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Transfer Pricing Perspective

Pharmaceuticals Industry 20 September 2014



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Transfer Pricing Environment

1

Global TP environment

- “Perfect storm” in global TP controversy :
 - Fiscal demands due to downturn
 - MNEs re-structure global operations to remain competitive
- Reputation risks & moral taxes in TP
- BEPS initiative by OECD → clear focus on substance

Indian TP Environment

1

TP additions of approx. 2.2 Lakh Crore over nine audit cycles



2

Almost 900 cases decided by the ITATs (majority rulings – favorable to taxpayers)



3

APA a “Hit”, more than 375 applications filed till March 2014



4

First five unilateral APAs signed till March 2014



5

Much awaited TP amendments in first budget of Arun Jaitley



TP Week ranked India #1 on Top 10 toughest tax authorities for TP

India Regulations: Recent Amendments



Roll back mechanism introduced in APA, can also be applied for previous four years

APA team to be strengthened to expedite disposals

Range concept alongside arithmetic mean and use of multiple year data

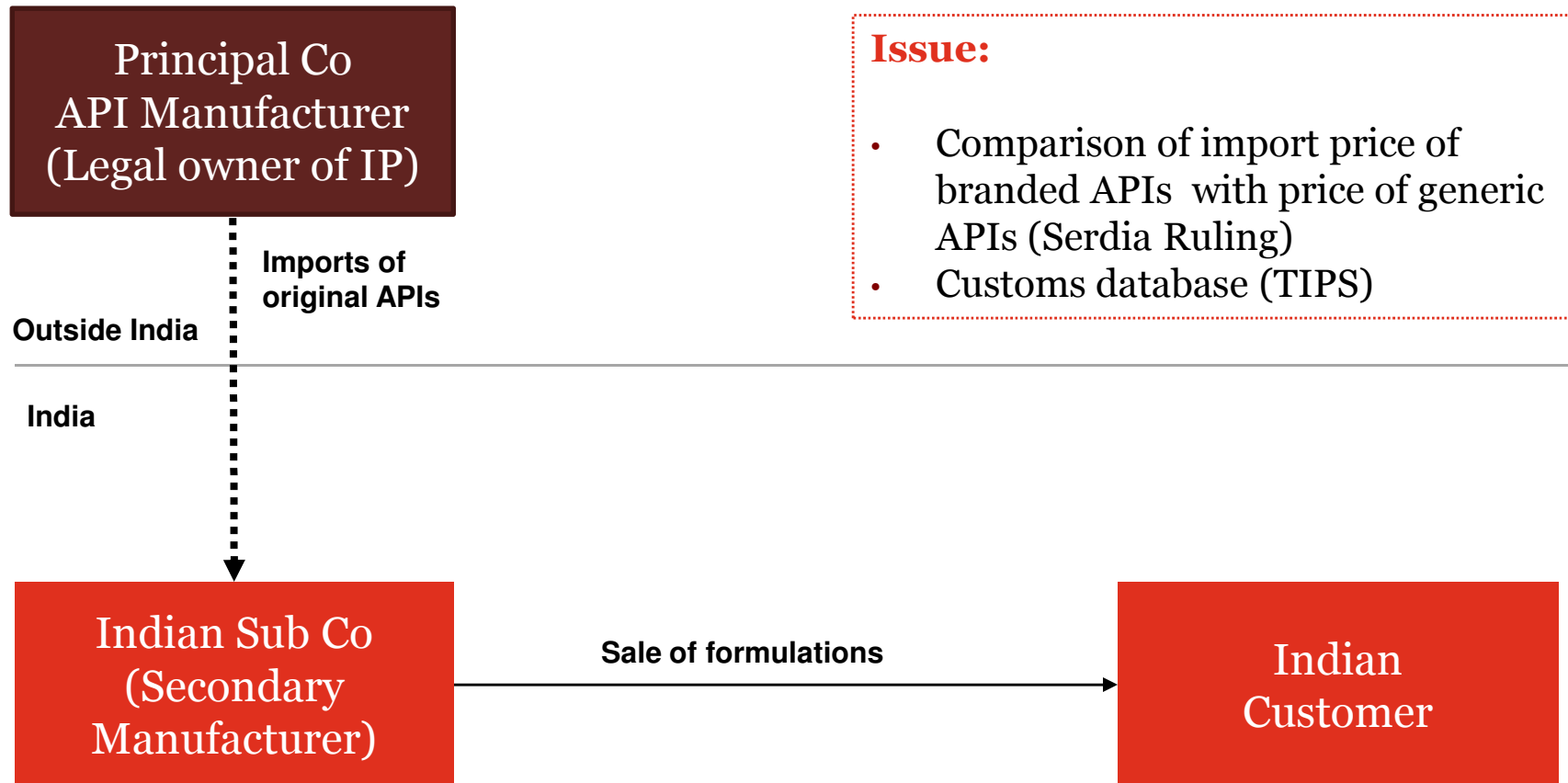
Transactions with a domestic unrelated party to be covered under the TP Rules under specified conditions

