.

(b) Second, the parties must analyze each invoice's dates to determine if it falls within the 482 Interest Free Exception. While payment terms for WDT's purchase of hard disk drives from WDM and WDTh were 90 days from date of invoice, the actual payment date of such invoices was determined based on Petitioner's fluctuating, scheduled payment dates. Therefore, the actual time outstanding for each invoice could vary greatly from the stated terms on each invoice. Petitioner would have to document the payment dates. If the payment documentation is unclear, the parties would need to adopt some method such as the First-In First-Out ("FIFO") to determine payment dates. The Court would have to agree with the parties' adopted method.

(c) Third, the parties will then, separately or jointly, have to construct aging schedules showing the applicability of the 482 Interest Free Exception to all invoices outstanding during FY2009 and FY2010. If the parties are unable to agree on schedules, experts would likely be needed to compile and

explain competing schedules.

(d) Finally, WDM reported $17 million and $48 million of intercompany returns for FY2009 and FY2010, respectively, and WDTh reported approximately $49 million and $51 million of intercompany returns for FY2009 and FY2010, respectively. The parties would have to determine the dates each of the approximate $165 million of intercompany returns occurred, and credit such amounts against the longest outstanding open invoices on such return dates using the FIFO method. See Treas. Reg. § 1.482-2(a)(iv).[4]

C. Respondent is not seeking an advisory opinion.

Pages 3 through 5 of Petitioner's Response assert that "Respondent's MPSJ could amount to an improper request for an advisory opinion." In essence, Petitioner's Response suggests that Respondent is seeking a ruling on a

[4] In addition, if this Court determines the 482 Interest Free Exception is somehow determinative of what meets the ordinary and necessary standard of Section 956(c)(2)(C), the parties and the Court then need to determine what outstanding invoice amounts constitute U.S. property at the close of each quarter for Petitioner's FY2009 and FY2010, as Section 956 is calculated on a quarterly basis. This analysis could result in additional amounts being treated as U.S. property under Section 956 as certain invoices outstanding between 60 and 75 days, while not contained in Respondent's Section 956 determinations, may exceed the 482 Interest Free Period and require inclusion. This would require the parties to amend the pleadings. See I.R.C. § 956(a)(1)(A).

hypothetical issue that may never come before the Court. That is inaccurate as discussed below.

Page 5 of the memorandum in support of Respondent's MPSJ sets forth the relevant facts as to the parties' dispute over the applicability of the 482 Interest Free Exception to Section 956(c)(2). As explained in the memorandum, during Respondent's examination of the tax years before the Court, Petitioner repeatedly argued that the 482 Interest Free Exception applies to Section 956(c)(2)(C). Seeking to clarify whether Petitioner intended to make this argument to this Court, on March 9, 2020, Respondent sent Petitioner's counsel a letter by email asking "please advice [sic] if you and Western Digital still believe and wish to litigate that Treas. Reg. § 1.482-2(a)(1)(iii) applies to the adjustments under I.R.C. §§ 951 and 956 here." See Exhibit A.

On March 25, 2005, Petitioner's counsel responded that "Petitioner believes that the regulation to which you refer is relevant to respondent's adjustments under I.R.C. §§ 951 and 956 and is among the factors the Court should consider in ruling on the issue." See Exhibit B. Petitioner did not say that it was considering the relevance or applicability of the 482 Interest Free Exception, was reserving its position on the applicability of the 482 Interest Free Exception or otherwise qualify

its response. Rather, Petitioner's Response was unambiguous and clear—it believes that the 482 Interest Free Exception is relevant. Thus, this issue is not a mere hypothetical argument that Petitioner may make. Petitioner has made it and stated that it will continue to make it. Because the Court will have to grapple with this purely legal issue head-on, Respondent maintains that it should do so as soon as possible.

Further, Petitioner cites Nickert v. Puget Sound Tug & Barge, 480 F.2d 1039 (9th Cir. 1973), for the premise that the Ninth Circuit ruled that motions for partial summary judgement are inappropriate when they are not dispositive of an entire issue and they only concern part of an issue. Petitioner's reliance on Nickert is misplaced because the Ninth Circuit simply held that the district court's partial summary judgment was an "announcement by a trial court of its then opinion on an abstract question of law prior to the taking of final, definitive action" and that it was not an interlocutory decision by the district judge giving the Court of Appeals immediate jurisdiction. Id. at 1041. The Ninth Circuit did not comment on the appropriateness of the district court granting of partial summary judgement, let alone rule that it was inappropriate for it to do so.

