

The Coca-Cola Company & Subsidiaries v. Commissioner: Tax Court Rejects Coca-Cola Experts' Alternative Transfer Pricing Methods

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This discussion considers the recent judicial decision issued by the U.S. Tax Court (the "Tax Court") in The Coca-Cola Company & Subsidiaries v. Commissioner of Internal Revenue matter (the "Coca-Cola case").¹ Specifically, this discussion describes (1) the background of the Coca-Cola case and (2) the intercompany transfer pricing issues involved in the judicial decision. Further, this discussion considers the Tax Court's conclusions related to the various transfer pricing methods applied by the parties' experts. In summary, the Tax Court concluded that the Coca-Cola Company ("Coca-Cola") experts' transfer pricing analyses did not result in an arm's-length price ("ALP") to be paid between Coca-Cola and its foreign affiliates. Further, the Tax Court concluded that the Internal Revenue Service's reallocation of taxable income to Coca-Cola from its affiliates, through the application of a comparable profits method transfer pricing analysis, did provide the best method for determining an ALP to be paid between Coca-Cola and its foreign affiliates.

INTRODUCTION

Transfer pricing analysts ("analysts") are often engaged to determine the arm's-length price ("ALP") for the intercompany transfers of property or services for federal income tax planning compliance and controversy purposes.

For U.S. income tax purposes, related-party transactions are regulated by the Internal Revenue Service (the "Service") according to Internal Revenue Code Section 482 and the associated Treasury Regulations.

The purpose of Section 482 is to ensure that a domestic taxpayer clearly reflects the income attributable to controlled party transactions. According to Regulation 1.482-1, the standard to be applied in

every intercompany transfer is that of a third-party taxpayer dealing at arm's length with an uncontrolled (and unrelated) taxpayer.

According to Regulation 1.482-1, a controlled transaction meets the arm's-length standard if the results of the controlled transaction are consistent with the results that would have been realized if two uncontrolled (i.e., unrelated, and independent) taxpayers had engaged in the same transaction under the same circumstances.

In the *Coca-Cola Company & Subsidiaries v. Commissioner of Internal Revenue* case, the Service's expert applied a comparable profits method ("CPM") analysis to reallocate taxable income from Coca-Cola to its foreign affiliates.

In rendering its decision, the Tax Court concluded that the Service did not abuse its discretion by reallocating income to Coca-Cola by employing a CPM analysis. That CPM transfer price analysis used the Coca-Cola foreign manufacturing affiliates as the tested parties and foreign independent bottlers as the comparable uncontrolled entities.

This judicial decision was a victory for the Service and an affirmation by the Tax Court that Coca-Cola was paid a transfer price by its affiliates that was not supported under the arm's-length standard.

This discussion describes the transfer pricing issues involved the Tax Court's recent decision in the Coca-Cola case. This discussion also considers the Tax Court's conclusions related to the various intercompany transfer pricing methods applied by the parties' experts.

BACKGROUND OF THE CASE

Coca-Cola is an industry leader in the soft drink and related beverage industry. Coca-Cola-branded beverages (including the Coca-Cola soft drink) are some of the most recognized (and most valuable) brands in the world.

Coca-Cola is the owner of certain intellectual property (the "Coca-Cola IP") related to Coca-Cola-branded beverages. The Coca-Cola IP is required to manufacture, distribute, and sell Coca-Cola-branded beverages.

The Coca-Cola IP includes trademarks, product names, logos, patents, secret formulas, and proprietary manufacturing processes.

Coca-Cola licenses the Coca-Cola IP to certain beverage concentrate manufacturing suppliers (the "suppliers"). Beverage concentrate is the syrup or powder that is mixed with water, sugar (in some cases), and carbon dioxide (in some cases) to produce finished consumer beverage products.

The suppliers use the Coca-Cola IP to produce beverage concentrate that is then sold to certain independent third-party bottlers (the "independent bottlers"). The independent bottlers produce the finished consumer beverage products so that the products may be sold to beverage distributors and retailers worldwide.

Coca-Cola enters into licensing agreements that grant the suppliers the limited right to use the Coca-Cola IP. Namely, these licensing agreements allow the suppliers to use the Coca-Cola IP to manufacture and distribute Coca-Cola-branded beverages.

