THE WALL STREET JOURNAL. ONLINE

September 12, 2006

Glaxo to Settle Tax Dispute With IRS Over U.S. Unit for $3.4 Billion

By ROBERT GUY MATTHEWS and JEANNE WHALEN
September 12, 2006; Page A3

Pharmaceutical giant **GlaxoSmithKline** PLC will pay the U.S. government $3.4 billion to settle a nearly two-decade-long dispute over how to tax dealings between the British company and its American subsidiary, in a case that underscores the Internal Revenue Service's resolve to confront corporate tax avoidance.

The settlement, which the IRS said was the largest ever, covers taxes the agency said Glaxo owed for 1989 through 2005 because the company's American unit improperly overpaid its British parent for drugs, mainly the antiulcer blockbuster Zantac. It said those overpayments reduced the company's profit in the U.S., thus lowering its U.S. tax bill.

The Glaxo settlement could help bolster the IRS's crackdown on corporate taxpayers. It follows a string of tax-shelter victories the IRS has racked up in court in the past year against such companies as **General Electric** Co., **Black & Decker Corp.** and aerospace-products maker Coltec Industries Inc.

MORE

• Read statements[3] from Glaxo and the IRS.

• Glaxo Gets New Tax Bill[4]
01/27/05

• **Page One:** Glaxo Battles IRS on Taxes[5]
06/11/02

Strong Medicines

These six Glaxo drugs account for 97% of the dispute between the company and the IRS

DRUG (TREATMENT)	DISCOVERY	U.S. LAUNCH
Ventolin (inhalable asthma treatment)	1966	1981
Zantac (ulcer medicine)	1976	1983
Ceftin (oral antibiotic)	1976	1988
Zofran (nausea treatment)	1983	1991
Imigran/Imitrex (migraines)	1984	1993
Serevent (long-acting asthma treatment)	1983	1994

Source: the company

Glaxo's decision to settle the dispute, which was headed for a trial in U.S. Tax Court in February, was particularly sweet for the IRS because it has a poor track record of winning disputes involving the accounting practice at stake in the Glaxo case. That practice, called "transfer pricing," is the art of attaching a monetary value to trademarks, patents, research and other intangibles that one arm of a multinational company transfers to another.

Transfer pricing determines how costs are distributed between the far-flung arms of a multinational company, and thus what profit is booked in what country. Higher costs cut into profit, lowering a company's tax bill, while lower costs do the opposite.

"Over the past 10 to 20 years, the government has brought a good number of transfer-pricing cases and come away with clear victories in very few of them," said Philip R. West, a tax partner at law firm Steptoe & Johnson in Washington.

Disputes over transfer pricing tend to be among the biggest fights between the IRS and corporate taxpayers, and they are of growing importance since more than 60% of world trade occurs inside multinational companies. Every country wants to maximize the tax revenue on goods and services produced within its borders, and every company has an incentive to book profits where taxes are lowest. That has bred a slew of disputes between companies and tax authorities over the proper pricing.

Julian Heslop, Glaxo's chief financial officer, called transfer-pricing disputes among the toughest issues for corporations to resolve with tax authorities. "It's probably the most complicated area of taxation in the world. It's not like buying a TV, where there is a market price," he said. "There isn't a market price within a company. There's quite a range of what might be acceptable."

Symantec Corp., a Cupertino, Calif., software maker, is currently in a $1 billion transfer-pricing Tax Court dispute with the IRS involving an Irish subsidiary of **Veritas Software** Corp., a company it acquired in 2005. The IRS is arguing that licensing fees paid by the subsidiary to Veritas in the U.S. were too low and that Veritas credited the U.S. business with too much of the cost of developing some technology. That wound up increasing the income of the subsidiary in Ireland -- a lower-tax country -- at the expense of income in the U.S., lowering the company's overall tax bill. Symantec has sued the IRS in U.S. Tax Court.

