Coca-Cola U.S. Challenges the IRS' Appropriateness of Transfer Pricing Methodolgy

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Transfer pricing is the setting of the price for goods and services sold between controlled or related legal entities within an enterprise. For example, if a subsidiary company sells goods to a parent company, the cost of those goods paid by the parent to the subsidiary is the transfer price.

In September 2015, Coca-Cola U.S. received a statutory notice of deficiency from the IRS for $3.3 billion for fiscal years 2007 to 2009. The IRS claims that Coca-Cola U.S. undercharged seven foreign licensees for intellectual property, mostly trademarks and formulas used in the production and sale of concentrates abroad. The foreign affiliates are located in Ireland, Swaziland, Brazil, Mexico, Chile, Costa Rica and Egypt. Coca-Cola responded to the IRS by filing a petition challenging the IRS' proposed $9.4 billion income tax adjustment related to the company's transfer pricing and the appropriateness of their transfer pricing methodology and noted certain inconsistences with prior audits.

Coca-Cola U.S. has followed the same methodology for determining their U.S. taxable income from foreign company operations for nearly 30 years. The IRS formally agreed to this methodology for tax years 1987 – 1995 and also approved the methodology during five successive audits through tax year 2006. A central issue in the dispute is whether the IRS properly relied on the comparable profits method (CPM) to allocate routine returns to the foreign licensees. Coca-Cola maintains that a 1996 closing agreement, which established a different method of allocating income between the licensees and the U.S. parent, should continue to apply.

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Businesses can expect that the IRS will be taking an aggressive stand on this issue and taxpayers should pay close attention to their existing business models and transfer pricing policies.

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