

# TRANSFER PRICING IN ARGENTINA



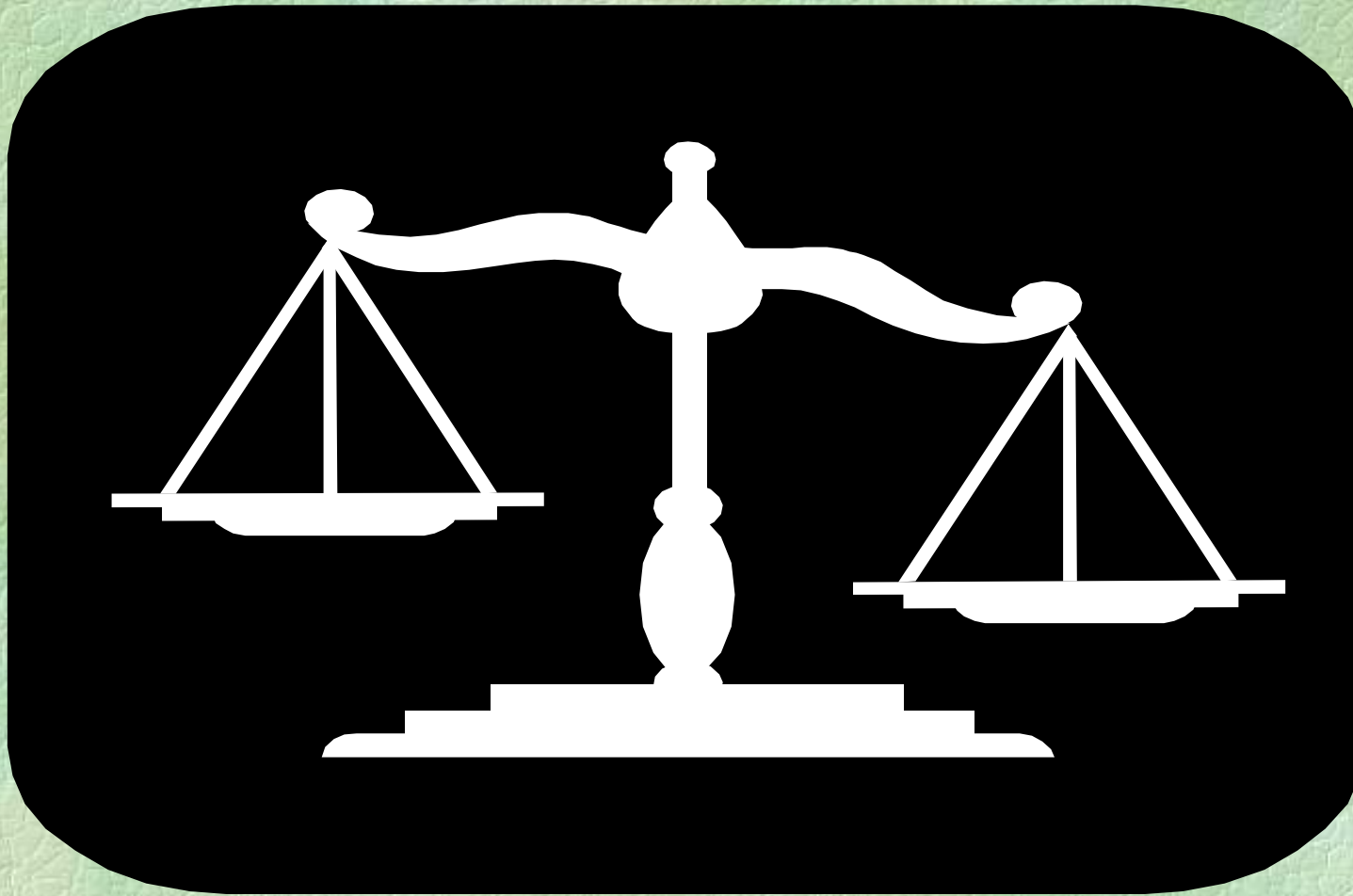
MIAMI, June 10, 2000

# CURRENT SITUATION IN ARGENTINA

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- √ *Legislation in force*
- √ *Proceedings carried out before the Argentine Chamber of Medicines*
- √ *New strategy to defend pricing policies - Functional analysis preparation*
- √ *Business relationships to be taken into consideration*
- √ *Pricing Study*
- √ *Business Transactions carried out during 1999*

# LEGISLATION IN FORCE



June 10, 2000

# CURRENT SITUATION IN ARGENTINA

## Legislation in Force:

- √ **Law 25.063 (in force since 31.12.98)**
- √ **Decree 485/99 (published on 12.05.99)**
- √ **General Resolution 702/99 (published on 15.10.99)**
- √ **Law 25.239 (in force since 1/1/2000)**
  
- √ **RATIFICATION OF THE ARM'S LENGTH PRINCIPLE**
  
- √ **ENFORCEMENT OF THE METHODS SUGGESTED BY THE OECD.**

# LEGISLATION IN FORCE- LAW 25.063

## Section 8°:

Modified by Law 25.239 (currently applicable since 1/1/2000 for unrelated companies)

### √ EXPORTS:

Should prices not be fixed or should those agreed upon be lower than the wholesale price in effect at the place of destination, the later shall be taken into consideration in order to determine the value of exported goods. Tax Authorities are empowered to determine export values.

