Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

[Third Party Communication:
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Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:INTL:B03
PLR-141346-09
Date:
December 30, 2009

Re:

Tax Year:

LEGEND

Taxpayer =

Year A =
State X =
Year B =
Business M =

Year C =
Year D =
Year E =
Country Y =

Dear :

This letter responds to your representative's letter dated September 14, 2009, and supplemental communication dated November 13, 2009, in which Taxpayer, in its capacity as the common parent corporation of a U.S. consolidated group of corporations ("the Taxpayer Group"), requests permission to change to the gross income methods of

apportioning research and experimental expenditures ("R&E"), pursuant to Treas. Reg. § 1.861-17(e)(2)[1], for tax years beginning with Year A.

The ruling contained in this letter is based upon information and representations submitted by Taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for ruling, it is subject to verification on examination.

FACTS

Taxpayer was incorporated in State X in Year B and conducts Business M. The Taxpayer Group files a consolidated federal income tax return on a calendar year basis. The Taxpayer Group maintains its books, and files its federal income tax returns, using the accrual method of accounting.

In Year C, Taxpayer elected to apportion its R&E pursuant to the gross income methods under Treas. Reg. § 1.861-17(d). It evidenced this election by checking the "Option 1 - Gross Income" box on Form 1118, Schedule H, as well as by applying this method to apportion its R&E for purposes of computing its foreign tax credit limitation. On its Year D federal income tax return, which is more than four years after Year C, Taxpayer elected to apportion its R&E according to the sales method under Treas. Reg. § 1.861-17(c).

Taxpayer Group had a limited staff preparing the international portions of its Year D consolidated federal income tax return. This staff consisted of one International Tax Manager, whose work was then reviewed by Taxpayer's Director of Tax. These two individuals were under severe time constraints when preparing the Year D tax return. These time constraints stemmed from personnel turnover in the tax department, as well as additional work backlogs caused by restatements of financial earnings for Taxpayer Group. Because of these problems, the decision to apportion R&E according to the sales method under Treas. Reg. § 1.861-17(c) was made at the last minute prior to the filing deadline for the Taxpayer Group's Year D tax return. Taxpayer states that the election to use the sales method was based on an error and that the error was not discovered until well after the Taxpayer Group filed the Year D tax return.

Taxpayer reverted to using the gross income methods of R&E apportionment on the Taxpayer Group's next year's (Year E's) consolidated federal income tax return without receiving prior consent of the Commissioner, as required by Treas. Reg. § 1.861-17(e)(2). Taxpayer states that it did not realize that the Year D use of the sales method required it to utilize that method for the four-year period following Year D. Taxpayer

[1] Unless otherwise indicated, all section references are to the U.S. Internal Revenue Code of 1986, as amended (the "Code"), and any references to regulation sections are to the U.S. Treasury Department regulations under the Code ("Treas. Reg. §").

states that it will amend its return for Year E to reflect its mandatory use of the sales method for that year.

For each of Years C, D, E, and A, Taxpayer filed a Form 1118 and elected to credit foreign income taxes. For each of these years, Taxpayer did not claim the section 199 deduction related to qualified production activities income, and allocated and apportioned its expenses solely for purposes of determining its foreign source tax credit limitation under section 904.

In Years C, D, and E, the gross income methods of apportioning Taxpayer's R&E were, or would have been had they been applied, more beneficial to Taxpayer because a lesser amount of the R&E was, or would have been, apportioned to foreign source gross income for purposes of the foreign tax credit limitation. In Year A, under the gross income methods, more R&E was apportioned to foreign source gross income than would have been apportioned had Taxpayer used the sales method because the Taxpayer Group had foreign source taxable income in excess of its worldwide taxable income, *i.e.,* it was in an overall domestic loss position. In Year A, Taxpayer received an unusually large dividend from a Country Y subsidiary.[2]

LAW

Section 864(g)(1)(C) provides that the remaining portion of qualified research and experimental expenditures, after the application of section 864(g)(1)(A) and (B), shall be allocated and apportioned on the basis of gross sales, or gross income, at the annual election of the taxpayer.

Under Treas. Reg. § 1.861-17, a taxpayer may elect to apportion R&E according to either the sales method of Treas. Reg. § 1.861-17(c), or the gross income methods of Treas. Reg. § 1.861-17(d). Treas. Reg. § 1.861-17(e)(1) provides that when a taxpayer chooses to use either method on its tax return for the first taxable year to which Treas. Reg. § 1.861-17 applies, such use constitutes a binding election to use the method chosen for that year and for the four following taxable years.

Treas. Reg. § 1.861-17(e)(2) states that the taxpayer's election of a method of R&E apportionment, pursuant to Treas. Reg. § 1.861-17(e)(1), may not be revoked during the five-year period without the prior consent of the Commissioner. Treas. Reg. § 1.861-17(e)(2) states that upon the expiration of the five-year period, the taxpayer may change R&E apportionment methods without the consent of the Commissioner; however, the use of a new method by the taxpayer constitutes a binding election for another five-year period unless the Commissioner's consent is obtained.

[2] Taxpayer requested this ruling before the due date of its Year A tax return, and filed that return utilizing the gross income methods of R&E apportionment with the expectation that its request would be granted. Taxpayer attached a copy of the letter ruling request to the return, as well as a Form 8275-R, disclosing and explaining its position.

RULING

Taxpayer's request to change from the sales method to the gross income methods of R&E apportionment under Treas. Reg. § 1.861-17(e)(2), for tax years beginning with Year A is granted.

CAVEATS

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to Taxpayer. Section 6110(k)(3) provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, copies of this letter are being sent to the first two authorized representatives identified on the Power of Attorney.

A copy of this letter ruling must be attached to Taxpayer Group's income tax return for the year following Year A. Alternatively, if Taxpayer Group files its returns electronically, it may satisfy this requirement by attaching a statement to its return for that year that provides the date and control number of this letter ruling.

Sincerely,

Anne O'Connell Devereaux
Senior Technical Reviewer, Branch 3
(International)

Enclosures:

Copy of this letter
Copy for section 6110 purposes

cc: