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On May 27 the Ninth Circuit decided *Xilinx v. Commissioner*.[1] By a 2-1 majority, the panel reversed the Tax Court and held that costs of employee stock options must be included in the pool of costs subject to a tax-sharing agreement.

The *Xilinx* decision is important for three reasons. First, cost sharing is probably the key element in current transfer pricing law because it is the principal way in which profits from intangibles get shifted from the United States to low-tax jurisdictions. Moreover, informed observers agree that the allocation of income from intangibles is the most important problem in transfer pricing, and because most intangible-intensive corporations rely heavily on employee stock options, the narrow issue decided in *Xilinx* has large revenue implications, especially for high-tech companies. This is evidenced by the filing of two amicus briefs on behalf of coalitions of high-tech companies siding with the taxpayer and by practitioners' reactions to the IRS victory.[2]

Second, *Xilinx* is the first IRS victory in a major transfer pricing case since *Dupont* was decided in 1979. While the issue in *Xilinx* was narrow, it is possible that this IRS victory could lead more multinationals to reconsider their decision to fight the IRS on transfer pricing issues rather than seek an advance pricing agreement. The author has long believed that given the litigation record of 30 years of successive taxpayer victories in transfer pricing cases, an important IRS victory is needed to encourage taxpayers to enter into APAs, and the combination of the $3.4 billion *Glaxo* settlement and *Xilinx* may be enough. Because only about half of the approximately 350 multinational companies enter into APAs, a significant increase in APAs would go a long way toward resolving the transfer pricing problem.

Third, the specific reasoning of the case casts renewed doubts on the continued viability of the arm's-length standard (ALS). In my view, this reasoning is correct, albeit too narrow. If the implications of *Xilinx* are understood, this may finally be the occasion to prod the Obama administration and Congress to engage in a major transfer pricing overhaul, which is a precondition to significant international tax reform.

The rest of this article will develop this third point. Part A explains how the reasoning in *Xilinx* fits in with broader critiques of the ALS. Part B explores the implications of this critique for the prospects of international tax reform. Part C concludes by explaining why this moment is an opportune one for such reform.

A. *Xilinx* and the ALS

The Tax Court decided *Xilinx* on the grounds that unrelated parties dealing with each other at arm's length would not have shared the cost of employee stock options, and therefore the ALS requires that those costs not be shared under a cost-sharing agreement, either.[3] The appeals court explicitly accepted this factual finding and even went further in explaining why unrelated parties would never share the costs of such options. Nevertheless, the majority decided (over a vigorous dissent by Judge Noonan) to require that stock option costs be included in the sharing pool.[4]

To understand the significance of this decision, it is necessary to step back and examine how the cost-sharing regime arose in the first place. Before 1986 there was a succession of cases in which U.S. pharmaceuticals successfully defended their transfer of patents on drugs developed in the United States to affiliates in Puerto Rico. The result was a lopsided allocation of costs to the United States and of profits offshore, where they were taxed at a very low rate. As the Court of Federal Claims stated in one of those cases:

> For tax years 1972 through 1976, MSDQ [Merck's Puerto Rican affiliate] reported taxable income that totals $181,802,000. Federal income tax paid was $657,000. The pricing process that produces such disparity between costs of production and end-product prices, and permits the accumulation of retained earnings that amount to 98.82 percent of

[1] *Xilinx, Inc. et al. v. Commissioner*, Nos. 06-74246, 06-74269 (9th Cir. May 27, 2009), *Doc 2009-11943*, *2009 TNT 100-9*.

[2] Sam Young, "Ninth Circuit Reversal of Tax Court in *Xilinx* a Major Government Victory, Practitioners Say," *Tax Notes*, June 1, 2009, p. 1070, *Doc 2009-11945*, *2009 TNT 100-1*. Of course, the revenue impact is enhanced by the large concentration of high-tech companies in the Ninth Circuit. An appeal of *Xilinx* to an *en banc* Ninth Circuit or to the Supreme Court seems likely. If *Xilinx* is upheld, one would expect taxpayers in other circuits to try to create a circuit split, and the decision may even cause high-tech companies to migrate out of the Ninth Circuit.

