

United States: District court upholds economic substance of intercompany transactions in *Perrigo*

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In brief

On September 25, 2025, the United States District Court for the Western District of Michigan issued its highly anticipated opinion in *Perrigo Co. v. United States*, No. 1:17-CV-00737. *Perrigo* was a bellwether for the IRS's erstwhile novel litigation approach, which sought to reanimate the economic substance doctrine and extend it and other seemingly malleable common law doctrines to controlled taxpayer transactions, using Section 482 adjustments only as an alternative backstop. The district court did not take the bait: (1) rejecting the IRS's attempt to sham *Perrigo*'s assignment of a third party supply and distribution agreement to its controlled Israeli affiliate, and (2) holding that the IRS's secondary Section 482 position, which reallocated nearly all of *Perrigo*'s Israeli affiliate's income to *Perrigo* – based on a discounted cash flow (DCF) analysis using ex-post sales data – was arbitrary, capricious, and unreasonable.ⁱ

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Key takeaways

Perrigo's precedential value is limited to its jurisdiction and its facts, but it is a strong counter and hopeful deterrent to IRS attempts test the limits, or expand the contours of, the economic substance doctrine and other anti-abuse common law doctrines in cases where those doctrines do not easily fit. See our [recent article](#) on *Patel v. Commissioner*, 165 T.C. No. 10 (November 12, 2025) (holding that the codified economic substance doctrine is conditioned upon a relevancy determination within the meaning of Section 7701(o)).

Perrigo also persuasively affirms several key points:

- assigning third-party contracts to offshore affiliates, where those affiliates bear real benefits and burdens of the agreements and pay an arm's length price for the assignment, is a rational and permissible business practice
- credible contemporaneous documentation illuminating both tax and business rationales for intercompany transactions can be particularly persuasive evidence of business motivations and transactional substance
- the IRS cannot use *ex post* sales figures as irrebuttable presumptions of what taxpayers should have anticipated *ex ante*, *cf. Facebook, Inc. v. Commissioner*, 164 T.C. No. 9, 52 (May 22, 2025) (“Evidence from after the transaction date can help us evaluate what was reasonably anticipated or expected then.”)
- Section 482's commensurate with income standard does not trump the arm's length standard (“To base arm's length pricing on actuals in all instances, rather than projections, even for intangibles, would be to eviscerate the arm's length standard.”). *Compare Altera Corp. & Subsidiaries v. Commissioner*, 926 F.3d 1061, 1083 (9th Cir. 2019) (“[I]n implementing the commensurate with income amendment, Treasury was moving away from a purely method-based, comparable-transaction view of the arm's length standard in attempting to achieve tax parity.”), *with 3M Co. & Subsidiaries v. Comm'r*, 160 T.C. 50 (2023) (holding that the commensurate with income standard was different from, and need not harmonize with, the arm's length standard), *rev'd* No. 23-3772 (8th Cir. 2025).

The IRS will likely appeal *Perrigo* to the United States Court of Appeals for the Sixth Circuit. In the interim, it should be a helpful tool for similarly situated taxpayers in exam, IRS Appeals, and other forums.

In more detail

Factual Background

As of 2009, Perrigo was a multinational pharmaceutical company with production facilities in the United States, Israel, the United Kingdom, Germany, and Mexico. Perrigo's domestic business focused on consumer health care – primarily the distribution of over-the-counter (OTC) products to retailers for sale under the retailer's own brand. An important part of this business was tracking patented brand name prescription drug products that were approaching patent expiration and identifying drugs that were good candidates to transition to the OTC market.