TPO's given power to initiate penalty if documents/ information is not provided

Key TP Issues

2

Import of API



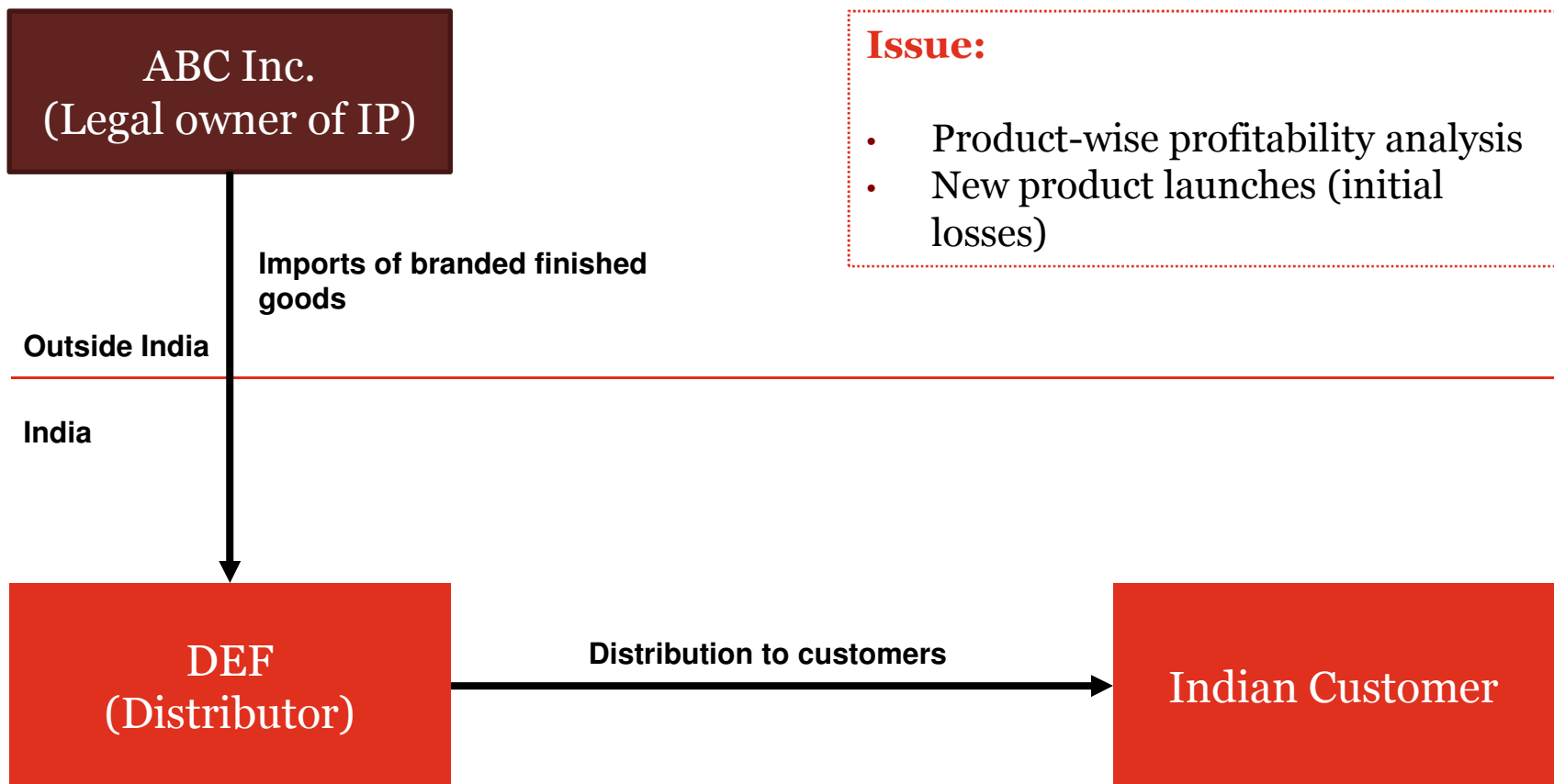
Import of API - Key points

- Adjustments in view of quality, purity etc. and their quantification
- Relevance of SVB Order

Serdia	Fulford
CUP most appropriate method for import of API transaction	Before applying CUP it is important to understand characterization of the entity importing API
Comparison of import price of off-patented API with generic API	Comparison with generic API not sustained, product accompanied with IP rights will fetch premium price

