

CONTRIBUTION RECEIVED FROM FEDERATION OF SWISS INDUSTRIAL HOLDING COMPANIES

Issue: COMP 1 – Requirement to perform an analysis of transactions vs. an analysis of third party information gathered at company level

RESPONSE: For our business, the pharmaceutical industry, there is practically no third party information at transactional level available. Therefore it is extremely important that we can bundle transactions into function related baskets. As baskets we have successfully used (1) all products supplied in finished form for which only marketing and distribution are performed locally, (2) all products which are locally packed and (3) all products for which local secondary manufacturing is done. Basket pricing should be permitted if an analysis proves that no comparable data is available on a narrower segment than the one(s) selected.

Furthermore our pharmaceutical business actually conducted consists of a bundled package of deliveries, contribution to current R&D, support services, continuity of supplies etc. A gross or net margin analysis on single products is contrary to the nature of such business. Therefore, a basket analysis of gross or net margins should be carried out.

We would welcome every effort to improve paragraph 1.42 of the 1995 TP Guidelines along the lines stated above.

Issue: COMP 2 – Need to rely on transactions that took place between independent enterprises

RESPONSE: A systematic rejection of comparable information of third party enterprises that are part of another MNE is not practical, if only such information exists. For instance our company experienced this in a European country and applied an inter-quartile arm's length range of returns on sales as published by 20 comparable affiliated companies. The approach was accepted during an audit by the tax administration.

In another circumstance where – due to the absence of relevant comparable data in the published accounts – only rough adjustments can be made to arm's length comparable information, a gross or net margin analysis using the published accounts of local affiliated companies which show a better functional comparability would not be without warrant.

We would welcome a respective improvement of paragraph 1.70 of the 1995 TP Guidelines.

Issue: COMP 3 – Need to obtain third party information relevant to the review of the five comparability factors

RESPONSE: Although the other TP methods require a lower degree of product comparability than CUP, it is impossible to find comparable gross or net margins for a specific pharmaceutical product. Therefore, for transfer price negotiations for individual products we successfully use the following indirect indicators to arrive at an appropriate product margin:

- weight of the individual product in the basket of products
- type of competitive market each product is in
- innovation of the product (i.e. different degree of R&D contribution)
- manufacturing intensity or difficulty
- relevance in the volume of all inter-company purchases
- age of the product (date of introduction to the market)
- selling price erosion since the introduction to the market
- exposure to future discounts
- marketing intensity over time

Issue: COMP 4 – Need to ensure objectivity of the list of external comparables

RESPONSE: In our view this is desirable and possible with the application of the inter-quartile range as a standard approach in the revised TP Guidelines.

Issue: COMP 5 – Determination of the years to be covered and use of multiple year data

RESPONSE: This is a real practical issue. Indeed, third party information available at the time of negotiating transfer prices is used by our company and no retroactive adjustments to these prices can be done, as the statutory accounts of our affiliates have also to be finalized in time. Since our TP documentation uses the basket analysis and shows whether our affiliate falls within an inter-quartile range of comparables, we follow the credo of the 1995 TP Guidelines that transfer pricing is not an exact science.

In cases where business or company specific market factors influence the yearly level of the gross or net margins of comparable companies, such fluctuations should be evened by using multiple year data on a rolling forward basis, if required.

Issue: COMP 6 – Choice of relevant sources of information, including but not limited to commercial database

RESPONSE: For our business, the pharmaceutical industry, we use those commercial databases which give the most reliable information and data on functional comparability. In many countries we use more than one database to increase the number of comparable companies.

Alternative sources of information are published accounts of individual companies which are selected manually.

In countries where there is limited or no public information available, we try to perform an analysis of comparable companies in other countries which are commercially and from a public health standpoint as close as possible to the country concerned.

Issue: COMP 7 – Definition of comparability adjustments where they are appropriate

RESPONSE: In our company, we tried to perform sophisticated adjustments to information on uncontrolled transactions by using a regression analysis. Although the methodology was welcomed by one tax authority, the other tax authority rejected such methodology also in competent authority proceedings. As a result we had to accept a much lower degree of comparability with the use of rather simple adjustments, an outcome which is not satisfactory in such a case.

We would welcome that the revised TP Guidelines would explicitly endorse the use of a regression analysis in certain difficult cases.

Issue: COMP 8 – Interpretation and use of data collected

RESPONSE: We would favour the application of the inter-quartile range as the comparability standard in the revised TP Guidelines. It not only eliminates the extreme gross or net margins, but also allows the statement that the result of the tested party must fall within such inter-quartile range and therefore, should be accepted as an arm's length result by a tax authority. If the result of the tested party is outside the inter-quartile range, a tax authority should be allowed to make a re-assessment to the median. The use of the inter-quartile range should not differ depending on the quality of the comparables, because transfer pricing is not exact science.

Issue: COMP 9 – Specific comparability issues when applying transactional profit methods

RESPONSE: In our company we ordinarily use the resale basket pricing method and apply the TNMM as a sanity check method. However, in certain countries where no data on comparable gross margins is publicly available, TNMM is used as standard method. We have not encountered any difficulties that would require further guidance.

We are very reluctant to use the profit split method, because it is indeed particularly difficult to obtain external market data on profit splits achieved by independent parties. On the other hand we experienced insurmountable difficulties with tax authorities in applying profit split by just using internal company data due to the need to use IAS accounting at headquarters and due to the struggle on certain allocation keys for functional expenses of the headquarters related to the business with a specific affiliated company.