



Pillar One – Amount B

OECD issues public
consultation document

December 2022 Alert 02/2022

Summary

The Organisation for Economic Co-operation and Development (OECD) / G20 Inclusive Framework (IF) issued a [consultation document](#) on 08 December 2022 outlining the design and progress on Amount B of Pillar One, and to seek public comments on the same by 25 January 2023. The consultation document discusses on qualifying transactions and scoping criteria for Amount B, pricing methodology including technical design of Amount B and other aspects such as documentation, transitional issues and tax certainty, along with the inputs on the respective areas. This alert captures the developments by IF on Amount B along with the inputs sought by IF on various aspects on Amount B.

Introduction

The IF agreed to a two-pillar solution (Pillar One and Pillar Two) to address the tax challenges arising from the digitalisation of the economy. Under Pillar One a new taxing right will be allocated to market jurisdictions, by way of Amount A, on the residual profits of the largest and most profitable MNEs. Further IF also agreed to finalise work on Amount B which simplifies and streamlines application of arm's length principle to in-country baseline marketing and distribution activities. Amount B was intended to, enhance tax certainty and address the needs of Low-capacity jurisdictions (LCJ). Unlike Amount A which are applicable where MNE Group has consolidated revenue in excess of € 20 billion and profitability in excess of 10%, there are **no threshold limits of Amount B**.

Amount B is aimed to provide an arm's length return for undertaking baseline wholesale distribution arrangements i.e., limited or lower functions performed, assets employed and risks assumed by the distributors as compared to its associated enterprises (AEs). The consultation document is broadly divided into three segments – Scoping of Amount B, Amount B pricing methodology and other aspects (Documentation, Transitional issues and Tax certainty) which is detailed in the below sections.



Amount B – Scope

Amount B applicable to distributors ('Tested party') engaged in either of following transactions:

Buy-sell arrangements	Purchasing goods from foreign AE(s) to cater to local market - wholesale distribution to third parties
Sales agency, commissionaire arrangements	Contributing to the wholesale distribution of goods by performing lower functions and assuming limited risks

The following scoping criteria (guiding features) to be reviewed for applicability of Amount B, where above transactions are entered.

- ▶ Distributors of only tangible property are currently covered and excludes distributor/marketer of commodities, and non-tangible goods;
- ▶ Carries out distribution of goods primarily in the local market with a threshold for non-domestic sales to be decided;
- ▶ Should not undertake disqualifying activities such as manufacturing, research and development, procurement, and financing;
- ▶ Must not perform strategic sales and marketing activities, which would create or contribute to marketing intangibles;
- ▶ Should not perform activities relating to creating or obtaining distribution rights in the market or specialised services, for which separate remuneration would be warranted;
- ▶ Should not assume economically significant risks associated with unique and valuable marketing intangibles or own any such intangibles;
- ▶ Ancillary activities such as distribution to end customers, marketing expenses, packing, assembly, after sales expenses or other support activities can be undertaken within permissible limits;
- ▶ Various other parameter threshold on single customer sales and annual operating expenses would be decided;
- ▶ Can assume limited level of risk including market risk, credit risk, product liability risk, forex risk, credit risk etc;
- ▶ Terms of Advance pricing agreement (APA) – bilateral or multilateral would prevail over Amount B;
- ▶ Written agreement / contract between the tested party and AEs documenting the roles and responsibilities, assumption of various risks is being discussed;
- ▶ Below exemption from Amount B are being discussed:
 - where another Transfer Pricing method is most appropriate such as Comparable Uncontrolled price method (CUP)
 - based on availability of local comparables or providing adjustments from Amount B



Amount B – Pricing Methodology

IF is working on a common benchmarking search criteria which is expected to provide a standardized process to identify comparable companies performing baseline marketing and distribution functions.

Amount B methodology consists of common benchmarking search criteria, technical and econometric analyses, and output options.

The objective is undertaking benchmarking analysis (including financial information) from public databases, provide results capturing economic characteristics of the tested party and comparables, and publish / periodically update arm’s length results.

Expected benefits to result from Amount B include reducing the burden of resources in undertaking benchmarking study, standardized and globally consistent Transfer pricing approach which reduces litigation arising out of selection of comparables, availability of latest information from databases, adaptability of Amount B to take into account relevant features of related party transaction while benchmarking using various filters and economic adjustments.

IF is also performing econometric analysis on the data (technical analysis) to improve comparability with tested party economic conditions.

IF is considering two output options viz., pricing matrix approach and mechanical pricing tool approach. Under the former approach a matrix will be formed based on economically relevant characteristics such as asset intensity, operating expenses to sales, etc. Each of the characteristics will have two or three slab range like ‘<x%’, ‘x% to y%’, ‘>y%’. The matrix will have a range of profitability of comparable companies for each of the combination between the factors. Depending on characteristics of the tested party, appropriate arm’s length profitability range can be mapped.

