



US International Tax Alert

OECD Pillar One – Amount B report and public consultation

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 Digitalization of the Economy, the OECD released on July 17, 2023, a [public consultation document](#) containing updated design elements of Amount B of Pillar One, outlining a new process for *pricing baseline marketing and distribution activities* in accordance with the *arm’s length principle*. Feedback is requested by September 1.

This follows a consultation on the main design elements of Amount B in December 2022. Since 2017, the member countries of the have developed a “two-pillar” approach. Amount B forms part of the Pillar One package on profit allocation.

The IF has developed a framework for Amount B, which aims to simplify and streamline the application of the arm’s length principle to *baseline marketing and distribution activities*. The framework sets out the scoping criteria, pricing methodology, documentation and tax certainty considerations relating to Amount B. It also seeks *stakeholder input* in several areas.

Scope

Amount B will apply to the following transactions:

- Buy-sell marketing and distribution transactions where the distributor purchases goods from another group entity for wholesale distribution to third parties; and
- Sales agency and commissionaire transactions where the entity contributes to the wholesale distribution of goods to third parties for another group entity.

Wholesale distribution includes distribution to any customers except end consumers. A wholesale and retail distributor is deemed to carry out wholesale distribution only if annual net retail sales (to end consumers) do not exceed 20% of total annual net sales.

Consideration is being given as to whether the scope should be expanded to include the wholesale distribution of digital goods as well.

An accurate delineation of the in-scope transaction will need to be undertaken in accordance with Chapter I of the OECD Transfer Pricing Guidelines. Businesses will then need to determine whether “baseline” activities are undertaken using the Amount B scoping criteria. The framework does not provide an exhaustive list of qualifying activities but identifies a set of core functions that distributors should perform in relation to in-scope transactions.

- The qualifying transaction must exhibit economically relevant characteristics that mean it can be reliably priced using a one-sided transfer pricing method, with the distributor, sales agent, or commissionaire being the tested party i.e., the simpler party to be tested under the transfer pricing rules, commonly but not exclusively using the Transactional Net Margin Method.
- A quantitative filter will apply to specify that the ratio of operating expenses to annual net sales must be within a range to be specified based on a three-year weighted average.
 - Under “Alternative A,” a largely quantitative approach based on the other scoping criteria and exemptions is considered sufficient and no additional qualitative criteria would be included.
- Views are sought on whether there should be separate qualitative scoping criteria to exclude entities that make non-baseline contributions from the scope of Amount B (“Alternative B” in the consultation). Examples of non-baseline contributions are given, including technical or specialized support activities (including customization or modification of the products distributed), and contributions specific to highly regulated industries.

Transactions are out of scope of Amount B if they are:

- Transactions involving the distribution of services or the marketing, trading or distribution of commodities; and
- Transactions where the entity carries out non-distribution activities (e.g., manufacturing or research and development) in addition to the distribution activities, unless the distribution activities can be adequately evaluated and priced separately from the non-distribution activities. Consideration will be given as to whether transactions should be removed from scope where there is a high dependence on allocation keys to apportion indirect costs between the distribution and non-distribution activities which could materially affect the respective net profit margins.

Application of the most appropriate method to in-scope transactions

The Transactional Net Margin Method is considered the most appropriate method for pricing in-scope transactions. Where “internal” comparable uncontrolled transactions are available to reliably price in-scope transactions, businesses and tax authorities are permitted to use the comparable uncontrolled price (CUP) method.

Pricing methodology

The IF has used common benchmarking search criteria, additional screening, and qualitative review to produce a global dataset of businesses that undertake baseline marketing and distribution activities. The financial information from that dataset has been used to approximate arm's length results and develop a matrix of arm's length pricing outcomes for in-scope transactions, using return on sales as the net profit indicator.

Businesses will determine the arm's length return for in-scope transactions by selecting the relevant segment of the pricing matrix that corresponds to their:

- **Industry grouping**, selected from three options based on whether the industry was found to have a significant relationship to levels of return; and
- **"Factor intensity classification,"** selected from five options based on the business's net operating asset intensity (ratio of net operating assets to net revenue - OAS) and operating expense intensity (ratio of operating expenses to net revenue - OES), calculated based on a weighted average of the business's most recent three-year financial period.