### √ IMPORTS:

If sale prices in the country are higher than those existing at the place of origin, the difference shall be deemed to be an Argentine source net profit for the foreign exporter. Tax Authorities are empowered to determine import values.

# LEGISLATION IN FORCE- LAW 25.063

## SECTION 15°

### TRANSFER PRICES:

- √ Related companies shall determine their profits and expenses, to be assessed according to values deriving from business relationships considered as among unrelated parties in comparable transactions.
  
- √ To determine whether transfer prices are consistent with customary market practices among unrelated parties, the **MOST APPROPRIATE** method of those hereinafter mentioned, shall be applied.

# LEGISLATION IN FORCE- LAW 25.063

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## Methods based on comparable transactions :

- √ Comparable Uncontrolled Price Method
- √ Resale Price Method
- √ Cost Plus Method

## Methods based on Comparable Company Profits:

- √ Profit Split Method
- √ Residual Profit Split Method
- √ Transactional Net Margin Method

**PROCEEDINGS BEFORE THE**  
**ARGENTINE CHAMBER OF**  
**MEDICINES**



June 10, 2000



## PROCEEDINGS BEFORE THE ARGENTINE CHAMBER OF MEDICINES

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The different Aspects having incidence on the Pharmaceutical Industry were Analysed in Depth in order to achieve Consensus and to create an Awareness of this new “Transfer Pricing” issue.

## **PROCEEDINGS BEFORE THE ARGENTINE CHAMBER OF MEDICINES**

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We have emphasized the special characteristics of the basic Research and Development functions in our industry, mentioning among others, the following notions:

- √ synthesis of substances and their supervision
- √ pre-clinical developments
- √ biological and toxicological essays
- √ efficacy and tolerance tests in humans

## PROCEEDINGS BEFORE THE ARGENTINE CHAMBER OF MEDICINES

- √ Nature of manufacturing process (the active ingredient discovered by Parent Company is not modified).
- √ Local company purchases the majority of active ingredients and products from its Parent Company.
- √ Parent Companies release their related companies from most risks.

## **PROCEEDINGS BEFORE THE ARGENTINE CHAMBER OF MEDICINES**

**Within the problems facing the foreign capital pharmaceutical industry, the following ones were pointed out:**

**the meaning of Research and Development expenses incurred by Parent Company**

- √ **impossibility of transferring Research And Development expenses to finished products**
- √ **existence of few successful but very well known products**
- √ **profits must cover the costs of failures**
- √ **profits are related to the extent of the risks assumed**
- √ **years taken for the Research and Development of an effective molecule (10 to 15 years)**

## **PROCEEDINGS BEFORE THE ARGENTINE CHAMBER OF MEDICINES**

**We want to point out that in the Argentine  
Pharmaceutical Industry there are labs which:**

- √ Invest in research and development at a worldwide level
- √ do not invest in research

## **PROCEEDINGS BEFORE THE ARGENTINE CHAMBER OF MEDICINES**

- √ **“Transfer Pricing” was submitted to the Executive Committee of the Argentine Chamber of Medicines (CAEME) in order to make such authorities become involved in such issue, so that they notify the relevant executives at the labs that are members of the Chamber.**
- √ **This issue (which may be considered technical in the first place) should be raised at the highest executive level within the organizations, as it could have an effect on policies to be followed.**

## **PROCEEDINGS BEFORE THE ARGENTINE CHAMBER OF MEDICINES**

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- √ **A meeting was held at the Argentine Chamber of Medicines, being Dr. Rodriguez Usé, UnderSecretary of Public Revenues of the Ministry of Economy, officials from the Administración Federal de Ingresos Públicos and members of the Tax Committee present. The purpose of such meeting was to create an awareness of the special characteristics of the Pharmaceutical Industry and to express our view as regards the Transfer Pricing issue for this Industry.**

## **PROCEEDINGS BEFORE THE ARGENTINE CHAMBER OF MEDICINES**

- √ **We have submitted data to the tax advisor at the Chamber in order to establish the link between the pharmaceutical industry problems and the tax technical aspect, to inform Tax Authorities that products imported by national laboratories are not comparable with products imported by multinational labs.**



