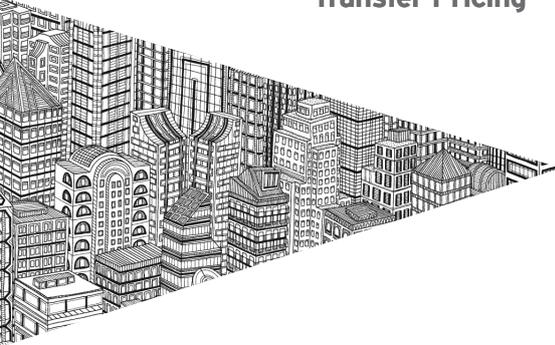


# International Tax Alert

News and views from  
Transfer Pricing



## Decreased drug prices may affect Turkish transfer pricing

### Executive summary

Under the Council of Ministers Resolutions no. 2009/15631 effective from 4 December 2009, drug prices in Turkey have been significantly decreased. New prices will inevitably result in material decrease in the turnover and profits of pharmaceutical companies (both manufacturers and country distributors).

In response to decreased prices, pharmaceutical companies whose transfer pricing policies are based on profitability analyses should take certain actions or change their transfer prices (if necessary) by reviewing contemporary transfer pricing methods, profitability expectations and purchase prices.

### Detailed discussion

#### **New resolution on drug prices and price reductions**

In order to sell a drug in Turkey, pharmaceutical companies must obtain a license and the drug prices must be approved by the Ministry of Health. The Ministry of Health has been determining the prices of drugs sold in Turkey under the Reference Price System since 2004. Accordingly, drug prices are determined on the basis of the lowest prices in the five reference countries, which are members of the European Union. Currently, the reference countries are France, Italy, Portugal, Spain and Greece.

Under the Council of Ministers Resolution no. 2007/12325, which was effective until December 2009, prices of original drugs were determined as 100% of the reference price, whereas the prices of generic drugs were determined as 80% of the reference price.

In order to reduce the health expenditures of the public sector, the Council of Ministers issued a new Resolution. Under the Resolution no. 2009/15631, which has been effective from 4 December 2009, the Council of Ministers decided:

- ▶ Prices of original drugs whose generic counterparts are not launched yet will be determined as 100% of the reference price,
- ▶ Prices of all other drugs will be determined as 66% of the reference price.

On the other hand, an additional discount from 11% to 23% must be applied for the drugs sold to the Social Security Institution.

It is inevitable that the new regulations would generally lead to significant reduction in the selling prices of drugs. The new prices are estimated to cause a contraction of up to 25% in the drug sector in the coming period. Price reductions are expected to affect all actors in the sector, with the highest impact on pharmaceutical companies (manufacturers and country distributors). Moreover, pharmaceutical companies are also required to recover the losses

resulting from the inventories of pharmaceutical warehouses and pharmacies due to the reduction in drug prices.

#### **Transfer pricing effects of price reductions**

The Turkish pharmaceutical industry is one of the sectors that has significant transfer pricing susceptibilities due to its structure, supply chain and the Turkish Tax Authority's inspections on pharmaceutical companies in the recent periods.

Foreign pharmaceutical companies operating in Turkey (particularly distributors) mostly prefer the resale price method and the transactional net margin method in their purchases from group companies.

The new resolution on drug prices, which became effective in early December, is expected to result in serious reduction in prices and material decrease in net sales and profits of pharmaceutical companies. Due to the decrease in the profits, companies whose transfer pricing policies are based on profitability analyses need to consider transfer pricing consequences of price reduction.

Under the new resolution, with decreased prices, pharmaceutical companies should take certain actions or change their transfer prices (if necessary) by reviewing contemporary transfer pricing methods, profitability expectations and purchase prices.

There are many potential transfer pricing actions companies can consider, examples of which include, but are not limited to, reducing the purchase prices, reducing purchase prices retrospectively, reducing the purchase prices of goods in the inventory, charging price reductions to group companies or charging the losses incurred by price reductions to group companies.

In cases where no action is taken despite the reduction in profits that leaves the local companies out of arm's length ranges, it is important to support current profitability levels with new benchmarking studies and document the impact of price reduction on the profitability levels in detail.

Pharmaceutical companies should also analyze retrospective year-end price adjustments, not only in terms of transfer pricing, but also in terms of value added tax and customs duties.

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