

# Eighth Circuit reverses US Tax Court's ruling in 3M appeal

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## In brief

### What happened?

On October 1, the US Court of Appeals for the Eighth Circuit (Eighth Circuit) in *3M Company and Subsidiaries v. Commissioner* ([Docket No. 23-3772](#)), reversed a sharply divided US Tax Court's 2023 decision that upheld the 1994 blocked income regulation under Section 482. The Eighth Circuit applied the standard established by the Supreme Court in *Loper Bright Enterprises v. Raimondo*, 603 U.S. 369 (2024) ([Loper Bright](#)), and gave no weight to the blocked income regulation based on the "best reading" of Section 482.

The Eighth Circuit held that 3M Company (3M) could not be taxed on royalty income that it was legally prohibited from receiving under Brazilian law. The case was remanded to the Tax Court to redetermine taxes owed by 3M for the tax year at issue (i.e., for 2006).

### Why is it relevant?

This case marks another tax law decision in the wake of *Loper Bright*, which brought an end to the era of *Chevron* deference (see *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984)). Building on the principles established in *Loper Bright*, the Eighth Circuit reiterated that regulations cannot expand an agency's statutory authority and that it is the judiciary's role to interpret a statute's meaning. The Eighth Circuit's analysis may significantly reshape the regulatory landscape for companies with foreign subsidiaries subject to restrictions on cross-border payments.

## Actions to consider

Taxpayers with subsidiaries facing foreign payment restrictions should reassess their transfer pricing exposures in light of this opinion. The Eighth Circuit's opinion provides strong arguments for taxpayers to challenge the IRS's reallocation of income under Section 482 where foreign law prevented payment. However, the decision may be subject to further review (e.g., the government could seek a rehearing en banc or petition the Supreme Court for certiorari).

Taxpayers within the Eighth Circuit (i.e., Arkansas, Iowa, Minnesota, Missouri, Nebraska, North Dakota, and South Dakota) are directly affected by this opinion, while those outside the circuit should continue to monitor how other courts and the IRS interpret its reasoning. Companies also should evaluate potential implications for ongoing audits and disputes, particularly in cases where payment restrictions are at issue, and stay abreast of any procedural developments that could alter the decision's precedential weight.

## In detail

### Background

3M, a US-based industrial and consumer products company, had a Brazilian subsidiary (3M Brazil) that used 3M trademarks and other intellectual property in 2006. 3M Brazil, during 2006, licensed trademarks owned by 3M, its US parent, under three separate trademark licenses. 3M and 3M Brazil applied the royalty "stacking" principle, based upon which each set of trademarks generated a 1% royalty. Under the stacking principle, if a particular product used trademarks covered by all three trademark licenses, the royalty would be 3% of the net sales of the product. Brazilian law (an unwritten policy of the Brazilian Patent and Trademark Office), however, strictly limited the royalty a local company could pay to a foreign controlling parent — effectively at 1% of net sales.

In 2006, 3M Brazil paid \$5.1 million in royalties to 3M, which was the maximum amount permitted under Brazilian law at the time. 3M reported this royalty income on its 2006 US tax return. The IRS, however, issued a deficiency notice reallocating approximately \$23.7 million in additional royalty income to 3M under Section 482, as the arm's-length amount it believed 3M Brazil should have paid. Both 3M and the IRS agreed that \$23.7 million represented an arm's-length royalty; the dispute centered on whether the IRS could tax 3M on that additional royalty amount when Brazilian law barred the subsidiary from paying it.

### Procedural history

3M challenged the IRS adjustment in the Tax Court. In February 2023, the Tax Court ruled for the IRS in a narrow 9–8 decision, mandating that 3M recognize royalty income even though Brazil's restrictions limited the actual payments. Two of the nine judges who held for the IRS concurred only in the result. The Tax Court's majority opinion deferred to the Treasury Department's "blocked income" regulation as a reasonable interpretation of Section 482. The eight dissenting judges, however, believed that the regulation exceeded the Treasury Department's authority under Section 482 and was procedurally defective because the Treasury Department failed to adequately explain the reasons for its adoption of the blocked income regulation and to respond to relevant public comments submitted during the rulemaking process. 3M appealed to the Eighth Circuit, challenging the blocked income regulation and arguing it conflicts with tax principles established in *Commissioner v. First Sec. Bank of Utah, N.A.*, 405 U.S. 394, 403 (1972) (*First Security Bank*) and related precedents. For additional background on the Tax

Court's decision, see our previous [PwC Tax Insight](#).