However, these licensing agreements do not provide the suppliers with any ownership interest in the Coca-Cola IP.

During the 2007–2009 time period, the suppliers paid Coca-Cola for the right to exploit the Coca-Cola IP under a formulaic apportionment method. Coca-Cola and the Service had agreed in 1996 (when settling the Coca-Cola tax liabilities for the 1987–1995 time period) that this formulaic apportionment method represented an arm's-length standard.

Under the formulaic apportionment method, the suppliers satisfied the royalty obligations by:

1. paying actual royalties or
2. remitting dividends to Coca-Cola.

During the 2007–2009 time period, the suppliers remitted dividends of \$1.8 billion to Coca-Cola to satisfy royalty obligations. The 1996 agreement between Coca-Cola and the Service did not address the transfer pricing method to be used subsequent to 1995.

After examining the Coca-Cola 2007–2009 income tax returns, the Service determined that the transfer pricing method Coca-Cola was utilizing did not result in an ALP. The Service determined that Coca-Cola overcompensated the suppliers and undercompensated itself for the right to exploit its IP.

The Service's expert performed a CPM analysis and reallocated income between Coca-Cola and the suppliers over the 2007–2009 time period. The Service CPM transfer price analysis relied on the profits earned between Coca-Cola and the independent bottlers as comparable uncontrolled entities.

The Service CPM transfer price analysis resulted in an increase in Coca-Cola's total taxable income for the 2007–2009 time period of over \$9 billion.

Based on the CPM analysis results, the Service determined income tax deficiencies for Coca-Cola as presented in Exhibit 1.

Exhibit 1 Coca-Cola Tax Deficiencies Based on the Service CPM Analysis

Year	Deficiency
2007	\$1,114,116,873
2008	\$1,069,425,951
2009	\$1,121,220,625

The Service further determined that additional tax deficiencies existed due to the Coca-Cola use of "split-invoicing" by some of its foreign affiliates. The additional tax deficiencies due to split invoicing were \$28,124,719 (2007), \$43,314,595 (2008), and \$63,465,860 (2009).

The Service-determined tax deficiencies resulted in Section 482 transfer pricing adjustments through which the Service reallocated a significant amount of income directly to Coca-Cola, primarily from foreign manufacturing affiliates (i.e., the suppliers) with plants located in South America, the Middle East, Africa, and Europe.

The Coca-Cola Intercompany Transfer Pricing Arrangement

Coca-Cola utilized the suppliers to manufacture Coca-Cola-branded beverage concentrates. The suppliers then sold and distributed the beverage concentrates to hundreds of independent bottlers worldwide.

The independent bottlers (mostly independent of Coca-Cola) used the beverage concentrate to produce the finished consumer beverage products (i.e., the Coca-Cola-branded beverages). These beverage products are marketed (directly or through distribution channels) to retail customers outside of the United States and Canada.

Coca-Cola utilized numerous local service companies (the “servicers”) to manage certain activities related to advertising and marketing of the Coca-Cola-branded beverages. The servicers also maintained relationships with the independent bottlers, as well as performed certain research and development activities.

Coca-Cola granted the suppliers with licenses to exploit the Coca-Cola IP to facilitate production of the Coca-Cola-branded beverages.

The Coca-Cola IP included valuable trademarks, brand names, logos, patents, secret formulas, and proprietary manufacturing processes.

The Service argued to the Tax Court that the suppliers undercompensated Coca-Cola significantly for the right to exploit the Coca-Cola IP.

During the 2007–2009 time period, Coca-Cola reported income from the suppliers based on the so-called “10-50-50 method,” consistent with the previous 11-year period. The “10-50-50 method” is a formulaic apportionment method that allowed the suppliers to secure 10 percent of gross sales as profit and split the remaining profit “50-50” with Coca-Cola.

Over the 2007–2009 time period, the suppliers paid dividends in excess of \$1.8 billion to Coca-Cola under the “10-50-50 method.”

Upon examination of the Coca-Cola income tax returns for 2007–2009, the

Service determined that the “10-50-50 method” did not reflect an ALP because it undercompensated Coca-Cola for the use of the Coca-Cola IP.