*Is CUP the right method
after ruling in case of
Fulford India Limited*

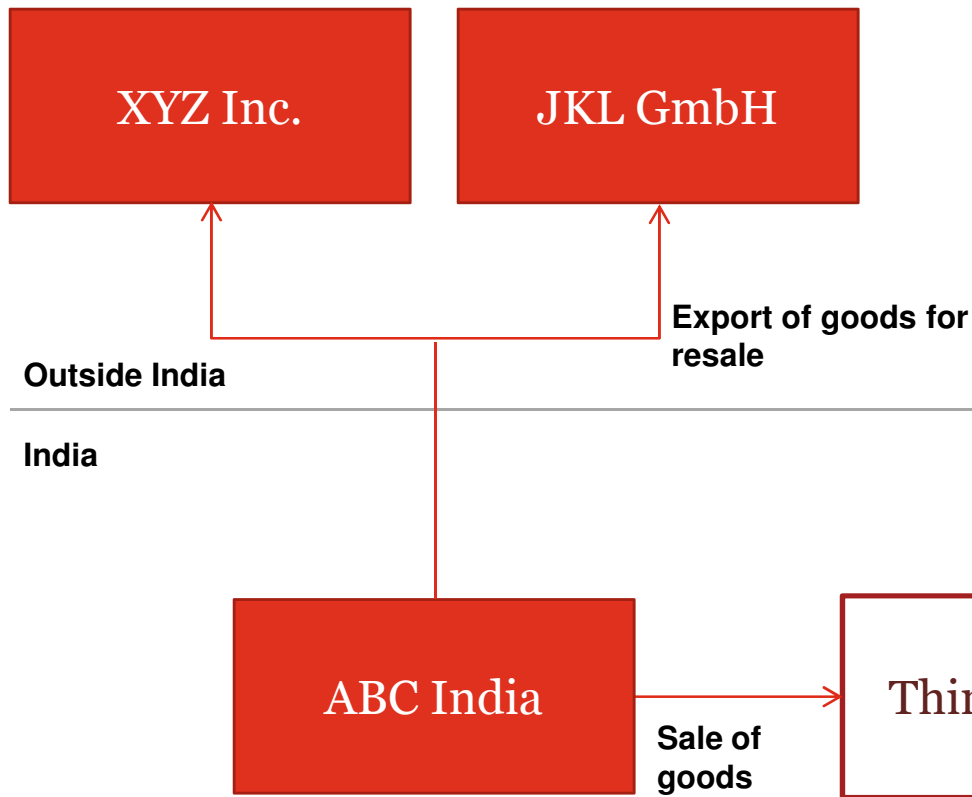
Import of Finished Goods



Import of Finished Goods – Key points

- Routine v/s marketer distributor
- Low operating margins – product launch/ start-up issue
- Harmonization with Custom positions
- Value addition at India: Reward
- Aggregation
- Basket of products

Exports to AEs



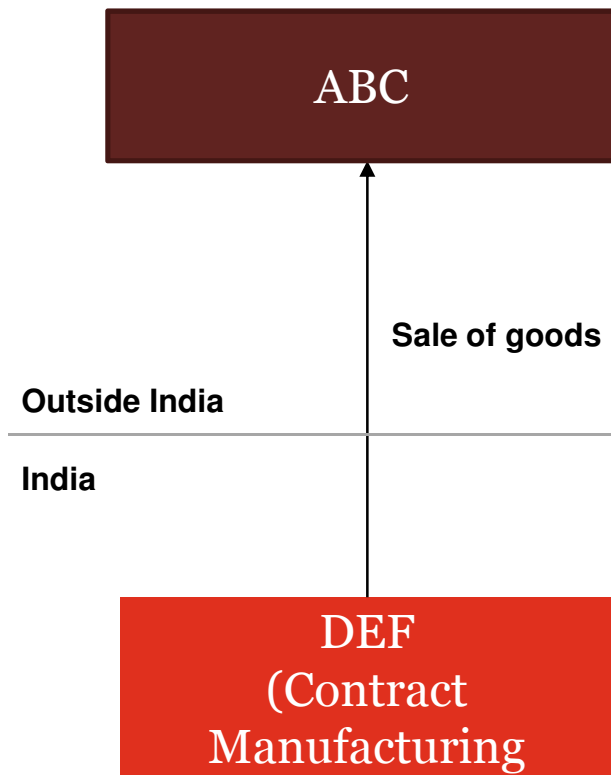
Issue:

- Comparison of sales to AEs with third party (domestic/ export) sales
- Tested Party selection

Exports to AEs – Key Points

- Generally non-comparable transactions – functional, risk and market differences
- Robust FAR analysis and characterizing operations of AEs
- Evaluate whether AEs can be selected as tested party
- Foreign Benchmarks
- Distribution agreements

