BEPS 2.0 – Inclusive framework report on Pillar One – Amount B

Background

In October 2021, the Organization for Economic Co-operation and Development ("OECD")/ G20 Inclusive Framework on Base Erosion and Profit Shifting ("Inclusive Framework") agreed to a two-pillar solution to address the tax challenges arising from the digitalization of the economy. For the past two years, Inclusive Framework members have worked on an equal footing to ensure that Amount B delivers meaningful simplification to price baseline marketing and distribution activities, considering the challenges that low-capacity jurisdictions face in applying transfer pricing.

On 19 February 2024, the Inclusive Framework published a report providing an optional simplified and streamlined approach that jurisdictions can choose to apply to in-scope distributors resident in their jurisdictions. This report applies to in-country baseline marketing and distribution activities, with a particular focus on the needs of low-capacity jurisdictions. The amount B guidance will be incorporated into the OECD Transfer Pricing Guidelines, with implementation beginning 1 January 2025.

The simplified and streamlined approach provides a pricing framework whereby a three-step process determines a return on sales for in-scope distributors. The report also provides guidance on documentation, transitional issues, and tax certainty considerations.

Overview

The report is applicable to wholesale distributors of tangible goods, and sales agents and commissionaires involved in the sale of goods. Distribution of digital goods, commodities, or services is specifically excluded.

Jurisdictions can choose to apply the simplified and streamlined approach to the qualifying transactions of their in-scope tested parties according to the two options[1] mentioned in the report.

[1] Under the first option, a jurisdiction can permit tested parties' resident within its jurisdiction to elect to apply the simplified and streamlined approach. Under the second option, a jurisdiction can require the use of the approach in a prescriptive manner by its

Similar to other elective approaches in the OECD Transfer Pricing Guidelines, the outcome determined under the simplified and streamlined approach by a jurisdiction that has chosen to apply the simplified and streamlined approach to qualifying transactions is non-binding on the counterparty jurisdiction.

Qualifying transactions

The following controlled transactions are qualifying transactions for the simplified and streamlined approach:

- **Buy-sell marketing and distribution transactions** where the distributor purchases goods from one or more associated enterprises for wholesale distribution to third parties. Essentially, this excludes sales made to related parties.
- **Sales agency and commissionaire transactions** where the sales agent or commissionaire contributes to another group entity's wholesale distribution of goods to unrelated parties.

Scoping criteria

For a qualifying transaction to be in-scope:

- *One-sided method:* The qualifying transaction must exhibit economically relevant characteristics that lead to the application of a one-sided transfer pricing method, with the distributor, sales agent or commissionaire being the tested party. Essentially, this means that the businesses should be able to delineate the transaction accurately.
- *Operating expense intensity threshold:* The tested party in the qualifying transaction must not incur annual operating expenses lower than 3% or greater than an upper bound of between 20% and 30% of the tested party's annual net revenues. The three-year weighted average ratio is considered for this quantitative filter. The upper bound, for example, acts as a proxy to exclude qualifying transactions from scope where the ratio of operating expenses to sales might indicate that additional functions are performed, suggesting that the pricing methodology under this guidance would have reduced reliability in practice. This quantitative filter is likely to create some level of subjectivity as the jurisdictions will be able to choose where to set the threshold between 20% and 30%.
- *Exclusion of certain products:* The tested party should not be engaged in the distribution of intangible goods or services, or the marketing, trading, or distribution of commodities.
- *Exclusion of certain activities:* The tested party must not carry out non-distribution activities (e.g., manufacturing, Research & Development, procurement, financing, or retail distribution) in addition to the qualifying transaction unless the qualifying transaction can be adequately evaluated and priced separately from the non-distribution activities.

tax administration and tested parties' resident in the jurisdiction, where the scoping criteria are met. In this case, the tax administration would be bound to apply it under similar circumstances.