# PRICING POLICY STRATEGIES

- FUNCTIONAL ANALYSIS PREPARATION -



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## **PRICING POLICY STRATEGY - FUNCTIONAL ANALYSIS PREPARATION -**

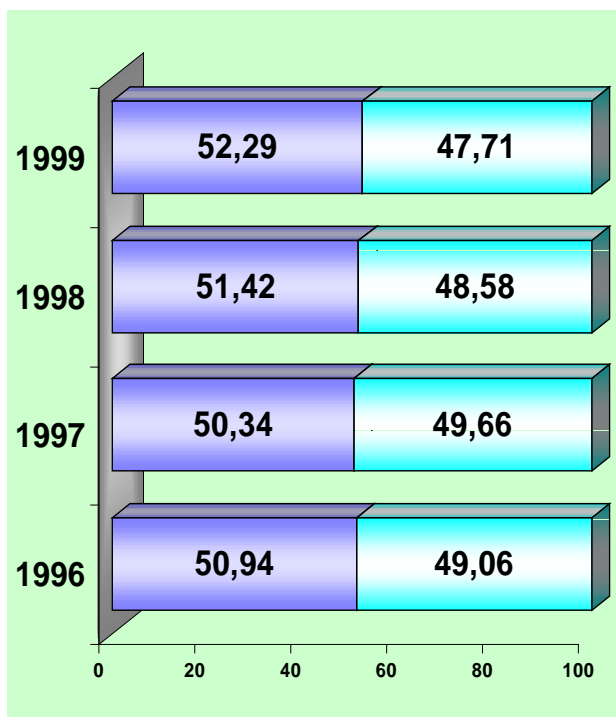
- √ **We have decided that it is convenient to include in the functional analysis a summary of the situation of this industry in our country. It is obvious that characteristics inherent to the local industry may or may not help to defend our pricing policy. We believe that given the characteristics of the Argentine industry it is advisable to include such information in our analysis.**

# ARGENTINE PHARMACEUTICAL MARKET

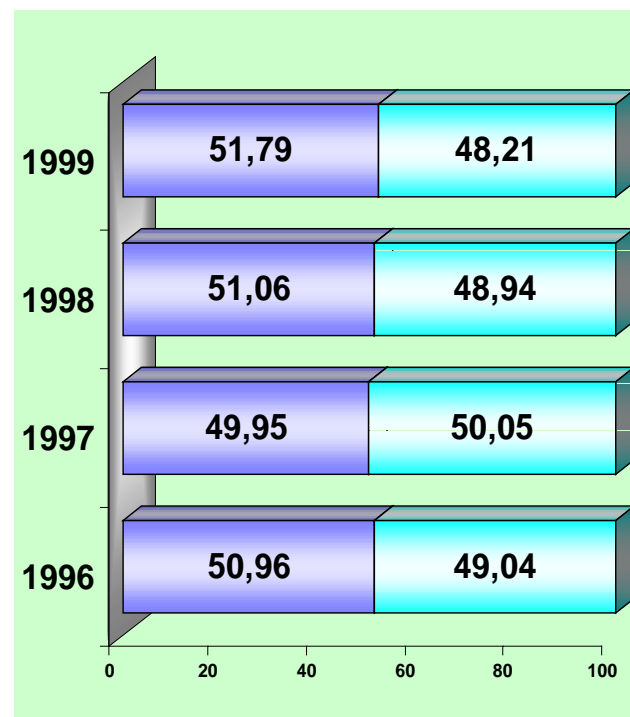
## MARKET SHARE ACCORDING TO LAB ORIGIN

SOURCE: IMS, 9/98 to 9/99

UNITS (%)



VALUES (%)