[3] *Xilinx Inc. et al. v. Commissioner*, 125 T.C. 37 (2005), *Doc 2005-18073*, *2005 TNT 168-4*.

[4] *Xilinx*, *supra* note 1.

> all reported taxable income, may be economically unjustified or socially unacceptable. Such results may underscore infirmities in the controls to be expected in regulated pharmaceutical markets. Such results do not establish a distortion of income as to MSDQ. Such problems cannot be addressed through Section 482, under the statute and regulations as presently written.[5]

In the early 1980s, Congress began to take steps to remedy this problem. The 1982 Tax Equity and Fiscal Responsibility Act amended section 936 to provide that income from intangibles transferred to Puerto Rico affiliates would be treated as income of the Puerto Rican corporation's U.S. shareholders, unless the corporation elected to make cost-sharing payments to its parent or to equally split the profits.[6] The next step was taken in the Deficit Reduction Act of 1984, which amended section 367(d) to treat a tax-free transfer of intangibles to related foreign corporations as a sale of the intangibles for annual payments over the useful life of the property, contingent on its productivity, use, or disposition.[7] Finally, in the 1986 Tax Reform Act, Congress for the first time amended section 482 by adding the second sentence, which states that ''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.''[8] This ''super-royalty'' rule was intended to force taxpayers that transfer intangible property out of the United States to make royalty payments that rise as the profits from the intangibles increase, thus nullifying the economic effect of the transfer.

At the time, there was significant criticism of the super-royalty rule as a departure from the ALS because it could rarely be shown that unrelated taxpayers would have agreed to such a royalty arrangement. However, the legislative history of TRA 1986 indicates Congress understood that the basic problem was the ALS and that the super-royalty rule was to apply even if it was inconsistent with the ALS. The House report stated:

> Many observers have questioned the effectiveness of the ''arm's length'' approach of the regulations under section 482. A recurrent problem is the absence of comparable arm's length transactions between unrelated parties, and the inconsistent results of attempting to impose an arm's length concept in the absence of comparables. . . .
>
> A fundamental problem is the fact that the relationship between related parties is different from that of unrelated parties. Observers have noted that multinational companies operate as an economic unit, and not ''as if'' they were unrelated to their foreign subsidiaries. In addition, a parent corporation that transfers potentially valuable property to its subsidiary is not faced with the same risks as if it were dealing with an unrelated party. Its equity interest assures it of the ability ultimately to obtain the benefit of future anticipated or unanticipated profits, without regard to the price it sets. The relationship similarly would enable the parent to adjust its arrangement each year, if it wished to do so, to take account of major variations in the revenue produced by a transferred item. . . .
>
> Certain judicial interpretations of section 482 suggest that pricing arrangements between unrelated parties for items of the same apparent general category as those involved in the related party transfer may in some circumstances be considered a ''safe harbor'' for related party pricing arrangements, even though there are significant differences in the volume and risks involved, or in other factors. . . . While the committee is concerned that such decisions may unduly emphasize the concept of comparables even in situations involving highly standardized commodities or services, it believes that such an approach is sufficiently troublesome where transfers of intangibles are concerned that a statutory modification to the intercompany pricing rules regarding transfers of intangibles is necessary.[9]

Given this critique, the House did not pretend that the commensurate with income standard was compatible with the ALS. The report states the transferor of intangibles in a multinational was looking to its equity investment, ''rather than to 'arm's length' factors,'' to recuperate its cost,[10] and that ''industry norms *or other unrelated party transactions* do not provide a safe harbor minimum payment for related party intangible transfers.''[11] Thus, even if a perfect comparable could be found in which the same intangible was transferred to an unrelated party in the same circumstances for a fixed royalty rate, the provision would still require the allocation of super-royalties to a related-party transferor. The conference agreement on TRA 1986 followed the House bill except for the expansion of the commensurate with income provisions to apply to inbound as well as outbound transfers.[12]