Contract Manufacturing



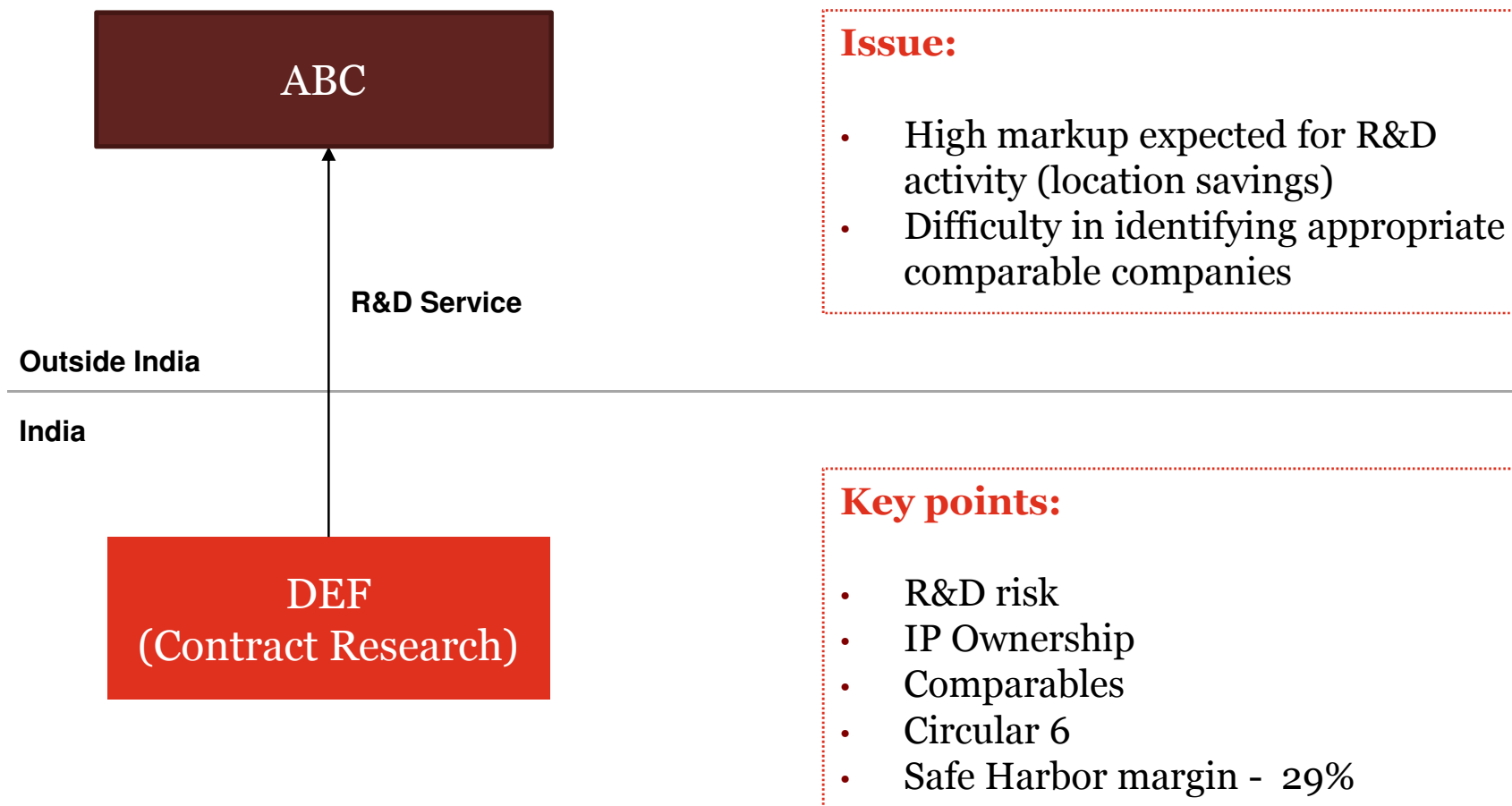
Issue:

- High markup expected for Contract Manufacturing activity (location savings)
- Difficulty in identifying appropriate comparable companies

