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Eighth Circuit Holds That IRS May Not Tax A Domestic Parent Company On Royalties It Could Not Legally Receive From A Foreign Subsidiary

3M Co. & Subsidiaries v. Commissioner of Internal Revenue,
No. 23-3772 – Decided October 1, 2025

On October 1, the United States Court of Appeals for the Eighth Circuit rejected the IRS's longstanding position that it may reallocate as taxable "income" royalties from a foreign subsidiary to its domestic parent company, even when foreign law legally prohibits the subsidiary from actually remitting those royalties.

"[D]ominion or control is the dividing line for income under § 482, and income attribution requires the taxpayer to be an entity that 'could have received it.'"

Stras, J., writing for the Court

Background

3M Company's foreign subsidiaries, including a Brazilian company called 3M do Brasil, pay 3M to use its intellectual property. But Brazilian law formerly capped the amount of royalties Brazilian companies could pay to non-Brazilian parent companies like 3M. So in 2006, 3M do Brasil paid

only $5.1 million for the use of 3M's intellectual property, which 3M reported on its 2006 federal tax return.

Years later, however, the IRS asserted that 3M owed almost five times that amount under the agency's "blocked-income" regulation, which establishes a multifactor test for when the IRS may reallocate income among commonly controlled entities. The IRS thus reallocated nearly $23.7 million in extra income to 3M to reflect what, in its view, 3M *should* have received from its Brazilian subsidiary.

3M challenged the determination in the Tax Court, arguing that the underlying statute authorizing reallocations, 26 U.S.C. § 482, does not permit the IRS to treat blocked income as taxable "income." 3M also argued that the blocked-income regulation is procedurally invalid under the Administrative Procedure Act, given the IRS's notice-and-comment violations in promulgating it.

The Tax Court upheld the IRS's determination in a deeply fractured ruling reviewed by the full Tax Court. A seven-judge plurality rejected 3M's APA argument, deemed 26 U.S.C. § 482 ambiguous, and deferred to the blocked-income regulation as reasonable under *Brand X* and *Chevron*. Two other judges believed 26 U.S.C. § 482 *required* the IRS to make the reallocation, regardless of the regulation. And eight dissenters would have come out the other way—some concluding that 26 U.S.C. § 482 unambiguously prohibits the IRS's reallocation, others concluding that the blocked-income regulation is procedurally invalid, and six rejecting the IRS's position on both grounds.

Issue Presented

Under 26 U.S.C. § 482, can the IRS tax a domestic parent company on royalties it could not legally receive from a foreign subsidiary?

Court's Holding

No. Given the Supreme Court's intervening decision in *Loper Bright*, which overruled judicial deference to agencies under *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), the Eighth Circuit focused directly on the statutory text of 26 U.S.C. § 482. Construing that text, the Eighth Circuit held that blocked income is not "income" under the statute. While the IRS may reallocate income among commonly controlled entities, for money to be "income," the "'taxpayer must have complete dominion over it,' meaning it is money that '*could* have been received.'" *Commissioner v. First Security Bank of Utah, N.A.*, 405 U.S. 394, 403 (1972). But 3M could not have received the income at issue due to Brazil's restrictions on foreign royalty payments. So that income was not subject to reallocation as "income" under 26 U.S.C. § 482.

The Eighth Circuit comprehensively rejected the IRS's counterarguments. The IRS contended its reallocation was authorized under statutory language in § 482 providing that "income" with respect to intangibles "shall be commensurate with the income attributable to the intangible." But the Eighth Circuit held that this provision merely explains how *much* income should be allocated—not *what* counts as "income." The Eighth Circuit also rejected the IRS's contention that *foreign* legal restrictions (as opposed to domestic legal restrictions) should not count. And it

"firmly" disagreed with the IRS's contention that 3M should have "evade[d]" Brazilian law to maximize its own tax liability by compelling its Brazilian subsidiary to pay 3M additional dividends to make up for the blocked royalty payments. The Eighth Circuit also emphasized the important differences between dividends and royalties for tax and other purposes and observed that the IRS's argument was "breathtaking in its potential reach" and could extend beyond dividends to allow the IRS to compel a subsidiary to liquidate to obtain the royalties the IRS believes should have been paid. The Eighth Circuit thus unanimously reversed the Tax Court.

What It Means

- The Eighth Circuit's decision repudiates the IRS's longstanding position on blocked income and reaffirms the Supreme Court's longstanding holding from *First Security* that blocked income is not "income" under 26 U.S.C. § 482. The decision also makes clear that the same principles underlying *First Security* extend to foreign legal restrictions.

- The decision shows how courts, after *Loper Bright*, must strive to find the "best reading" of underlying statutes, even in highly technical areas like taxation that feature a tangle of regulations.

- The decision also effectively invalidates the blocked-income regulation in the Eighth Circuit, which rests on the IRS's erroneous view that 26 U.S.C. § 482 permits the agency in some circumstances to reallocate blocked income as "income."

- The decision does not bind the IRS and Tax Court for taxpayers outside the Eighth Circuit, however. The same issue is pending before the Eleventh Circuit. It remains to be seen how the agency will address taxpayers in other circuits and whether the Tax Court will be afforded the opportunity to revisit the issue.

***Gibson Dunn** represented the prevailing party, 3M Company. Partner Jonathan Bond argued the appeal on behalf of 3M. He was joined by Saul Mezei, Jeff Liu, and Christian Talley.*

The Court's opinion is available here.

Gibson Dunn's lawyers are available to assist in addressing any questions you may have regarding these issues. Please contact the Gibson Dunn lawyer with whom you usually work, the authors, or any leader or member of Gibson Dunn's Tax Controversy & Litigation or Appellate & Constitutional Law practice groups:

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