OECD pricing matrix (return on sales %) derived from the global data set

| Industry Grouping Factor intensity | Industry Grouping 1 | Industry Grouping 2 | Industry Grouping 3 |
|----------------------------------------------------|---------------------|---------------------|---------------------|
| [A] High OAS / any OES >45%/any level | 3.50% +/- 0.5% | 5.25% +/- 0.5% | 5.50% +/- 0.5% |
| [B] Med/high OAS / any OES 30%-44.99%/any level | 3.25% +/- 0.5% | 3.50% +/- 0.5% | 4.50% +/- 0.5% |
| [C] Med low OAS/any OES 15%-29.99%/any level | 2.75% +/- 0.5% | 3.25% +/- 0.5% | 4.25% +/- 0.5% |
| [D] Low OAS / non-low OES <15%/10% or higher | 2.00% +/- 0.5% | 2.25% +/- 0.5% | 3.00% +/- 0.5% |
| [E] Low OAS/low OES <15% OAS/<10% OES | 1.50% +/- 0.5% | 1.75% +/- 0.5% | 2.25% +/- 0.5% |

Source: OECD (2023), *Public consultation document: Pillar One – Amount B (July 2023)*, <https://www.oecd.org/tax/beps/public-consultation-document-pillar-one-amount-b-2023.pdf>

A number of mechanisms are being considered to address potential geographical differences. In each case, a list of relevant countries will be published by the OECD and periodically updated.

- **A modified pricing matrix** could apply for entities in countries where geographical differences influence the profitability of baseline marketing and distribution entities.
- **A data availability mechanism** could be used for entities in countries where there is insufficient data in the global dataset but evidence

exists of country risk that may influence the arm's length return. An uplift to the arm's length return (taken from the standard pricing matrix) would be calculated by multiplying the entity's asset intensity percentage (capped at 85%) by a specified percentage based on the sovereign credit rating category of the country. For example, countries with a rating of BBB+ or higher will have no adjustment but countries with a rating of CCC- or lower will apply an upward adjustment equal to 8.6% multiplied by the entity's asset intensity percentage.

- **Local pricing matrices** could be produced by relevant tax authorities. These will be verified by the IF and published prospectively. Work continues to determine the limited circumstances in which this approach could be used.

A *Berry ratio cap-and-collar guardrail* will be used to prevent the over-remuneration of low-operating expense intense entities, and the under-remuneration of high-operating expense intense entities. Where the return on sales determined under the pricing matrix, converted into a ratio of gross profit to operating expenses, is outside the cap-and-collar range of 1.05 to 1.5, the return on sales will be adjusted to the nearest edge of the range. This applies to all in-scope transactions.

The analysis underpinning the pricing matrices will be updated every five years (unless there is a significant change in market conditions in the interim); other financial data (including the country risk adjustment percentage under the data availability mechanism and the Berry ratio cap-and-collar range) will be updated annually.

Documentation requirements

Businesses with transactions within the scope of Amount B will be required to provide information to tax authorities as part of the transfer pricing local file. This is expected to include:

- Explanation of the delineation of the in-scope transaction, including the functional analysis, the parties to the transaction, and the context of the transaction (e.g., other commercial or financial relations that may influence accurate delineation of the transaction);
- The written contract (if one exists) or agreements governing the transaction;
- Calculations of the revenue, costs and assets allocated to the in-scope transaction; and
- Information and allocation schedules tying financial data used with respect to the scoping criteria and application of the transfer pricing method to the financial statements.

Tax authorities can request further information relevant to assessing the application of Amount B.

In the first year of application, business should include in their documentation a *consent to apply* Amount B for a *minimum of three years*, unless transactions are no longer in scope during that period or there is a significant change to the business.

Individual country tax authorities may require businesses to provide a *written contract* signed prior to the in-scope transactions (but there is no general requirement for a written contract).

Tax certainty

Where disputes arise between businesses and tax authorities with respect to the application of Amount B, existing tax dispute prevention and resolution mechanisms will apply, including advance pricing arrangements (APAs) and mutual agreement procedures (MAPs). A MAP or bilateral APA reached prior to the adoption of Amount B will take priority for in-scope transactions.

Implementation framework

Amount B rules will be incorporated into the OECD Transfer Pricing Guidelines by January 2024. Further work will be undertaken by the IF with respect to implementation, including whether Amount B should be a “safe harbor.” The implementation timetable will take into account the time businesses need to prepare.

Next steps

Comments on the pricing framework are invited by September 1, 2023.

Contacts

[Bob Stack](#), Washington, DC

[Firas Zebian](#), Houston



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30 Rockefeller Plaza
New York, NY 10112-0015
United States

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