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INSIGHT: Medtronic Remand--Should U.S. Tax Court Appoint Special Masters?

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In its opinion released on August 16, 2018, the Eighth Circuit remanded the decision of the U.S. Tax Court in Medtronic v. Commissioner (T.C. Memo 2016-112), with instructions to the court to make several specific factual findings, including the review of several comparability factors that the appeals court deemed to have been not analyzed sufficiently.

The lower court had (as is often the case in transfer pricing litigation) rejected the analysis of both the taxpayer and the government and had ultimately reached a result different from both litigants, but very close to the taxpayer's filing position. The court made the point that it was simply a coincidence that its determination was virtually identical to the position the taxpayer had abandoned in litigation, but the similarities are quite striking.

The Eighth Circuit had before it a typical transfer pricing case, where the litigants had each presented expert testimony to support their respective positions, where the court apparently had not been persuaded by either side, and where the court adopted the transfer pricing method espoused by one of the parties but made significant adjustments to reach a result different from both parties. Instead of either affirming or reversing the decision, the appellate panel took the somewhat unusual step of remanding the case to the tax court for further findings. The concurring judge strongly suggests that he is not likely to be persuaded that the tax court's analysis is correct (''I harbor serious doubts that the Medtronic-Pacesetter agreement can serve as an appropriate CUT'') but he reiterates that the Tax Court did not do the analysis required for him to make a proper review of the court's decision.

So the case goes back, and then what? While the appeals court ordered the Tax Court to make additional findings, there is a question of how that will or should happen. Will the parties develop new positions? Will the taxpayer, who won much more than it lost, try to develop analysis that will support the Tax Court's decision? Will the government try to develop an analysis that will allow the court to reject the Medtronic-Pacesetter agreement as a CUT and adopt a profit-based method as proposed in the government's litigating position?

These are important, complex questions, and they require us to focus on an uncomfortable reality of transfer pricing litigation, which is that the Tax Court (or any court for that matter) seems to be ill equipped to perform a proper transfer pricing analysis. This is not to in any way denigrate the court or criticize the effort that goes into the process of reaching a decision in such cases. But it seems clear that the type of analysis needed to reach a best method conclusion in a transfer pricing case requires skills and expertise possessed by transfer pricing professionals, primarily but not exclusively economists, and typically not members of the bench.

Which brings me to a suggestion: Rule 53 of the Federal Rules of Civil Procedure authorizes the appointment of a master (sometimes referred to as a special master) to (in relevant part):

''A. Perform duties consented to by the parties;
B. Hold trial proceedings and make or recommend findings of fact on issues to be decided without a jury if the appointment is warranted by:
a. Some exceptional condition; or
b. The need to perform an accounting *or resolve a difficult computation of damages (emphasis added)"*

Before appointing a master, the court must give the parties notice and an opportunity to be heard, and the parties may themselves suggest candidates for appoint-

ment. The scope of the master's authority is determined by the appointing court, and can include conducting evidentiary hearings, making findings of fact, and ultimately issuing an order, report, or recommendation for resolving the case. The appointing order must direct the master to proceed with all reasonable diligence, must state the master's duties, must state the circumstances, if any, where the master may communicate ex parte with either the court or the parties, must explain the nature of the materials to be preserved and filed as the record of the master's activities, and provide instructions on any time limits that apply, and the standards that it will employ to review the master's orders, findings and recommendations. A master must not have a relationship to the parties, attorneys, action or court that would require the disqualification of a judge under the federal rules, unless the parties consent to the appointment after the master discloses any potential grounds for disqualification.

There is a robust record of masters being appointed in cases before various federal district courts, often to handle discovery issues or resolve matters of damages, for example, the distribution of funds in large class action cases, but also to tap into a master's expertise in the topic at hand in the case. One notable example was the appointment of Professor Larry Lessig as a master in antitrust litigation involving Microsoft, where the court tapped into the professor's expertise in both antitrust law and the Internet to prepare a report recommending a result in the litigation. In a case involving claims of respiratory injury brought by 9-11 survivors the trial court noted that he would likely appoint a leading expert or experts in mass torts, probably an academic to provide impartiality as well as expertise, in order to settle what could be up to 3,000 cases. (In re World Trade Ctr. Disaster Site Litig., No. 03 Civ. 00007, 2006 WL 2948821, at *1 (S.D.N.Y. Oct. 17, 2006) (Hellerstein, J.)).

