



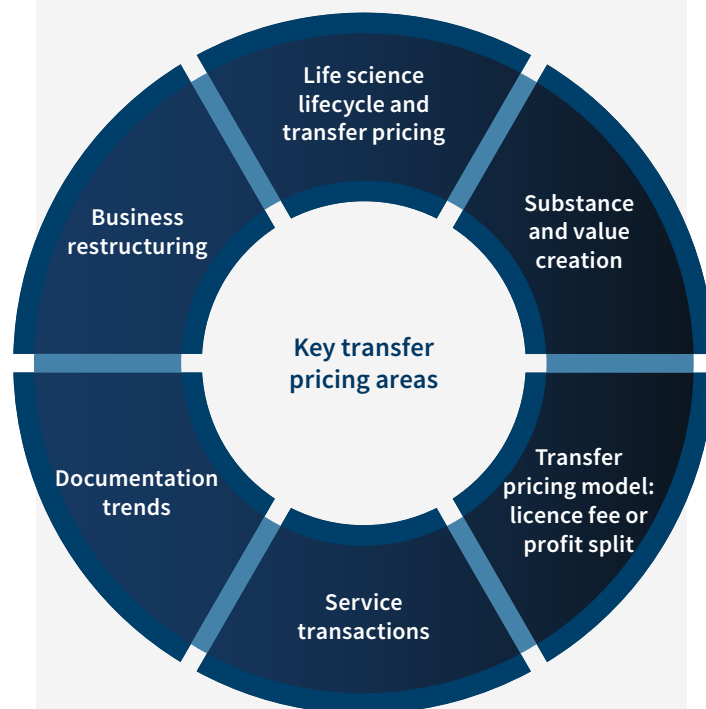
Life Sciences Insights 4:

Navigating Transfer Pricing in the Life Sciences Sector

Transfer pricing is at the forefront of tax authority priorities globally. Recent HMRC statistics reveal revenue yield from transfer pricing enquiries have increased by over 89% in the past two years, reflecting intensified scrutiny following the Organisation for Economic Co-operation and Development's ("OECD") Base Erosion and Profit Shifting ("BEPS") initiatives.¹ Tax authorities continue to have an increased focus on whether profit allocations align with genuine value creation and economic substance.

For life sciences companies, this scrutiny can present different challenges depending on the stage in their lifecycle. The life sciences sector has inherent complexity, including IP ownership and licensing, cross-border R&D activities and integrated functions performed in more than one jurisdiction. These can create the need for multi-jurisdictional operating models and transfer pricing planning. However, for early-stage companies, the key questions can be when the right time is to consider transfer pricing, and can they take a more pragmatic approach?

Outlined below are some key transfer pricing areas of focus within the Life Science industry:



¹ HM Revenue & Customs, "Transfer Pricing and Diverted Profits Tax Statistics: 2024 to 2025", GOV.UK (11 March 2026), <https://www.gov.uk/government/publications/transfer-pricing-and-diverted-profits-tax-statistics-2024-to-2025/transfer-pricing-and-diverted-profits-tax-statistics-2024-to-2025>

Life Science Lifecycle and Transfer Pricing

Transfer pricing priorities in life sciences evolve alongside the business lifecycle as functions, risks and value drivers change. As businesses grow, transfer pricing analysis and governance requirements typically increase.

Early Development Stage

Businesses are often focused on R&D, with limited revenues and centralised control. Transfer pricing priorities centre on ensuring development entities are appropriately remunerated, while entrepreneurial risk is borne by entities with the capability and financial capacity to control and fund development.

In practice, transfer pricing arrangements are usually relatively straightforward and focused on establishing defensible intercompany arrangements for R&D activities.

Commercialisation

As manufacturing, distribution and marketing activities expand across jurisdictions, operating models become more complex. Transfer pricing priorities shift towards rewarding these activities appropriately, aligning returns with the development and exploitation of intangibles and addressing any transfers of functions or assets resulting from business expansion.