		Asset Intensity		
		< x%	x% to y%	>y%
Opex to Sales Ratio	< y%			
	x% to y%			
	>x%			

Under the mechanical pricing tool approach, a formula would be arrived based on robust econometric analysis, using the relevant characteristics. On inputting the relevant characteristics of the tested party to the formula, an arm’s length profitability (range) would be arrived.

Amount B methodology is based on TNMM, and IF is considering using of alternative profit ratios such as berry ratio, return on sales with berry ratio cap-and-collar, return on assets or a combination of profit indicators. After the arm’s profitability of comparable companies is arrived, IF is also considering narrowing the range of results – smaller than interquartile range, under both of the output options.

To align with OECD guidelines, where there are material economic differences between comparable companies and tested party IF is considering providing comparability adjustments such as Inventory / working capital / operating asset / total asset intensity adjustments, Functional intensity adjustments, Country / Industry risk adjustments and adjustments for commissionaire or sales agent.



Other Aspects

- ▶ **Transitional Issues:** MNEs may restructure the entities either to meet or not meet the scoping criteria of Amount B evaluating both the pros and cons. When doing so the transfer pricing implications provided in OECD guidelines (Chapter IX – Restructuring) will have to be considered.

- ▶ **Tax certainty:** There can be disagreements between taxpayers and tax administrators while applying scoping criteria. In such cases taxpayers can opt for APA to obtain certainty on application and effects of Amount B. MNEs can also opt for Mutual Agreement procedure (MAP) for any dispute resolution with respect to double taxation.
- ▶ **Documentation:** MNE group will have to maintain detailed documentation as part of local file of the respective Group entity where Amount B is opted including satisfaction of scoping criteria, adherence to arm's length price as per Amount B, opting for any comparability adjustments, etc. Where MNE decides to reorganize the Group – transitional issues, the same will have to be documented and substantiated in the respective local file. Consistency will have to be maintained between local files and Master File and Country-by-Country report.



Key Takeaways and Conclusion

Amount B is a pragmatic approach, for taxpayers and tax administrations, providing tax certainty for baseline distribution activities using the arm's length principle and aims at reducing significant litigation inventory, which is a welcoming move by an international body. Considering ongoing work to finalize Amount B by IF (consisting of 142 member countries¹) is based on a consensus approach, there is a high probability of Amount B approach being adopted / accepted in the respective member countries tax jurisdiction, a milestone in dispute resolution. Nevertheless, the following points would be key for Amount B to be a success:

- Arriving at an amicable approach on benchmarking search criteria, at least on a region basis if not on a jurisdiction basis. This includes extent to which the framework is exhaustive and leaving limited scope for subjectivity;
- Procedure for dissemination of search process and results to taxpayers and tax administrations considering database license restrictions;
- Flexibility (or rigidity) of jurisdictions, such as India, in accepting use of global databases against local databases / local market comparables, and accepting comparability adjustments to be effected which are pivotal to Amount B;
- Ease of administration of Amount B in the respective jurisdictions / Tax officers, and ensuring it is not an avenue for tax collection / tax dispute by frequently challenging the fundamental approach adopted by Amount B. Perhaps, as mentioned in consultation document, Amount B can be implemented / designed as a safe harbour²;
- Evaluation from an indirect tax perspective (Customs duty), else it might not be efficient for MNEs to align with benchmarking results as per Amount B.

Additionally, finalization (rules expected to come into effect by early 2024) and acceptance of Amount B would provide legal backing for substantiating transfer pricing aspects frequently disputed in various tax jurisdictions such as comparability adjustments, since it is a consensus-based approach. Benchmarking search process / criteria laid down in Amount B would also streamline the benchmarking exercise undertaken generally in the respective tax jurisdictions and would avoid de facto revisiting of the benchmarking study in the local file of the taxpayer by the tax administration.

¹ Updated December 2022 (<https://www.oecd.org/tax/beps/inclusive-framework-on-beps-composition.pdf>)

² Note: Different from the safe harbor referred to in Amount A, that provides a cap to which Amount A can be taxed in market jurisdictions where residual profits have been taxed in such market jurisdiction.



How Can We Support

- Evaluating option of Amount B based on detailed review of functional analysis of the distribution entities of MNE Group. This includes:
 - ❖ Whether the distribution entities satisfy the scoping criteria
 - ❖ Alignment of distribution entities to opt under Amount B
 - ❖ Requirement for payment/receipt of exit charges on account of such alignment
 - ❖ Understanding financial impact with and without opting for Amount B
 - ❖ Preparation of robust documentation for distribution entities where only certain jurisdictions opt for Amount B
 - ❖ Undertaking scenario analysis to evaluate any risk flags from indirect tax perspective
- Alignment of three tier documentation – local file, master file and Country-by-country reporting

About us



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Our offering spans the end-to-end Transfer Pricing value chain, including design of intercompany policy and drafting of Interco agreement, ensuring effective implementation of the Transfer Pricing policy, year-end documentation and certification, BEPS related compliances (including advisory, Masterfile, Country by Country report), safe harbor filing, audit defense before all forums and dispute prevention mechanisms such as Advance Pricing agreement.

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