Deere & Co. v. Commissioner, 133 T. C. 246 (2009) (United States Tax Court, 2009)

The U. S. Tax Court ruled that Deere & Co. must include foreign branch gross receipts in calculating its average annual gross receipts for the research credit, impacting how multinational corporations compute tax credits. This decision clarifies the scope of gross receipts for the alternative incremental research credit, emphasizing that all income from foreign branches must be included, even if not directly related to U. S. operations. The ruling affects the tax planning strategies of companies with international operations seeking to leverage the research and experimentation (R&E) tax credit.

Parties

Deere & Company and Consolidated Subsidiaries (Petitioner) v. Commissioner of Internal Revenue (Respondent). Petitioner, a consolidated group of corporations, was the appellant in this case before the United States Tax Court.

Facts

Deere & Company, a U. S. corporation, operated through foreign branches in Germany, Italy, and Switzerland. For the tax year ending October 31, 2001, Deere claimed a credit for increasing research activities under Section 41 of the Internal Revenue Code, electing the alternative incremental research credit method prescribed by Section 41(c)(4). In calculating this credit, Deere excluded the gross receipts from its foreign branches for the four preceding taxable years from the computation of its average annual gross receipts, asserting that these receipts should not be included in the calculation under Section 41(c)(1)(B).

Procedural History

The Commissioner of Internal Revenue issued a notice of deficiency disallowing Deere’s research credit claim for the tax year ending October 31, 2001, arguing that Deere incorrectly excluded the gross receipts of its foreign branches from the calculation. Deere filed a petition with the United States Tax Court contesting the deficiency. Both parties filed motions for summary judgment. The Tax Court granted the Commissioner’s motion and denied Deere’s motion, upholding the inclusion of foreign branch gross receipts in the computation of the research credit.

Issue(s)

Whether Deere & Company is required to include in the calculation under Section 41(c)(1)(B) of its average annual gross receipts for the four taxable years preceding the tax year at issue the total annual gross receipts from its foreign branch operations in Germany, Italy, and Switzerland.

Rule(s) of Law

Section 41(c)(1)(B) of the Internal Revenue Code defines the base amount for the research credit as the product of the fixed-base percentage and the average annual gross receipts of the taxpayer for the four taxable years preceding the credit year. Section 41(c)(6) specifies that, for a foreign corporation, only gross receipts effectively connected with the conduct of a trade or business within the United States are considered. However, no similar exclusion is provided for unincorporated foreign branches.

Holding

The Tax Court held that Deere & Company must include in the calculation under Section 41(c)(1)(B) the total annual gross receipts from its foreign branches in Germany, Italy, and Switzerland for the four taxable years preceding the tax year ending October 31, 2001, when computing the alternative incremental research credit under Section 41(c)(4).

Reasoning

The court reasoned that the structure and legislative history of Section 41 did not support Deere's position to exclude foreign branch receipts. The court rejected Deere's argument that the term "gross receipts" should be interpreted to exclude foreign branch receipts based on the historic domestic focus of the research credit, emphasizing that Congress's intent was to promote research conducted in the United States, not to limit the scope of gross receipts to U. S. operations. The court noted the absence of any statutory provision similar to Section 41(c)(6) for unincorporated foreign branches, indicating Congressional intent to include all gross receipts in the calculation. The court also dismissed Deere's claim that including foreign branch receipts would discriminate against U. S. corporations, as no compelling evidence supported this assertion. The court further found that the aggregation rule under Section 41(f) did not justify excluding foreign branch receipts, as it applies to prevent artificial increases in research expenditures but does not address the inclusion or exclusion of gross receipts.

Disposition

The Tax Court granted the Commissioner's motion for summary judgment and denied Deere's motion, affirming the inclusion of foreign branch gross receipts in the calculation of Deere's research credit for the tax year ending October 31, 2001.

Significance/Impact

This decision establishes that multinational corporations must include gross receipts from all foreign branches in calculating the research credit, impacting tax planning strategies for companies with international operations. It clarifies the scope of "gross receipts" under Section 41(c)(1)(B) and may lead to adjustments in how companies claim the research and experimentation tax credit. The ruling has implications for the tax treatment of foreign income and may influence future legislative or regulatory actions regarding the inclusion of foreign source income in domestic tax calculations.