In the 1990's, Perrigo identified omeprazole (*i.e.*, Prilosec) as a potential candidate to transition to the OTC market. In 2005, as Perrigo's independent efforts to develop a generic version of omeprazole on an acceptable timeline stalled, Perrigo entered into a "Supply & Distribution Agreement" with Dexcel Pharma (an Israeli pharmaceutical company) to bring a generic omeprazole product to the US market. Under the Supply & Distribution Agreement, Dexcel would develop the omeprazole drug and sell it at cost to Perrigo's US entity, L. Perrigo Co., for US distribution. In exchange, Perrigo would receive a 6% sales and marketing fee based on net sales and 50% of the remaining profit. In 2006, as part of an international growth strategy, Perrigo assigned the Supply & Distribution Agreement to its Israeli affiliate, Perrigo Israel Trading Limited Partnership and Perrigo LLC (PITLP/LLC), for \$877,832. At that time, PITLP/LLC had no operational employees or assets. Thereinafter, PITLP/LLC engaged L. Perrigo Co. to distribute the product in the United States. The agreement was later memorialized under a written "Sales and Distribution Agreement."

Following an audit of Perrigo's 2009-2012 tax year returns, the IRS asserted that Perrigo's assignment lacked economic substance and business purpose and should, therefore, be disregarded under various common law doctrines, reallocating all PITLP/LLC income from sales of omeprazole to Perrigo's US entities. As an alternative, the IRS reallocated under Section 482 all PITLP/LLC income to Perrigo's domestic entities. At trial, the government's economics expert bundled the assignment of the Supply & Distribution Agreement and the Sales and Distribution Agreement and, applying a DCF analysis using actual, *ex post*, sales data, valued those rights at \$474 million (equivalent to a 21.5% royalty rate).

In 2014 and 2016, the IRS issued to Perrigo notices of deficiency, determining deficiencies in tax, interest, and penalties of approximately \$143 million for Perrigo's 2009 through 2012 tax years. Perrigo fully paid the amount, then filed claims for refund, which were disallowed by the IRS. In 2017, Perrigo filed suit for refund.

Legal Analysis

The district court addressed in sequence the economic substance doctrine and other judicial anti-abuse doctrines, before turning to the Section 482 adjustments. The IRS characterized the doctrines as "useful mechanism[s]" that demonstrated that "there was no risk and nothing to Perrigo's transactions other a desire to escape domestic tax laws." Perrigo referred to the doctrines as irrelevant, "ill-fitted bludgeoning tool[s]," and framed the issue ultimately as one of price, rather than of substance.

The district court sided with Perrigo, determining that the common law theories were "pertinent, but ultimately unavailing." After tracing the various doctrines' lineages, the district court conceptualized them as "coalesc[ing] around the same basic point – making sure that a taxpayer can't create an alternative reality simply for tax purposes." It is, the district court continued, the "substantive realities" of a transaction that govern its tax consequences:

There must be some real economic substance and purpose to the transactions and structure, and there further must be some indicia that the taxpayer honored that structure. If these things are honored, then under any number of cases, it is permissible for the taxpayer to structure things with both the motive and effect of minimizing taxes. Of course, what the taxpayer can't do is generate an income stream and then construct an artificial and alternate reality to reach back and assign the income to some entity that doesn't pay taxes. But that didn't happen here.

The district court reiterated that the presence of tax motivations, or, in fact, their predomination, is not disqualifying:

In the Court's mind what this means is that under the economic substance doctrine a taxpayer cannot merely clothe itself in corporate jargon to point to a motivation other than tax avoidance. But the Court also believes this is not a demanding standard for the taxpayer either. Indeed, the subjective prong "does not mean a reason for a transaction that is free of tax considerations" to pass muster. *United Parcel Serv. of Am., Inc. v. Comm'r*, 254 F.3d 1014, 1019 (11th Cir. 2001); see also *Dow Chemical Co. v. United States*, 435 F.3d 594, 610 (6th Cir. 2006) (Ryan, J., dissenting) (framing the subjective business purpose prong as whether the transaction was entered into "for the sole purpose of tax avoidance"). After all, "[t]ax planning is as American as apple pie." Bittker & Lokken, *supra* at ¶ 4.3.2 [1 Boris I. Bittker & Lawrence Lokken, *Federal Taxation of Income, Estates and Gifts* ¶ 4.3.2 (online ed. Mar. 2025)]. So, to meet the subjective prong there simply must be something more than a negative change in tax obligations. *Richardson v. Comm'r*, 509 F.3d 736, 741 (6th Cir. 2007) (after finding

transaction trusts lacked economic substance, concluding the trust “also had no ‘valid, non-tax business purpose.’”). And in this case the objective and subjective largely overlap; ultimately, the “essential inquiry is whether the transaction had any practicable economic effect other than the creation of economic tax losses.” *Rose v. Comm’r*, 868 F.2d 851, 854 (6th Cir. 1989).