THE SERVICE CPM ANALYSIS

In order to determine what an ALP should have been between Coca-Cola and the suppliers, the Service reallocated income from the suppliers to Coca-Cola by relying on a CPM transfer price analysis. The Service CPM analysis relied on the independent bottlers as comparable uncontrolled entities.

The CPM analysis is described in the Section 482 Regulations as follows:

The comparable profits method evaluates whether the amount charged in a controlled transaction is arm’s length based on objective measures of profitability (profit level indicators) derived from uncontrolled taxpayers that engage in similar business activities under similar circumstances.²

Specifically, the Section 482 Regulations state the following with regard to the application of the CPM:

the determination of an arm’s length result is based on the amount of operating profit that the tested party would have earned on related party transactions if its profit level indicator were equal to that of an uncontrolled comparable (comparable operating profit). Comparable operating profit is calculated by determining a profit level indicator for an uncontrolled comparable, and applying the profit level indicator to the financial data related to the tested party’s



most narrowly identifiable business activity for which data incorporating the controlled transaction is available (relevant business activity). To the extent possible, profit level indicators should be applied solely to the tested party's financial data that is related to controlled transactions. The tested party's reported operating profit is compared to the comparable operating profits derived from the profit level indicators of uncontrolled comparables to determine whether the reported operating profit represents an arm's length result.³

As noted, the CPM analysis is performed by determining a comparable operating profit level by an analysis of uncontrolled (i.e., unrelated) entity operating profit levels. The analyst then applies that operating profit level to the subject (or tested) entity.

To the extent that the actual profit level of the subject entity is not supported by the comparable operating profit level, that may indicate that the arm's-length standard is not satisfied.

For the purposes of its CPM analysis, the Service determined that the independent bottlers (i.e., the uncontrolled entities) were comparable to the suppliers (i.e., the tested entities).

The Service reached this determination because the independent bottlers and the suppliers:

1. operated in the same industry,
2. incurred similar risks,
3. held similar contractual relationships with Coca-Cola,
4. exploited much of the same Coca-Cola IP, and
5. shared the same income stream from sales of Coca-Cola-branded beverages.

The Service CPM analysis relied on an average return on assets ("ROA") for a comparable group of the independent bottlers. The Service then applied this average ROA to the suppliers' operating assets to determine an arm's-length operating profit.

The Service then reallocated any of the suppliers' profit above that "arm's-length" profit level (i.e., any excess profit) to Coca-Cola.

The Tax Court concluded that, by relying on the ROA of the independent bottlers as comparable entities to the suppliers, the Service CPM analysis was reliable and the analysis adequately represented the universe of independent bottlers engaged in the

business of bottling and distributing Coca-Cola-branded beverages.

The Tax Court further concluded that the Service CPM analysis reasonably calculated operating assets by relying on the net book value figures reported by the independent bottlers and the suppliers. Further, the Service CPM analysis primarily calculated operating profit by adopting the parties' classifications as reported on the companies income statements.

Finally, the Service CPM transfer price analysis calculated geographically segmented independent bottler ROAs to improve the reliability of the CPM analysis conclusions.

COCA-COLA PROPOSED ALTERNATIVES

Coca-Cola challenged the Service CPM analysis (and the reallocations of income) as being not reasonable. Coca-Cola argued that the Service acted arbitrarily when it determined that the "10-50-50 method" no longer represented an arm's-length standard, despite the Service agreeing to the use of that method for the preceding five audit periods (more than a decade).

Further, Coca-Cola argued that the Service CPM analysis inappropriately reallocated income from the suppliers to Coca-Cola.

Coca-Cola claimed that the independent bottlers were not comparable entities to the suppliers because the suppliers owned valuable IP that were not reported on the suppliers' balance sheets or in a written contract.

Coca-Cola referred to these valuable assets as "marketing intangibles" or "IP associated with trademarks" and alleged that these IP were created when the suppliers financed advertising in foreign markets.

Coca-Cola contended that the independent bottlers were businesses that operate:

1. with little marketing and
2. at a different level of the global beverage market.

