



## Treatment of Gross Receipts Attributable to Intra-Group Transfers under Section 41

### Issue

May a domestic corporation exclude transfers from foreign members of its controlled group in computing its base amount under section 41(c)?

### Background

On May 1, 2002, the Service issued CCA 200233011, which concluded that, given the particular facts and circumstances of this case, a domestic corporation may exclude sales to its majority-owned foreign subsidiaries when computing gross receipts for purposes of determining its base amount under section 41(c). The CCA interprets the term "transfer" as it is used in Treas. Reg. sec. 1.41-6(e) (currently Treas. Reg. sec. 1.41-6T(i)) very broadly and as including intra-group sales giving rise to gross receipts.

Notably, CCA 200233011 states that Congress had specifically indicated what gross receipts should be taken into account for purposes of determining the base amount under section 41(c) when it enacted section 41(c)(6) (a foreign corporation must take into account only gross receipts which are effectively connected with the conduct of a trade or business within the United States). CCA 200233011 further states that, while Treas. Reg. sec. 1.41-8 was amended and renumbered as Treas. Reg. sec. 1.41-6 in 2000, Treas. Reg. sec. 1.41-6(e) was not amended to reflect the effect of gross receipts on the research credit. Accordingly, the CCA reasons that Treas. Reg. sec. 1.41-6(e) (currently Treas. Reg. sec. 1.41-6T(i)) should continue to be interpreted as it was interpreted prior to the insertion of gross receipts into the calculation of the research credit: as applying generally to intra-group transfers, including transfers with respect to research expenditures.

On February 14, 2006, the IRS published a second CCA, addressing substantially the same question as CCA 200233011. But instead of limiting the question to gross receipts from intra-group sales, the new CCA asks if a domestic corporation may exclude receipts in general (not just those attributable to intra-group sales) from its majority-owned foreign subsidiaries when computing gross receipts for purposes of determining its base amount under section 41(c). The new CCA applies the same authorities to basically the same question but reaches the opposite answer. The new CCA concludes that, under the facts and circumstances it assumes, a taxpayer may not exclude receipts from its foreign subsidiaries when computing gross receipts for purposes of determining the base amount under section 41(c).

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## Policy Considerations

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The legislative purpose of the aggregation rules of section 41(f)(1)(A)(i) which treat all members of a controlled group of corporations as a single taxpayer, was to prevent artificial increases in the credit through a shifting of expenditures among commonly controlled persons. When enacted in 1981, section 44F(f)(1) contained essentially the same aggregation rule as present section 41(f)(1):

“In determining the amount of the credit under this section—

- i. all members of the same controlled group of corporations shall be treated as a single taxpayer...

Similarly, present section 41(f)(5) contains the same language as original section 44F(f)(5) defining the term “controlled group of corporations”:

“The term ‘controlled group of corporations’ has the same meaning given to such term by section 1563(a), except that—

- A. ‘more than 50 percent’ shall be substituted for ‘at least 80 percent’ each place it appears in section 1563(a)(1), and
- B. the determination shall be made without regard to subsections (a)(4) and (e)(3)(C) of section 1563.”

A “controlled group of corporations” includes controlled foreign subsidiaries (CFS). The IRS National Office has concluded that a CFS is a member of a controlled group of corporations for purposes of the research credit. See TAM 8643006 (7/23/86); CCA 200233011. See also 1.267(f)-(1)(b)(3). Section 1563(a), does not exclude foreign corporations from a controlled group of corporations. Section 1563(a) does not incorporate or refer to section 1563(b) (defining “component member” of a controlled group).

The statute is unambiguous: all members of a controlled group of corporations are a single taxpayer for purposes of determining the research credit. As such, they must be viewed as divisions of a single corporation with respect to intercompany transactions. Thus under the aggregation rules, sales of property between members of a controlled group, and the payment of dividends, interest, royalties, etc. between members of a controlled group must be disregarded in computing the taxpayer’s gross receipts.



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### **Recommendation**

There is no basis articulated in the new CCA for ignoring the clear wording of section 41(f)(1), the decades old regulations that interpret that statute, the Service's own well reasoned CCA 200233011, and the long settled tax principle that a taxpayer cannot do business with itself. Transfers between members of controlled groups, including transfers that give rise to gross receipts, must be disregarded for purposes of section 41. The CCA is a results-based attempt by the Service to stem numerous refund claims and the SVTDG recommends that it be revoked.