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NOTE: Where it is feasible, a syllabus (headnote) will be released, as is being done in connection with this case, at the time the opinion is issued. The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See *United States v. Detroit Timber & Lumber Co.*, 200 U. S. 321, 337.

SUPREME COURT OF THE UNITED STATES

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BOEING CO. ET AL. v. UNITED STATES**CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR
THE NINTH CIRCUIT**

No. 01–1209. Argued December 9, 2002—Decided March 4, 2003*

Under a 1971 statute providing special tax treatment for export sales made by an American manufacturer through a subsidiary that qualified as a “domestic international sales corporation” (DISC), no tax is payable on the DISC’s retained income until it is distributed. See 26 U. S. C. §§991–997. The statute thus provides an incentive to maximize the DISC’s share—and to minimize the parent’s share—of the parties’ aggregate income from export sales. The statute provides three alternative ways for a parent to divert a limited portion of its income to the DISC. See §994(a)(1)–(3). The alternative that The Boeing Company chose limited the DISC’s taxable income to a little over half of the parties’ “combined taxable income” (CTI). In 1984, the “foreign sales corporation” (FSC) provisions replaced the DISC provisions. As under the DISC regime, it is in the parent’s interest to maximize the FSC’s share of the taxable income generated by export sales. Because most of the differences between these regimes are immaterial to this suit, the Court’s analysis focuses mainly on the DISC provisions. The Treasury Regulation at issue, 26 CFR §1.861–8(e)(3) (1979), governs the accounting for research and development (R&D) expenses when a taxpayer elects to take a current deduction, telling the taxpaying parent and its DISC “what” must be treated as a cost when calculating CTI, and “how” those costs should be (a) allocated among different products and (b) apportioned between the DISC and its parent. With respect to the “what” question, the regulation includes a list of Standard Industrial Classification (SIC) cate-

*Together with No. 01–1382, *United States v. Boeing Sales Corp. et al.*, also on certiorari to the same court.

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gories (*e.g.*, transportation equipment) and requires that R&D for any product within the same category as the exported product be taken into account. The regulations use gross receipts from sales as the basis for both “how” questions. Boeing organized its internal operations along product lines (*e.g.*, aircraft model 767) for management and accounting purposes, each of which constituted a separate “program” within the organization; and \$3.6 billion of its R&D expenses were spent on “Company Sponsored Product Development,” *i.e.*, product-specific research. Boeing’s accountants treated all Company Sponsored costs as directly related to a single program and unrelated to any other program. Because nearly half of the Company Sponsored R&D at issue was allocated to programs that had no sales in the year in which the research was conducted, that amount was deducted by Boeing currently in calculating its taxable income for the years at issue, but never affected the calculation of the CTI derived by Boeing and its DISC from export sales. The Internal Revenue Service reallocated Boeing’s Company Sponsored R&D costs for 1979 to 1987, thereby decreasing the untaxed profits of its export subsidiaries and increasing its taxable profits on export sales. After paying the additional taxes, Boeing filed this refund suit. In granting Boeing summary judgment, the District Court found §1.861–8(e)(3) invalid, reasoning that its categorical treatment of R&D conflicted with congressional intent that there be a direct relationship between items of gross income and expenses related thereto, and with a specific DISC regulation giving the taxpayer the right to group and allocate income and costs by product or product line. The Ninth Circuit reversed.

Held: Section 1.861–8(e)(3) is a proper exercise of the Secretary of the Treasury’s rulemaking authority. Pp. 8–19.

(a) The relevant statutory text does not support Boeing’s argument that the statute and certain regulations give it an unqualified right to allocate its Company Sponsored R&D expenses to the specific products to which they are factually related and to exclude such R&D from treatment as a cost of any other product. The method that Boeing chose to determine an export sale’s transfer price allowed the DISC “to derive taxable income attributable to [an export sale] in an amount which *does not exceed* . . . 50 percent of the *combined taxable income* of [the DISC and the parent] which is *attributable* to the qualified export receipts on such property derived as the result of a sale by the DISC plus 10 percent of the export promotion expenses of such DISC attributable to such receipts . . .” 26 U. S. C. §994(a)(2) (emphasis added). The statute does not define “combined taxable income” or specifically mention R&D expenditures. The Secretary’s regulation must be treated with deference, see *Cottage Savings Assn.*

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v. Commissioner, 499 U. S. 554, 560–561, but the statute places some limits on the Secretary’s interpretive authority. First, “does not exceed” places an upper limit on the share of the export profits that can be assigned to a DISC and gives three methods of setting the transfer price. Second, “combined taxable income” makes it clear that the domestic parent’s taxable income is a part of the CTI equation. Third, “attributable” limits the portion of the domestic parent’s taxable income that can be treated as a part of the CTI. The Secretary’s classification of all R&D as an indirect cost of all export sales of products in a broadly defined SIC category is not arbitrary. It provides consistent treatment for cost items used in computing the taxpayer’s domestic taxable income and CTI; and its allocation of R&D expenditures to all products in a category even when specifically intended to improve only one or a few of those products is no more tenuous than the allocation of a chief executive officer’s salary to every product that a company sells even when he devotes virtually all of his time to the development of the Edsel. Reading §994 in light of §861, the more general provision dealing with the distinction between domestic and foreign source income, does not support Boeing’s contrary view. If the Secretary reasonably determines that Company Sponsored R&D can be properly apportioned on a categorical basis, the portion of §861(b) that deducts from gross income “a ratable part of any expenses . . . which cannot definitely be allocated to some item or class of gross income” is inapplicable. Pp. 8–13.

(b) Boeing’s arguments based on specific DISC regulations are also unavailing. Language in 26 CFR §1.994–1(c)(6)(iii), part of the rule describing CTI computation, does not prohibit a ratable allocation of R&D expenditures that can be “definitely related” to particular export sales. Whether such an expense can be “definitely related” is determined by the rules set forth in the very rule that Boeing challenges, §1.861–8. Moreover, the Secretary could reasonably determine that expenditures on model 767 research conducted in years before any 767’s were sold were not “definitely related” to any sales, but should be treated as an indirect cost of producing the gross income derived from the sale of all planes in the transportation equipment category. Nor do §§1.994–1(c)(7)(i) and (ii)(a), which control grouping of transactions for determining the transfer price of sales of export property, and §1.994–1(c)(6)(iv), which governs the grouping of receipts when the CTI method is used, speak to the questions whether or how research costs should be allocated and apportioned. Pp. 13–17.

(c) What little relevant legislative history there is in this suit weighs in the Government’s favor. Pp. 18–19.

258 F. 3d 958, affirmed.

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STEVENS, J., delivered the opinion of the Court, in which REHNQUIST, C. J., and O'CONNOR, KENNEDY, SOUTER, GINSBURG, and BREYER, JJ., joined. THOMAS, J., filed a dissenting opinion, in which SCALIA, J., joined.