No. 2025-289
October 1, 2025

Eighth Circuit: Reallocation of blocked royalty income not allowed under section 482

The U.S. Court of Appeals for the Eighth Circuit today reversed the U.S. Tax Court and held that section 482 does not allow the IRS to reallocate royalty income to the taxpayer that the taxpayer could not legally receive from its non-U.S. subsidiary.

The case is: *3M Company and Subsidiaries v. Commissioner,* No. 23-3772 (8th Cir. October 1, 2025). Read the Eighth Circuit's **decision**

Summary

The taxpayer P is the common parent company of a consolidated group of corporations with subsidiaries around the world. One of P's most important assets is its intellectual property (IP), and its non-U.S. subsidiaries generally pay to use it. However, Brazilian law capped the amount P's Brazilian subsidiary B could pay in royalties to a non-Brazilian controlling company like P. On its 2006 federal income tax return, the P consolidated group reported as income the IP royalties that B paid to P in 2006.

Several years later, the IRS sent a notice of deficiency to P determining that the income of the P consolidated group must be increased by nearly $23.7 million under section 482 to account for an arm's length rate of compensation for B's use of P's IP. P agreed that the amount reflects the compensation an unrelated entity would have paid to use P's IP, but P's position was that the IRS cannot reallocate unpaid royalties to P that Brazilian law would have prevented B from paying.

P challenged the IRS's determination in the U.S. Tax Court, arguing that section 482 does not allow the IRS to tax what Brazilian law blocked P from receiving. In support of its position, P relied on various authorities, including the text and legislative history of section 482, as well as four cases interpreting section 482 that held that the IRS did not have the authority to allocate income to a taxpayer that the taxpayer did not receive and could not legally receive. See *L.E. Shunk Latex Prods., Inc. v. Commissioner*, 18 T.C. 940 (1952); *Commissioner v. First Sec. Bank of Utah, N.A.*, 405 U.S. 394 (1972); *Procter & Gamble Co. v. Commissioner*, 95 T.C. 323 (1990), aff'd, 961 F.2d 1255 (6th Cir. 1992); and *Exxon Corp. & Affiliated Cos. v. Commissioner*, T.C. Memo. 1993-616, 66 T.C.M. (CCH) 1707 (1993), aff'd sub nom. *Texaco, Inc., & Subs. v. Commissioner*, 98 F.3d 825 (5th Cir. 1996). P also argued that Treas. Reg. §1.482-1(h)(2), which the IRS relied on to tax the blocked income, was invalid under *Chevron, U.S.A., Inc. v. Nat. Res. Def. Council, Inc.*, 467 U.S. 837, 844 (1984), because it was an unreasonable interpretation of the statute, and because the IRS did not follow the Administrative Procedure Act (APA) when it adopted the blocked-income regulation.

A seven-judge plurality in the Tax Court rejected P's procedural argument and deferred to the blocked-income regulation as a reasonable interpretation of an ambiguous statute. Reaching a majority required adding the votes of two concurring judges, who thought the statute required the IRS to make the reallocation, regardless of what the regulation said. The eight dissenters would have come out the other way. Some thought the statute unambiguously prohibited the IRS from reallocating income that P could not legally receive. Others believed that even if the statute was ambiguous, the blocked-income regulation was unenforceable because the IRS had failed to follow the APA when adopting it. Six judges agreed with both points. Read *TaxNewsFlash*

The Eighth Circuit noted that the "legal landscape has changed since the case's last stop. After the Tax Court decision, the Supreme Court decided *Loper Bright Enterprises v. Raimondo*, which frees courts to adopt the 'best reading of the statute': the one 'the court would have reached if no agency were involved' (citation omitted). Our task, post *Loper Bright*, is to 'use every tool at [our] disposal to . . . resolve [any] ambiguity' (citation omitted)."

The Eighth Circuit stated its ultimate holding as follows: "Statutes trump regulations. Over three decades ago, another court decided that the IRS could not tax a domestic parent company on royalties it could not legally receive from a foreign subsidiary. See *Procter & Gamble Co. v. Comm'r*, 961 F.2d 1255, 1259 (6th Cir. 1992). The IRS then authorized by regulation what a statute had not. That strategy might have worked before, see *Nat'l Cable & Telecomms. Ass'n v. Brand X Internet Servs.*, 545 U.S. 967, 982–83 (2005), but not now, see *Loper Bright Enters. v. Raimondo*, 603 U.S. 369, 400 (2024), so we reverse."