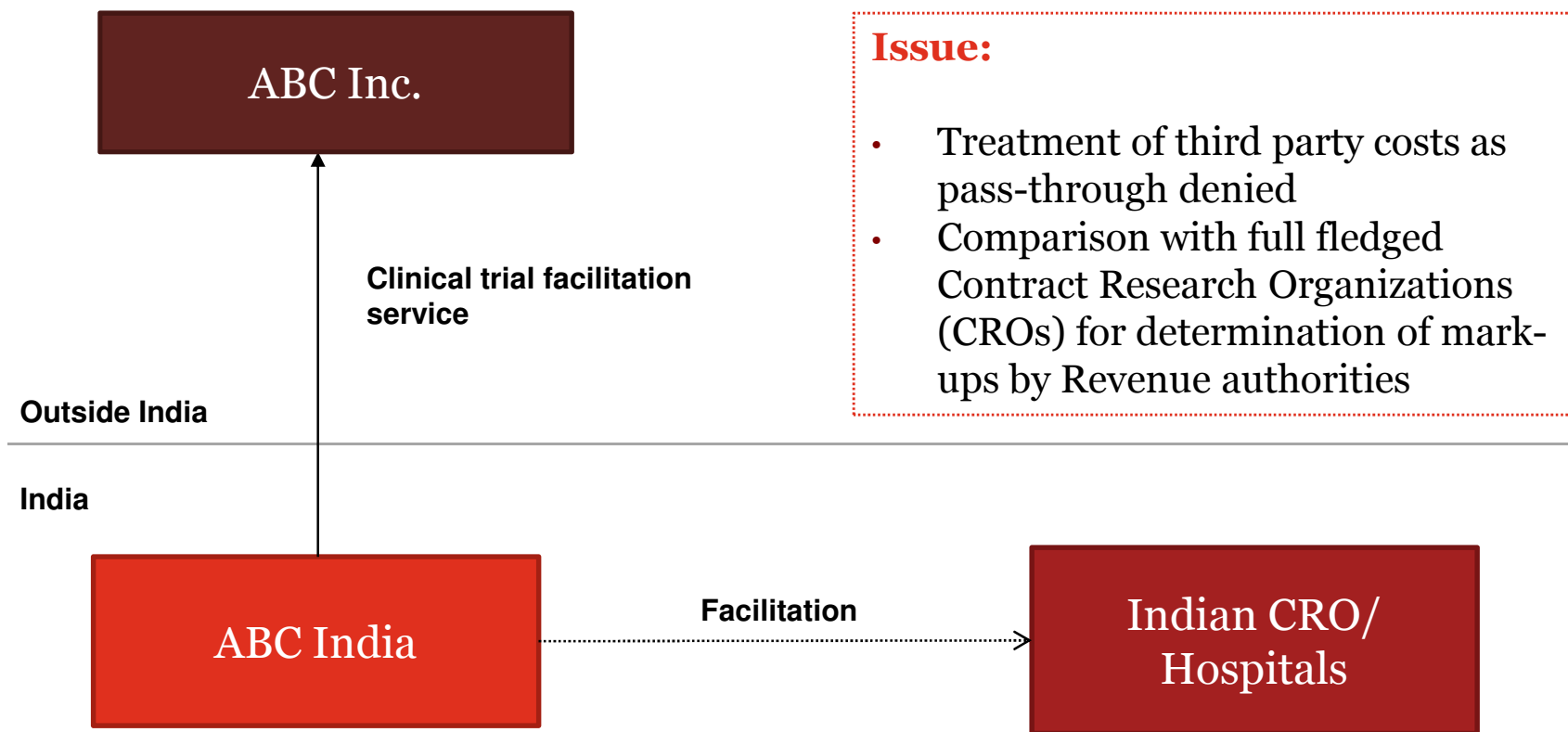
Key points:

- Agreement
- Prior purchase orders / Volume Commitment
- Operating cost definition, ROA
- Capacity Utilisation
- Early termination
- Comparables

