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BUSINESS

Medtronic Wins U.S. Tax Case

Dispute involved medical-device maker's profits in Puerto Rico

Medtronic won a U.S. Tax Court case in a $1.4 billion dispute with the Internal Revenue Service over how profits involving a Puerto Rican subsidiary should be taxed. *PHOTO: SIMONE BARIBEAU/BLOOMBERG NEWS*

By **RICHARD RUBIN** and **JEANNE WHALEN**

Updated June 9, 2016 7:06 p.m. ET

The U.S. Tax Court handed Medtronic Plc a victory in a $1.4 billion dispute with the Internal Revenue Service over how much of the medical device maker's profits should be taxed by Puerto Rico and how much should face higher federal taxes instead.

In a 144-page ruling, Judge Kathleen Kerrigan agreed with the company, saying it had proved the government's "allocations were arbitrary, capricious, or unreasonable." The Puerto Rican subsidiary, she wrote, "was involved in every aspect of the manufacturing process" and thus was making significant contributions to the overall company's profits.

The dispute dates back to the 2005 and 2006 tax years, before Medtronic merged with Covidien PLC and moved its legal address to Ireland.

Had the IRS won, it could have applied the same arguments to every Medtronic tax return from 2007 forward, potentially pursuing several billion dollars more in taxes.

The case involved transfer pricing, or the rules that govern transactions between different arms of the same company. Corporations must make such transactions as if they were engaged in arm's length deals between unrelated companies, and allocate income where it is earned, depending on which entity truly generates the profits.

But those standards frequently lead to fact-intensive disputes with the IRS. In this case, the company and the government were arguing about the proper methods for determining how profits should be split between foreign and domestic operations.

Although Puerto Rico is part of the U.S., companies based there are considered foreign corporations for U.S. corporate income-tax purposes. That means companies pay the local tax and don't have to pay the full 35% U.S. tax rate until they repatriate the money.

Medtronic's Puerto Rican subsidiary manufactured medical devices, and the company said it was attributing an appropriate amount of the profits to its U.S. operations.

Judge Kerrigan, who was also critical of some parts of the company's analysis, determined precise income allocations that were different from what the IRS or Medtronic contended. Her findings, however, were close to what Medtronic had initially proposed.

The exact amount Medtronic will owe hasn't been determined at this stage of the case.

Medtronic said after the ruling that "our preliminary review indicates that this decision appears to be favorable to Medtronic on many key aspects of the case, and it appears to be generally consistent with the company's most likely scenario for resolution that has previously been communicated to investors."

"We will continue to assess the 144-page ruling and will provide any additional guidance as required," the company said. "Final resolution could take several months or longer if appealed."

Thomas Linguanti, a partner at Baker & McKenzie LLP who represented Medtronic, said, "The Tax Court completely rejected the IRS's position."

The IRS didn't respond to a request for comment.

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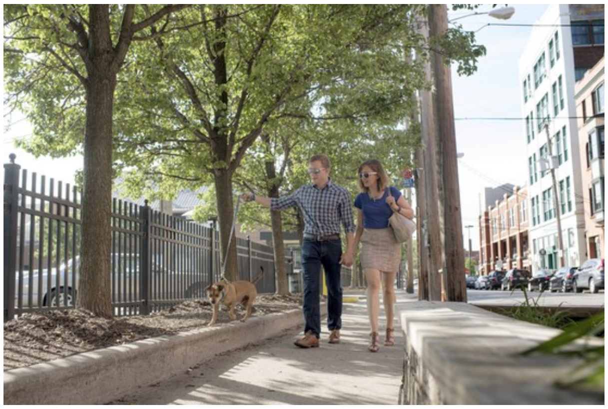

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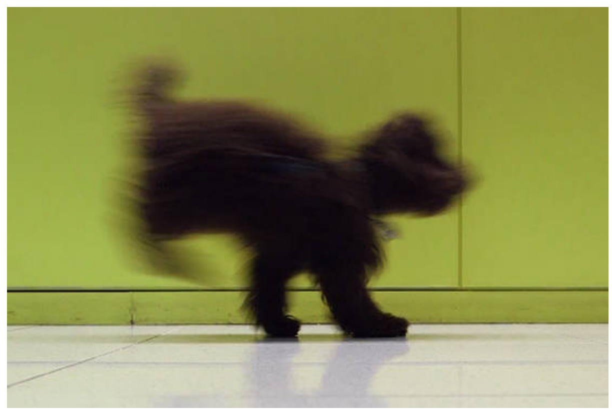

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