Similarly, Petitioner's citation to and quotations from Mazzocchi Bus. Co., Inc. v. Commissioner, T.C. Memo. 1990-292, do not support Petitioner's arguments. First, Mazzocchi was issued in 1990, 20 years before F.R.C.P. 56 was explicitly amended to allow for motions for partial summary judgment on "any part of the legal issues in controversy." (Emphasis added.) This amendment diminishes any value of Mazzocchi, if not rendering it moot as overridden. Second, in their motion for partial summary judgment, the moving party in Mazzocchi asked the Tax Court to opine on how to calculate earnings and profits based on a set of theoretical facts that the moving party conceded only for purposes of its motion. Petitioner's intent to invoke the 482 Interest Free Exception is not theoretical. Third, the moving party failed to demonstrate how granting the motion for partial summary judgment would affect the disposition of the case. Respondent's MPSJ and this reply demonstrate how considering the 482 Interest Free Exception would affect the case. Finally, the moving party in Mazzocchi could not articulate why granting the motion for partial summary judgment would help conserve the parties' or Court's resources. Here, as detailed on pages 5 through 7 above, granting Respondent's MPSJ will definitively save innumerable

resources and avoid the parties and the Court from having to review every invoice covering nearly $17 billion in intercompany transactions.

II. RESPONDENT'S MPSJ IS CONSISTENT WITH CONGRESSIONAL PURPOSE

Petitioner's claim that Respondent's Section 956 adjustments in this matter "flout congressional purpose" is irrelevant to Respondent's MPSJ and erroneous. Petitioner's Response, page 6. As explained in Respondent's MPSJ, Congress enacted Section 956 to prevent the untaxed repatriation of income. Respondent's MPSJ, Memorandum page 8. The nature and amount of the adjustments are not the subject matter of Respondent's MPSJ. The purely legal question presented in Respondent's MPSJ is whether the 482 Interest Free Exception is relevant to Section 956(c)(2)(C) determinations.

Further, Petitioner's reliance on Congress's "intention not to permit the funds to remain in the United States indefinitely" is misguided. Petitioner's Response, pages 7-8. Section 956 does not contain the term "indefinite" within its text. Section 956(c)(2)(C) explicitly states the determination is based not on whether the amounts remained indefinitely outstanding, but rather whether "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." I.R.C. § 956(c)(2)(C) (emphasis added). Petitioner's misapplication of Congressional intent in its response would require an intercompany payable outstanding for 50 years to be excluded from Section 956 as such time outstanding is not "indefinite."

Petitioner argues that Respondent's MPSJ should be denied because the term "ordinary and necessary" is ambiguous. Petitioner's Response, pages 7-8. Whether a taxpayer is required to pay interest on an intercompany payable under Treas. Reg. § 1.482-2(a)(1) is irrelevant to the "all facts and circumstances" determination under Section 956(c)(2)(C). "Facts and circumstances" inquiries of whether property is considered held incident to the financial services business (Treas. Reg. § 1.904-4(e)(4)(i)(A)), whether a periodic adjustment commensurate with income should be made (Treas. Reg. § 1.482-4(f)(2(i)), and whether records for charitable contributions are reliable (Treas. Reg. § 1.170A-13(a)(2)(i)), are equally irrelevant to Section 956 determinations.

Neither Section 956 nor its regulations contemplate the kind of safe harbor for sales contracts created, whether explicitly or implicitly, by considering Treas.

Reg. § 1.482-2(a)(1)(iii). The Court should reject Petitioner's suggestion that the Court "retain all of the interpretative tools in its arsenal . . . ."[5] As explained in Respondent's MPSJ, this Section 482 regulation does not apply, notwithstanding that the Section 956 determination involves "all facts and circumstances."

Also, Petitioner's Response was silent as to the fact the definition of "trade receivables" in the 482 Interest Free Exception includes intercompany indebtedness related to services. See Treas. Reg. §§ 1.482-2(a)(1)(ii)(A)(2) and (a)(1)(iii)(A). Treas. Reg. § 1.956-2(d)(2)(ii) contains an explicit exemption for services—a 60-day safe harbor period for service payables from inclusion as U.S. property. Applying of the 482 Interest Free Exception to Section 956(c)(2)(C) would undercut this listed exemption and completely alter the regulatory landscape surrounding Section 956(c)(2)(C).

Finally, Petitioner cites to Lowell and M. Martin, U.S. International Transfer Pricing as support for the Court not limiting the Section 956(c)(2)(C) inquiry as requested in Respondent's MPSJ. Petitioner's Response, page 10. Petitioner's citation, however, is truncated and fails to provide the proper context. A more complete citation is provided below; Petitioner's excerpt is underlined:

---

[5] Petitioner's Response, page 9.

> In this situation, the Section 482 Regulations will determine the appropriate interest rate for the use of money (and exclusionary period in which no interest is due), and the Section 956 Regulations will determine whether the period of the account payable/receivable is ordinary and necessary. 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 (emphasis added).