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[5]*Merck & Co. v. United States*, 24 Cl. Ct. 73 (1982). For a survey of the other cases, see Reuven S. Avi-Yonah, ''The Rise and Fall of Arm's Length: A Study in the Evolution of U.S. International Taxation,'' 15 *Va. Tax Rev*. 89 (1995), updated version in 9 *Finance and Tax L. Rev*. 310 (2006).

[6]Joint Committee on Taxation, 97th Cong., 2d Sess., ''General Explanation of the Revenue Provisions of the Tax Equity and Fiscal Responsibility Act of 1982,'' 82-96 (Comm. Print 1983).

[7]Section 367(d)(2).

[8]Section 482. A similar commensurate with income standard was applied to section 367(d) transfers of intangibles and to section 936(h) cost-sharing payments.

[9]H.R. Rep. No. 426, 99th Cong., 1st Sess. 423-424 (1985) (footnote omitted).

[10]*Id*. at 424.

[11]*Id*. at 425 (emphasis added).

[12]H.R. Conf. Rep. No. 841, 99th Cong., 2d Sess. II-637 (1986), reprinted in 1986 U.S.C.C.A.N. 4075, 4725.

The following period (1986-1994) was what Michael Durst has called ''the Great Transfer Pricing Wars.''[13] After the United States published the white paper in 1988 and proposed regulations under section 482 in 1992, there was a concerted lobbying effort by our trading partners and by the multinationals to weaken what they saw as departures from the ALS and as steps in the direction of formulary apportionment. The result was a compromise embodied in the final regulations under section 482 and the new OECD transfer pricing guidelines (1995). More importantly for our purposes, the new regulations included the cost-sharing method.[14]

Cost sharing rests on the idea that there should be some relationship between the allocation of profits from an intangible and the allocation of the costs to develop it, which also underlies the profit-split method in the regulations and stems ultimately from the 1988 white paper.[15] Under cost sharing, the U.S. parent and its foreign affiliate agree to share the costs of developing an intangible, and if they meet the requirements of a valid cost-sharing agreement, the regulations permit them to allocate the profits from the intangible in the same proportion as the costs.

There are three fundamental problems with cost sharing. First, the basic idea that the profits from an intangible are related to the costs of developing it is wrong. As shown by *Bausch and Lomb* and many others, in many situations the profits from an intangible result from the relationship between the related parties and therefore are unrelated to where the costs of development were incurred.[16]

Second, if an intangible is successful, its profits bear little relation to its costs. The idea behind cost sharing is that taxpayers would be reluctant to lose the deductions allocated to the foreign affiliate, and therefore would not allocate too high a cost and profit to the foreign affiliate. But taxpayers whose costs are $1 million to develop a patent worth $1 billion are happy to risk losing $800,000 to an 80/20 cost-sharing agreement with an Irish affiliate if they could avoid current U.S. tax on $800 million when the research succeeds.

Third, cost sharing has proven in practice to undermine the rationale behind the super-royalty rule. Taxpayers have used cost sharing to transfer the majority of their intangible assets overseas without having to do any real research and development outside the United States. Those intangibles then generate income that is eligible for deferral, especially with the use of the check-the-box regs and section 954(c)(6) to shift profits from high-tax to low-tax jurisdictions without triggering subpart F inclusions. The result has been that taxpayers are able to locate as much profit in low-tax jurisdictions as they could before 1986.[17]

With this background, we are now ready to understand *Xilinx*. The issue in the case was whether to include the cost of employee stock options in the pool of costs to be shared under a cost-sharing agreement with Xilinx's Irish subsidiary. In general, the more costs there are that must be shared, the less valuable the cost-sharing agreement is to the taxpayer, because costs allocated to the Irish subsidiary cannot be deducted in the United States. Many high-tech companies are able to eliminate their U.S. tax liability by deducting the cost of stock options while locating their foreign profits in low-tax jurisdictions such as Ireland.