Under Rule 53 the parties typically bear the expense of the master's compensation, unless the case involves a fund of potential damages to be distributed, and the expenses are allocated by the court after considering the nature and amount of the controversy, the parties' means, and the extent to which any party is more responsible than other parties for the reference to a master. (Rule 53(g)).

Certainly there is a strong argument that transfer pricing cases, which typically involve complex issues of both fact and law, which often present difficult questions of valuation, which appear to take an inordinate amount of the Tax Court's time, from evidentiary rulings to court hearings to post trial motions and appeals, are good candidates for the use of a special master with transfer pricing expertise. The special master could hear the case and make both the factual determinations needed and the ultimate decision regarding the best method and the ultimate results of the taxpayer's transfer pricing transactions (in essence, the proper computation of damages). And given that the litigants in such cases are the government and (usually) large multinational enterprises, the requirement to bear the master's expenses presumably would not be problematic.

The Tax Court Rules do not explicitly allow for such appointments however, and arguably the Court would need to adopt Rule 53 (or some version thereof) in order to make such appointments. There are many reasons why such an addition to the rules would be beneficial as a general matter, but it is important to note that the existing Tax Court rules *might* allow for the appointment of a special master with the consent of the parties to a specific case even without an amendment to the general rules.

Tax Court Rule 1 provides:

''These Rules govern the practice and procedure in all cases and proceedings before the Court. Where in any instance there is no applicable rule of procedure, the Court or the Judge before whom the matter is pending may prescribe the procedure, *giving particular weight to the Federal Rules of Civil Procedure to the extent that they are suitably adaptable to govern the matter at hand. (emphasis supplied)"*

Rule 1 also states:

''The Court's Rules shall be construed to secure the just, speedy, and inexpensive determination of every case.''

Looking at a potential transfer pricing case where, as in Medtronic, the financial results of various transfer pricing transactions is the salient issue, one could argue that there is no applicable rule of procedure in the court that would secure the ''just, speedy, and inexpensive determination'' of the case. This should be distinguished from a case like *Altera*, where the salient issue is the validity of a Treasury regulation governing transfer pricing. That is, in *Altera* there was no issue regarding the specific amounts that should be charged out by the parties to the cost sharing agreement, but rather, the court had to determine whether the government had the authority to require the amounts to be charged out. Such an inherently legal question is one that the Tax Court has particular expertise to resolve, and such a case would not be one where the use of a master would be appropriate.

For the typical transfer pricing case, however, there are many reasons why the appointment of a master could be a boon to the court, to taxpayers, and to the government, the rare win-win-win. First, for the court, appointing a master would take a complex case that would likely take a significant amount of time for both the judge and his or her clerks and move it to a master who is perhaps better suited to analyze the pleadings, manage discovery, make specific factual findings and prepare the case for trial or facilitate a settlement. For both the taxpayer and the government, developing and presenting positions to a transfer pricing specialist would likely take less time and generate fewer expenses, since much of the background information that is typically included in the presentation of a transfer pricing case could be dispensed with and the parties could cut to the chase, if you will. Also, to the extent that the master requests additional information those requests presumably would be narrowly tailored to address whatever specific issue the master has concerns with.

Finally, since the master could be given the power to conduct settlement negotiations, the master could work with the parties to find common ground and avoid a full trial in front of the judge, or at least narrow the issues significantly before providing his or her report to the judge.

Given all the potential benefits, it certainly seems like it would be useful for the Tax Court to at least consider amending the rules to explicitly allow for the use of masters in Tax Court proceedings, even if the court disagreed with me that the current rules already leave

room for the appointment of a master in a particular case with the consent of the parties. And for potential litigants in transfer pricing cases, it might be worth considering whether, in fact, a special master might provide them with a more efficient way to resolve the litigation and whether it would be worth making that suggestion to the Tax Court judge assigned to the case.

But for now we will follow the Medtronic remand and see if the appellate court's observations lead to any significant change in the tax court's reasoning or decision.

Author Information

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