# OECD's Report on Pillar One Amount B - Analysis

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The Organization for Economic Co-operation and Development (OECD) Inclusive Framework released the report on Pillar One's Amount B[1], marking a significant milestone in international tax reform efforts. This comprehensive document captures the collective feedback garnered from a broad spectrum of stakeholders during extensive consultations. The aim is to simplify tax compliance for businesses and enable tax authorities to dedicate more resources to complex issues, thereby improving the efficiency and effectiveness of tax administration globally.

### Background

The inception of 'Amount B' was announced in an October 2021 statement, with the objective of standardizing the application of the arm's length principle specifically for marketing and distribution functions across different countries. This initiative was particularly targeted at assisting countries with limited resources in tax administration.

Following the initial proposal, the OECD sought feedback on a working draft in December 2022, acknowledging the need for a consensus within the Inclusive Framework, which was still pending at that time. By July 2023, notable advancements were made in the development of the Amount B framework, as detailed in a subsequent consultation document. However, this document also highlighted that certain issues were still under consideration. An integral part of this report is the annexure titled "Special Considerations for Baseline Distribution Activities," which has been incorporated into the 2022 OECD Transfer Pricing Guidelines.

### What is Amount B

Amount B is an optional simplified and standardized remuneration for eligible distributors that perform "baseline marketing and distribution activities" within multinational groups.

The report defines the criteria for eligibility and outlines the exclusions, particularly in relation to risk and ownership of intangible assets. It sets forth a three-step pricing approach designed specifically for these distributors, along with comprehensive guidelines on documentation, transitional measures, and enhancing tax certainty.

The report gives jurisdictions the flexibility to adopt this approach for qualifying transactions from fiscal years starting on or after 1 January 2025. This m ove is expected to harmonize tax practices worldwide, reduce disputes, and promote a more transparent, fair, and efficient international tax environment.

Qualifying Transactions for the simplified and streamlined approach

- Buy-sell marketing and distribution transactions - where a distributor purchases goods from its Associated Enterprise (AE) for wholesale distribution to unrelated parties.

- Sales Agency and commissionaire transaction – where the entity contributes to AE in relation to wholesale distribution of goods to unrelated enterprises.

**Scoping Criteria**

**Inclusions**

- The qualifying transaction must exhibit economically relevant characteristics, i.e., it can be reliably priced using a one-sided transfer pricing method with the distributor, sales agent or commissionaire being the tested party.

- 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.

**Exclusions**

- The distribution of non-tangible goods, services, or marketing, trading, or distribution of commodities and whether the tested party carries out non-distribution activities in addition to the qualifying transaction.

The tested party carries out non-distribution activity (in addition to the qualifying activity) that can be separately evaluated.

**Application of Most Appropriate Method(MAM)**

Regarding in-scope transactions, it is not mandatory to evaluate each of the prescribed methods when choosing the MAM. The Transaction Net Margin Method (TNMM) is usually chosen as the MAM. However, it is recognized that there may be instances where the usage of Comparable Uncontrolled Price (CUP) could be more appropriate where internal comparable exists and, hence, that can be applied.

**Determination of Arm's Length Return**

**Pricing Matrix**

The report has provided a benchmarking search criteria (using Moody's BvD Orbis Database) that provides the basis of the suggested pricing matrix. The benchmarking included an initial research of database filtering, followed by a manual review of companies and a quantitative review of company data from a global dataset of companies involved in baseline marketing and distribution activities.

The approximation of the arm's length results has been translated into the 'pricing matrix,' which is based on the return on sales as the profit level indicator.

The arm's length results are for specified levels of Operating Asset to Sales intensity (OAS) and Operating Expense to Sales intensity (OES). The matrix also distinguishes between different types of industries, which are classified into three groups. Distributors have been characterized into three predefined groups. This categorization is based on the relationships between certain industries or products and the profit associated with the basic distribution of those products. Each of the three groups includes different categories of goods.

