

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



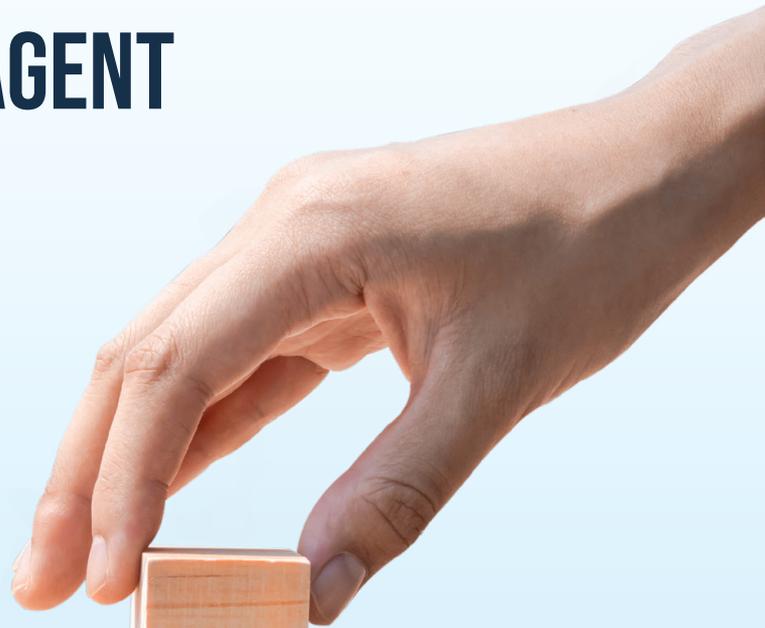
FULL FLEDGED DISTRIBUTOR

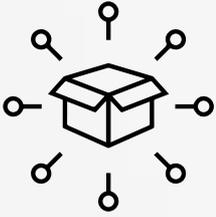


LIMITED RISK DISTRIBUTOR



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**



Sells finished goods to distributor

Distributor



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

Customers





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



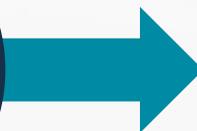
TYPICAL REMUNERATION MODEL
IN LINE WITH TP PRINCIPLES:

ASSURED MARGIN ON SALES

**Foreign
Entity**

Distributor

Customers



Sells finished goods to distributor and assumes all significant risks and functions

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



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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