The Tax Court and the dissent argued that because the costs of the options would not be shared by unrelated parties, under the ALS they cannot be included in the pool of costs shared under the cost-sharing agreement. They pointed out that reg. section 1.482-1(b)(1) requires that ''the standard to be applied *in every case* is that of a taxpayer dealing at arm's length with an uncontrolled taxpayer,'' and that article 9 of the Ireland-U.S. tax treaty requires applying the ALS to transfer pricing cases. In his dissent, Judge Noonan argued that the ALS is essential to the purpose of the transfer pricing regulations, which is ''parity between taxpayers in uncontrolled transactions and taxpayers in controlled transactions. The regulations are not to be construed to stultify that purpose. If the ALS is trumped by the cost-sharing regulations, the purpose of the statute is frustrated.''[18]

However, the majority held that the ALS was not the focus of section 482: ''Significantly, achieving an arm's length result is not itself the regulatory regime's goal; rather, its purpose is to prevent tax evasion by ensuring taxpayers accurately reflect taxable income attributable to controlled transactions.''[19] It then held that the language of reg. section 1.482-1(b)(1), incorporating the ALS, is irreconcilable with the language of reg. section 1.482-7(d)(1), which required the sharing of ''all of the costs'' related to developing the shared intangible. According to the court, the conflict arises because unrelated taxpayers do not share the costs of stock options because (1) they are hard to value because no cash outlay is involved, (2)

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[13]Michael Durst, IFA Canada speech (May 21, 2009). For a discussion, see Avi-Yonah, *supra* note 5. For the text of the speech, see p. 1269.

[14]T.D. 8632 (1995), *Doc 95-11248*, *95 TNT 247-4*; reg. section 1.482-7. As the *Xilinx* majority emphasized, the cost-sharing regulations were finalized six months after the other transfer pricing regulations.

[15]Notice 88-123, 1988-2 C.B. 458.

[16]*Bausch & Lomb v. Commissioner*, 92 T.C. 525 (1989), *aff'd*, 933 F.2d 1084 (1991). In *Bausch & Lomb* the taxpayer transferred valuable knowledge to its Irish subsidiary. The knowledge enabled the subsidiary to manufacture contact lenses at a much lower cost than that of its competitors. This added value would be lost if the subsidiary were unrelated to the parent; therefore, the courts correctly rejected the IRS's attempt to allocate the added value to where the knowledge was developed.

[17]*See* Martin A. Sullivan, ''Obama Launches International Tax Reform: The Battle Begins,'' *Tax Notes*, May 11, 2009, p. 646, *Doc 2009-10299*, or *2009 TNT 87-3* (23 percent of the before-tax profits of U.S. multinational entities were in five low-tax jurisdictions in 2006); Avi-Yonah, Clausing, and Durst, ''Allocating Business Profits for Tax Purposes: A Proposal to Adopt a Formulary Profit Split,'' *Fla. Tax Rev*. (2009), Figure 2 (30 percent of the profits of U.S. multinational entities in 2005 were in Bermuda, Luxembourg, and the Netherlands, and 8 out of the top 10 locations had an effective tax rate of below 10 percent).

[18]*Xilinx*, *supra* note 1, at 6180.

[19]*Xilinx*, *supra* note 1, at 6167.

sharing them in an unrelated joint venture would create an incentive to minimize the value of the joint venture to reduce the cost of the options, and (3) sharing the costs reduces the deductions available to the taxpayer.[20] For these reasons, there will be no comparables in which the costs are shared, but the court nevertheless held that the all-costs requirement governs because it is the more specific regulation. Finally, the court rejected the challenge based on the Ireland-U.S. tax treaty because of the savings clause, which is found in every U.S. tax treaty and states that the treaty cannot affect the ability of the United States to tax its own residents, such as Xilinx.