Contract Research Services



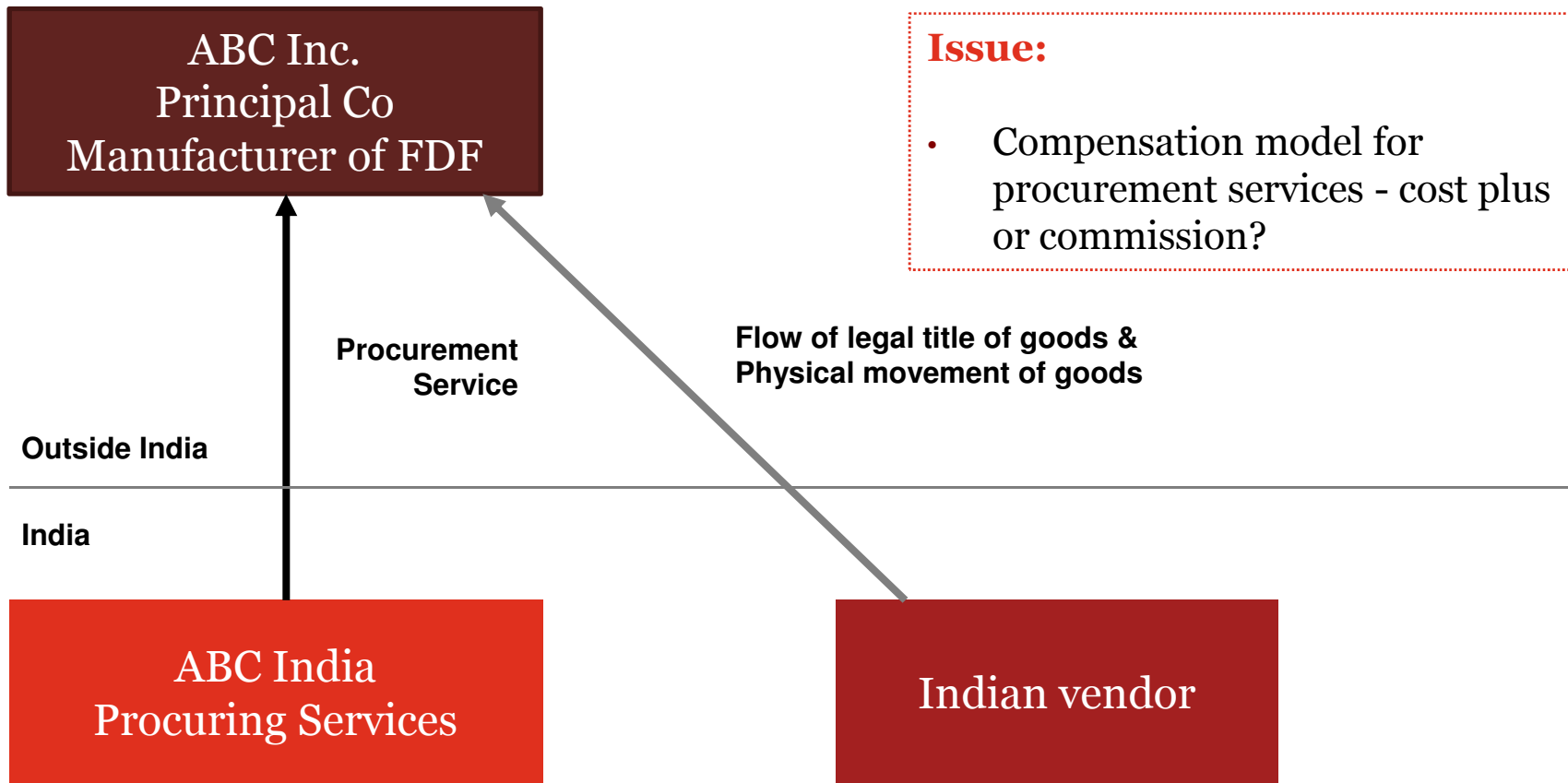
Clinical Trials Facilitation Services



Clinical Trials Facilitation Services – Key points

- Key points:
 - Agreement
 - Comparables
 - Support services v/s clinical trials
 - Robust FAR

Procurement Services



Procurement Services – Key points

- Where services of procurement co are:
 - routine services (liaison, exchange of information, market research etc) – cost plus model is appropriate; or
 - value driving activities for the organization – commission / profit split method may be preferable
- Examples of value driving activities could be:
 - Determining procurement volumes
 - Decision to outsource procurement function to India
 - Negotiation skill
 - Bargaining power of the brand etc

*Agreement, FAR
and Comparables*

Marketing Intangibles

- Advertising and promotional activities - Focus area of TP authorities in India
- Promotional spends considered a service to the parent
- Possible adjustment scenarios:



Marketing Intangibles – Key points

- Key points:
 - Review of economic and legal rights of Indian entity
 - Evaluating whether promotional spend in India actually benefits the parent's brands directly
 - Identifying “routine” and “non-routine” advertising and promotional expenses
 - Careful selection of comparables

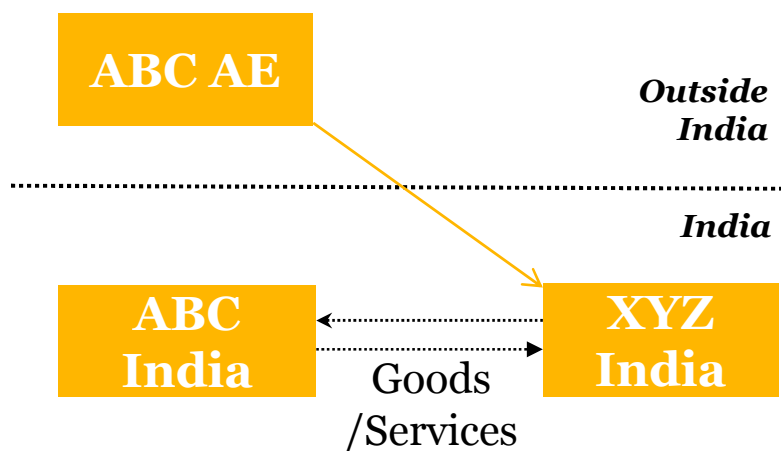
*Non Routine expenses
have potential to
create marketing
intangibles*