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)). This citation is in the context of an example involving an intercompany payable arrangement payable on 60-day terms. The first part of the citation, which Petitioner omitted, explains that the Section 482 Regulations solely determine when interest is required to be charged and at what rate while the Section 956 Regulations determine whether the outstanding period of the account payable/receivable was ordinary and necessary. With the full citation, it becomes clear that the treatise is not suggesting that the 482 Interest Free Exception should have bearing on Section 956. Instead, it is theorizing that an interest charge under Section 482 would be more appropriate than applying Section 956. This treatise

clearly reinforces Respondent's position that the 482 Interest Free Exception has no bearing on Section 956.

CONCLUSION

Respondent prays that the Court grant Respondent's Motion for Partial Summary Judgment and, rule that the 482 Interest Free Exception does not apply to Section 956(c)(2)(C).

MICHAEL J. DESMOND
Chief Counsel
Internal Revenue Service

Lloyd T. Silberzweig

Digitally signed by Lloyd T. Silberzweig
DN: c=US, o=U.S. Government, ou=Department of the Treasury, ou=Internal Revenue Service, ou=People, serialNumber=408792, cn=Lloyd T. Silberzweig
Date: 2020.07.15 13:49:50 -07'00'

Date: July 15, 2020 By: _____

LLOYD T. SILBERZWEIG
Counsel for Respondent
Special Trial Attorney
Tax Court Bar No. SL0630
IRS Office of Chief Counsel
100 First Street, Suite 1800
San Francisco, CA 94105
Telephone: (415) 547-3806
Lloyd.T.Silberzweig@irscounsel.treas.gov

OF COUNSEL:
ROBIN GREENHOUSE
Division Counsel (Large Business & International)
EWAN D. PURKISS
Area Counsel (Large Business & International)
H. CLIFTON BONNEY, JR.
Deputy Area Counsel: Strategic Litigation
(Large Business & International)

OFFICE OF THE CHIEF COUNSEL

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
OFFICE OF DIVISION COUNSEL
LARGE BUSINESS & INTERNATIONAL
100 FIRST STREET, 18TH FLOOR
SAN FRANCISCO, CA 94105
(415) 547-3806
FAX: (415) 281-9508

March 9, 2020

Via Electronic Mail

Sanford W. Stark, Esq.
Morgan, Lewis & Bockius, PC
1111 Pennsylvania Avenue NW
Washington, DC 20004-2541

Re: Western Digital Corp. and Subs. v. Commissioner
Docket Nos. 18984-18 and 4818-19
Applicability of Treas. Reg. § 1.482-2(a)(1)(iii) to I.R.C. §§ 951 and 956

Dear Mr. Stark:

As you know, these cases involve certain adjustments to Western Digital's income under I.R.C. §§ 951 and 956. During the Examination and Appeals process for these cases, Western Digital, through its counsel at the time, argued that Treas. Reg. § 1.482-2(a)(1)(iii) provided for a safe-harbor exemption period that applied to these adjustments. The petitions in these cases broadly assign error to these adjustments, but do not reference Treas. Reg. § 1.482-2(a)(1)(iii).

In determining the scope of disagreements in these cases, please advice if you and Western Digital still believe and wish to litigate that Treas. Reg. § 1.482-2(a)(1)(iii) applies to the adjustments under I.R.C. §§ 951 and 956 here. We would appreciate your response no later than March 26, 2020.

Please let me know if you have any questions. If you would like to discuss this further, please contact me.

Sincerely,

Lloyd T. Silberzweig

Lloyd T. Silberzweig
Special Trial Attorney (SL)
(Large Business & International)

Morgan Lewis

Saul Mezei
Partner
+1.202.373.6250
saul.mezei@morganlewis.com

March 25, 2020

VIA EMAIL

Lloyd T. Silberzweig
Special Trial Attorney (Large Business & International)
Internal Revenue Service
100 First Street, Suite 1800
San Francisco, CA 94105

Re: Western Digital Corporation and Subsidiaries v. Commissioner
Tax Court Docket Nos. 18984-18 and 4818-19
Response to March 9, 2020 Letter Regarding Applicability of
Treas. Reg. § 1.482-2(a)(1)(iii)

Dear Mr. Silberzweig:

This letter responds to your letter dated March 9, 2020, in which you ask whether we "believe and wish to litigate that Treas. Reg. § 1.482-2(a)(1)(iii) applies to the adjustments under I.R.C. §§ 951 and 956 here." Petitioner believes that the regulation to which you refer is relevant to respondent's adjustments under I.R.C. §§ 951 and 956 and is among the factors the Court should consider in ruling on the issue.

Please contact me if you have any questions or otherwise would like to discuss this issue further.

Sincerely,

E-SIGNED by Saul Mezei

Saul Mezei

Morgan, Lewis & Bockius LLP

1111 Pennsylvania Avenue, NW
Washington, DC 20004
United States
+1.202.739.3000
+1.202.739.3001