

ABC Ltd.

Benchmarking Study for Fiscal Year Ended _____

<<Date of Report>>

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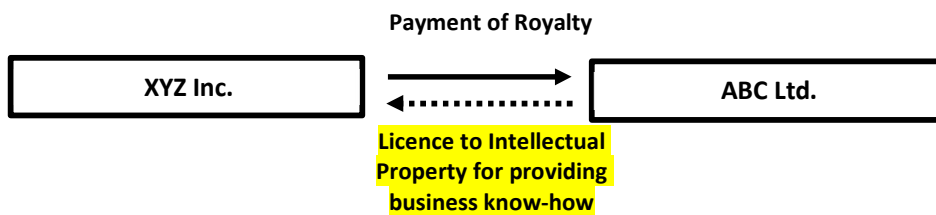
I. BACKGROUND AND UNDERSTANDING

ABC Limited (“the Company”), a company incorporated under the relevant laws of the Middle East and North Africa (MENA) region has engaged the firm to undertake benchmarking analysis to provide guidance on certain inter-company transaction (the “controlled transactions”) between ABC Ltd. and its subsidiary company located in the United States, i.e., XYZ Inc. for the tax year [REDACTED].

The transactions covered (“Covered Transactions”) for the purpose of analysis in this report is discussed below:

- **Payment of Royalty by XYZ Inc. to ABC Ltd in relation to granting the license to specific intellectual property for providing business know-how**

Relevant Transaction Flow for Covered Transaction



The study is based on OECD TP Guidelines for Multinational Enterprises and Tax Administrations (“OECD TP Guidelines”) and in accordance with the US Treasury Regulations promulgated under Revenue Code Section 482. These frameworks are widely accepted as global standards for applying the arm’s length principle. The analysis also takes into consideration the **Transfer Pricing practices and regulatory expectations commonly followed across the MENA region**, which are generally aligned with the OECD TP Guidelines. Collectively, these international standards and regional practices are hereinafter referred to as the “TP Regulations.”

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II. SCOPE OF THE REPORT

The firm assisted ABC Ltd. with the preparation of this report solely for undertaking the **aforementioned benchmarking analysis in connection with transaction pertaining to Payment of Royalty by XYZ Inc. to ABC Ltd. in relation to granting the license to specific intellectual property for providing business know-how**. Accordingly, this document is limited to a comparable company search and cannot be considered as the TP documentation.

This work shall not be used for any other purpose and may not have considered issues relevant to any third parties. Thereby, any use such third parties intend to make of this report is entirely at their own risk and we shall have no responsibility whatsoever in relation to any such use.

The TP benchmarking analysis for the transaction pertaining to **Payment of Royalty by XYZ Inc. to ABC Ltd in relation to granting the license to specific intellectual property for providing business know-how**, in this report is in accordance with the TP regulations and based on the information in the public domain and analysis of documents/information provided by the management of the Company.

This report represents our conclusions only and should not be taken as an assurance of the ultimate treatment of the controlled transactions by the tax authorities of the various countries where the Company and its affiliates operates. The analysis contained in this document is not binding on the tax authority and should not be considered as an assurance that the tax authority will necessarily agree with our conclusions or that, the Company or its affiliates will prevail if the tax authority adopts a contrary position. Any other tax matter, including, but not limited to, other corporate income tax aspects, indirect tax issues/customs issues, as well as accounting and legal matters, which may or may not relate to the covered transactions under review, fall outside the scope of this report.

The report also contains information obtained from third-party sources such as information databases, filed annual accounts and relevant industry publications. Although we have used our experience to assess, as far as was reasonably possible, the reliability and suitability of such third-party data, however its accuracy cannot be guaranteed.

The following sections of this benchmarking report provide a description of broad functional and economic/benchmarking analysis undertaken to identify independent comparable companies and present the results of the financial analysis performed.

