Analog Devices, Inc. & Subsidiaries v. Commissioner, 147 T. C. No. 15 (2016)

In a significant ruling on the scope of tax closing agreements, the U. S. Tax Court held that accounts receivable established under a *Rev. Proc. 99-32* closing agreement do not constitute retroactive indebtedness for the purposes of reducing a taxpayer's dividends received deduction under IRC Section 965. This decision overturned prior precedent and clarified that closing agreements are strictly construed to the issues enumerated therein, impacting how such agreements are interpreted in future tax disputes.

Parties

Analog Devices, Inc. & Subsidiaries (Petitioner) v. Commissioner of Internal Revenue (Respondent). The case was adjudicated at the trial level before the United States Tax Court.

Facts

Analog Devices, Inc. (ADI), a U. S. corporation, owned Analog Devices B. V. (ADBV), a controlled foreign corporation (CFC) incorporated in the Netherlands. ADI entered into a closing agreement with the IRS under *Rev. Proc. 99-32* to reconcile cash accounts after adjusting royalties from ADBV to ADI from 2% to 6% for the years 2001-2005, pursuant to a *Section 482* adjustment. ADI claimed an 85% dividends received deduction (DRD) under *Section 965* for a 2005 dividend from ADBV. The IRS later contended that the accounts receivable established in the closing agreement constituted related party indebtedness under *Section 965(b)(3)*, thereby reducing the DRD. ADI disputed this, leading to the litigation.

Procedural History

The IRS issued a notice of deficiency for ADI's 2006 and 2007 tax years, asserting deficiencies of $3,997,804 and $22,112,640, respectively, due to the reduction of the DRD. ADI filed a timely petition for redetermination with the U. S. Tax Court. The case was fully stipulated under Tax Court Rule 122. The Tax Court had previously addressed a similar issue in *BMC Software, Inc. v. Commissioner*, which was reversed by the U. S. Court of Appeals for the Fifth Circuit. The Tax Court, influenced by the reversal, revisited its analysis in the instant case.

Issue(s)

Whether the accounts receivable established under a *Rev. Proc. 99-32* closing agreement constitute related party indebtedness under *Section 965(b)(3)*, thereby reducing the amount of the dividends eligible for the DRD?

Rule(s) of Law

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Section 965 allowed a temporary 85% DRD for certain dividends received from CFCs. *Section 965(b)(3)* reduces the DRD by any increase in the CFC's related party indebtedness during the testing period. *Rev. Proc. 99-32* permits taxpayers to establish accounts receivable to effect secondary adjustments after a primary *Section 482* allocation, avoiding deemed dividend treatment. Closing agreements under *Section 7121* are final and conclusive as to the matters agreed upon and are strictly construed to encompass only the issues enumerated therein.

Holding

The Tax Court held that the accounts receivable did not constitute related party indebtedness under *Section 965(b)(3)*. The closing agreement did not specifically address the treatment of the accounts receivable under *Section 965*, and thus, the accounts receivable did not retroactively create indebtedness during ADI's testing period.

Reasoning

The court reasoned that the closing agreement's phrase "for all Federal income tax purposes" was part of the standard boilerplate and did not extend the agreement's scope beyond the specifically enumerated issues. The court emphasized the principle of *expressio unius est exclusio alterius*, stating that the specificity of the closing agreement's provisions implied that unmentioned tax consequences, such as those under *Section 965*, were excluded. The court also considered the timing requirement in *Section 965(b)(3)*, which required indebtedness to exist "as of" the close of the election year, a condition not met by the accounts receivable which were established after the testing period. The court overruled its prior decision in *BMC Software I*, aligning its interpretation with the Fifth Circuit's reversal and the plain meaning of *Section 965(b)(3)*. The court further noted that the IRS's guidance in *Notice 2005-64* lacked analysis and conflicted with the statute, thus being unpersuasive. The court rejected the IRS's contention that extrinsic evidence indicated an intent to treat the accounts receivable as retroactive indebtedness, as such evidence was not incorporated into the closing agreement.

Disposition

The Tax Court entered a decision for the petitioner, ADI, allowing the full amount of the claimed DRD.

Significance/Impact

This case significantly clarifies the scope and interpretation of closing agreements under *Section 7121*, emphasizing that such agreements are strictly limited to the issues specifically enumerated. It overrules prior Tax Court precedent and aligns with the Fifth Circuit's reversal in *BMC Software II*, impacting future tax disputes involving the retroactive effect of accounts receivable established under *Rev. Proc.*

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99-32 closing agreements. The decision reinforces the necessity of clear contractual language in closing agreements and may influence the IRS's approach to drafting such agreements. It also underscores the importance of the timing requirement under *Section 965(b)(3)* for determining related party indebtedness.

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