According to Coca-Cola, the suppliers owned local rights to the Coca-Cola IP and, therefore, should earn higher than typical returns as "master franchisees" or long-term licensees.

Coca-Cola provided three alternative methods to the Service CPM analysis. The Coca-Cola proposed alternative methods were as follows:

1. A comparable uncontrolled transaction ("CUT") method

2. A residual profit split method (“RPSM”)
3. An “unspecified method”

According to Coca-Cola, the CUT method and the RPSM were the “best methods” for determining the suppliers’ arm’s-length profit.

Alternatively, Coca-Cola claimed that if a CPM analysis based on ROA profit level is applied to the suppliers, each suppliers’ asset base should be increased to reflect the value of its “marketing intangibles.”

The “best method” rule is defined in the Section 482 Regulations as follows:

The arm’s length result of a controlled transaction must be determined under the method that, under the facts and circumstances, provides the most reliable measure of an arm’s length result. Thus, there is no strict priority of methods, and no method will invariably be considered to be more reliable than others. An arm’s length result may be determined under any method without establishing the inapplicability of another method, but if another method subsequently is shown to produce a more reliable measure of an arm’s length result, such other method must be used. Similarly, if two or more applications of a single method provide inconsistent results, the arm’s length result must be determined under the application that, under the facts and circumstances, provides the most reliable measure of an arm’s length result.⁴

As presented above, the “best method” in a transfer pricing context refers to the method that provides the most reliable measure of an ALP.

To demonstrate its position, Coca-Cola produced transfer pricing analysis reports from three different experts who relied on:

1. a CUT method analysis,
2. an RPSM analysis, and
3. an unspecific method analysis.

Comparable Uncontrolled Transaction Method

The first Coca-Cola expert opined that the CUT method represented the best method for determining the arm’s-length income that should be allocated



to Coca-Cola. The expert derived the supposed CUTs from “master franchising transactions” that companies such as McDonald’s and Domino’s Pizza execute with regional franchisees globally.

The Coca-Cola expert claimed that regional franchisees may (1) own and operate their respective fast-food restaurant locations and/or (2) sub-franchise with owners of other individual restaurant locations.

The Coca-Cola expert relied on one “master franchising agreement” for the 2007–2009 time period in their analysis.

Based on a number of complex calculations and assumptions, Coca-Cola’s expert purported to extract a royalty rate from the “master franchising agreements” that was payable to the franchisor for the right to exploit its IP.

The Coca-Cola expert grouped together both the suppliers and the servicers of Coca-Cola into one operational unit referred to as “the Field.” In the Coca-Cola CUT method analysis, “the Field” represented a “master franchisee” that would license the Coca-Cola IP and assume the responsibility of maintenance and development of the Coca-Cola IP.

The Coca-Cola expert concluded that master franchisees paid McDonald’s and Domino’s Pizza an average royalty equal to 2.2 percent of gross retail sales. The 2.2 percent royalty was then applied to Coca-Cola’s branded beverage gross retail sales in the relevant foreign markets to conclude that an average 12.3 percent royalty rate was payable to Coca-Cola.

That is, the Coca-Cola expert concluded that the suppliers (acting at arm’s length) were entitled to receive 87.7 percent of Coca-Cola’s branded

beverage gross retail sales in the relevant foreign markets.

Residual Profit Split Method

The second Coca-Cola expert opined that the RPSM represented the best method for determining the arm's-length income that should be allocated to Coca-Cola.

This Coca-Cola expert also grouped together both the suppliers and the servicers of Coca-Cola into "the Field."

According to this expert, from an economic perspective, the suppliers and the servicers together encompass the counterparty to Coca-Cola in the analyzed intercompany licensing transactions.

To establish a residual profit to be split between Coca-Cola and "the Field," the expert first estimated the "routine profit" of the Field. The expert concluded the Field routine profit was 8.5 percent based on consideration that the suppliers act as "contract manufacturers."

The transfer price expert subtracted this 8.5 percent routine profit from the total operating profit of the suppliers and the servicers in order to estimate the "residual profit."

The transfer price expert claimed that the residual profit should be split (or allocated) between "the Field" and Coca-Cola based on historical consumer advertising spending.

