

Global Transfer Pricing

Introduction

The long awaited judgment in the case presented by Canada Revenue Agency (herein referred to as "CRA") against GlaxoSmithKline Inc. (herein referred to as "GSK") was reached on the 30th of May 2008. The Tax Court of Canada ruled in favor of CRA in the perhaps the most crucial transfer pricing case in Canada. The case has its significance in the regard to the court's interpretation of the applicability of the OECD guidelines. Indian multinational companies may also take a cue from this judgment and brace their transfer pricing policies.

Facts Of The Case

GSK purchased Ranitidine which is an active ingredient in a drug called 'Zantac', manufactured and sold by GSK in Canada from an affiliated non-resident Swiss company 'Adechsa S.A'. Ranitidine was manufactured by another related party in Singapore. The transfer price paid by GSK to Adechsa in the said inter-company transaction was between, \$1,512 - \$1,651 per kilogram. Whereas the generic pharmaceutical companies in Canada purchased Ranitidine from third party manufacturers at \$194-\$304 per kilogram. The CRA contended that the GSK paid higher price to non-arm's length vendor. The proposed income readjustment by the Minister of National Revenue (herein referred to as "MNR") for the years 1990-93 was almost \$51.5 million.

The CRA put forward that the Comparable Uncontrolled Price (herein referred to as "CUP") method applied, and the price paid for Ranitidine by GSK should be comparable to that paid by generic pharmaceutical companies in Canada. GSK argued that the generic drug companies were not an appropriate comparison as, firstly the business circumstances of the transactions between Adechsa and GSK were considerably different, and secondly the Ranitidine purchased by GSK was manufactured under GSK's higher worldwide standards. GSK also proposed that the Resale Price method was better suited analysis for the given situation.

GSK had a separate supply agreement with regard to Zantac with the Swiss entity and an inter-company license for the rights to certain intangibles and services for which it paid 6% royalty to a related party in United Kingdom. The Tax Court of Canada however did not view

the license agreement as 'circumstances' requiring consideration.

Court Ruling

The Tax Court of Canada upheld the CRA's contention regarding the use of CUP to determine the transfer price to be paid by GSK. Siding with the CRA the Tax Court of Canada ruled that the issue in this case was essentially, that if the price paid by GSK was 'reasonable under the circumstance'. The Tax Court of Canada held that CUP was the correct method and Canadian pharmaceutical companies were best comparators as they purchased Ranitidine on wholesale scale and performed similar functions of secondary manufacturing and distribution as GSK. Hence the price paid by GSK for Ranitidine should be the highest price paid by the generic drug companies plus a \$25 mark - up, since the Ranitidine purchased by GSK was granulated.

Warning Bells For India Inc!!!

The verdict reflects the courts endorsement of the hierarchy of methods set out in OECD guideline, where transaction based methods trump profit based analysis. In the context of Indian multinational companies, especially companies which have setup or acquired foreign manufacturing and distribution units, the CRA verdict could raise a number of questions on their transfer pricing policies. Most Indian multinational companies treat their foreign subsidiaries as "full scope manufacturer/distributors" and generally apply the Resale Price method or the Transactional Net Margin Method (a profit based method). Indian Tax authorities on their part are pushing Indian companies to retain higher profits in the Indian parent company, leading to low or even no net margins being left for the foreign subsidiaries. The use of the CUP method may well leave unacceptable levels of profits for the Indian parent company. Such conflicts between the revenue authorities of parent and subsidiary countries are the genesis of transfer pricing litigations.

Source: KNAV Desk

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