WilmerHale Secures Appellate Reversal for Xilinx

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In what has been termed a “dramatic reversal ... in a case that only months ago had been seen as a major victory for the government,” on March 22, 2010, a panel of the Ninth Circuit reversed itself and ruled in favor of WilmerHale’s client Xilinx in an important tax appeal.

The case involved two IRS regulations: one restating the longstanding “arm’s-length” standard, under which income or deductions may be reallocated among related taxpayers only if unrelated parties would have dealt with each other on different terms, and another requiring that certain cost-sharing agreements between related parties must apply to “all costs.” The Tax Court heard extensive evidence and found that arm’s-length parties entering into a cost-sharing agreement would not treat US tax deductions relating to certain employee stock options (ESOs) as sharable costs. In its original decision, the Ninth Circuit panel nonetheless permitted the IRS to apply the “all costs” regulation to require Xilinx to share ESO deductions with its Irish subsidiary, thus reducing Xilinx’s US deductions. That outcome would have been devastating for many US companies, resulting in billions of additional taxes.

Xilinx engaged WilmerHale appellate partners Seth Waxman and Ed DuMont and tax partner Terrill Hyde to join its existing counsel in seeking further review. (The firm had not previously been involved in the case.) The team filed a petition for rehearing, emphasizing the background, context, and importance of the arm’s-length standard and arguing that the panel’s decision violated a bedrock principle of tax law.

On January 13, 2010, the panel withdrew its original opinions. On March 22, in an unusual self-reversal, the panel issued a new decision ruling for Xilinx.