And, ultimately, the district court held that Perrigo had cleared its low evidentiary burden, demonstrating that the relevant transactions had “genuine business purpose and motivation— beyond tax planning—in diversifying and expanding [Perrigo’s] international footprint.” Emphasizing robust case law supporting a “taxpayer’s right to structure its business in the most advantageous way possible[.]” the district court identified several key factors highlighting Perrigo’s business purpose and substance: Perrigo’s international growth during the relevant tax years, how that growth aligned with the tax strategy it implemented, and the specific details, particularly the timing of the assignment of the Supply & Distribution Agreement (*i.e.*, its assignment at a time when future outcomes remained uncertain): “Rather than have a winning lottery ticket in hand, Perrigo was still waiting for the numbers to be drawn. It saw significant uncertainty in Dexcel’s omeprazole product.” The district court concluded that Perrigo was “contemporaneously forming the infrastructure of its international expansion in a way that had a meaningful business purpose with a transfer of rights and obligations that had real value.”

Importantly, the district court also disregarded the IRS’s argument that Perrigo engaged in paper-only transactions:

At a high level, the Government’s paper-pushing bookkeeping analogy is an incomplete assessment. Certainly, there was nothing untoward in setting up subsidiaries, even those without brick-and-mortar office space or dedicated employees. Ms. Voortman testified that it is common for multinational employees to set up offshore finance companies; and hold intellectual property in non-operational holding companies. (Trial Tr. vol. II, 120-121, ECF No. 380, PageID.5582-5583). Nor is there any surprise in a company subcontracting its contractual rights. [The IRS’s economics expert] testified that a contracting party may subcontract its performance obligations to another member of a related party group. (Trial Tr. vol. IX, 73, ECF No. 387, PageID.7095). Of course, just because something permissible, or even common, does not mean a transaction had business purpose or economic substance. But it did here for the reasons the Court explained above.

Turning to the Section 482 adjustments, the district court also largely sided with Perrigo. Both parties’ economic experts supported their positions with DCF analyses, but each used different sales (and other) inputs. The IRS used *ex-post* sales data, which greatly exceeded Perrigo’s contemporaneous projections, to artificially inflate the assignment’s price. The district court rejected the IRS’s argument that “actual profit experience is a viable substitute for the anticipated profit experience” in the arm’s length calculation:

The Court is not persuaded by [the IRS’s economics expert] and the Government’s justifications for using Perrigo’s actual sales data. It cannot be the case that anytime a party fails to pay an arm’s length price for a transaction involving intangible assets, the only avenue towards correction is to use actual sales. If it were otherwise, the analysis under the line of cases including *Kenco Restaurants, Inc.* [*Kenco Restaurants, Inc. v. Comm’r*, 206 F.3d 588 (6th Cir. 2000)]; *Eli Lilly & Co. v. Comm’r*, 856 F.2d 855 (7th Cir. 1998); and *Amazon.com Inc.* [*Amazon.com Inc. v. Comm’r*, 148 T.C. 108 (2017)] would be simple: the IRS could make Section 482 reallocations using actual sales data anytime profits proved higher than expected, and the taxpayer would have no recourse. The Government makes a fair point that taxpayers could sometimes intentionally lowball their pricing, and run the risk that of slipping through the cracks of an IRS audit. There must be a stick, in other words, to disincentivize taxpayers from dodging the arm’s length standard. But this is ultimately an argument that is either best handled by penalties or by Congress.... To be sure, Perrigo agrees there may be cases without any reliable contemporaneous information where actual profits could be a useful estimate of what would have been anticipated to determine an arm’s length price. But this isn’t one of those cases[.]