Application of the TNMM

Under this approach, the Transactional Net Margin Method ("TNMM") is considered the most appropriate method for pricing in-scope transactions with Return on Sales ("ROS") as the Net Profit Indicator ("NPI").

An exception is provided, where the application of the Comparable Uncontrolled Price ("CUP") method, using internal comparables', could potentially be more appropriate to apply to in-scope transactions. However, the actual use of the CUP method may be rare – as the distribution of commodities is excluded from the scope.

Determining the return

The approximation of arm's length results has been presented as matrix segments according to the following factors: net operating asset intensity ("OAS"), operating expense intensity ("OES")[2], and industry groupings. A pricing matrix detailing the arm's length results determined from global datasets has been included in the report as a matrix for the various industry groups.

In determining the arm's length return for the tested party involved in qualifying in-scope transactions, a three-step process will have to be followed, namely, determining the relevant industry group; determining factor intensity classification, and lastly, identification of the arm's length return.

Documentation requirements

The report states that the Local file documentation report should include sufficient and reliable information that enables the tax administrations to assess whether the taxpayer's qualifying transaction meets the scoping criteria. Taxpayers and tax administration can also leverage the information provided in the Master file to support their position with regard to the application of the pricing approach.

Also, when the taxpayer is seeking to apply the simplified and streamlined approach for the first time, the taxpayer should include in its documentation, a consent to apply the approach for a minimum of three years, unless transactions are no longer in scope during that period or there is a significant change in the taxpayer's business, and notify that circumstance to the tax authorities of the jurisdictions involved in the qualifying transaction.

Transitional issues

MNE Groups are free to organize their business operations as they see fit and tax administrations do not have the right to dictate to MNE Groups how to design their structure or where to locate their business operations. Tax administrations, however, have the right to determine the tax consequences resulting from the reorganization, based on Chapter IX – Restructuring of the OECD Transfer Pricing Guidelines.

[2] OAS and OES should be computed using a three-year weighted average.

The tax administrations may also scrutinize instances where associated enterprises artificially reorganize intra-group arrangements to derive tax advantages from applying the simplified and streamlined approach.

In some instances, the simplified and streamlined approach may apply to a restructured distributor with built-in losses from prior fiscal years. The tax treatment of such losses, in particular, whether they are available or can be deductible, depends on each jurisdiction's domestic legislation and administrative procedures and is not within the scope of this guidance.

Tax certainty and elimination of double taxation

The report acknowledges that the application of Amount B has the potential to lead to double taxation if the jurisdiction in which the counterparty is resident seeks to make a primary adjustment that is inconsistent with Amount B. In such scenarios, the MAP proceedings must be based on the TPG excluding the guidance on Amount B.

Conclusion

This report provides an option to the jurisdictions for the adoption of Amount B, and as such, it remains to be seen which countries agree to apply Amount B and which do not. For example, India, has made a number of reservations against the approach. In addition, the OECD is still working on further implementation guidance (e.g., defining additional qualitative criteria for in-scope distributors, and identification of low-capacity jurisdictions).

Taxpayers worldwide will have to review their existing transfer pricing policies related to the qualifying transactions, and at the same time, check the implementation by countries, particularly since a transfer pricing outcome in an adopting jurisdiction is not binding on a non-adopting jurisdiction. Taxpayers will have to consider the potential impact of implementing Amount B and conduct a detailed functional analysis of the distributors across their MNE Group to assess the in–scope transactions.

Please stay tuned for a deeper discussion on Amount B of Pillar One.

Should you have any questions or need assistance in assessing the impact of this report on your business, please contact us.

DFDL contacts:

Jack Sheehan
Partner and Tax Leader
Jack.Sheehan@dfdl.com

Sowmya Varadharajan
Head of Transfer Pricing
Sowmya.Varadharajan@dfdl.com

Vandana Vijayakumar
Regional Transfer Pricing Director
Vandana.Vijayakumar@dfdl.com