I believe that given the history of section 482 and the cost-sharing regulations, the majority is correct, albeit not quite for the reason it gives (as the dissent correctly notes, it is hard to put too much weight on canons of construction such as the one the majority relies on that the specific trumps the general). First, section 482 predates the ALS by at least a decade, so it cannot be said that achieving the ALS is ''the purpose'' of section 482.[21] Rather, as the majority correctly argued, the purpose of section 482 is to accurately reflect the taxpayer's income and prevent tax evasion, and the ALS is only a means to that end (which was not really given meaning until 1968, over four decades after the language of section 482 was enacted).

Second, there is a good reason why cost sharing cannot be reconciled with the ALS: Cost sharing grew out of the super-royalty rule, which was explicitly not based on the ALS. Thus, the majority is correct in viewing cost sharing as a distinct regime that is not subject to the ALS. If unrelated parties do not share costs that related parties do, that means that cost sharing between related parties cannot be governed by the ALS, and that the ALS is irrelevant to this area of transfer pricing law. That was Congress's goal when it enacted the super-royalty rule in 1986, and the same insight should be applied to cost sharing.

Third, the majority is also correct in rejecting the challenge posed by the Ireland-U.S. treaty. However, its reasoning has interesting implications that it does not seem to appreciate. The majority states that ''Xilinx is not a foreign entity, so applying [reg. section] 1.482-7(d)(1) to it does not violate the treaty, even if the regulation's all costs requirement is at odds with the treaty's arm's length standard.''[22] But this point applies to *all* transfer pricing cases, not just to those involving a U.S. parent, because *Xilinx* also involved a foreign entity (the Irish subsidiary). If the savings clause is read to enable the IRS to apply non-ALS methods to Xilinx, it can also apply them to U.S. subsidiaries of foreign parents because those are also U.S. resident corporations. In that event the only cases in which the ALS applies under a treaty would be to U.S. branches of foreign entities, as the courts held (incorrectly) in *NatWest*.[23]

B. *Xilinx* and International Tax Reform

The particular point decided in *Xilinx* is narrow but important. The basic problems of cost sharing will continue unabated: Taxpayers will still be able to use cost sharing to move profits from intangibles out of the United States, even if the costs are somewhat more broadly defined to include stock options (as they explicitly are under the new, post-*Xilinx* cost-sharing regulations). Cost sharing underlies the skewed profit distributions noted above. Thus, a broader reform is needed, and *Xilinx* points the way.

Fundamentally, I have long believed that corporate taxation should be source-based rather than residence-based. I believe this for two reasons. First, corporate residence is not very meaningful because, unlike individuals, corporations are not physically present in any country, cannot vote, and are an inappropriate subject for redistributive taxation. Second, source-based taxation of corporations rests on the benefits corporations receive from engaging in business activity in countries that incurred costs to enable that business activity to take place.

This argument supports the view of those who would move the United States closer to a territorial system. Territoriality has many advantages because it eliminates the incentive not to repatriate earnings and offers simplification potential by reducing the need for a foreign tax credit. If done properly, it is also a revenue raiser because deductions allocated to exempt foreign-source income would be disallowed.

But I have also repeatedly argued against territoriality in the current context and have supported efforts (like the current one by the Obama administration) to restrict or even repeal deferral. The reason is simple: Without transfer pricing reform, territoriality will lead to an even stronger incentive to shift profits overseas and to further revenue losses and the erosion of the U.S. corporate tax base.[24]

I believe the key to any international tax reform must be a transfer pricing overhaul. As my coauthors Kim Clausing and Michael Durst and I have argued, one possibility is to adopt a formula (which we suggested should be sales based) to split profits left over after routine contributions by the related affiliates are accounted for.[25]

Such a reform can be enacted by Congress, and we have included proposed legislative language in our article. *Xilinx* supports our position because it points out that the ALS cannot be applied in a key area of transfer pricing law.