Recent Developments

3

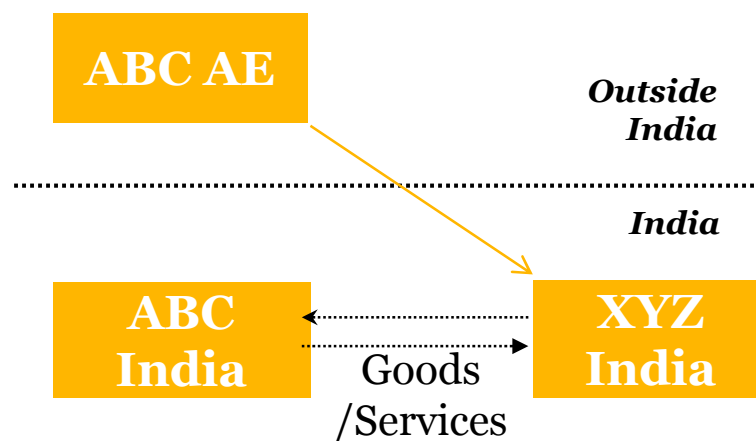
Amendment of Section 92B(2)

Old provision



Not covered under the ambit of TP provisions

Proposed amendment



Will be covered under TP provisions, if ABC AE:
(i) has prior agreement with XYZ India; or
(ii) determines the terms in substance with XYZ India

Scope of Domestic Transactions

Tax holiday undertakings covering:

- inter-unit transfer of goods and services
- transactions with entities having close connection

Expenditure incurred between related parties defined u/s 40A

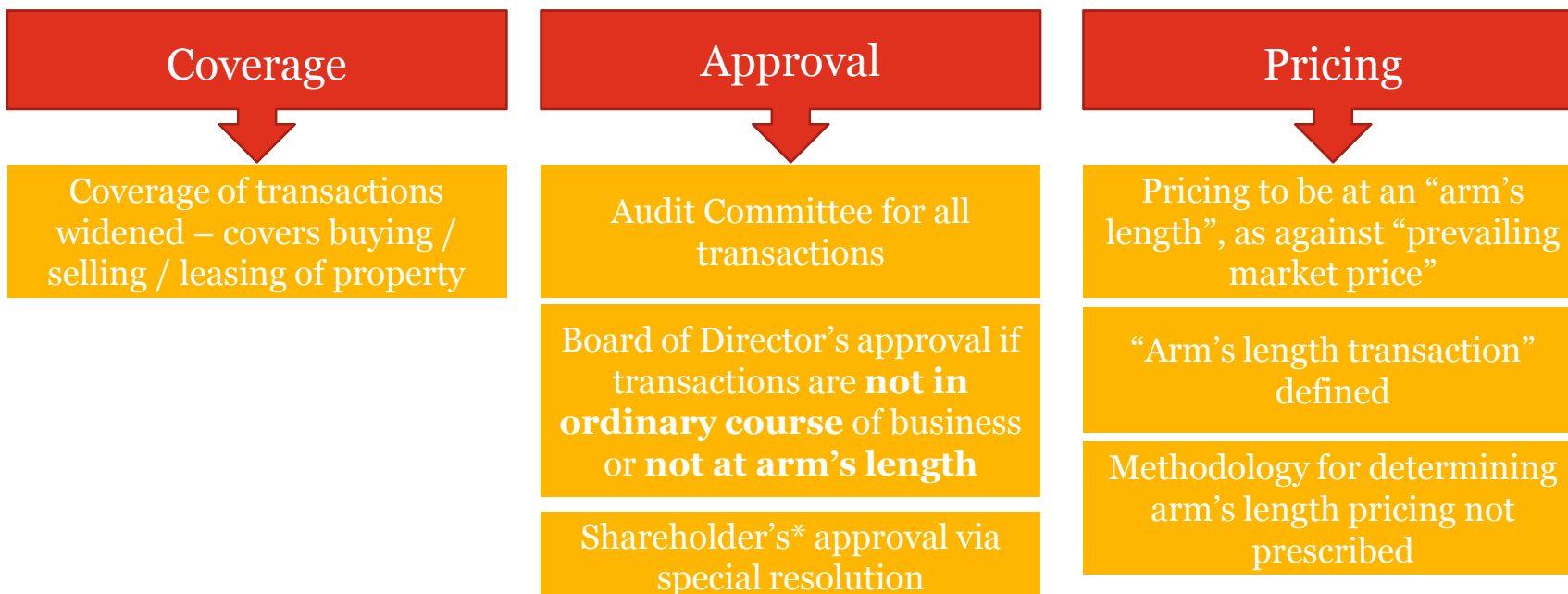
Any other transaction that may be specified

Aggregate transaction value exceeds Rs 50 million in a financial year (Applicable for FY 2012-13)

Important Rulings..

