

Cannabis Ruling In Tax Case Highlights Coke's Uphill Battle

By **Molly Moses**

Law360 (April 23, 2021, 6:15 PM EDT) -- Coca-Cola may have an uphill battle in its appeal of an unfavorable U.S. Tax Court ruling in a transfer pricing case, based on the Ninth Circuit's rejection of constitutional arguments in a recent case involving a marijuana business.



Attorneys for Coca-Cola Co. have said the company plans to raise constitutional arguments in its appeal to the Eleventh Circuit of an unfavorable U.S. Tax Court ruling in a transfer pricing case. (AP Photo/John Locher)

In the case of Patients Mutual Assistance Collective Corporation, which does business as Harborside Health Center, the Ninth Circuit **shot down a challenge** to a tax code clause that bars pot businesses from taking deductions. The court declined Thursday to address Harborside's argument that Internal Revenue Code **Section 280E** violates the 16th Amendment, saying the argument wasn't presented before the Tax Court.

Attorneys for Coca-Cola Co. have said the company, like Harborside, plans to raise constitutional arguments in its appeal to the Eleventh Circuit once the Tax Court issues a final decision in the case. But because Coca-Cola didn't raise those arguments before the Tax Court, the appeals court, like the Ninth Circuit in Harborside, could decline to address them.

"The principle that new arguments can't be raised on appeal is pretty much black-letter law," said Elizabeth Stevens of Caplin & Drysdale Chtd. "I doubt you'll find the general rule to be any different in any circuit."

In Coca-Cola, **Tax Court Judge Albert Lauber said** the Internal Revenue Service was within its rights to adjust the company's transfer pricing methodology for foreign affiliates involved in distribution and marketing, despite a prior closing agreement.

The agreement covered tax liabilities from 1987 to 1995, and laid out percentages to divide income between the parent company and foreign affiliates involved in bottling, distribution and marketing in countries such as Brazil, Mexico and Ireland. Although the agreement didn't apply after 1995, the company continued to follow it for many years without challenge from the IRS. That changed in 2015, when the agency notified Coca-Cola that it would increase its taxable income for 2007-09, creating \$3.3 billion in new tax liabilities.

Coca-Cola **announced in February** that it had hired Laurence H. Tribe, a Harvard professor and noted expert in constitutional law, to represent it in its challenge to the Tax Court's ruling.

At the time he joined the company's litigation team, Tribe accused the IRS of "baiting The Coca-Cola Company for two decades, abruptly switching its position on the appropriate tax calculation for no legitimate reason, and imposing taxes on the company retroactively, frustrating the investment-backed expectations formed in reliance on the government's promises, representations and continuing course of conduct."

James Mann, who represented Harborside before the Ninth Circuit, noted that the constitutional challenge in the cannabis case was a 16th Amendment challenge as opposed to Coca-Cola's argument, which is that the IRS violated the Fifth Amendment's due process clause.

"I do not believe in my research on constitutional law in tax cases that there are many — if any — tax cases that strike down a case on due process grounds," he said.

A court will sometimes make exceptions, noted Matthew Frank of Steptoe & Johnson LLP. A 2011 Eleventh Circuit case, *In re Lett* , states that while litigants generally are not supposed to be "surprised" by an appeals court's decision on issues for which they haven't been able to offer evidence, "this principle is not unyielding."

The Lett court said there may be "exceptional cases or particular circumstances" that will prompt an appellate court to consider questions of law that "were neither pressed nor passed upon" by the lower court.

But, Frank said, fitting into an exception can be a challenge for a company, and the Ninth Circuit's decision "is a reminder of the obstacle the company will have to try to overcome."

Mann, on the other hand, saw compelling reasons for the Ninth Circuit to have considered the constitutional argument in Harborside.

"The Constitution is the supreme law of the land, and all judges are supposed to operate at all times with the Constitution as the guiding star," he said. "There's no statute, there's nothing providing that they couldn't have taken up the constitutional question."

There are several reasons the Eleventh Circuit might wish to consider Coca-Cola's constitutional arguments, Mann said.

They are being made by a noted constitutional scholar, so "they're really good arguments," he said. "Coca-Cola is a really big company; the tax liability, the numbers there are really big. It would be OK if the court looked at his arguments and gave the taxpayer a fair shake."

--Additional reporting by Diana Novak Jones and Alex M. Parker. Editing by Robert Rudinger and Vincent Sherry.