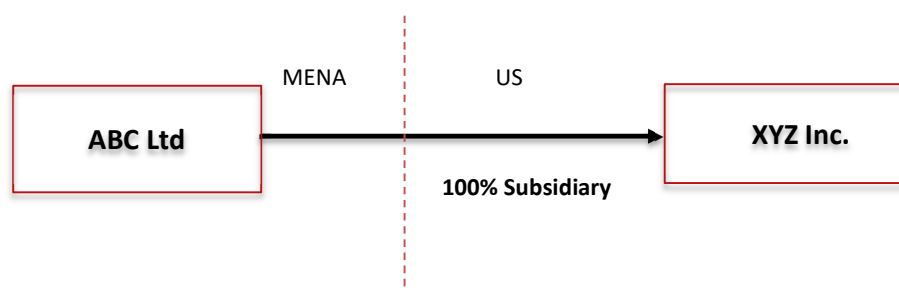
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III. CORPORATE & BUSINESS OVERVIEW

- **Relevant Group Structure**

The following chart depicts the relationship between XYZ Inc. and ABC Ltd.:

Figure 1: Organization structure



- **Overview of the Relevant Group Companies**

➤ **ABC Ltd. – <<To be changed as Per Company's Business Profile>>**

ABC Ltd. offers to its customers comprehensive solutions, from delivery of capital equipment to disposable medical devices. Its primary practice areas include:

- Interventional Cardiology & Radiology
- Intensive Care & Recovery
- Patients' Monitoring
- Imaging,
- Oncology
- Women Health
- Endoscopy and OR Equipment, OR infrastructure.

Additionally, ABC Ltd has a service department that provides after-sale services for Installation, repair, maintenance, upgrade and technical training. ABC Ltd. owns 100% of XYZ Inc. shares.

➤ **XYZ Inc. <<To be changed as Per Company's Business Profile>>**

XYZ Inc. is a company registered under the laws of United States of America. XYZ Inc. is a limited risk distributor, which serves as a logistics center for XYZ's customers in US or customers who would like products delivered within United States.

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IV. FUNCTIONAL ANALYSIS

- **Background**

A functional analysis identifies the functions undertaken by each enterprise, the risks each enterprise assumes, and the assets used by each enterprise in the transaction. It also assists in determining the economic value added by each enterprise involved in the controlled transaction.

The importance of functional analysis emanates from the fact that it defines roles, responsibilities and risks assumed by each transacting enterprise and examines the economic substance of the transactions and the business of the company as a whole. Functional Analysis can be defined generally as the process of identifying the components of a business transaction that contributes to the realization of proceeds from a transaction. It aims at identifying all 'Value-added activities', i.e. all activities that are encompassed in the development, manufacturing, or marketing/customer relation process or in the provision of services. The identification of these relevant activities and processes will aid in understanding the specific risks and economics associated with the transactions. Further, this analysis can aid in identifying specialized and critical business assets and activities that are fundamental to the business.

- **Functional Analysis**

Provided below is a summary of the economically relevant contributions of XYZ Inc. and ABC Ltd., participating in intercompany transaction in relation to **Payment of Royalty by XYZ Inc. to ABC Ltd. in relation to granting the license to specific intellectual property for providing business know-how.**

The marks in the following table denote the contributions made by each enterprise as follows:

Mark	Explanation
-	No or insignificant contribution
√	Limited contribution
√√	Significant contribution

Table 1: Summary of FAR Analysis <<To be changed as per profile of companies>>

Contribution	XYZ Inc.	ABC Ltd.
FUNCTIONS PERFORMED:		
Strategy development		√√
Business management		√√
Headquarters, including : Operation, commercial, Finance, HR		√√
Regulatory affairs		√√
Licensing of Intellectual Property	-	√√
Research and Knowledge Development	-	√√
Implementing Business Know-How	√√	√
Support and Training	-	√√
Developing business knowhow		√√

