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TRANSFER PRICING ('TP') REMUNERATION MODELS FOR DISTRIBUTORS

Swipe

BACKDROP

Transfer pricing refers to allocating profits and costs among related entities operating in different tax jurisdictions

An entity’s profitability is related to the functions, risks, and assets associated with its activities

Distribution of goods in transfer pricing is pivotal, involving the cross-border movement of tangible and intangible assets

The business model adopted by an enterprise typically drives the type and amount of compensation under arm's length principles

COMMONLY ADOPTED BUSINESS MODELS

- FULL FLEDGED DISTRIBUTOR
- LIMITED RISK DISTRIBUTOR
- COMMISSION AGENT

FULL FLEDGED DISTRIBUTOR

Full-fledged distributor is responsible for purchasing goods from a foreign entity and reselling them in the local market

Such distributor assumes functions and risks pertaining to sales, marketing, after-sales support, inventory and credit

Such distributors are involved in value adding activities including significant brand building, development and exploitation of marketing intangibles

Compensation of a full-fledged distributor must be reflective of its value-added functions

TYPICAL REMUNERATION MODEL IN LINE WITH TP PRINCIPLES:

RETURN ON SALES

Foreign Entity | **Distributor** | **Customers**

Sells finished goods to distributor

Sells goods in local market & assumes all sales and marketing risks

LIMITED RISK DISTRIBUTOR ('LRD')

LRDs buy product from the master distributor and resell the same to the customers

LRDs assumes minimal risks and functions associated with items like inventory or bad debts

Other significant functions or risks are borne by the foreign entity/entrepreneur

LRD's profit margin is lower considering minimal risks assumed and activities undertaken do not involve substantial value-adding functions

TYPICAL REMUNERATION MODEL IN LINE WITH TP PRINCIPLES:

ASSURED MARGIN ON SALES

Foreign Entity → **Distributor** → **Customers**

Foreign Entity: Sells finished goods to distributor and assumes all significant risks and functions

Distributor: Sells goods in local market & assumes limited risks relating to inventory & distribution

Customers

COMMISSION AGENT

Agency model involves a related entity acting as an agent rather than a distributor

The agent takes orders on behalf of the foreign principal and earns a commission for its services

The principal retains the risks and rewards associated with the sale of goods

Permanent Establishment and other regulatory implications needs a robust evaluation under this model

TYPICAL REMUNERATION MODEL IN LINE WITH TP PRINCIPLES:

COMMISSION AS A PERCENT OF SALES

Foreign Entity

Commission Agent

Customers

Sells finished goods to customers and assumes all risks

Sells goods in local market on behalf of foreign entity & receives commission for the same

PARTING THOUGHTS

- Transfer Pricing policy should consider the positioning of the business model (low-risk, full-fledged, hybrid)
- Functions, risks, and assets of each entity involved must be carefully evaluated
- The business model should align with economic substance, value-addition, and business strategy
- Compliance and documentation are crucial as transfer pricing regulations evolve
- Other aspects such as PE risk, input VAT distribution, customs valuation and withholding taxes, should also be evaluated
- Planning and understanding the supply chain can mitigate tax risks in business activities

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