In a last ditch effort that the district court found “surprising,” the IRS argued (for the first time meaningfully in post-trial briefs) that Perrigo’s litigating position implicated the variance doctrine—which limits taxpayer refund litigation to the grounds fairly within the denied administrative refund claim—precluding recovery. Perrigo’s economics expert valued the assignment under two scenarios,ⁱⁱ determining that, under a DCF analysis, the net present value was around either \$43 million or \$37 million, with royalty rates of 6.04% or 5.24%, respectively. This differed from Perrigo’s original \$877,832 refund claim, which it supported using a comparable profits method (CPM) analysis. The district court ultimately held that the variance argument was belatedly made and waived, but even if it was timely, Perrigo’s change did not unduly surprise the IRS and allowed the IRS to fully evaluate the claim, precluding any variance concerns:

The purpose of the ‘variance rule’ is to prevent surprise, and to give the IRS adequate notice of the claim and its underlying facts so that it can make an administrative investigation and determination regarding the claim.” *McDonnell v. United States*, 180 F.3d 721, 722 (6th Cir. 1999).... Thus, the Court concludes the jurisdictional wrapping on the Government’s challenge misses its mark and by failing to muster any meaningful challenge based on the variance doctrine until well after trial, the Court further finds the Government has waived or forfeited a variance doctrine-based argument.

But on the merits, there was no litigation surprise and no variance problem in Perrigo’s selection of the DCF method at trial. During its administrative claims for refund, Perrigo plainly challenged the Government’s primary theory—that the transactions lacked economic substance—and the alternative Section 482 reallocation as arbitrary and capricious. To be sure, it maintained that its CPM method pricing was within an acceptable range.... The Court is still eminently satisfied there is no variance problem when, during trial, the taxpayer attempts to satisfy its burden by presenting a different arm’s length pricing model under the same statutory provision—Section 482—underlying its claim for refund. This is especially true where, as here, it would lead to an increased tax obligation. If it were otherwise, it would undermine the well-established framework set out above, and simply leave the Court to determine whether it agreed, or not, with the IRS’s administrative determination under an arbitrary or capricious standard of review. Accordingly, there is no variance problem where Perrigo asks for a different arm’s length price at trial.

The district court also rejected accuracy-related and, alternatively, valuation misstatement penalties, finding that Perrigo acted in good faith and relied on the advice of its advisors.

Conclusion

Perrigo is a strong counterbalance to the IRS’s efforts to more readily assert the economic substance doctrine in transfer pricing disputes (see [February 2023 Tax News and Developments](#)). The case reiterates that tax considerations can meaningfully impact taxpayer behavior without stripping economic substance from real transactions that shift risks, burdens, and benefits to different controlled parties and that credible business purpose narratives, supported by both testimony and contemporaneous documents, undermine IRS arguments that transactional structures are mere paper artifices. The case also pushes back on IRS efforts to use *ex post* data, under its ever-changing view of the commensurate with income standard, to propose greater adjustments under Section 482.

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ⁱ The district court also rejected proposed accuracy-related and valuation misstatement penalties, determining that Perrigo acted in good faith and in reliance on its advisors. Additionally, the district court held that Perrigo was entitled to deduct as ordinary and necessary business expenses, as opposed to capitalize, its Section 271(e)(2) patent litigation expenses, related to an Abbreviated New Drug Application.

ⁱⁱ Perrigo's economic expert presented two scenarios: Scenario A and Scenario B. Under Scenario A, Perrigo's operating profit was calculated based on Perrigo's economic expert's determination that the agreed-to profit share in the Distribution Agreement was not arm's length and that, as a result, PITLP/LLC paid too much for the distribution. Under Scenario B, Perrigo's economic expert assumed that the Distribution Agreement was arm's length. The district court largely adopted the framework of Scenario B, with modifications made to the discount rate used for determining an equivalent royalty rate, and by applying Perrigo's projected sales, general, and administrative (SG&A) costs.