Contribution	XYZ Inc.	ABC Ltd.
Sales Activities	√	-
Determination of Pricing	-	√√
ASSETS HELD:		
Tangible Assets	-	√√
Intangible Assets	-	√√
RISKS UNDERTAKEN:		
Market risk	√	√
Research and Development Risk	-	√√
Infringement Risk	-	√√
Intangible Property Right Risk	-	√√
Credit Risk	√ [Third-Party]	√

- CHARACTERIZATION OF ENTITY**

Functional analysis serves as the foundation to characterize entities for purposes of TP analysis of inter-company transactions. Based on the facts as presented in the above analysis of functions performed, risks borne and assets employed, **ABC Ltd. is characterized as the entrepreneurial entity** with respect to the Tested Transaction while **XYZ Inc. is characterized as Limited Risk Distributor in one of the region of North American Region.**

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V. ECONOMIC ANALYSIS

The following section describes the economic analyses performed in order to assess the arm's length nature of the Covered Transactions. In light of the same, this section summarizes the economic analysis undertaken to evaluate whether the price for the transactions between XYZ Inc. and ABC Ltd. are in accordance with the arm's length standard as per the TP Regulations. The economic analysis includes a description of the TP method selected and an explanation of why that method was selected as the most appropriate method.

A. SELECTION OF THE MOST APPROPRIATE METHOD

A discussion of methods prescribed in the TP Regulations and its appropriateness, or lack thereof, is necessary to properly identify the Most Appropriate Method ("MAM"). The MAM is that method which, under the facts and circumstances of the transaction under review, provides the most reliable measure of an arm's length result.

Further, for analyzing inter-company transactions to determine the arm's length result of the transaction, taxpayer must select the MAM that provides the reliable results. According to Chapter II and Chapter III of the OECD Guidelines, the TP methods available for analyzing the arm's length transfer price include traditional transactions methods, such as the comparable uncontrolled price, resale price and cost plus methods and Profit-based methods, such as the transactional net margin method and profit split method, may also be used if they provide a better result than those methods classified as transactional.

The following section discusses each of the methods and selection of the MAM for the transaction under review between XYZ Inc. and ABC Ltd.:

Traditional Transaction Methods

I. Comparable Uncontrolled Price Method

The Comparable Uncontrolled Price Method ("CUP Method") evaluates the arm's-length character of a controlled transaction by comparing the price charged in the controlled transaction to the amount charged in a comparable uncontrolled transaction in comparable circumstances. CUP Method requires a high degree of comparability of products and functions such as quality; contractual terms; geographic market; embedded intangibles; and foreign currency risks etc.

For the purposes of the CUP method, an uncontrolled transaction is considered comparable if one of the following conditions is met:

- None of the differences between the transactions being compared or between the enterprises involved in the transactions could materially affect the price in the open market; or
- Adjustments can be made to eliminate the material effects of such differences.

For the prices analysed in this report, the comparability of uncontrolled transactions is determined by reference to interest rates paid between independent parties with similar terms and conditions. There are two types of CUP methods that may be appropriate:

- Internal CUP method: evaluates comparable uncontrolled transactions between one of the related parties and third parties; and

- External CUP method: evaluates comparable uncontrolled transactions between uncontrolled parties.

Since reliable market data is readily available in public financial sources in relation to the aforesaid transaction, reliable comparable uncontrolled transactions can be identified. Therefore, **the external CUP method is regarded as a reasonable and direct method** to perform an arm's-length analysis for the transactions under review.

II. Resale Price Method

The resale price method ("RPM") tests the arm's-length character of a transfer price in a controlled transaction by reference to the gross profit margin (i.e., gross profit divided by net sales) realized in a comparable uncontrolled transaction. The RPM begins with the price at which a product is resold to an independent enterprise. This price (the resale price) is then reduced by an appropriate gross margin (the "resale price margin") from which the reseller would seek to cover its operating expenses and make an appropriate profit. The RPM is most often used for distributors that resell products without physically altering them or adding substantial value to them.