Based on that analysis, the expert allocated the residual profit to "the Field" 94.6 percent, 95.1 percent, and 95.4 percent in 2007, 2008, and 2009, respectively.

The expert concluded the Coca-Cola residual profit allocation (or royalty rate) to be 5.4 percent in 2007, 4.9 percent in 2008, and 4.6 percent in 2009. The expert then compared the concluded Coca-Cola royalty rates to the actual royalty rates paid by the suppliers to Coca-Cola over the 2007–2009 time period.

This comparison resulted in an indication that billions of dollars of profit should actually be reallocated back to the suppliers from Coca-Cola.

Unspecified Method

The third Coca-Cola expert opined that a so-called "asset management model" represented the best method for determining the arm's-length income that should be allocated to Coca-Cola. The "asset management model" would be considered an unspecified method as that term is defined in the Section 482 Regulations.

Under the third Coca-Cola expert's analysis, Coca-Cola operates as the "headquarters" and "the Field" operates as the actual business enterprise. In this scenario, Coca-Cola operates as a "skilled asset manager" that focuses on issues of governance, best practices sharing, and high-level strategy.

The expert argued that hedge fund managers (i.e., skilled asset managers) are typically compensated in a two-tiered structure, receiving:

1. a base fee computed based on "assets under management" and
2. a profit fee based on annual "net asset appreciation."

Under this asset management model, the transfer price expert determined that (1) a 2 percent base fee and (2) a 20 percent profit fee to be paid from the suppliers to Coca-Cola was reasonable.

The Coca-Cola expert produced a series of calculations and assumptions to estimate Coca-Cola "assets under management" and annual "net asset appreciation" during the 2007–2009 time period.

The transfer price expert then converted the 2 percent base fee and 20 percent profit fee percentages into royalties payable from the suppliers to Coca-Cola.

The result of the asset management model analysis equaled a weighted average annual royalty rate for Coca-Cola of 9.3 percent.

TAX COURT OPINIONS RELATED TO THE COCA-COLA PROPOSED ALTERNATIVES

After consideration of the (1) Service CPM analysis, (2) Coca-Cola CUT method analysis, (3) Coca-Cola RPSM analysis, and (4) Coca-Cola so-called "asset management model" analysis, the Tax Court determined that the Service CPM analysis provided the best indication of an ALP to be paid between Coca-Cola and the suppliers.

The following section of this discussion summarizes some of the Tax Court's reasons for not relying on the Coca-Cola proposed alternative transfer pricing methods.

Tax Court's Comments on the Coca-Cola CUT Method Analysis

The Tax Court noted several issues with the Coca-Cola CUT method analysis that rendered it as not representing an ALP.

First, the Tax Court disagreed with the Coca-Cola CUT method analysis premise that suppliers are responsible for managing Coca-Cola's foreign businesses and overseeing the relationships with the independent bottlers. The Tax Court also disagreed that the suppliers are responsible for marketing activities or for expenditures related to exploiting and developing the Coca-Cola IP.

The Tax Court noted that the Coca-Cola CUT method analysis relied on a premise that inappropriately conflated the suppliers with the servicers as one operating unit called "the Field." All three Coca-Cola proposed transfer pricing method analyses relied on this premise of "the Field."

The Tax Court disagreed with "the Field" premise in all three of the Coca-Cola proposed alternative transfer pricing method analyses.

According to the Tax Court, one flaw with "the Field" is that the Section 482 Regulations require that income be properly allocated among "controlled taxpayers." The "controlled taxpayers" in the Coca-Cola case are Coca-Cola, the suppliers, and the servicers.

Coca-Cola and the Service agreed that the servicers transacted at arm's length with Coca-Cola. The Tax Court stated that by conflating the suppliers and the servicers into "the Field," the Coca-Cola CUT method analysis creates a controlled taxpayer that does not actually exist.

Second, the Tax Court disagreed that the suppliers could be considered "master franchisees" as described in Coca-Cola's CUT method analysis. The suppliers operated with short-term contracts that Coca-Cola could (and routinely did) terminate at its discretion.