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| **Group 1** | Perishable foods, grocery, household consumables, construction materials |

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| | and supplies, plumbing supplies and metal. |
| **Group 2** | IT hardware and components, electrical components and consumables, animal feeds, agricultural supplies, alcohol and tobacco, pet foods, clothing, footwear and other apparel, plastics and chemicals, lubricants, dyes, pharmaceuticals, cosmetics, health and wellbeing products, home appliances, consumer electronics, furniture, home and office supplies, printed matter, paper and packaging, jewellery, textiles, hides and furs, new and used domestic vehicles, car parts and supplies, mixed products and products and components that are not separately listed in group 1 or 3. |
| **Group 3** | Medical machinery, industrial machinery including industrial and agricultural vehicles, industrial tools, industrial components, miscellaneous supplies |

The pricing matrix is as follows:-

| **Factor Intensity** | **Industry Grouping 1** | **Industry Grouping 2** | **Industry Grouping 3** |
|---|---|---|---|
| High OAS (>45%) and any OES | 3.50% | 5.00% | 5.50% |
| Med to High OAS (30%44.99%) and any OES | 3.00% | 3.75% | 4.50% |
| Med to low OAS (15% - 29.99%) and any OES | 2.50% | 3.00% | 4.50% |
| Low OAS (<15%) and nonlow OES (10% or higher) | 1.75% | 2.00% | 3.00% |
| Low OAS (<15%) and Low OES (<10%) | 1.50% | 1.75% | 2.25% |

*Each ratio has a variance margin of +/- 0.5%*

| | |
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| Step 1: Vertical Column Identification | Determine the relevant industry group ( 1 or 2 or 3) of the tested party.<br><br>If there is only one Industry Group - Identify the applicable vertical column of return on sales in the pricing matrix.<br><br>If there is more than one Industry Group – where one group has more than 80% of sales, then Identify the applicable vertical column of return on sales in the pricing matrix for that major group only.<br><br>If there is more than one Industry Group (other than the above), then Identify the applicable vertical column of return on sales in the pricing matrix on a weighted average basis. |
| Step 2: Horizontal Row | Determine the relevant factor intensity classification (A or B or C or D or E) of the tested party considering the (i) OAS - Operating Asset Intensity (OAS) and (ii) OES - Operating Expense Intensity (OEI). |

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| Identification | Then, identify the applicable horizontal row for the relevant return on sales in the pricing matrix. |
| Step 3 | Identify the range from the pricing matrix segment that corresponds to the intersection of step 1 and 2 for the tested party. If needed, a weighted average return may be adopted, keeping the sales as the weight-factors. |

For the purpose of this matrix, the three-year average of the net operating assets and operating expenses has to be considered for this computation.

The return determined from the pricing matrix can be further adjusted in two ways:

**- Operating expense cross-**check: Additional criteria within which the primary return on sales net profit indicator is applied. Under this guardrail, if the application of the return on sales produces a result outside of the predefined operating expenses cap-and-collar model, the profitability of the party will be adjusted appropriately.

<table>
<tr><td>Step 1: Return on Expense derivation</td><td>Determine the return on sales for the tested party and thereon compute the equivalent return on operating expenses derived from that return.</td></tr>
<tr><td>Step 2: Cap-and-Collar Range Check</td><td>Determine the applicable operating expenses cap and collar range as follows:-
<table>
<tr><th>Factor Intensity</th><th>Default cap rates</th><th>Alternative cap rates for qualifying jurisdiction</th><th>Collar Rate</th></tr>
<tr><td>High OAS [A]</td><td>70%</td><td>80%</td><td rowspan="3">10%</td></tr>
<tr><td>Med to High OAS [B], [C]</td><td>60%</td><td>70%</td></tr>
<tr><td>Low OAS [D], [E]</td><td>40%</td><td>45%</td></tr>
</table>
The cap rate is determined by reference to the factor intensity. If the tested party is located in a qualifying jurisdiction then alternative cap rates would apply.</td></tr>
<tr><td>Step 3: Compare the equivalent return</td><td>Compare the return derived from Step 1 with the cap-and-collar determined in Step 2.</td></tr>
<tr><td>Step 4: Adjustment</td><td>If the return derived from Step 1 is within the cap-and-collar range as determined in Step 2, then no further adjustment is needed.<br><br>However, the return derived from Step 1 is outside the operating expenses cap; the return on sales of the tested party will be adjusted downwards/upwards as the case maybe.</td></tr>
</table>

- Data availability mechanism for qualifying jurisdictions: This report takes into account the reality that in certain jurisdictions, comparable data may not be available. In this context, where no or insufficient data is available for the purpose of determining the arm's length range - the return calculated as per the pricing matrix is adjusted, comprising the OAS multiplied by a net risk adjustment based on the sovereign credit rating of the qualifying jurisdiction is made to the return from the pricing matrix (see paragraph 5.3 of the report).