Case	Ruling
GlaxoSmithkline Consumer Healthcare Limited	No adjustment to be made for AMP expense incurred for promotion of domestic brand owned by taxpayer
Indigene Pharmaceuticals	Reimbursement of R&D expenses not sham transaction. TPO cannot question business decision
Zydus Altana Healthcare Pvt. Ltd.	The determination of arm's length price should be based on functional and asset profile of the company. Distinguished between research and Clinical trial
Cadila Healthcare Limited	Deduction under section 80-IB and 80-IC of the Act are available on the profits earned by the eligible unit from the overall activity, the AO cannot segregate manufacturing and sale activity for the purpose of computing deduction

Related Party Transactions under Section 188



**Related parties cannot vote in a general meeting*

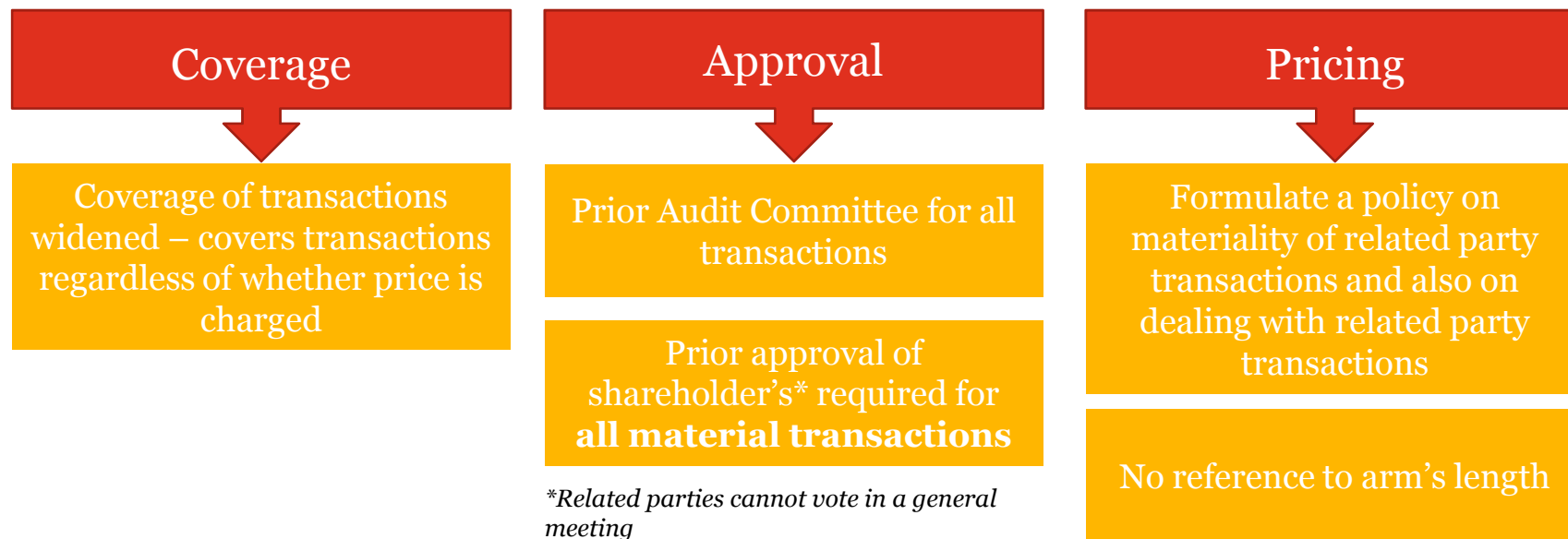
Exemptions from BoD’s and Shareholder’s Approval

- Transactions entered in ordinary course of business; **and**
- Transactions undertaken on arm’s length basis

Disclosure in BoD’s Report with justification and filing with ROC

Need for setting-up internal process for transacting & monitoring RPTs

Related Party Transactions under Clause 49 of Listing Agreement



**Related parties cannot vote in a general meeting*

Policy of dealing with RPT to be disclosed on Website and in Annual Report

Details of all material RPT to be disclosed quarterly along with the compliance report on corporate governance

Need for setting-up internal process for transacting & monitoring RPTs

Best Practices

4

Best Practices

1. Harmonize the working of Tax (TP) team and Business team

2. Follow logical sequence for rational results – first price setting then price testing

3. Document and demonstrate every “journey” of price setting

4. Consider employee compensation structures while setting transfer prices

5. Undertake TP analysis to prevent arbitrary profit attribution to PEs

6. Synchronize with customs and global TP policies as far as possible

7. Obtain auditor certification for TP specific segmentation

8. Do not underestimate the relevance of industry and market data

9. Invest in good quality comparables

10. Align TP documentation with websites/ other public documents

Thank you

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