Coca-Cola Owes $3.3 Billion in Taxes Over Foreign Transfer Licensing

An audit found reported income from 2007 to 2009 should have been higher

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Coca-Cola Co. on Friday said the Internal Revenue Service had notified it of a potential $3.3 billion federal income-tax liability, becoming the latest U.S. multinational challenged over so-called foreign transfer pricing.

The Atlanta beverage giant also disclosed the IRS has recommended the matter be designated for litigation after a government audit determined the company’s reported income from 2007 to 2009 should have been higher.

“The company firmly believes that the assessments are without merit and plans to pursue all administrative and judicial remedies necessary to resolve this matter,” Coke said in a regulatory filing, adding it plans to file a petition in U.S. Tax Court challenging the notice.
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Coke said the dispute relates to how it reports income from foreign licensing of manufacturing, distribution, sale, marketing and promotion of products in overseas markets. Coke said it followed the methodology for the licenses outlined in a 1996 agreement with the IRS. The company’s compliance with the agreement was confirmed by five audits covering the subsequent years through 2006, with the most recent audit ending in 2009, Coke added.

An IRS spokesman declined to comment, citing a federal law prohibiting the IRS from discussing specific taxpayers.

Such disputes, in which the IRS accuses U.S. multinationals of transferring profits to countries with lower tax rates, have become increasingly common in recent years. The IRS is believed to have filed hundreds of such cases totaling tens of billions of dollars, particularly in the technology and pharmaceutical industries.

“It’s almost more common than not to have a transfer pricing dispute with the U.S.,” said Robert Willens, an independent tax consultant in New York.

The IRS dispute with Coke primarily revolves around how the company accounts for profit from its sales of concentrate used to make soda. Coke has several concentrate plants around the world and makes money from selling the concentrate to bottlers in local markets.

Coke says it derived 57% of its $46 billion in revenue last year from outside the U.S., but it books a higher percentage of its operating income overseas. As a result, it reported an effective tax rate of 23.6% in 2014, below the statutory U.S. tax rate of 35%.

Mr. Willens, the tax consultant, said such transfer pricing disputes typically are resolved out of court, typically for a fraction of the amount that the IRS is seeking.

In its filing, Coke said its 1996 agreement with the IRS protects the company from penalties if the methodology is followed. The company didn’t give details about the methodology.

The company said it doesn’t believe the dispute will have a material impact on its results and noted it regularly assesses its tax reserves for such situations.
Top lawmakers and the White House have been discussing an ambitious overhaul of how the U.S. taxes its multinational firms.

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