Formula Prescribed for the Adjusted return on sales

**ROS^TP** **(NRA^J** **x** **OAS^TP)**[NNS1]

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|---|---|---|---|---|
| the return on sales of the tested party (as per the pricing matrix and adjusted for cap-and-collar). | | The net risk adjustment of the qualifying jurisdiction as derived from below. | | The net operating asset intensity percentage of the tested party for the relevant fiscal year - but will not exceed 85% for the purpose of computing the adjusted return on sales of the tested party. |

| **Sovereign Credit Rating Category** | | **Net Risk Adjustment** |
|---|---|---|
| Investment Grade | BBB+ | 0.0% |
| | BBB | 0.0% |
| | BBB- | 0.3% |
| Non-Investment Grade | BB+ | 0.7% |
| | BB | 1.2% |
| | BB- | 1.8% |
| | B+ | 2.8% |
| | B | 3.8% |
| | B- | 4.9% |
| | CCC+ | 5.9% |
| | CCC | 7.5% |
| | CCC- (or lower) | 8.6% |

*The applicable category is determined by reference to the sovereign credit rating of the qualifying jurisdiction of the tested party applicable on the first day of the relevant fiscal year.*

**Periodic Updates**

In order to simplify the compliance burden with administering this simplified and streamlined approach, the prescribed computations are recommended to be updated every five years – unless there is a significant change in the market conditions that warrants an interim update. However, the financial data should be reviewed annually and updated where necessary.

**Documentation**

The report also covers the documentation requirements in the context of Amount B. In principle, it is assumed that the local file requirements currently under the Transfer Pricing Guidelines will include sufficient information to examine the taxpayer's position under the streamlined and simplified approach. However, there are items of information relevant to Amount B that could be included as part of the local file. However, it is also provided that jurisdictions may consider the introduction of targeted documentation requirements and may consider simplifying the requirements for small and medium enterprises to limit the cost and compliance burden.

Additional factors to the local file include

- Clarificatory documentation relevant to the application of the approach, such as:

  - The delineation of the in-scope qualifying transaction, including the functional analysis of the taxpayer and relevant AE with respect to the in-scope transactions and the context in which such transactions take place.
  - Calculations show the determination of the relevant revenue, costs and assets allocated or attributed to the in-scope transaction.
  - Information and allocation schedules show how the financial data used in assessing the applicability of the simplified and streamlined approach and applying the transfer pricing method ties to the annual financial statements.

- Copies of contracts/agreements that govern the said transactions as 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.

**Transitional Issues**

The report acknowledges that multinational groups may reorganize their distribution business models to fall within the scope of Amount B. The report notes that where groups attempt to artificially reorganize their arrangements to derive tax advantages from the application of the Amount B approach, tax authorities may adopt targeted approaches to prevent the use of the approach for tax planning.

**Tax Certainty and Elimination of Double Taxation**

Since it is stated that the Amount B approach is an optional one that jurisdictions are not obliged to implement, hence, where one jurisdiction applies the Amount B approach and the counter-party jurisdiction adopts a more traditional transfer pricing approach, there would be a mismatch in the results.

In such circumstances, the report clarifies that corresponding adjustments would be considered only as part of Mutual Agreement Procedures. On filing a Mutual Agreement Procedure (MAP) that arises as a result of that disagreement would be conducted and based on the remainder of the Transfer Pricing Guidelines rather than Amount B and the competent authorities of both jurisdictions must justify their positions based only on the remainder of these Guidelines.

Specifically, in such cases, the simplified and streamlined approach under this guidance must not be considered or referenced by the relevant competent authorities as an approach that is treated as leading to an acceptable outcome. This includes for the purposes of conducting the Mutual Agreement Procedure as a basis of a resolution of the Mutual Agreement Procedure, or by any party (including arbitrators) in the conduct of any arbitration procedure.

**Our Comments**

The simplified and streamlined approach is designed to make pricing for in-scope transactions easier by approximating an arm's length outcome in the jurisdiction of the tested party. However, in jurisdictions that do not adopt this approach, it is not recognized as providing an arm's length outcome and accordingly, decisions made under this approach in one jurisdiction are not binding on other jurisdictions. This may lead to double taxation and an increase in Transfer Pricing disputes, which was one of the main points for having a common approach to ease TP compliances.