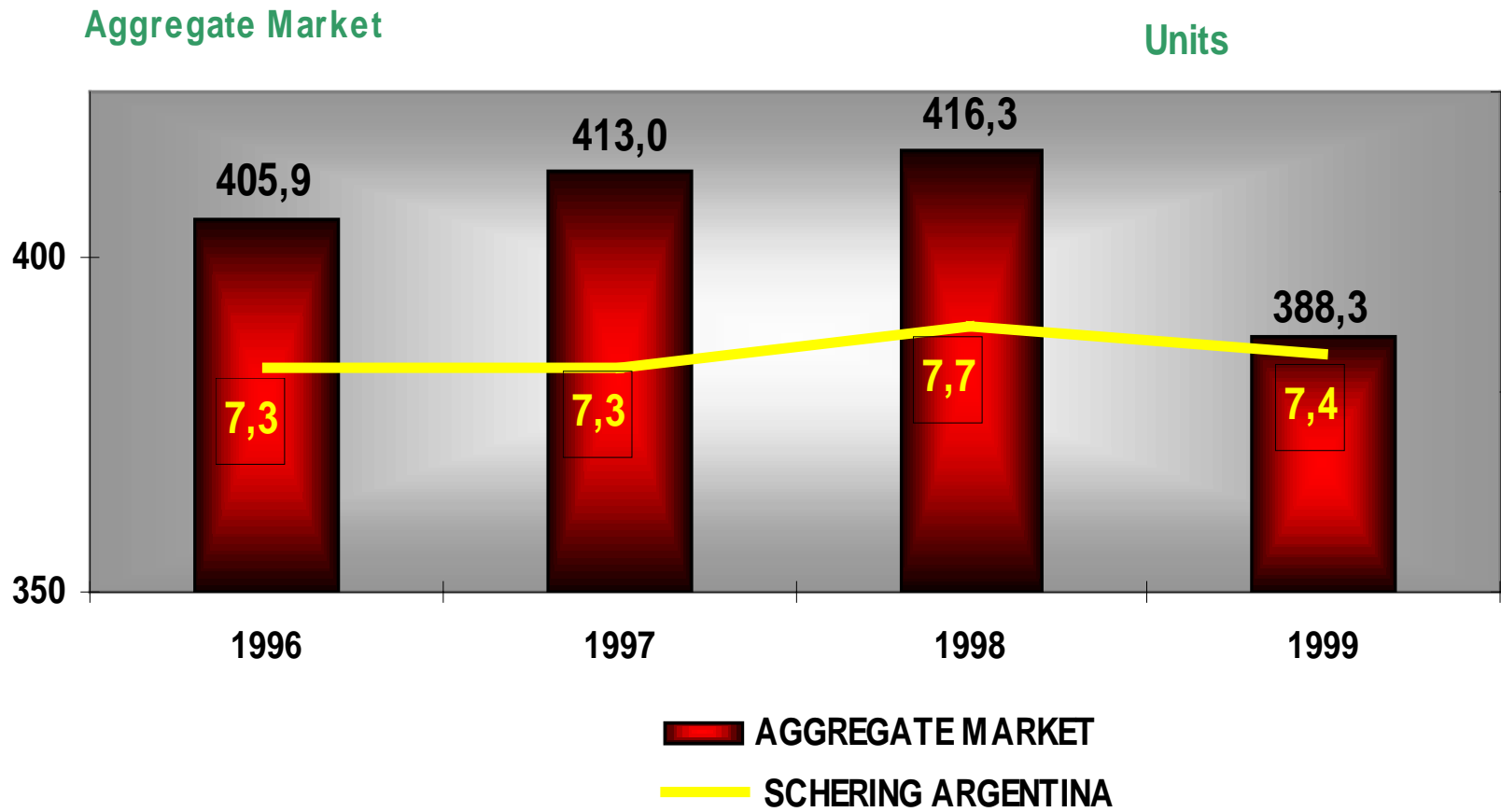


 NATIONAL

 MULTINATIONAL

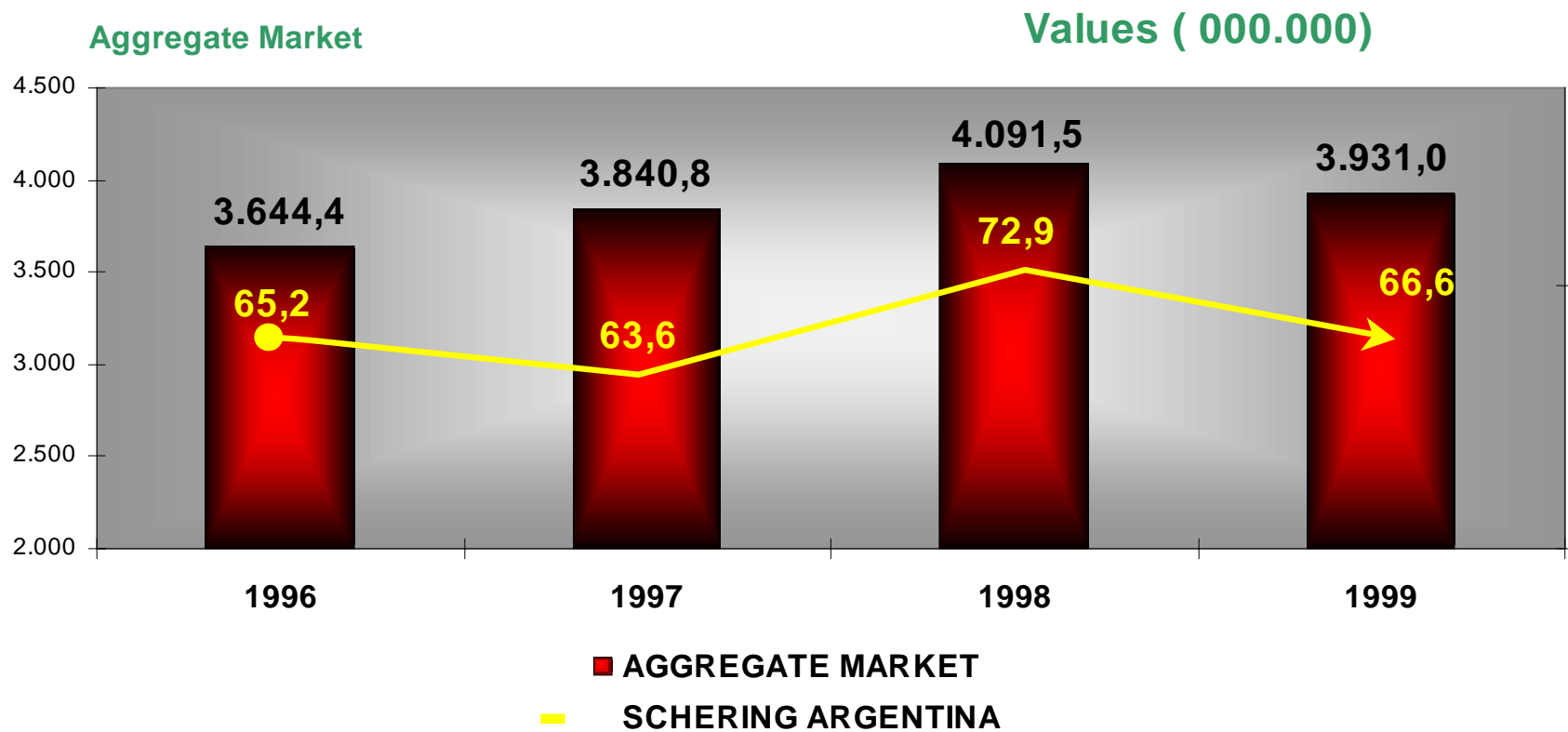
# ARGENTINE PHARMACEUTICAL MARKET

## SCHERING VS. AGGREGATE MARKET



# ARGENTINE PHARMACEUTICAL MARKET

## SCHERING VS. AGGREGATE MARKET



# AVERAGE WEIGHTED PRICE

Medicine Wholesaler level —→ Pharmacy without VAT

	1/1999 to 12 / 1999 <b>Year 1999</b>	3/1999 to 3/2000 <b>Year 2000</b>
PHARMACEUTICAL INDUSTRY	10.13	10.15
<b>SCHERING</b>	8.61	8.68
NATIONAL LABS	9.74	9.76
MULTINATIONAL LABS	10.58	10.67

