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OECD releases Pillar 1 Amount B Consultation Document and invites public input

Overview

As part of the ongoing work of the OECD/G20 Inclusive Framework on BEPS ("Inclusive Framework" or IF) to implement the Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy, the OECD released on December 8 a Public Consultation Document on Amount B of Pillar One with a request for feedback by January 25, 2023. The Consultation Document builds on earlier documents, as well as the October 2021 statement of the Inclusive Framework joined by 137 countries.

Background

On October 14, 2020, the Inclusive Framework released the report "Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint." The Blueprint stated that Amount B was intended to streamline the process for pricing baseline marketing and distribution activities in accordance with the arm's length principle (ALP), with the goal of enhancing tax certainty and reducing resource-intensive disputes between taxpayers and tax administrations. The Blueprint additionally noted that Amount B should address the needs of low-capacity jurisdictions (LCJs).

On October 8, 2021, the IF agreed a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy. The related IF Statement described Amount B as one of the components of Pillar One. Amount B will apply to all multinational businesses that undertake 'routine' distribution activities, and, unlike Amount A, is not limited to the world's largest multinationals.

The Consultation Document released December 8 is a relatively "early stage" document and several options included in the draft are open for further debate, so the Amount B proposal could change in important respects before it is finalized. OECD is targeting mid-2023 to release the final Amount B deliverable and 2024 for application and implementation of Amount B.

Scope of Amount B

Amount B would apply to the following intra-group transactions that satisfy certain "scoping criteria" identified below:

- Buy-sell agreements where the tested party purchases goods from one or more associated enterprises resident in other jurisdictions for wholesale distribution to unrelated parties primarily in its local market
- Sales agency and commissionaire arrangements where the tested party contributes to wholesale distribution of goods for a related party and to the extent they exhibit economically relevant characteristics similar to those outlined in the scoping criteria for Amount B.

Amount B applies to tangible property, subject to certain proposed exemptions, and does not capture the distribution and marketing of services or digital property. Based on further work to be undertaken by the IF, as well as input from commentators, the scope could be extended to the distribution of software or digital goods should the economically relevant characteristics of distribution of those non-tangible goods result in an accurately delineated transaction that would otherwise fall within the Amount B scoping criteria.

The scoping criteria contain a mixture of *qualitative assessments* that relate to the economically relevant characteristics of the controlled transaction, as well as *quantitative measurements* that may be derived from the financial statements of the distributor.

The IF is currently evaluating the following set of criteria that would apply for purposes of determining whether transactions are within the scope of Amount B:

- The business documents the transactions in a *written contract* that includes the responsibilities, obligations, rights, and assumption of economically significant risks of the distribution activities, and does not contain terms inconsistent with the scoping criteria;
- The distributor *primarily* distributes in its *market of residence* (with a cap on sales from customers located in other countries);
- The distributor *does not perform* any other economic activity for which it is (or should be) remunerated at arm's length, including *manufacturing*, *research and development*, *procurement*, and *financing activities*;
- The distributor *does not perform any risk-control functions* that lead to an assumption of economically significant risks associated with the development, enhancement, maintenance, protection or exploitation (DEMPE) of *marketing intangibles*;
- The distributor *does not undertake activities that relate to creating or obtaining distribution rights* where the activity would be remunerated at arm's length, or *perform any significant valuable specialized services for customers* that would play a significant role in maintaining a customer relationship (*e.g.*, regulatory activities or annual maintenance contracts);
- The distributor *does not perform strategic sales and marketing activities that generate intangible assets* relating to the exploitation of the products sold in the market;
- The *net sales to any single customer* do not exceed a (to-be-defined) proportion of total net sales;

- Certain *ancillary activities* are permitted up to (to-be-defined) permissible thresholds, including distribution to end consumers through physical and online stores, expenditure on marketing and advertising expenses, packaging and assembly expenses, and after-sales product support/processing product returns or similar support services;
- The *ratio of operating expenses to net sales* falls within a (to-be-defined) range;
- The distributor *does not assume economically significant risks* above a (to-be-defined) limited level, including market risk, credit risk, inventory risk, product liability risk, and foreign exchange risk;
- The distributor *does not own any intangible assets* such as marketing intangibles, and does not have ownership of market access rights or regulatory licences that create barriers to entry; and
- Amount B will not apply to transactions covered by a bilateral *or multilateral advance pricing arrangement*.