## The Eighth Circuit opinion

### No Section 482 authority to tax blocked income

The Eighth Circuit's decision highlights that, in a post-*Loper Bright* environment, courts must independently interpret statutes and adopt the “best reading of the statute” — the interpretation the court would reach independently, without regard to the agency's view. Applying this standard, the Eighth Circuit closely examined the text of Section 482, which authorizes the IRS to reallocate income among commonly controlled companies, but only for two specific purposes: to prevent tax evasion or to clearly reflect income.

The court emphasized that these statutory safeguards limit the IRS's authority under Section 482. In this case, the IRS did not allege tax evasion. Instead, it argued that Brazilian legal restrictions on royalty payments distorted 3M's income, since an unrelated licensee would have paid much higher royalties to an unrelated licensor in a comparable transaction.

The Eighth Circuit, drawing on the Supreme Court's decision in *First Security Bank*, highlighted a further limitation: for income to qualify, a taxpayer must have dominion and control over it — taxpayers cannot be taxed on amounts they neither received nor could lawfully receive (in a domestic law context). Applying this same principle, the Eighth Circuit concluded that the IRS could not disregard Brazilian legal restrictions and reallocate income to 3M. The court found that attributing such blocked income to 3M would not “clearly reflect” its income under Section 482.

**Observation:** The Eighth Circuit opinion reinforces the principle that the IRS cannot use regulations to expand the boundaries created by Congress under Section 482. In a post-*Loper Bright* environment, courts are required to independently interpret the statute and will not defer to agency regulations that attempt to broaden the IRS's reach. This decision provides reassurance that, at least for taxpayers resident within the Eighth Circuit, the IRS cannot use Section 482 to impute income to a US taxpayer where there is a genuine foreign legal restriction preventing the receipt of that income. For taxpayers outside the Eighth Circuit, the decision is persuasive but not binding, and the IRS may continue to assert its position until there is a broader judicial consensus, Supreme Court review, or the regulation is withdrawn. It is advisable for taxpayers to explicitly document any such legal constraints impacting pricing in their transfer pricing documentation, as clear evidence of these restrictions is essential to support that any deviation from the arm's-length standard was mandated by law.

### Commensurate with income

In this case, the IRS argued that the “commensurate with income” (CWI) provision in Section 482 provides another basis to disregard the foreign legal restrictions. As a reminder, the CWI provision provides that income with respect to any transfer (or license) of intangible property *shall be* commensurate with the income attributable to the intangible property. Given the statutory text, the IRS argued that the CWI clause in Section 482 requires that any income “attributable to” intangible property counts, including whatever 3M Brazil earned from it, even if it cannot legally pay for what it used.

The Eighth Circuit, however, interpreted the CWI clause within the broader context of Section 482. The court found that the best reading of the statute is that the IRS can allocate income, but only when the taxpayer has “dominion and control” over it — a principle established by the Supreme Court in *First Security Bank*. The CWI provision addresses how to measure the amount of income to be allocated in cases involving intangible property — it must be commensurate, or “equal in measure” or “proportionate”

to the income generated by the intangible property. Importantly, the CWI clause does not change the meaning of “income” itself; rather, it simply answers the how-much question, not the what-gets-allocated question. As a result, the court found that the IRS’s reliance on the CWI provision does not support reallocating royalties that Brazilian law prevents 3M Brazil from paying.