*Source: IMS December '99 and March '00*

**June 10, 2000**

# WEIGHTED AVERAGE PRICE HORMONAL CONTRACEPTIVES

Medicine Wholesaler Level —————> Pharmacy without VAT

• Hormonal Contraceptives (average market price)	7.94	\$ /unit
• <b>SCHERING</b> (Multinational)	<b>7.64</b>	\$ / unit
• WYETH (Multinational)	8.72	\$ / unit
• ORGANON (Multinational)	8.95	\$ / unit
• GADOR (National)	7.58	\$ / unit
• ELEA (National)	9.18	\$ / unit

## **PRICING POLICY STRATEGY - FUNCTIONAL ANALYSIS PREPARATION -**

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- √ **The purpose of a Transfer Pricing study is to evaluate whether intercompany transactions have been carried out observing the arm's length principle.**
- √ **One of the objectives of the Transfer Pricing study is to reduce the chances of possible adjustments, if any. In Argentina, attention must be paid to the Income Tax Law (with modifications introduced by means of Law 25.064 and 25.239) and by General Resolution N°702 (G.R. 702/99).**



## **PRICING POLICY STRATEGY - FUNCTIONAL ANALYSIS PREPARATION - -**

- √ **As regards the procedure used to evaluate the market value of intercompany transactions under study, methods used shall have to be consistent with the Pricing Policy of Schering Group at a worldwide level and with that suggested by external consultants, in order to minimize contingencies.**
- √ **Generated documentation may be used in the case of a Transfer Pricing inspection, a controversy before argentine courts, a procedure undertaken by the relevant authorities or a foreign arbitration procedure .**

## **PRICING POLICY STRATEGY - FUNCTIONAL ANALYSIS PREPARATION -**

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- √ **If it is necessary to resort to the profit - based methods, arm's length companies shall be sought through international databases providing the information necessary for preparing the analysis.**
- √ **In this sense, we have arrived at the conclusion that additional methods may be employed, to be used as back-up to those adopted by the group.**

# **BUSINESS RELATIONSHIPS TO BEAR IN MIND**



**June 10, 2000**

# BUSINESS RELATIONSHIPS TO BEAR IN MIND

## Business relationships with Schering Aktiengesellschaft:

- √ Imports of raw materials
- √ Bulk imports
- √ Imports of finished products
- √ Bulk exports
- √ Exports of finished products
- √ Royalty payments
- √ Credits for expense reimbursements
- √ Debits for expense reimbursements

# BUSINESS RELATIONSHIPS TO BEAR IN MIND

## Business relationships with Schering do Brasil, Química e Farmacéutica Ltda.:

- √ Bulk imports
- √ Imports of finished products
- √ Manufacturing and packaging process
- √ Exports of finished products
- √ Credits for expense reimbursements
- √ Debits for expense reimbursements

# BUSINESS RELATIONSHIPS TO BEAR IN MIND

## Business relationships with Schering Mexicana S.A. de C.V.:

- √ Manufacturing of products to be exported
- √ Packaging process
- √ Exports of finished products
- √ Use of SAP server
- √ Credits for expense reimbursements
- √ Debits for expense reimbursements

## Business relationships with Schering las Américas S.A.:

- √ Manufacturing of products to be exported
- √ Bulk imports
- √ Packaging of finished products
- √ Packaging of imported bulk
- √ Exports of finished products

# BUSINESS RELATIONSHIPS TO BEAR IN MIND

## Business relationships with Schering Colombiana:

- √ Bulk manufacturing
- √ Manufacturing of finished products
- √ Packaging of imported bulk
- √ Packaging of manufactured products
- √ Bulk exports
- √ Exports of finished products
- √ Credits for expense reimbursements
- √ Debits for expense reimbursements

# BUSINESS RELATIONSHIPS TO BEAR IN MIND

## Business relationships with Schering Uruguay S.A.:

- √ Manufacturing of finished products
- √ Bulk manufacturing
- √ Product packaging
- √ Exports of imported bulk
- √ Exports of finished products
- √ Credits for expense reimbursements
- √ Debits for expense reimbursements

## Business relationships with Schering Peruana S.A.:

- √ Manufacturing of finished products
- √ Bulk manufacturing
- √ Product packaging
- √ Packaging of imported bulk
- √ Exports of finished products
- √ Debits for expense reimbursements

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# BUSINESS RELATIONSHIPS TO BEAR IN MIND