[20]*Xilinx*, *supra* note 1, at 6176.

[21]Avi-Yonah, *supra* note 5.

[22]*Xilinx*, *supra* note 1, at 6171.

[23]*National Westminster Bank v. United States*, 512 F.3d 1347 (Fed. Cir. 2008), *Doc 2008-905*, *2008 TNT 11-10* (holding that the ALS in article 7 of the U.K.-U.S. treaty trumps the interest allocations regulations). In my opinion this case was wrongly decided because of the long tradition of applying formulas to reach arm's-length results, which is the only requirement under article 7 (see OECD model article 7(4)).

[24]*See* Avi-Yonah, ''Comment on Yin, Reforming the Taxation of Foreign Direct Investment by US Taxpayers,'' 28 *Va. Tax Rev.* 281 (2008).

[25]Avi-Yonah, Clausing, and Durst, *supra* note 17.

However, our proposals have not persuaded opponents of FA. Instead, the advocates of the ALS point to a list of asserted deficiencies of FA, including:

- FA is inherently arbitrary;
- FA will produce double taxation because some countries will apply the ALS and others FA, and each FA country will have a different formula;
- FA requires an impossible-to-achieve uniformity of the tax base;
- FA violates tax treaties; and
- FA will be impossible to enact because of the opposition of the multinationals and of countries that will lose from its implementation.

I believe that there is a good answer to each of those arguments, and have in fact replied to them at length elsewhere.[26] However, I also realize that my answers are unlikely to persuade FA opponents. Thus, I want to use this article to propose a more modest step forward: adopting FA only in the context of the ALS (rather than replacing the ALS with FA).

The basic problem arises in situations when there are no good comparables. If good comparables exist, the traditional methods (comparable uncontrolled price, cost-plus, and resale price) can be used, and that would end the story. But as the OECD guidelines acknowledge, in many cases good comparables are hard to find.

The next possible alternative under the OECD guidelines is the transactional net margin method (TNMM). However, TNMM requires a tougher comparability test than does the U.S. CPM, which is good because CPM has proven to be the most manipulable of the current methods. An informed economist working for a major accounting firm has told me he can achieve any result the client wants using CPM. CPM is also a huge source of transactional complexity — a boon to the large accounting firms and a problem for those who cannot afford their services. But the tougher OECD TNMM comparability standard means that TNMM cannot be applied in many cases in which CPM is used in the United States.

This leaves profit split. Under the profit-split method, comparables are used to allocate the return on routine functions. But that usually leaves a residual in place, which arises precisely because multinationals exist to earn a return that cannot be achieved in an arm's-length relationship. That is why good comparables are hard to find.

The main issue in transfer pricing is how to allocate the residual under the profit-split method. The U.S. regulations assume that the residual is the result of high-profit intangibles and allocate it to where such intangibles were developed. However, this method is not helpful, because (1) the OECD and the rest of the world reject it, (2) it penalizes multinationals for conducting R&D in the United States, and (3) it encourages multinationals to enter into cost-sharing agreements that artificially shift profits to low-tax jurisdictions. Also, as the *Bausch & Lomb* court stated, if the value of the intangible results from the fact that two parties are related, that added value is distinct from where it was developed.

If the U.S. approach is rejected, the question is how to allocate the residual. The OECD guidelines are silent on this issue. This presents an opportunity. Perhaps in this context, it is possible to adopt a formula to allocate the residual.

One must realize that if there are no comparables (by definition) and the residual results from the relationship between the parties and would disappear if they were unrelated, the ALS is meaningless and any allocation is arbitrary. Under these circumstances the key is to adopt the formula that is most likely to achieve consensus.