**Observation:** This case serves as an important check on the IRS’s continued efforts to use the CWI provision to expand its authority under Section 482. Congress added the CWI provision to Section 482 in 1986, and Treasury has consistently interpreted it as operating consistently with the arm’s-length standard — beginning with Notice 88-123 (known as the “White Paper”), and reiterated in treaty technical explanations (e.g., Treasury Department Explanation of the 2001 U.S.-U.K. Income Tax Convention, Art. 9: the CWI standard “was designed to operate consistently with the arm’s length standard”; Treasury Department Technical Explanation of the 2006 Model Income Tax Convention, Art. 9 (same)). Similarly, Chief Counsel Memorandum AM-2007-007 (March 15, 2007), noted that Treasury and the IRS “have long maintained in regulations and other published guidance that transfer pricing allocations pursuant to the provisions of either sentence [in Section 482] must be in accordance with the arm’s length standard as the unifying principle.”

However, in Generic Legal Advice Memorandum 2025-001 (January 15, 2025), the IRS took the position that where none of the regulatory exceptions to periodic adjustments apply (e.g., extraordinary events beyond the control of the taxpayers that could not reasonably have been anticipated at the time of the transaction), a taxpayer cannot overcome the IRS’s consideration of actual profits via periodic adjustments by invoking the general arm’s-length standard in Reg. 1.482-1(b)(1). In other words, the IRS’s apparent view — contrary to its prior positions — is that CWI can, in certain instances, trump the arm’s-length standard. This marked a significant shift in the IRS’s interpretation, indicating that the CWI provision gives the IRS the authority to make transfer pricing adjustments based on ex post results, even for transactions originally priced at arm’s length. The Eighth Circuit’s opinion, however, imposed limitations on the IRS’s ability to apply the CWI provision, and a taxpayer victory here could portend further success against the IRS’s efforts to expand CWI through litigation. *See, e.g., Altera Corp. & Subs. v. Comm’r*, 926 F.3d 1061 (9th Cir. 2019).

## Loper Bright

Initially, the IRS relied on *Chevron* deference, arguing that it was entitled to judicial deference with respect to the 1994 blocked income regulation. Following the Supreme Court’s decision in *Loper Bright*, the IRS submitted a supplemental brief urging the court to defer to its interpretation given that Section 482 “delegat[ed] discretionary authority” to the IRS to make the proposed reallocation. The Eighth Circuit, however, emphasized that even assuming that is the case, it remains the court’s responsibility to “fix[] the boundaries of [that] delegated authority” by closely examining the statute’s text. The IRS also argued for deference based on its “specialized experience,” but the Eighth Circuit rejected this argument, noting that deference is not warranted when the agency “recently invented” its interpretation and the statute itself supports a “better reading.”

Applying this framework, the court declined to give weight to the Treasury Department’s blocked income regulation.

**Observation:** With *Chevron* deference overturned, under *Loper Bright*, courts (not agencies) will resolve statutory ambiguities and gaps, including those under Section 482. The Eighth Circuit’s decision illustrates how courts may independently interpret a statute’s text to determine the “best reading of the statute,” relying on established principles of statutory interpretation — such as the plain meaning of the language, the structure of the statute, and relevant Supreme Court precedent — to determine the scope of IRS authority.

# The takeaway

While the Eighth Circuit's decision addresses a relatively narrow issue, its implications are significant. The opinion effectively invalidates the blocked income regulation under Section 482 within the Eighth Circuit, but it is not binding on the IRS or the Tax Court for taxpayers outside of that circuit. Companies therefore should be mindful that similar disputes could continue to arise elsewhere, particularly where foreign subsidiaries face restrictions on outbound payments due to currency controls or other governmental limitations.

The Eighth Circuit also emphatically rejected the IRS's attempt to recharacterize the payments made by 3M Brazil as dividends in lieu of royalties. The court stated that this position was "breathtaking in its potential reach," emphasizing that taxpayers are not required to "purposely evade" foreign law to satisfy US transfer pricing principles. The court's holding makes clear that actual transactions (or lack thereof) should be evaluated, not hypothetical transactions.

## Let's talk

For a deeper discussion of how this case might affect your business, please contact:

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