**Coca-Cola vs. US IRS: Implications for Global Transfer Pricing Frameworks**

The prolonged and high-stakes litigation between The Coca-Cola Company and the U.S. Internal Revenue Service (IRS) stands as one of the most consequential judicial interventions in international transfer pricing (TP) jurisprudence in recent memory. At the heart of the dispute is the IRS’s rejection of Coca-Cola’s long-standing 10:50:50 profit spilt for allocation and imposing the Comparable Profits Method (CPM) under Section 482 of the Internal Revenue Code (IRC). This shift resulted in a $9 billion income adjustment and an associated $3.3 billion tax deficiency for the 2007–2009 tax years.

In its comprehensive 240-page 2020 ruling, the U.S. Tax Court upheld the IRS’s position, concluding that Coca-Cola had overcompensated its foreign syrup-manufacturing affiliates, referred to as “supply points”, while undercompensating the U.S. entity for the use of its U.S.-owned proprietary intangibles. These supply points operated across seven countries, though nearly $8 billion of the adjustment stemmed from just two jurisdictions: Ireland and Mexico. Notably, Coca-Cola Ireland reported an effective tax rate of only 1.4% during the period under review.

While the case falls within the ambit of U.S. tax law, it holds significant precedential value for jurisdictions worldwide that routinely scrutinize transfer pricing structures involving outbound licensing and the ownership of intellectual property (IP). This article explores the key aspects of the Coca-Cola case and assesses its potential impact on global transfer pricing enforcement, particularly in the context of Article 9(2) of Double Taxation Avoidance Agreements (DTAAs), the concept of economic ownership of intangibles, and evolving cross-border profit allocation models.

**The Legacy of the 10:50:50 Method and the IRS’s Rejection**

Under a 1996 IRS closing agreement, Coca-Cola implemented a formulary apportionment model that:

* Allowed foreign supply units (FSUs) (‘supply points’) to retain a fixed return of 10% of gross revenues and
* Further split the residual profits equally (50/50) between Coca-Cola U.S. and the FSUs.

The methodology, known as the 10:50:50 formula, was not derived from traditional TP methods under the Section 482 of the U.S. IRC or OECD Guidelines but was a bespoke resolution to earlier disputes for the years 1987–1995.

Notably, Coca-Cola continued this method post-1995. However, the IRS, after five audit cycles that acquiesced to this model, abandoned it in 2007, contending that it no longer adhered to the arm’s length principle under Section 482. Instead, the IRS applied CPM, selecting Coca-Cola’s independent bottlers as the uncontrolled comparable and benchmarking the FSUs as the tested parties.

The IRS found that the bottlers were the proper benchmark because they operated in a similar beverage industry, held the same economic risks and contractual relationships, employed the same intellectual property from Coca-Cola, and ultimately shared from the same income stream as the supply points sales.

In the report that economist T. Scott Newlon prepared for the IRS, he included a list of comparable entities consisting in 18 unrelated bottlers, headquartered in ten countries all with qualified auditor statements. In the expert witness report that Newlon later submitted to the Tax Court, this comparable list was enlarged to 24 bottlers. The same report concluded that the best profit level indicator (PLI) is ROA.

This recharacterization treated FSUs as limited-risk contract manufacturers (LRCMs) without ownership rights over valuable intangibles, entitled only to routine returns.

**Tax Court’s Endorsement of the IRS’s Functional Recharacterization and CPM Application**

The U.S. Tax Court ruled in favour of the IRS in 2020 (155 T.C. 145), holding that:

1. The IRS did not abuse its discretion under Section 482 by abandoning the 10:50:50 model.
2. The FSUs did not economically or legally own intangibles—thus, residual profits attributable to Coca-Cola’s brand, trademarks, and marketing strategies had to be allocated to the U.S. entity.
3. CPM was the “best method” under U.S. Treasury Regulations (Treas. Reg. Section 1.482-1(c)) given the available data and comparability criteria.

Significantly, the Tax Court rejected the applicability of the Comparable Uncontrolled Transaction (CUT) method, citing lack of external market transactions for similar intangibles under comparable circumstances, and dismissed Coca-Cola's claims that FSUs held franchise or marketing intangibles of substantive economic value.

**Application of Return on Operating Assets (ROA) as PLI**

The IRS’s economic expert applied ROA as the Profit Level Indicator (PLI) for CPM, referencing 24 unrelated bottlers globally, with adjustments to reflect industry, geography, and asset intensity. The FSUs showed supernormal returns:

* ROA in Ireland, Brazil, and Costa Rica exceeded 100–200%.
* Compared to the arm’s length range derived from the tested comparables (6–8.5%), these margins were anomalously high.

