

into a bona fide cost-sharing arrangement, in accordance with the provisions of § 1.482-7, with the taxpayer for the purpose of developing intangible property, then that corporation shall not reasonably be expected to benefit from the taxpayer's share of the research expense.

(d) *Gross income methods*—(1)(i) *In general.* In lieu of applying the sales method of paragraph (c) of this section, the remaining amount of the deduction for research and experimentation, not apportioned under paragraph (a)(4) or (b)(1)(ii) of this section, shall be apportioned as prescribed in paragraphs (d)(2) and (3) of this section, between the statutory grouping (or among the statutory groupings) of gross income and the residual grouping of gross income.

(ii) *Optional methods to be applied to all research and experimental expenditures.* These optional methods must be applied to the taxpayer's entire deduction for research and experimental expense remaining after applying the exception in paragraph (a)(4) of this section, and may not be applied on a product category basis. Thus, after the allocation of the taxpayer's entire deduction for research and experimental expense under paragraph (a)(2) of this section (by attribution to SIC code categories), the taxpayer must then apportion as necessary the entire deduction as allocated by separate amounts to various product categories, using only the sales method under paragraph (c) of this section or only the optional gross income methods under this paragraph (d). The taxpayer may not use the sales method for a portion of the deduction and optional gross income methods for the remainder of the deduction separately allocated.

(2) *Option one.* The taxpayer may apportion its research and experimental expenditures ratably on the basis of gross income between the statutory grouping (or among the statutory groupings) of gross income and the residual grouping of gross income in the same proportions that the amount of gross income in the statutory grouping (or groupings) and the amount of gross income in the residual grouping bear, respectively, to the total amount of gross income, if the conditions described in paragraph (d)(2)(i) and (ii) of this section are both met.

(i) The amount of research and experimental expense ratably apportioned to the statutory grouping (or groupings in the aggregate) is not less than fifty percent of the amount that would have been so apportioned if the taxpayer had used the method described in paragraph (c) of this section; and

(ii) The amount of research and experimental expense ratably apportioned to the residual grouping is not less than fifty percent of the amount that would have been so apportioned if the taxpayer had used the method described in paragraph (c) of this section.

(3) *Option two.* If, when the amount of research and experimental expense is apportioned ratably on the basis of gross income, either of the conditions described in paragraph (d)(2)(i) or (ii) of this section is not met, the taxpayer may either—

(i) Where the condition of paragraph (d)(2)(i) of this section is not met, apportion fifty percent of the amount of research and experimental expense that would have been apportioned to the statutory grouping (or groupings in the aggregate) under paragraph (c) of this section to such statutory grouping (or to such statutory groupings in the aggregate and then among such groupings on the basis of gross income within each grouping), and apportion the balance of the amount of research and experimental expenses to the residual grouping; or

(ii) Where the condition of paragraph (d)(2)(ii) of this section is not met, apportion fifty percent of the amount of research and experimental expense that would have been apportioned to the residual grouping under paragraph (c) of this section to such residual grouping, and apportion the balance of the amount of research and experimental expenses to the statutory grouping (or to the statutory groupings in the aggregate and then among such groupings ratably on the basis of gross income within each grouping).

(e) *Binding election*—(1) *In general.* A taxpayer may choose to use either the sales method under paragraph (c) of this section or the optional gross income methods under paragraph (d) of this section for its original return for its first taxable year to which this section applies. The taxpayer's use of either the sales method or the optional gross income methods for its return filed for its first taxable year to which this section applies shall constitute a binding election to use the method chosen for that year and for four taxable years thereafter.

(2) *Change of method.* The taxpayer's election of a method may not be revoked during the period referred to in paragraph (e)(1) of this section without the prior consent of the Commissioner. After the expiration of that period, the taxpayer may change methods without the prior consent of the Commissioner. However, the taxpayer's use of the new method shall constitute a binding

election to use the new method for its return filed for the first year for which the taxpayer uses the new method and for four taxable years thereafter. The taxpayer's election of the new method may not be revoked during that period without the prior consent of the Commissioner.

(i) *Short taxable years.* For purposes of this paragraph (e), the term *taxable year* includes a taxable year of less than twelve months.

(ii) *Affiliated groups.* In the case of an affiliated group, the period referred to in paragraph (e)(1) of this section shall commence as of the latest taxable year in which any member of the group has changed methods.

(f) *Special rules for partnerships*—(1) *Research and experimental expenditures.* For purposes of applying this section, if research and experimental expenditures are incurred by a partnership in which the taxpayer is a partner, the taxpayer's research and experimental expenditures shall include the taxpayer's distributive share of the partnership's research and experimental expenditures.

(2) *Purpose and location of expenditures.* In applying the exception for expenditures undertaken to meet legal requirements under paragraph (a)(4) of this section and the exclusive apportionment for the sales method and the optional gross income methods under paragraph (b) of this section, a partner's distributive share of research and experimental expenditures incurred by a partnership shall be treated as incurred by the partner for the same purpose and in the same location as incurred by the partnership.

(3) *Apportionment under the sales method.* In applying the remaining apportionment for the sales method under paragraph (c) of this section, a taxpayer's sales from a product category shall include the taxpayer's share of any sales from the product category of any partnership in which the taxpayer is a partner. For purposes of the preceding sentence, a taxpayer's share of sales shall be proportionate to the taxpayer's distributive share of the partnership's gross income in the product category.

(g) *Effective date.* This section applies to taxable years beginning after December 31, 1995. However, a taxpayer may at his or her option, apply this section in its entirety to all taxable years beginning after August 1, 1994.

(h) *Examples.* The following examples illustrate the application of this section:

*Example 1*—(i) *Facts.* X, a domestic corporation, is a manufacturer and distributor of small gasoline engines for lawn mowers. Gasoline engines are a product within the category, Engines and Turbines