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Daimler pays \$1.5-billion to end tax fight

By GREG KEENAN
From Tuesday's Globe and Mail

After 11 years, settlement in cross-border dispute will go to federal, Ontario and Alberta governments

The final chapter in the stormy marriage and divorce of Daimler-Benz AG and Chrysler Corp. will provide a \$1.5-billion (U.S.) windfall to the deficit-ridden federal, Ontario and Alberta governments.

Daimler AG as the maker of Mercedes-Benz cars is now known, will pay the three governments \$1.5-billion to settle a dispute over 11 years of Chrysler taxes that began in the mid-1990s and lasted until Daimler unloaded the No. 3 Detroit auto maker in 2007.

The tax fight is about transfer pricing, or how Chrysler accounted for intercompany shipments of vehicles and parts across the Canada-U.S. border. The auto maker was reassessed taxes by the Canada Revenue Agency for those 11 years, starting in 1996. The agency asserted that Chrysler Canada Inc. should have reported higher profits in Canada and lower profits in the United States.

The payment of taxes and interest by Daimler is believed to be one of the largest Canadian settlements in a transfer pricing case. "It's a pretty significant number in the Canadian context," said Michael Peggs, a partner in the taxation practice of accounting firm Grant Thornton LLP in Toronto.

The battle between the auto maker and the Canadian governments took on added significance when it became public in 2009, just as Ottawa and Ontario were negotiating a bailout of Chrysler that helped keep the company solvent and allowed it to maintain 9,000 jobs in Canada.

Daimler has already paid \$656-million in taxes and interest after accepting a settlement in June, 2010, Chrysler said in a 312-page filing with the U.S. Securities and Exchange Commission. The final reassessment of the taxes was made in December, 2010, the filing said.

"We also anticipate that during 2011, Daimler will make all payments to settle the net amount owing to the Canadian tax authorities under the final reassessment," added Chrysler, which is now controlled by Fiat SpA.

A spokesman for the Department of Finance said such gains are not unexpected because reassessments of taxes are made every year and are built into projections of corporate income tax revenues.

But Mr. Peggs said he attended a conference on transfer pricing last week where a Canada Revenue Agency official said all the reassessments of taxes performed in 2009 amounted to \$1.4-billion (Canadian).

By the time the governments began going after the companies for the back taxes, the one-time automotive "marriage made in heaven" consummated in 1998 between Germany-based Daimler and Auburn Hills, Mich.-based Chrysler had already broken up. The two companies were unable to bridge differences in corporate culture, and European shareholders complained loudly that Chrysler was dragging the merged company down.

Daimler effectively paid hedge fund Cerberus Capital Management LP to take most of Chrysler off its hands in 2007. Daimler kept a 19.9-per-cent stake, but agreed to indemnify Chrysler against the tax reassessments.

The lion's share of the \$1.5-billion (U.S.) settlement will go to the federal and Ontario governments, which contributed \$2.21-billion to a U.S.-led bailout of Chrysler LLC in 2009.

The bailouts of Chrysler and General Motors Corp., which total about \$12.7-billion, were partly responsible for the record-setting deficits the two governments racked up to fight the recession. Those governments are still fighting to stem the red ink.

The federal deficit for the April-December, 2010, period was \$27.4-billion (Canadian). Ontario is on track to post a deficit of \$18.7-billion in the fiscal year that ends March 31. Alberta, meanwhile, tabled a budget last week that forecasts a deficit of \$3.4-billion for 2011-12.

At one point in the tax battle with Daimler and Chrysler, the federal and Ontario governments slapped liens worth \$1.2-billion (U.S.) on Chrysler's assets in Canada, which includes assembly plants in the Ontario cities of Brampton and Windsor. Chrysler was also required to post cash collateral of \$335-million.

The case might never have come to light if not for the crisis that beset the auto industry in 2008 with the soaring price of gasoline and the near-collapse of the U.S. financial system.

Chrysler, traditionally the first of the Detroit Three auto makers to be affected by a downturn, went cap-in-hand to the U.S., Canadian and Ontario governments that fall, warning that it faced a severe cash crunch and a possible liquidation without government help. Governments provided interim loans while they looked for a saviour, which turned out to be Fiat.

As part of the complex deal that saved Chrysler, Daimler was prepared to hand over its stake in the company to Cerberus, which would help clear the way for Fiat to buy 20 per cent of Chrysler.

Tom LaSorda, who was Chrysler's president when the negotiations to save it went down to the wire in March, 2009, told a House of Commons committee at the time that the company needed assurances from the CRA that it would not seek more cash collateral while the tax dispute was being resolved.

No more cash was demanded, Chrysler was bailed out and has invested more than \$1-billion in its Canadian plants. Fiat is preparing an initial public offering of the company, possibly as soon as this year.

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