In the unilateral U.S. context, my coauthors and I support a sales-based formula similar to the destination-based formula for a VAT. This formula favors exports and therefore is likely to be politically popular, and it favors the United States because of our trade deficit.[27] In the OECD context, I would prefer a more balanced formula with three components: payroll, tangible assets, and sales.

Those three components are of course part of the traditional U.S. state FA formula. This formula has proven to be remarkably successful, because, in addition to being used by many U.S. states, it is also the basis for the global dealing regulations in the United States and OECD, and is a leading candidate for the common consolidated corporate tax base formula. I believe it makes sense because each of its elements is objective (payroll and sales are transactions with outside parties, and while tangible assets depend on valuations, there is a lot of experience with asset-based formulas, such as the U.S. interest allocation formula). Intangibles are excluded, but in my opinion that is appropriate because their value results from physical and human capital and from the market, and those elements are included, and you cannot allocate their value, and trying to include them invites manipulation.

Thus, I would propose that in difficult transfer pricing cases, in which no comparables can be found beyond the return on routine functions, the United States should adopt and the OECD should endorse using the traditional three-factor state formula to allocate the residual under the profit-split method.

I believe this proposal addresses the problems with FA outlined above.

- While the formula is arbitrary, it relates to economic reality, and any allocation is arbitrary without comparables. The OECD guidelines are also arbitrary in not allocating residuals.
- It is unlikely that this outcome would lead to more double taxation than what already occurs for residuals under the ALS. If the United States allocates residuals based on the location of R&D and other

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[26]Avi-Yonah, Clausing, and Durst, *supra* note 17; on the treaties point, see also Avi-Yonah and Clausing, "Reforming Corporate Taxation in a Global Economy: A Proposal to Adopt Formulary Apportionment," in Jason Furman and Jason Bordoff, eds. *Path to Prosperity: Hamilton Project Ideas on Income Security, Education, and Taxes* (Brookings Institution Press) 319-344 (2008). If the *Xilinx* court is right, however, FA does not violate article 9 of the treaties because of the savings clause.

[27]Avi-Yonah and Clausing, *supra* note 26.

countries disagree, double taxation is already a threat. Disputes can be resolved using the new arbitration provision under the OECD model.
- If the OECD accepts the residual formula under ALS, it does not violate treaties and it can be handled in the context of article 9.
- Because it is only a residual formula, the base has already been defined under ALS.
- A balanced formula is less likely to produce consistent losers.

C. Conclusion: The Time for Reform Is Now

Xilinx presents an opportunity for reforming U.S. international taxation. Narrowly, it may lead more multinational entities to enter into APAs, which are the key to reducing transfer pricing disputes in the current system.

More broadly, *Xilinx* indicates yet again that the ALS is irreparable. The reasons are set out at length elsewhere, and I will not repeat them.[28] I believe now is the time to reform transfer pricing, for three reasons:

- The current debate over deferral and territoriality is unlikely to be resolved unless the administration and Congress undertake transfer pricing reform.
- The EU, traditionally the bulwark of the ALS, is moving toward adopting FA as part of its Common Consolidated Corporate Tax Base project.[29]
- Even the OECD, also a bulwark of the ALS, is showing some flexibility toward adopting formulas in the context of profit split, and is about to designate profit split as a method on par with the traditional ALS-based methods.[30]

Thus, I believe this a propitious time for reform and that the administration and Congress should use the current debate over deferral and territoriality to engage in transfer pricing reform along the lines outlined above.

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[28]Avi-Yonah, Clausing, and Durst, *supra* note 17.

[29]On CCCTB, see, e.g., Jack Mintz and Joann Weiner, "Some Open Negotiation Issues Involving a Common Consolidated Corporate Tax Base in the European Union," 62 *Tax L. Rev*. 81 (2008).

[30]*See* Avi-Yonah, "Between Formulary Apportionment and the OECD Guidelines: A Proposal for Reconciliation," *available at* http://ssrn.com/abstract=1411649.