

## Peter Barnes Comments on Medtronic Victory

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Peter A. Barnes spoke with *Bloomberg BNA* regarding Medtronic's recent victory over the IRS in the U.S. Tax Court. Mr. Barnes comments on his concerns with the transfer pricing case's decision and what it now means for contract manufacturers. For the complete article, please visit *Bloomberg BNA's* website (subscription required).

*Excerpt taken from the article.*

### **Trouble for Contract Manufacturers?**

Peter Barnes, a senior fellow at Duke University who is of counsel at Caplin & Drysdale, Chartered, had a different take on the case. Where other practitioners read victory for the taxpayer, he saw trouble for other multinationals.

"I worry about this decision and what it means for contract manufacturers generally," Barnes said. "I'm not sure she got it right. Because a contract manufacturer is low-risk, not low-skill."

Kerrigan described MPROC as "a sophisticated company that is not dramatically different from lots of sophisticated manufacturing companies all around the world," Barnes said. It isn't unusual for contract manufacturers to be very concerned about quality, to bring a highly skilled workforce to the table and to be engaged in continually improving processes.

"Continuous improvement is a mantra for every business everywhere," he said.

Barnes's fear is that foreign governments will read the case as giving them authority to reallocate much more income to contract manufacturers than they are really earning. A similar thing happened after the resolution of a dispute brought by GlaxoSmithKline Holdings (Americas) Inc., he said. In Glaxo's case, the IRS argued that marketing intangibles in the U.S. entitled the American subsidiary of a U.K. multinational to a much higher return than the taxpayer had reported.

"Glaxo settled and the IRS received a lot of money," Barnes said. "but other countries subsequently have used Glaxo to argue that there are marketing intangibles in those countries and that the marketing intangibles should drive higher returns."

Kerrigan focused on functions and activities in determining that MPROC was entitled to a higher return, Barnes said, but the true line of demarcation is not functions—it is risk. The essence of entrepreneurship is that "I can lose my money," Barnes said.

### **Assumption of Risk**

In Medtronic, a central argument by the IRS was that the foreign affiliate assumed very little risk, and therefore the residual profits connected to the intangibles should go not to it, but to the owner of the intangibles, which was the U.S. parent.

The contributions of a sophisticated contractor, on the other hand, are compensated in an entirely different way, Barnes said. The manufacturer's expertise is reflected in the cost base and rewarded through a higher markup.

Barnes elaborated in an e-mail that "it is not convincing to me for the opinion to state that MPROC's focus on quality was somehow more important than the focus on quality by the whole corporation. Without a clearer explanation of how much financial risk MPROC was taking," he said, "I don't understand why MPROC is entitled to such a high share of the system profit."

## **Attorneys**

Peter A. Barnes

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