In the preparation of the economic analysis, adequate external comparable companies were identified. However, even when it has been determined that the comparables are highly functionally comparable it is still necessary to determine if the accounting definitions of gross margins used by each comparable and the taxpayer coincide. Financial information that would allow for such a comparison was unavailable for the comparables identified. As a result, the resale price method is not considered to be the most appropriate method in the circumstances, due to the lack of reliable data.

III. Cost Plus Method

The Cost-Plus Method tests the arm's length character of a transfer price in a controlled transaction by reference to the profit mark-up realized in a comparable uncontrolled transaction. The profit mark-up provides both compensation for the performance of manufacturing, assembly or service functions and a return on capital invested and risks assumed by the manufacturer / service provider.

The cost-plus method requires detailed comparisons of products manufactured or services provided, functions performed, risks borne, cost structures and intangibles between controlled and uncontrolled transactions. Comparability is most likely found among controlled and uncontrolled transactions involving the same suppliers (i.e., internal cost-plus method). In the absence of such transactions, an appropriate comparison may be derived from comparable uncontrolled transactions involving other suppliers (i.e., external cost-plus method).

Since the cost-plus method is most suitably applied in situations in which the tested party provides routine manufacturing, assembly or services, it is unlikely that an application of this method based on aggregate financial data obtained from comparable external entities to test the distribution returns earned by XYZ Inc. would be appropriate in this situation.

Profit-Based Methods

I. Profit Split Method

The Profit Split Method (“PSM”) evaluates whether the allocation of the combined profit or loss attributable to one or more controlled transactions is arm’s length by reference to the relative value of each controlled taxpayer’s contribution to that combined profit or loss. The PSM is designed to be applied where transactions are very interrelated and cannot be reliably evaluated on a separate basis using one of the transactional methods. PSM is particularly relevant when each party to the transaction has significant intangible assets and/ or the operations of the parties to the transaction are highly integrated and cannot be evaluated on a separate basis.

These conditions are not applicable to the transactions analyzed in this report. The operations of XYZ Inc. or ABC Ltd. are distinct and as such there is no difficulty in evaluating the transactions independently. Having regard to these factors, the PSM is not an appropriate method to be used in case of the subject transaction.

II. Transactional Net Margin Method (“TNMM”)/ Comparable Profits Method (“CPM”)

The TNMM/CPM examines the net profit margin relative to an appropriate base (e.g., costs, sales, and assets) realized on the transaction. For example, return on capital employed, or the ratio of operating income to operating assets, may be examined.

Under the TNMM/CPM, the standards of comparability are less stringent relative to the other methods with only broad similarity of functions required. Accordingly, comparables need to be broadly similar and some product diversity and limited functional diversity between the controlled and uncontrolled parties is acceptable under the TNMM/CPM.

The TNMM/CPM has the following practical advantages:

- In the case of TNMM/CPM, the net margins (e.g. return on assets, operating income to sales, and possibly other measures of net profit) are less affected by transactional differences than is the case with price, as used in the CUP;
- The net margins may also be more tolerant to some functional differences between the controlled and uncontrolled transactions than gross profit margins; and
- The differences in functions performed between enterprises are often reflected in variations in operating expenses. Consequently, enterprises may have a wide range of gross profit margins but still earn broadly similar levels of profits.

Since we have selected CUP method for benchmarking the subject transaction, TNMM has been rejected for benchmarking the transaction under review.

CONCLUSION

Keeping in view the nature of transaction and degree of comparability, CUP is selected as MAM which provides the most reliable measure of an arm’s-length price for the services performed by XYZ Inc.

B. SEARCH FOR COMPARABLE UNCONTROLLED DATA

The objective of our search was to determine whether the royalty paid by XYZ Inc. (licensee) to ABC Ltd (licensor) is at arm’s length from a transfer pricing perspective. This report provides a description of the approach undertaken to identify comparable royalty agreements and presents the results of royalty terms between the licensor and licensee. The search was conducted to identify royalty rates involving similar royalty agreements globally.

