

Big Win for IRS Against 3M as Tax Court Upholds Transfer Pricing Regulations

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Report from our correspondent Jannica Robles Santos, J.D.

The US Tax Court has upheld the validity of regulations that address when the US Internal Revenue Service (IRS) can reallocate intercompany profits without regard to foreign legal restrictions (*3M Co. et al. v. Commissioner of Internal Revenue*, No. 5816-13, 9 February 2023).

In the present case, 3M Company contested its income tax deficiencies for tax year 2006, arguing that the IRS erroneously allocated nearly USD 24 million of royalty income to 3M from its subsidiary 3M Brazil under [section 482](#) of the Internal Revenue Code (IRC) even when Brazilian law barred the royalty payments.

The Tax Court discussed that in determining whether to defer to an agency's interpretation of a statute, courts employ the two-step test articulated in *Chevron, U.S.A., Inc. v. Natural Res. Def. Council, Inc.* (467 U.S. 837, 842-843 (1984)). Under Chevron step one, a court must, applying the ordinary tools of statutory construction, determine, whether Congress has directly spoken to the precise question at issue. However, if the statute is ambiguous, then under Chevron step two, a court must defer to the agency's interpretation of the statute if the interpretation is reasonable.

The Tax Court held that the requirement of *Treasury Regulations, section 1.482-1(h)(2)(i)* (2006) that "a foreign legal restriction will be taken into account only to the extent that it is shown that the restriction affected an uncontrolled taxpayer under comparable circumstances" is not invalid under Chevron step 2.

In addition, the Tax Court determined that the Brazilian legal restrictions at issue are not publicly promulgated. The Tax Court stated that the requirement under *Treasury Regulations section 1.482-1(h)(2)(ii)(A)* (2006) that foreign legal restrictions be taken into account under section 482 of the Internal Revenue Code only if they are publicly promulgated, means that the foreign legal restrictions must be in writing. The Tax Court also held that this requirement is not invalid under Chevron step 2.

The Tax Court also stated that the requirement that foreign legal restrictions be taken into account only if they are "generally applicable to all similarly situated persons (both controlled and uncontrolled)" is not invalid under Chevron step 2.