Thus, the IRS allocated the excess profits to Coca-Cola U.S., attributing it to its ownership of IP, marketing intangibles, and centralized strategic control. The Tax Court upheld this, observing that Coca-Cola U.S. was the exclusive legal owner of nearly all registered IP.

**Implications for Outbound Structures and IP-Rich Entities**

The Coca-Cola ruling sets a precedent for several ongoing and future disputes globally:

**1. Parent company owned Intangibles**

Where multinationals develop or control global IP from the jurisdiction of the parent company, the tax authorities may use this case to argue:

* That foreign subsidiaries act as Contract manufacturers or limited-risk distributors (LRDs);
* That routine returns alone are justified for such foreign entities;
* That excess profits should be attributed to the parent company under the arm’s length principle.

**2. Negotiating Renewal clauses of Advanced Pricing Agreements (“APAs”) or Transfer Pricing Settlements**

The IRS’s successful abandonment of a historical method may embolden the tax authorities to revisit advancements while renewing the APAs. Especially where the multinationals have relied on informal formulas or “settled” allocation keys.

**3. Challenges to Marketing Intangibles**

The key subsidiaries incurring marketing expenditure for global brands may struggle to claim ownership of “marketing intangibles” unless:

* There’s a valid cost contribution arrangement (CCA) or documenting Development, Enhancement, Maintenance, Protection and Exploitation (DEMPE) functions;
* The contracts clearly confer economic ownership of developed intangibles.

In the Coca-Cola case, the absence of a formal APA led the court to dismiss marketing intangible claims made by FSUs.

**Double Taxation Risks and the Role of Treaty-Based Relief**

The Coca-Cola case, though grounded in U.S. tax law, underscores a broader global issue, when tax authorities in different countries reallocate income, especially involving intangibles and IP ownership, it can result in double taxation unless resolved through treaty mechanisms. Many DTAAs, such as the India–U.S. agreement, include provisions like Article 9(2), allowing the other country to make a corresponding adjustment if it agrees the original adjustment is justified. In practice, however, such relief is rarely automatic and often depends on bilateral negotiations under the Mutual Agreement Procedure (MAP). For multinationals operating across borders, particularly those using low-tax entities or cost-sharing models, this presents significant risk, as illustrated in Coca-Cola, where the IRS reattributed residual profits to the U.S. parent and disregarded a long-standing allocation method. If a similar case involved an Indian entity, for example, both the U.S. and India could claim taxing rights over the same income, making effective MAP coordination essential. This highlights the need for aligning intercompany arrangements with economic substance and proactively leveraging treaty protections to mitigate cross-border tax exposure.

**Amicus Briefs: Warning Signs for MNEs**

The joint amicus curiae brief by high profile professional services firms, along with submissions by U.S. industry bodies, underscores growing concerns that tax authorities may renege on long-standing agreements wherein:

* APA agreements and MAP settlements are critical tools of TP certainty.
* Retroactive changes in TP positions could undermine taxpayer confidence and investment climate.

**Strategic Recommendations for Multinationals**

1. **Reassess the Intercompany Agreements:** Especially where royalty payments or brand usage terms are vague or formula-driven. All arrangements must conform with substance and control analyses.
2. **Perform Robust DEMPE Analysis:** Clearly document which entity undertakes each of the DEMPE functions for every significant intangible.
3. **Use APAs:** APAs provide certainty. Coca-Cola’s reliance on a closing agreement, unlike a binding APA, proved insufficient.
4. **Account for Foreign Legal Restrictions:** Especially in structuring outbound royalty flows. Document blocked income risks under local law to counter future adjustments.
5. **Strengthen Article 9(2) Defense:** Where a TP adjustment has correlative implications, maintain proactive dialogue with Indian Competent Authority for early MAP invocation.

**Parting Thoughts**

The Coca-Cola case underscores the global trend of functional recharacterization and profit reallocation toward the IP-owning parent, especially when the functional profile of foreign affiliates is limited. For multinationals, this means that economic substance must align with legal form and that historical comfort with legacy TP models is no longer tenable.

As the Eleventh Circuit prepares to issue its ruling, companies must prepare for a new era of transfer pricing enforcement, one where IP location, DEMPE functions, and treaty relief mechanisms will determine both the allocation of global profits and the risk of double taxation.