

# PUBLICATION

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## IRS Ruling Addresses Application of Medical Device Excise Tax in Contract Manufacturing Arrangement

May 22, 2014

In Private Letter Ruling 201420004 (released May 16, 2014), the Internal Revenue Service (IRS) has ruled on the question of which party in a contract manufacturing arrangement is the "manufacturer" for purposes of the medical device excise tax. The tax is imposed at a rate of 2.3 percent on any manufacturer, producer or importer of a "taxable medical device." In general, the tax is measured by the "price" of the medical device, which includes the total consideration for the device, including costs of packaging and certain other charges as determined in the Treasury Regulations. The excise tax is effective for sales made after December 31, 2012.

Under the facts of the new ruling, "Company 1" was a contract manufacturer and produced a device for "Company 2" pursuant to a license agreement. Under the terms of the license, Company 1 transferred all intellectual property rights related to the medical device to Company 2, Company 2 maintained complete control over the quantity of the device to be produced by Company 1, and Company 1 sold its entire production of the device to Company 2. The ruling does not specify whether Company 1 and Company 2 are related parties.

After applying the Manufacturers and Retailers Excise Tax Regulations and prior revenue rulings, the IRS ruled that, based on the facts stated in the ruling, Company 1, the contract manufacturer, was not the "manufacturer, producer or importer" of the medical device. Rather, Company 2 was the "manufacturer, producer or importer" for medical device excise tax purposes.

If you would like to discuss this private letter ruling or the federal medical device excise tax, please contact one of the members of Baker Donelson's Tax Group.