However, in the Coca-Cola CUT method analysis, the "master franchisees" operated with long-term contracts (10 to 50 years) that provided numerous exclusive rights in specific regions.

Third, according to the Tax Court, the CUT method is especially reliable only if there are uncontrolled transactions involving the transfer of the same IP under substantially similar circumstances as the controlled transaction.



The Tax Court determined that neither Coca-Cola nor Coca-Cola's expert provided any pricing data for uncontrolled transactions with the same IP (e.g., the Coca-Cola trademarks, brand names, etc.). Instead, the Coca-Cola CUT method analysis relied on pricing data from the fast-food restaurant industry.

Fourth, the Coca-Cola expert did not provide convincing evidence that the analyzed CUTs had comparable contractual terms. According to the Tax Court, the Coca-Cola CUT method analysis failed to even compare the contractual terms that the suppliers operated under and the "master franchisees" operated under. In fact, four of the five transactions analyzed in the Coca-Cola CUT method analysis did not include actual master franchise agreements.

Finally, the Tax Court stated that Coca-Cola's CUT method analysis itself was deficiently implemented. Notably, the CUT method analysis included dozens of assumptions, estimates, adjustments, and reallocations related to operating expenses and income streams.

According to the Tax Court, the CUT method analysis assumptions were "aggressive" and almost always favored Coca-Cola. And, the Tax Court agreed with the Service's interpretation that many of the Coca-Cola CUT method analysis assumptions were mathematically or economically unsound.

For the various reasons described above, the Tax Court concluded that the Coca-Cola CUT method analysis did not satisfy the arm's-length standard required under Section 482.

Tax Court's Comments on the Coca-Cola RPSM Analysis

The Tax Court noted several issues with the Coca-Cola RPSM analysis that rendered it as not representing an ALP.

First, the Tax Court stated that (much like with the CUT method analysis) the Coca-Cola RPSM analysis reliance on “the Field” premise inappropriately conflates the suppliers with the servicers as one operating unit.

According to the Tax Court, “the Field” premise inappropriately resolved certain weaknesses within the RPSM analysis, chief among them that the suppliers did not actually perform any of the valuable functions identified in the RPSM analysis.

Notably, these valuable supplier functions included implementing consumer advertising and managing relationships with the independent bottlers. However, none of these functions was actually performed by the suppliers. Rather, these functions were performed by the servicers. Thus, by inappropriately relying on “the Field” premise, the RPSM analysis assigned these valuable functions to the suppliers.

Second, the Coca-Cola RPSM analysis concluded that the residual profit should be split among Coca-Cola and the suppliers based on the respective spending on marketing, over a 70-plus year period in the foreign markets where the Coca-Cola-branded beverages were sold.

However, the Tax Court noted that the RPSM analysis:

1. did not have reliable historical data related to all foreign markets and
2. did not account for the fact that no supplier had a consistent market to itself because the beverage concentrate supply was regularly shifted between various suppliers over this period.

The RPSM analysis indicated that Coca-Cola had spent billions of dollars related to foreign market advertising and that “the stock of consumer awareness in each country created by TCCC [Coca-Cola] depreciated and was replaced by new investments by the Foreign Licensees [suppliers] in existing and new products.”⁵

The RPSM analysis considered these “investments” as “marketing-related IP,” “IP associated with trademarks,” and/or “intangible development costs.”

The Tax Court noted that such costs were incurred by the servicers, and not by the suppliers.

The RPSM analysis then “amortized” these costs over the relevant period, indicating that the historical advertising expenses (i.e., Coca-Cola’s portion) decreased every year while “the Field’s” portion increased.

The Tax Court disagreed that such advertising costs could be classified as IP and certainly would not be owned by the suppliers.

Third, the Tax Court stated that even if the suppliers did own the IP that the RPSM analysis indicated, that analysis did not determine how much of the relative value that this IP contributed could be assigned to Coca-Cola or the suppliers.

Fourth, the Tax Court determined that the reliability of the advertising expense data relied on in the RPSM analysis and the assumptions contained therein was limited.

Notably, the Tax Court claimed that there exists no economic consensus on:

1. whether ordinary advertising expense data can be properly capitalized into IP or
2. what the useful life of such IP would be.