At this stage, it is important to consider the utilisation of development-stage tax losses, as well as the design of licensing arrangements to support the evolving operating model. The transfer pricing work becomes more substantial, requiring the design and implementation of a scalable framework supported by robust analysis.

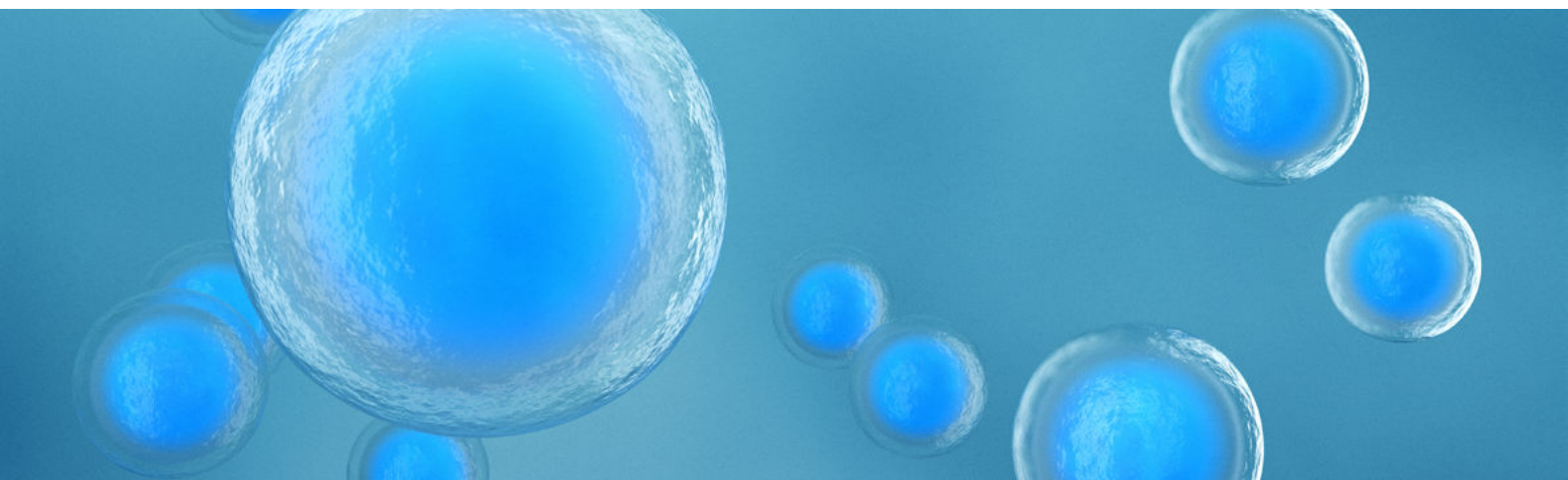
Substance and Value Creation

The importance of aligning transfer pricing outcomes with value creation is articulated through the OECD's Development, Enhancement, Maintenance, Protection and Exploitation of intangibles ("DEMPE") framework. This considers how businesses create value from IP and how this impacts the allocation of profit. This challenge is more acute in sectors where value is largely derived through intellectual property.

Tax authorities continue to scrutinise arrangements in which legal ownership of IP is situated in a jurisdiction that does not perform the corresponding value-creating activities. This evolving focus has heightened the distinction between legal and economic ownership, introducing greater complexity into transfer pricing considerations. Hence, legal title alone is no longer sufficient to substantiate entitlement to returns derived from IP.

Accordingly, it is important for companies to consider the following for transfer pricing purposes:

1. **Align returns with value creation:** assess whether profits continue to be allocated in line with where DEMPE functions are performed and whether each jurisdiction is appropriately rewarded for its contributions.
2. **Keep pace with organisational change:** changes in people, decision-making and the location of DEMPE functions can shift where value is created. Transfer pricing arrangements should be revisited to ensure they continue to reflect the economic reality of the business.
3. **Maintain robust support:** ensure transfer pricing outcomes are supported by contemporaneous documentation that clearly evidences why remuneration is consistent with the functions performed, assets employed and risks assumed.