Both finished and unfinished goods, including components or intermediate goods, are within scope.

Amount B may not apply where an *exemption or exclusion* applies. Some of the situations where potential exemptions and exclusions are being considered include:

- Where a transfer pricing method *other than the Transactional Net Margin Method* is the *most appropriate method* (*e.g.*, comparable uncontrolled price);
- Where *local-market comparables* are available to price the transaction;
- Transactions involving the distribution of *commodities*; and
- Transactions involving the distribution of *non-tangible goods*.

Amount B pricing methodology

To simplify and streamline application of the ALP to in-country baseline marketing and distribution activities and considering the specific needs of low-capacity countries, the pricing methodology will rely on the application of common benchmarking search criteria to identify comparable entities performing baseline marketing and distribution activities, drawing upon publicly available corporate financial information. The Amount B pricing methodology will include the common benchmarking search criteria and the economically relevant characteristics that are observed to correlate with profitability to produce either a pricing matrix or mechanical pricing. Note that the design and form are still under consideration and further development in this area is expected based on feedback from stakeholders.

While critical components of Amount B design remain in progress, the Amount B pricing methodology currently builds upon the following objectives:

- To rely on financial information of comparable independent entities drawn from commercial databases through the application of commonly agreed search criteria;
- To provide arm's length results that account for the relevant economic characteristics of the tested party and the comparables used; and
- To publish and periodically update the arm's length results.

Key design features for the pricing methodology will focus on:

- Common benchmarking search criteria
    - To standardize process and minimize redundancy in performing initial steps
    - To build iterations to better suit a tested party
- Technical analysis
    - Produce a global dataset to be used for Amount B
    - Refine analysis based on factors including, but not limited to, geography, local business fact patterns, and quantitative factors
    - Factors affecting econometric analysis shall include
        - Geographic relevance
        - Industry relevance
        - Asset intensity
        - Operating expense intensity

Potential outputs of the Amount B methodology

While the final output and form is still under consideration, the IF is currently exploring two output options: (1) a pricing matrix approach, and (2) a mechanical pricing tool approach. Both output options will broadly rely on the same underlying benchmarking and technical analyses.

Pricing matrix: The pricing matrix option would group comparable marketing and distribution entities in subsets according to their relevant economic characteristics.

For example, if it were observed that asset intensity and operating expense to sales ratio were the two most economically relevant characteristics correlating to profitability among baseline marketing and distribution entities, then a pricing matrix could be constructed to identify an arm's length amount that matches those comparables with a similar combination of asset intensity and operating expense to sales ratios.

Mechanical pricing tool: This approach would allow a "translation" of the underlying data derived under the common benchmarking search criteria into mechanical pricing tools such as a formula or a set of quantitative adjustments, to reliably derive arm's-length profitability returns adapted to the economically relevant characteristics of the tested party (*e.g.*, a regression equation).

Documentation requirements

The consultation document provides detailed guidance on the three-tiered approach to transfer pricing documentation consisting of the master file, local file and the country-by-country report and underlines the advantages of adopting such an approach. Building on the existing documentation requirements in the OECD Transfer Pricing Guidelines (TPG), the public consultation document describes the additional items of information specific to Amount B that could be included as part of the local file.

Tax certainty

It is expected that Amount B will improve tax certainty and reduce disputes involving in-scope baseline marketing and distribution transactions.

Taxpayers can make use of the mechanisms available to avoid future disputes related to the application of Amount B. The most well-known instrument to provide tax certainty and prevent transfer pricing disputes is the advance pricing arrangement. Any agreement reached prior to adoption of Amount B under a mutual agreement procedure (MAP), another mechanism for transfer pricing dispute resolution, should continue to prevail. In the case of ongoing and prospective MAP cases, the guidance on Amount B can be taken into consideration.

Next steps

Deloitte will host a webcast in January to discuss in greater detail the transfer pricing and tax considerations related to the Public Consultation Document.

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