Further, the Tax Court stated that these so-called “marketing-related IP,” “IP associated with trademarks,” or “intangible development costs” could not reasonably be used by an unrelated party without ownership of the numerous other IP owned by Coca-Cola.

Lastly, the Tax Court noted that under the RPSM analysis assumptions and methodology, over time, Coca-Cola’s older advertising expenses would be amortized out of existence and eventually, “the Field’s” share of the “marketing-related IP” would approach 100 percent. That is, the suppliers could require Coca-Cola to pay the suppliers for the right to use Coca-Cola’s own IP.

For the various reasons described above, the Court found that the Coca-Cola RPSM analysis did not satisfy the arm’s-length standard required under Section 482.

Tax Court's Comments on the Coca-Cola Unspecified Method Analysis

The Tax Court noted several issues with the Coca-Cola “asset management model” analysis that rendered it as not representing an ALP.

The Tax Court stated that, by the expert’s own admission, the asset management model analysis would not typically be applied to determine the ALP of an IP license. The Tax Court noted that was an understatement.

According to the Tax Court, the asset management model did not resemble any of the “specified methods” for estimating the value of IP under the Section 482 Regulations.

In fact, the Tax Court noted that the expert described the assignment as developing a transfer pricing methodology “without the constraint of specific transfer pricing regulations.”

The asset management model was found to be not meaningful by the Tax Court for purposes of the Coca-Cola case.

Significantly, the asset management model inappropriately assumed that Coca-Cola would need to be compensated only for asset management services that include functions related to:

1. governance,
2. sharing of best practices, and
3. high-level strategy.

The Tax Court noted that the asset management model ignored the contributions made by Coca-Cola that were relevant to the case. That is, it ignored the numerous and valuable IP required to manufacture, distribute, and sell Coca-Cola-branded beverages in foreign markets.

Specifically, the Tax Court stated that hedge fund managers typically do not supply such IP to the companies managed in their portfolios. In the Tax Court’s view, by compensating Coca-Cola only for the services described above, the asset management model ignored the IP that are central to the Coca-Cola case.

For the various reasons described above, the Tax Court concluded that the Coca-Cola asset management model analysis did not satisfy the arm’s-length standard required under Section 482.

SUMMARY AND CONCLUSION

This discussion (1) described the background of the *Coca-Cola* case and (2) summarized the transfer pricing issues involved in the judicial decision.

The *Coca-Cola* case demonstrates certain issues that analysts should be aware of in the context of an intercompany transfer price analysis.

Some of the takeaways to be considered by taxpayers and analysts from the *Coca-Cola* judicial decision are listed below.

- By applying the ROA of independent bottlers, as comparable entities to the suppliers, the Service’s CPM transfer price

analysis was reliable and adequately represented the universe of independent bottlers engaged in the business of bottling and distributing Coca-Cola-branded beverages.

- The Coca-Cola experts inappropriately conflated the suppliers and the servicers in order to support fundamentally flawed positions in their analyses. By failing to analyze the actual relevant entities only (i.e., Coca-Cola and the suppliers), the Coca-Cola experts produced analyses that the Tax Court was inclined to reject.
- In a transfer pricing context, analysts should avoid assuming hypothetical scenarios (e.g., that the suppliers performed valuable functions that included implementing consumer advertising and managing relationships with the independent bottlers) that do not actually exist.
- Analysts should rely on an application of the “specified methods” for estimating the value of IP under the Section 482 Regulations and not rely on *de novo* methods such as the “asset management model.”
- A transfer pricing method should produce credible results in order to be considered reliable under the arm’s-length standard. For example, a transfer pricing method should not indicate unreasonable results, such as Coca-Cola being required to pay the suppliers for the right to exploit its own IP (as assumed in the Coca-Cola RPSM analysis).

Notes:

1. *The Coca-Cola Company & Subsidiaries v. Commissioner*, 155 T.C. No. 10 (2020).
2. Regulation 1.482-5(a).
3. Regulation 1.482-5(b)(1).
4. Regulation 1.482-1(c)(1).
5. *The Coca-Cola Company & Subsidiaries v. Commissioner*, at *71 (2020).



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