## Business relationships with Schering de Venezuela S.A.:

- √ Manufacturing of finished products
- √ Manufacturing and packaging process
- √ Packaging of finished products
- √ Packaging of imported bulk
- √ Exports of finished products
- √ Credits for expense reimbursements
- √ Debits for expense reimbursements

## Business relationships with Schering de Chile S.A.:

- √ Manufacturing of finished products
- √ Bulk manufacturing
- √ Product packaging
- √ Packaging of imported bulk
- √ Exports of finished products
- √ Debits for expense reimbursements

# BUSINESS RELATIONSHIPS TO BEAR IN MIND

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## Business relationships with Proquina S.A. de C.V.:

- √ Imports of raw materials
- √ Debits for expense reimbursements

## Business relationships with Schering Wien G.m.b.H.:

- √ Loan interest payments
- √ Purchase of machinery

## Business relationships with Germapharm G.m.b.H.:

- √ Imports of raw materials

# **BUSINESS RELATIONSHIPS TO BEAR IN MIND**

## **Business relationships with Leiras Oy:**

- √ Bulk imports

## **Business relationships with Farmades SpA.:**

- √ Imports of machinery

## **Business relationships with Schering**

## **Ecuatoriana C.A. Industrial y Comercial:**

- √ Debits for expense reimbursements

# BUSINESS RELATIONSHIPS TO BEAR IN MIND

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## Business relationships with Schering Boliviana Ltda.:

- √ Debits for expense reimbursements

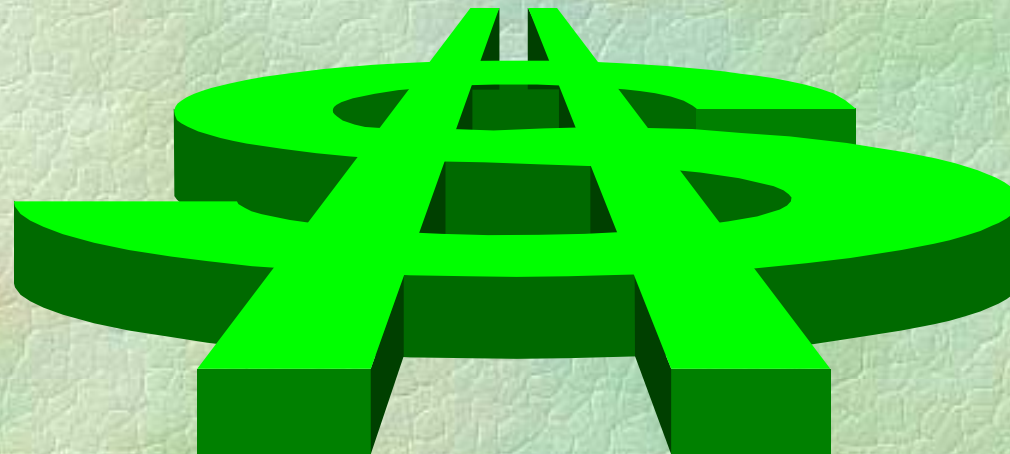
## Business relationships with Schering Guatemala S.A.:

- √ Debits for expense reimbursements

## Business relationships with Schering Dominicana S.A.:

- √ Debits for expense reimbursements

# PRICING STUDY



Schering Argentina S.A.I.C.

June 10, 2000

# PRICING STUDY

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- √ We have defined the convenience of incorporating in our functional analysis, a chapter on Schering AG's transfer pricing policy in order to strengthen the situation of the argentine subsidiary in the country.
- √ We evaluate the need to know whether Schering AG supplies the same active ingredients to other domestic labs, as in the case of John Wyeth which purchases Gestoden. If this happens, we should be informed as this would be the case of comparable companies in the country.

