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IRS LB&I Withdraws CSA SBC Directive

The IRS's Large Business and International (LB&I) division withdrew Directive LB&I-04-0118-005 (<https://www.irs.gov/businesses/corporations/withdrawal-of-directive-lbi-04-0118-005>), Cost Sharing Arrangement (CSA) Stock Based Compensation (SBC) Directive, dated Jan. 12, 2018 (the Directive), which provided instructions for examiners on transfer pricing issue selection related to SBC in CSAs. Under Treasury Regulation Sections 1.482-7A(d)(2) and 1.482-7(d)(3), U.S. taxpayers that are cost sharing participants are required to include SBC as intangible development costs (IDCs), if such costs are directly identified with, or reasonably allocable to, the intangible development activity of the CSA. Treasury Regulation Section 1.482-7A(d)(2) was invalidated by the U.S. Tax Court in *Altera Corp. v. Commissioner* (https://scholar.google.com/scholar_case?case=6417109839260292249&q=Altera+Corp.+v.+Commissioner,+145+T.C.+91&hl=en&as_sdt=6,33&as_vis=1), 145 T.C. 91 (2015). The IRS issued the Directive in response directing examiners to stop opening new examinations for issues related to SBC until the Altera case was resolved. On appeal, the United States Court of Appeals for the Ninth Circuit reversed the Tax Court's decision. With the issuance of the Directive's withdrawal, examiners should continue applying with Treasury Regulation Sections 1.482-7A(d)(2) and 1.482-7(d)(3) and open new examinations of CSA SBC issues.

Minnesota District Court Invalidates Regulation Defining Educational Organization

In *Mayo Clinic v. U.S.* (https://www.govinfo.gov/content/pkg/USCOURTS-mnd-0_16-cv-03113/pdf/USCOURTS-mnd-0_16-cv-03113-1.pdf), the U.S. District Court for the District of Minnesota held that Treasury Regulation Section 1.170A-9(c)(1), which further defines "educational organization," is invalid. Educational organizations under Section 170(b)(1)(A)(ii) are exempt from paying tax on certain unrelated business income for purposes of Section 514. (Section references are to the Internal Revenue Code of 1986, as amended.)

Under Section 170(b)(1), an educational organization is an organization which "normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on." Treasury Regulation Section 1.170A-9(c)(1) further provides that "an educational organization is described in section 170(b)(1)(A)(ii) if its primary function is the presentation of formal instruction and it normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on. ... It does not include organizations engaged in both educational and noneducational activities unless the latter are merely incidental to the educational activities."

The IRS determined that the Mayo Clinic was not an "educational organization" because, while it did meet the test in Section 170(b)(1)(A)(ii), it did not satisfy the primary function requirement or merely incidental requirement in Regulation Section 1.170A-9(c)(1), so it was not entitled to a tax refund on certain taxes it paid on unrelated business income. On appeal, the U.S. District Court for the District of Minnesota, in relying on the Chevron deference test, noted that the statute, Section 170(b)(1)(A)(ii), was not ambiguous and that the intent of Congress was clear in not specifically including

a primary function test. The court noted that a primary function test was included in another definition in Section 170 regarding medical or hospital care and that Congress unambiguously chose not to include it in the definition for education organization. Since Congress did not intend to include the additional requirements provided for in the Treasury Regulation, such regulation is unlawful. As such, the Mayo Clinic was awarded a \$11.5 tax refund.

Draft Schedules A and B for Form 1040 Now Available

The IRS has released drafts (<https://apps.irs.gov/app/picklist/list/draftTaxForms.html;jsessionid=KhXFUAN66eOCLDHP9rYfsP1D7tzR4e9JMxrf60wh.-?value=1040&criteria=formNumber&submitSearch=Find>) of Schedules A and B, and accompanying instructions, for Form 1040 for the 2019 tax year.



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