Motorola Inc., the Schaumburg, Ill., cellphone and telecommunications-equipment maker, is in a dispute with the IRS that could result in additional taxes of roughly $800 million, largely related to transfer pricing, according to company disclosures.

"The settlement of this case," said IRS Commissioner Mark Everson of the Glaxo case "sends a strong message of our resolve to continue to deal with this issue going forward." Chief IRS counsel Donald Korb added that it showed that "our lawyers can go up against the best firms the private tax bar has to offer...and achieve quite successful results."

Glaxo said that, despite the settlement's massive size, it won't have any significant impact on the company's reported earnings. Glaxo had set aside £2.3 billion ($4.3 billion) to cover tax disputes. Mr. Heslop, the company's chief financial officer, said a significant amount of that sum related to the U.S. dispute. He said the company was confident it would prevail in the case but settled because of the time and cost of litigation, which had been expected to last two to three years, including the inevitable appeals.

At 4 p.m. in New York Stock Exchange composite trading, Glaxo's American depositary shares were up 17 cents at $55.25.

The majority of transfer-pricing cases are settled out of court. The trickiest involve, as the Glaxo case did, the value of intangibles, such as brand names. A Toyota automobile made in Japan, for instance, is worth more in the U.S. than the sum of its steel, rubber and electronics, because the Toyota brand name adds value. Attaching a price figure to that value can be a contentious affair.

In an attempt to simplify transfer-pricing guidelines, the IRS changed its rules in the 1990s. The Glaxo case, which dates to 1989, fell under old rules, which gave companies more leeway in determining prices.

Under the current rules, "I would be astonished that a company would take as far-out a position" as Glaxo did under the old ones, said H. David Rosenbloom, a Washington lawyer with Caplin & Drysdale. "Their auditors would be hanging off the ceiling."

Under the new rules, which came into widespread use in the late 1990s, a company must document a "reasonable" calculation for its transfer pricing; in the past, the burden was on the IRS to prove the calculation inaccurate. In addition, the IRS now has the power to levy a 40% penalty -- in addition to taxes owed -- if it wins a dispute, another reason for companies to avoid resisting the IRS as long as Glaxo did.

In addition, the IRS today often avoids levying penalties, beyond taxes owed, if companies can show they made a good-faith effort to come up with a meaningful price; in the past, the IRS had little option but to examine a company's books in detail and try to discern if an appropriate rationale was used to determine the internal pricing.

In the Glaxo case, the company contended the value of drugs it sold in the U.S. was in the research and development done in Britain, and that that justified the high price the British parent charged the American unit for the drugs. The biggest chunk of profit at issue stems from Zantac, which was the world's best-selling drug from the mid-1980s to the mid-1990s, at one point accounting for half of the company's total revenue. Glaxo paid taxes in Britain on the Zantac profit but less than it would have paid had the profit been assigned to the U.S.

The IRS argued that marketing efforts by Glaxo in the U.S. were critical to Zantac's success, and thus more of the income should have been attributed to the American unit -- and subject to U.S. tax. The IRS said the company has conceded more than 60% of the amount at issue in court. Glaxo said the net cash cost of the settlement would be $3.1 billion, including federal, state and local taxes; interest, and deductions for the taxes paid.

In its 2005 annual report, Glaxo said a transfer-pricing dispute it was discussing with British tax authorities for the years 1995 to date could also lead to litigation. A Glaxo spokeswoman yesterday said the British dispute wasn't related to the case settled in the U.S.

---- Jesse Drucker contributed to this article.

Write to Robert Guy Matthews at robertguy.matthews@wsj.com[1] and Jeanne Whalen at jeanne.whalen@wsj.com[2]

URL for this article:
http://online.wsj.com/article/SB115798715531459461.html

Hyperlinks in this Article:
(1) mailto:robertguy.matthews@wsj.com
(2) mailto:jeanne.whalen@wsj.com
(3) http://online.wsj.com/article/SB115798900617459481.html
(4) http://online.wsj.com/article/SB110677715868037102.html
(5) http://online.wsj.com/article/SB102375541877026600.html