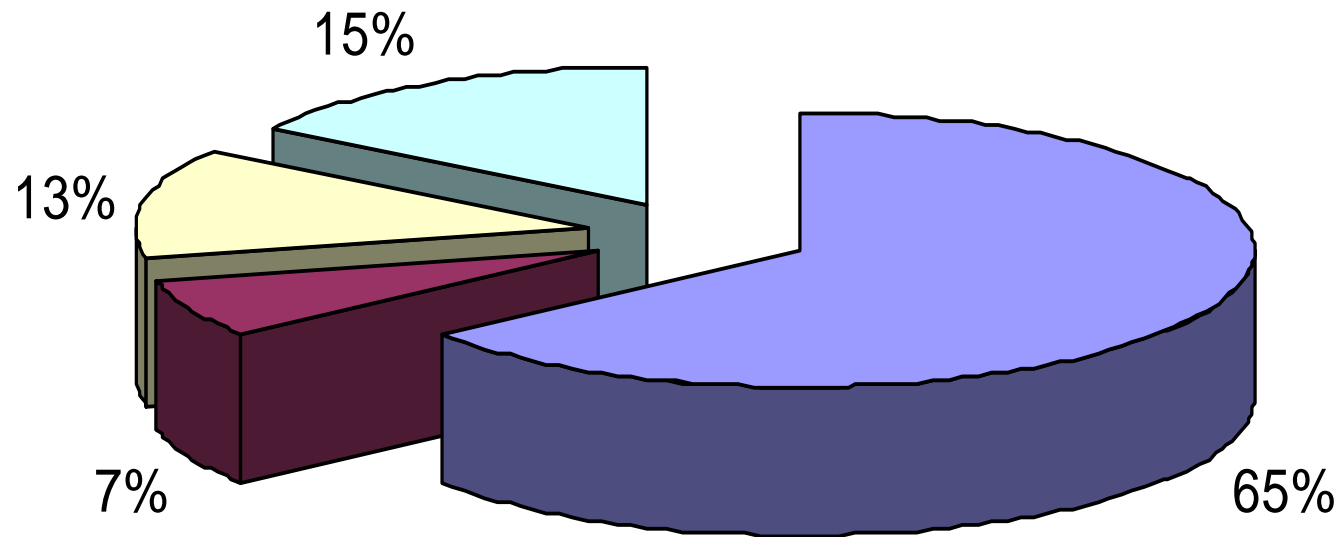
# PRICING STUDY

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√ We have approached the Pricing Study from different points of view in order to analyze its compatibility with imports and exports prices, terms of payment, royalties, loans, financing (capitalization), that is to say:

- Gross profit analysis, per product and per segment
- Import price analysis as regards other labs
- Analysis of raw materials per country of origin and per product
- Analysis from a global point of view related to prices/ terms/ royalties

# EFFECTIVE SALES 1999



■ Fertility Control ■ Menopause ■ Endocrinological products / other ■ Prostate Therapy



# EFFECTIVE SALES 1999

## PER SEGMENTS

<b>SEGMENT</b>	<b>Invoiced amount</b>	<b>COST</b>			<b>GROSS PROFIT</b>	
		<b>Variable Cost</b>	<b>Fixed Cost</b>	<b>Total Cost</b>	<b>Value</b>	<b>Percentage</b>
Fertility Control	32.370.732	6.021.069	543.969	6.565.038	25.805.694	79,72%
Menopause	3.449.410	1.135.678	62.802	1.198.480	2.250.930	65,26%
Endocrinological products/ other	6.568.680	1.291.722	262.347	1.554.069	5.014.611	76,34%
Dermatology	5.272.824	1.934.259	255.250	2.189.509	3.083.315	58,48%
Prostate Therapy	7.766.468	8.297.179	180.389	8.477.568	-711.100	-9,16%
Diagnoses	4.503.865	3.458.096	134.422	3.592.518	911.347	20,23%
Remaining Therapeutic	3.125.790	2.410.177	3.231	2.413.408	712.382	22,79%
Not in product line	-34.973			0	-34.973	100,00%
<b>TOTAL PHARMA</b>	<b>63.022.796</b>	<b>24.548.180</b>	<b>1.442.410</b>	<b>25.990.590</b>	<b>37.032.206</b>	<b>58,76%</b>
Third parties	5.174.267	175.173	5.610.439	5.785.612	-611.345	-11,82%
Exports	15.357.044	12.020.772	2.206.891	14.227.663	1.129.381	7,35%
<b>GENERAL TOTAL</b>	<b>83.554.107</b>	<b>36.744.125</b>	<b>9.259.740</b>	<b>46.003.865</b>	<b>37.550.242</b>	<b>44,94%</b>

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# IMPORTS

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- √ We shall specify import prices for some active ingredients that appear on the records of the General Customs Office, entity that depends on the Administración Federal de Ingresos Públicos.
- √ In some cases, such substances enter the country both through labs and through medicine wholesalers which subsequently sell them on the local market.

# IMPORTS

## HYDROCORTISONE:

Kg. FOB value in US\$

√ Schering Arg S.A.I.C.	3.484,00
√ Carpe-Scheider y cia.S.A.	1.080,00
√ Pfizer S.R.L.	1.007,33
√ Roemmers S.A.I.C.F.	942,95
√ Glaxo Wellcome S.A.	937,77
√ Monsanto Arg.S.A.I.C.	925,00
√ Lab. Temis Lostalo S.A.	896,31
√ Drawer S.A.	866,58
√ Hoechst Marion Roussel S.A.	850,00
√ Unifarma S.A.	817,53
√ Lab. Pablo Cassara S.R.L.	721,00
√ Drog.Saporiti Sacifia	590,90

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# IMPORTS

## ISOCONAZOLE NITRATE:

Kg. FOB value in US\$

- √ **Schering Argentina S.A.I.C.** **6.000**  
(Sole importer in the country)

## DIFLUCORTOLONE VALERATE :

- √ **Schering Argentina S.A.I.C.** **92.700**  
(Sole importer in the country)

# IMPORTS

## NEOMYCIN SULFATE:

Kg. FOB value in US\$

√ Carpe-Scheider y cia. S.A.	11.786,66
√ Cientifica Balmor Integral S.A.	9.785,00
√ Glaxo Wellcome S.A.	591,36
√ <b>Schering Argentina S.A.I.C.</b>	<b>293,42</b>
√ Lab. Dallas S.A.	97,92
√ Schering-Plough S.A.	82,02
√ Lab. Tems Lostalo S.A.	52,76
√ Lab. Northia S.A.C.I.F.	48,91
√ Unifarma S.A.	42,58
√ Inmobal Nutrer S.A.	24,81
√ Romkin S.A.	24,38
√ Drog. Beiro S.R.L.	23,13