Taxpayers should be cautious about using the simplified and streamlined approach as a basis for claiming an arm's length outcome on their tax returns in jurisdictions that do not recognize this approach. For transactions outside the simplified approach, arm's length outcomes should be determined using the guidelines' detailed principles. Non-qualification for the simplified approach does not imply that an activity's returns are inherently higher or lower, nor does it set a profitability benchmark for distribution activities.

India has been an active member of the Inclusive framework and while the report is stated to be approved and declassified by the Inclusive Framework, there are various reservations made specifically by India. India’s reservations highlights its uncertainty in adoption especially in light of the practical challenges and technical gaps of the report that need to be clarified.

It is important to note that there are some reservations made by India that have been spelled out in the report on the simplified and streamlined approach:

**- Incomplete Definitions:** there is the absence of clear definitions for 'low-capacity jurisdictions' and 'qualifying jurisdictions', stressing that these should be clarified before further commitments are made.

**- Qualitative Scoping Criterion:** India insists on the inclusion of a qualitative criterion to accurately identify baseline distributors that should fall under Amount B, expressing reluctance to support the framework without this criterion.

**- Pricing Methodology Concerns:** India objects to specific design aspects of the Amount B pricing methodology, including the operating expense cross-check mechanism, the exclusion of goodwill in calculating net operating assets, the allowed deviation range in the pricing matrix, and the reliance on a single database that lacks geographical representation.

**- Operating Expense-Based Metric:** India opposes using operating expenses as a metric to limit distributor returns under Amount B, arguing that it does not accurately reflect a distributor's value and could disproportionately affect lower-income countries. It considers that the value of a distributor's functional contributions is reflected in its sales, not in the distributor's operating expense. India also believes that the cross-check could adversely affect lower-income countries, considering that the operating expense of similarly placed distributors is systemically lower than in high-income countries and that the alternative cap rates may not sufficiently address this issue.

**- Resource Concerns for Monitoring:** India expresses reservations about the proposal to develop a framework for monitoring the practical application of Amount B, citing concerns about the resource intensity of such an exercise, especially for jurisdictions with limited capacity.

For the purposes of this guidance, there are specific terminologies used, a few of which are set out below:

| | |
|---|---|
| **Distributor** | Encompasses wholesale distributors, sales agents and commissionaires involved in the sale of goods. In some instances, specific reference may be made to "*wholesale distributor*," "*sales agent,*" or "*commissionaire,*" as applicable. Wholesale distribution is the distribution of goods to any type of customer other than end consumers. The scope of this guidance is limited to the wholesale distribution of tangible goods and does not include services (including digital services). |
| **Non-distribution Activities** | Economic activities that are distinct from wholesale distribution, including, for example, manufacturing, research and development, procurement, or financing, are non-incidental to a qualifying transaction. Strictly for the purposes of applying scoping criteria, non- |

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| | distribution activities include retail distribution above the de minimis threshold noted in the definition of wholesale distribution (in cases where this threshold is exceeded, all retail distribution is treated as a non-distribution activity). For the purposes of this guidance, a distributor that engages in both wholesale and retail distribution will be considered to be engaged solely in wholesale distribution if its three-year weighted average net retail revenues do not exceed 20% of its three-year weighted average net revenues. |
| **Operating Expenses** | Total costs less cost of goods sold, pass-through costs appropriately excluded and costs associated with financing, investment or income taxes, calculated in accordance with applicable accounting standards. |
| **Net Revenue** | Total sales revenue, excluding any sales returns, allowances, and discounts, calculated in accordance with applicable accounting standards. |
| ***Net Operating Assets*** | Tangible and intangible fixed assets plus working capital calculated on an average basis for a relevant fiscal year in accordance with applicable accounting standards<br><br>*Tangible fixed assets include property, plant, and equipment net of accumulated depreciation plus land plus net capital leases. Intangible fixed assets include all intangible fixed assets, net of accumulated amortization, but excluding goodwill. Working capital is the sum of stock plus debtors less creditors.* |
| **Net Operating Asset inte nsity** (OAS) | The ratio of net operating assets to net revenues expressed as a percentage. |
| **Operating Expense Int ensity** (OEI) | The ratio of operating expenses to net revenue is expressed as a percentage. |

[1]https://www.oecd.org/tax/beps/release-of-report-on-amount-b-relating-to-the-simplification-of-transfer-pricing-rules-and-conforming-changes-to-the-commentary-of-the-oecd-model-tax-convention.htm

[NNS1]TP means Tested Party and J mean jurisdiction