Tax Insights
PwC Israel Tax Group
Update from the Transfer Pricing and Israeli Tax clusters

May 16th, 2022

Dear Clients and colleagues,

Subject: Tax Insight 26/2022 - District Court ruling in the Medingo case dated May 8, 2022

Recently, the Israeli District Court (the "Court") has ruled on the case of Medingo Ltd. ("Medingo"), an Israeli pharma company that sold all of its shares to a Swiss company, F. Hoffmann-La Roche Ltd. (hereinafter, Roche and its affiliates will be referred to as "Roche") in 2010 for 160 million United States Dollars ("USD"), and additional 19 million USD that will be provided according to several agreed upon milestones.

Six months after the shares acquisition, Medingo entered into four intercompany agreements with Roche. The agreements include:

- an agreement for the provision of research and development ("R&D") services;
- an agreement for the provision of marketing services; technical support services and consulting services with regard to use of patents;
- an agreement for the provision of manufacturing and packaging services; and
- a license agreement to use Medingo's IP developed up to the date of the acquisition, for which it is remunerated with royalty payments.

The agreements are collectively referred to as the "IC Agreements''.

In 2013, it was decided to sell Medingo's IP to Roche for 166 million New Israeli Shekels ("NIS"), and terminate its operation in Israel.

The ITA claimed that in 2010, when Medingo's shares were acquired, Medingo in fact transferred most of its functions, assets and risks ("FAR") associated with its operations to Roche. The ITA claimed that the IC Agreements show that Medingo had, in fact, transferred most of its FAR, and that it was left with no substance. The ITA argued that Medingo had effectively been converted from an independent entity into a service center of Roche. As such, the ITA argued that the overall arrangement was a business restructuring that should be classified as a sale and be priced based on the price on the initial sale of the shares.

In its ruling, **the Court accepted Medingo's approach**. The Court ruled that after the shares acquisition in 2010, and the introduction of the IC Agreements, Medingo continued its operation (under the remuneration prescribed within the IC Agreements) with regard to its R&D, manufacturing, marketing and management functions, and hence, no FAR was transferred. In addition, the Court noted that Medingo's headcount increased and that Medingo has become a profitable company where it historically was a loss-making company. As for Medingo's assets, Medingo remained the owner of the 'old' IP.

Thus, the Court stated that as long as Medingo and Roche operated in accordance with IC Agreements, which are common practice in the pharma industry and it made logical business sense to conduct them, there was no problem with the characterization of the IC Agreements and their substance did not reflect a sale of the company operations.

It should be emphasized that the Court found the circumstances of this case to be similar in essence to the circumstances of the Broadcom Semiconductor Ltd. case ("Broadcom"). With regard to Broadcom, the Court ruled that following three agreements that the company signed in a similar manner to that of Medingo, Broadcom's operation expanded its income and its profit had grown, as well as its headcount. In the Broadcom case the court ruled that the intercompany agreements should be respected and accepted the taxpayers appeal.

Similarly to Broadcom, the Court ruling reflects the perspective that there may be cases for which a business restructuring is supported by economic and business consideration, in a way that does not implement a taxable sale. The facts and circumstances of each case should be examined.

The Court decision emphasizes the importance of the preparation and signing of contractual intercompany agreements and transfer pricing documentation in order to accurately reflect the transactions and the responsibilities, rights and obligations of the parties involved, as well as the arm's length price of the relevant transactions.

For further information and related questions, the PwC Israel Tax Group is at your disposal.

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With Regards,

PwC Israel