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# IMPORTS

## CYPROTERONE ACETATE:

**Kg. FOB value in US\$**

√ Schering Arg. S.A.I.C.	32.000,00
√ Lab. Rontag S.A.	13.500,00
√ Labinca S.A.	12.977,32
√ Lab. Flaxis S.A.	12.000,00
√ Lab. Fabra S.R.L. Resol.	11.715,00
√ Lab. Varifarma S.A.	11.179,43
√ Lab. Kampel Martian S.A.	10.953,03
√ Asofarma S.A. Indu.	6.085,00
√ Elvetium S.A.	5.123,56
√ Lab.Prof.Dr.Raffo S.A.	5.017,19
√ Lab. Richmond S.A.C.I.F.	4.844,00
√ Delta Farma S.R.L.	4.466,42
√ Microsules Arg. S.A de S	4.294,00

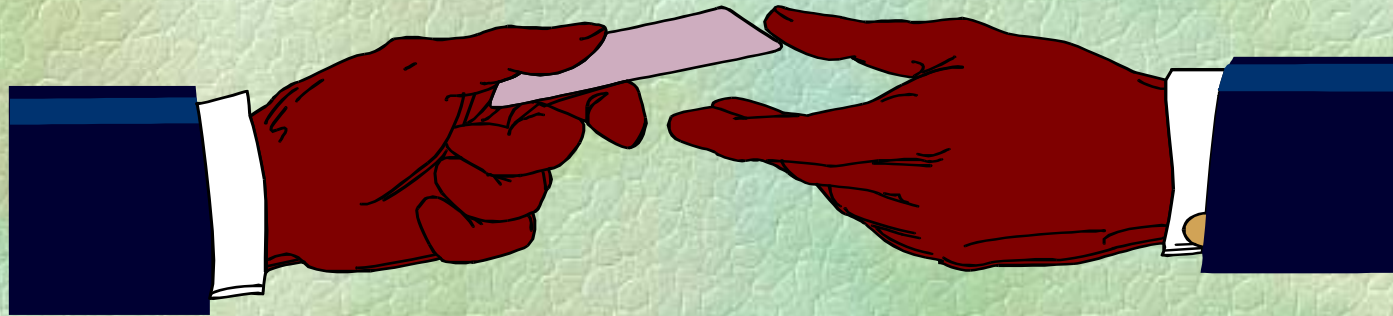
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# PRICING STUDY

√ Economic facts concerning royalties are being analyzed through the different laws:

- Laws related to the royalty issues
- Tax laws
- Transfer Pricing rules

# **Business transactions carried out during 1999**



**Schering Argentina S.A.I.C.**

**June 10, 2000**



# Transactions that have been declared before Tax Authorities year 1999 (in thousands of US\$)

## Exports:

√ Schering do Brasil Ltda.	8.812
√ Schering Aktiengesellschaft	3.258
√ Schering Colombiana S.A.	1.229
√ Schering Mexicana S.A.	754
√ Schering Peruana S.A.	657
√ Schering Uruguay S.A.	561
√ Schering de Venezuela S.A.	70
√ <u>Schering de Chile S.A.</u>	<u>16</u>
<b><u>TOTAL:</u></b>	<b><u>15.357</u></b>

## Purchases to group companies:

√ Schering Aktiengesellschaft	25.331
√ Germapharm G.m.b.H.	4.053
√ Schering do Brasil Ltda.	3.675
√ Proquina S.A. de C.V.	531
√ Schering las Américas S.A.	79
√ Schering Wien S.A. G.m.b.H.	40
√ Farmades Spa	16
√ <u>Leyras Oy</u>	<u>7</u>
<b><u>TOTAL:</u></b>	<b><u>33.732</u></b>

# Transactions that have been declared before Tax Authorities year 1999 (in thousands of US\$)

## **Royalty payments for use of trademark:**

√ Schering Aktiengesellschaft	1.329
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## **Loan Interest payments:**

√ Schering Wien G.m.b.H.	741
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# Transactions that have been declared before Tax Authorities year 1999

(in thousands of US\$)

## Credits as expense reimbursements:

√ Schering Mexicana S.A. de C.V.	161
√ Schering de Venezuela	52
√ Schering do Brasil Ltda.	41
√ Schering Aktiengesellschaft	28
√ Schering Uruguay S.A.	9
√ <u>Schering Colombiana S.A.</u>	<u>5</u>
<b><u>TOTAL:</u></b>	<b><u>296</u></b>

# Transactions that have been declared before Tax Authorities year 1999 (in thousands of US\$)

## Debits as expense reimbursements :

√ Schering do Brasil Ltda.	316
√ Schering Aktiengesellschaft	86
√ Schering Mexicana S.A. de C.V.	18
√ Schering Colombiana S.A.	16
√ Schering Uruguay S.A.	11
√ Proquina S.A. de C.V.	9
√ Schering de Chile S.A.	8
√ Schering Peruana S.A.	7
√ Schering de Venezuela S.A.	7
√ Schering Ecuatoriana S.A.	6
√ Schering Dominicana S.A.	5
√ Schering Guatemalteca S.A.	5
√ <u>Schering Boliviana Ltda.</u>	<u>4</u>

**TOTAL:** **498**