Transfer Pricing Model: Licence Fee or Profit Split

Life sciences companies often face challenges in assessing whether each party's unique and valuable contributions support a profit split, or whether a licence fee arrangement better reflects value creation. While businesses may prefer one model, the transfer pricing method adopted must be supported by the underlying transfer pricing analysis and accurately reflect how value is created.

Some of these challenges are driven by the extent to which each entity owns valuable IP, such as patents and proprietary drug formulations, the locations where these R&D activities are undertaken and the ability to distinguish between where the DEMPE functions are undertaken and where the related remuneration is made.

Depending on the Group's functional profile, a profit-split model or licence fee model may be used to ensure that the arm's length principle is adhered to. To determine which model to use, it is important to consider the following:

1. How integrated are the group functions?
2. Where are the DEMPE functions undertaken within the group?
3. Have there been any changes to where DEMPE functions within the group are being undertaken?

Service Transactions

Life science companies engage in different intercompany service arrangements spanning R&D activities, distribution and sale of drugs, manufacturing activities and centralised corporate support functions. Establishing arm's length pricing for these services requires careful consideration of critical elements that tax authorities routinely examine.

Some of these elements include:

1. **Accurate delineation of transactions:** This could prove challenging in integrated life science groups where functions overlap and value chains are interconnected. It is therefore important to be able to distinguish between direct services benefiting a specific group entity versus shareholder activities that benefit the group collectively. In addition, identifying whether services constitute low value-adding or specialised high-value functions is equally important.
2. **Determination of appropriate mark-ups:** This requires assessing the nature, complexity and value of services provided. For specialised life science services, this requires benchmarking mark-ups earned by comparable independent service providers.
3. **Determination of the cost base:** This includes considering whether to include direct costs only or incorporate indirect overheads, whether to capitalise or expense certain development activities and what allocation keys should be adopted for each indirect intragroup transaction.

Documentation Trends

Tax jurisdictions have different transfer pricing documentation requirements. In the UK, companies are expected to prepare specific transfer pricing documentation depending on their business size, as defined by HMRC.

In addition, there are specific requirements on how frequently benchmarking studies should be prepared and updated. This is not necessarily the same for each transaction. For example, services transactions and licence transactions have different expectations regarding how frequently benchmark studies should be undertaken.

Tax authorities continue to put more emphasis on substance over form, with authorities examining whether documented policies align with actual business operations, cash flows and risk allocation.

It is therefore important to consider:

1. How frequently is transfer pricing documentation and other supporting documents prepared?
2. Which transfer pricing documents are required for your business, as differing business sizes are expected to produce different TP documentation?
3. Does your transfer pricing documentation sufficiently cover the functions performed, risks managed and assets owned by each group entity?

Business Restructuring

Businesses evolve due to organic growth, mergers or acquisitions, or even new government regulations. Therefore businesses may need to revisit their transfer pricing operating models to reflect these changes in their business.

It is important for businesses to ensure that changes to the functional profile of their entities are aligned with the OECD Guidelines, and these changes are well documented.

Life science companies who restructure face scrutiny from tax authorities who examine whether transfers of valuable intangibles, functions or risks warrant compensation beyond ongoing operational remuneration. Key considerations include how the post-restructuring operating model differs

from the prior model, whether the restructuring involves transferring something of value such as marketing intangibles that an independent party would compensate, how to value such transfers when comparable transactions are scarce, as well as whether post-restructuring profit allocation genuinely reflects the new functional and risk profile.

Tax authorities will challenge restructuring that appears designed primarily to shift profits to low-tax jurisdictions without corresponding substance.



How We Can Help:

Our transfer pricing team supports life sciences clients at every stage of their lifecycle with tailored advice, including:

- Preparation of transfer pricing policy documents
- Preparation of intragroup agreements
- Preparation of benchmarking studies
- Preparation of transfer pricing documentation – e.g. master file and local files
- Tax enquiries or tax audit support
- Business restructuring documentation (Chapter IX analysis)
- Thin-capitalisation analysis for intra-group debt



For more information about our services, see European Tax Advisory

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