For this purpose, a search to identify agreements engaged predominantly in **licensing of intellectual property to provide business-know.**

Search Process

➤ **Step 1**

To identify the independent comparable license agreement in the identical industry and market, the search was conducted on the **RoyaltyRange Database** by using the following screening criteria:

➤ **Industry**

- Business Services
- Medical Devices
- Pharmaceutical & Biotech
- Proprietary Info

➤ **Agreement Type**

- Proprietary Info
- Know-how
- Consulting
- Marketing
- Research
- Trade Secrets

➤ **Royalty Base**

- Net Sales

➤ **Step 2**

Post the keywords screening, a set of 222 potentially similar royalty agreements were derived. In order to refine the agreements and to eliminate non-comparable agreements, we undertook a detailed review of all the aforesaid agreements. After a considerable review, we rejected the agreements on the basis of following reasons/filters:

Table 2: Summary of Analysis

Sr. No.	Rejection Criteria	Number of Agreements Rejected
1	Agreements that were related to dissimilar products were rejected during the review of agreements	217

2	Agreements wherein the term of the agreement has expired during the year under consideration were rejected	0
3	Agreements with insufficient availability of information were rejected	0
Total Agreement Rejected		217

Finally, **five** comparable royalty agreements were identified as potential comparable agreements.

Table 3: Final set of Comparable

Sr. No.	Type of Agreement	Licensee Name	Licensor Name
1	Know-how; Patent; Process; Software; Technology; Trademark	Acrongenomics Inc.	Molecular Vision Ltd.
2	Know-how; Patent; Supply	3M Drug Delivery Systems Division; 3M Innovative Properties Co.	Sepracor Inc.
3	Distribution; Proprietary Information	Heartbuds AK, LLC	G Medical Innovations Ltd.
4	Know-how; Patent; Process; Supply; Technology	Eurand America, Inc.	Global Pharmaceutical Corp.
5	Amendment; Know-how; Patent	Gentium SpA	Sigma-Tau Pharmaceuticals, Inc.

➤ **Step 3**

Result of final comparable royalty agreements engaged predominantly in licensing of intellectual property to permit manufacture, supply, and maintain products is provided below:

Table 4: Final set of Comparable

S.NO	Reference	Licensor Name	Licensee Name	Type of Agreement	Rate
1	L16057	Acrongenomics Inc.	Molecular Vision Ltd.	Know-how; Patent; Process; Software; Technology; Trademark	0.40%
2	L22864	3M Drug Delivery Systems Division; 3M Innovative Properties Co.	Sepracor Inc.	Know-how; Patent; Supply	3%
3	L39293	Heartbuds AK, LLC	G Medical Innovations Ltd.	Distribution; Proprietary Information	5%
4	L638	Eurand America, Inc.	Global Pharmaceutical Corp.	Know-how; Patent; Process; Supply; Technology	5%
5	L25088	Gentium SpA	Sigma-Tau Pharmaceuticals, Inc.	Amendment; Know-how; Patent	7%
Count					5

Arithmetic Mean	4.08%
Median	5.00%
25th Percentile	3.00%
75th Percentile	5.00%

The accept-reject matrix of the abovementioned royalty agreements is enclosed as **Annexure A**. Further, the royalty rate and brief description of the comparable royalty agreements is enclosed as **Annexure B**.

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VI. ANNEXURES

ANNEXURE A: ACCEPT REJECT MATRIX

ANNEXURE B: ROYALTY RATES AND DESCRIPTION OF COMPARABLE AGREEMENTS

A. ACCEPT REJECT MATRIX

As enclosed herewith.



Annexure A_Accept
Reject Matrix.xlsx

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B. ROYALTY RATES AND DESCRIPTION OF COMPARABLE AGREEMENTS

As enclosed herewith.



Annexure B_Royalty
Rate of Comparable

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