Tax Insights
from Transfer Pricing

Treasury releases Pillar One Amount B Guidance

December 23, 2024

In brief

What happened?

On December 18, Treasury and the IRS issued guidance (Notice 2025-04) (Notice) announcing their intention to issue proposed transfer pricing regulations adopting the simplified and streamlined approach (SSA) (i.e., Amount B) of Pillar One as a taxpayer-elective safe harbor.

According to the Notice, the proposed regulations will "provide a new method for pricing certain controlled transactions involving baseline marketing and distribution activities" as described in the OECD's February 2024 Report on Amount B (OECD Report). The Notice states that Treasury and the IRS expect that the proposed regulations will not substantively diverge from any aspect of the OECD Report and will implement the substance of the OECD Report in its entirety. See PwC's Tax Policy Bulletin dated March 14, 2024.

Why is it relevant?

The introduction of the SSA provides US taxpayers with a new method for determining transfer prices for specific controlled transactions where the new method is intended to simplify the application of an existing specified method – the comparable profits method (CPM). US taxpayers generally may rely on the SSA for their US tax reporting for tax years beginning on or after January 1, 2025, and before proposed regulations are published in the Federal Register. This alignment with the OECD's international framework aims to offer consistency in tax treatment across jurisdictions, which is crucial for multinational enterprises. However, potential challenges may exist if the counterparty jurisdiction does not adopt the SSA, with such inconsistency raising the possibility of disputes.

Understanding the implications of this notice is essential for businesses to assess compliance and analyze their transfer pricing strategies.

Action to consider

Taxpayers engaged in distribution activities that could fall within the scope of the SSA should evaluate the potential impact of the SSA on their existing transfer pricing policies. It is important to determine whether electing the SSA would be beneficial and to identify any necessary steps to qualify for its application. Additionally, taxpayers and organizations should consider participating in the public comment process, with written comments requested by March 7, 2025, to help shape the final regulations.

It is also critical to analyze the tax policies of counterparty jurisdictions to anticipate potential challenges if they do not adopt the SSA. Aligning SSA pricing with general transfer pricing rules may reduce risks in the event of disputes and potential mutual agreement procedure proceedings.

In detail

Notice 2025-4

In a 26-page notice, Treasury and IRS announced their intention to adopt the SSA ("at a minimum") as a taxpayer-elective safe harbor, which would permit taxpayers that are subject to US tax with respect to in-scope transactions (both US distributors and US-related suppliers) to elect to apply the SSA for tax years beginning on or after January 1, 2025. The election (for now) must be made on a transaction-by-transaction basis and for each tax year during which that transaction occurred. The Notice provides details on qualification, application of the pricing matrix, proposed procedures to elect the SSA, and documentation requirements (including a list of requirements to maintain sufficient books and records).

***Observation*:** As agreed by the OECD Inclusive Framework (IF), jurisdictions have the option of adopting Amount B for fiscal years commencing on or after January 1, 2025. If a country chooses to apply it, there are two options: (Option 1) make it a taxpayer-elective safe harbor available when the tested party meets the scoping criteria, or (Option 2) make it binding on in-scope taxpayers at the election of the tax administration of the Distributor Country.

The Notice states that Treasury and IRS continue to consider whether proposed regulations should permit the IRS to apply the SSA to in-scope transactions consistent with Option 2. Treasury and IRS also are considering whether the SSA should include a requirement of consistent treatment such that a taxpayer's election to apply the SSA would be applied in some manner other than on a transaction-by-transaction and tax year-by-tax year basis. As noted below, comments are requested on both of these issues.

The Notice states that the SSA is meant to be a simplifying measure that "reflects a carefully balanced tradeoff between reliability and administrability" that is intended to "alleviate administrative burdens, reduce compliance costs, reduce the likelihood of lengthy, expensive and unnecessary cross-border tax disputes." In this way, the SSA is suggested to be similar to the safe haven interest rate of Reg. 1.482-2(a)(2)(iii) or the Services Cost Method of Reg. 1.482-9(b). Similar to those safe harbors, to the extent a valid election to apply the SSA is made to an in-scope transaction, the IRS will respect the SSA as the best method. However, unlike those other safe harbors, the SSA is expected to closely approximate the result under the best method, given that it determines a return based on comparables and is sensitive to material factual differences between the comparables and the tested parties.

To the extent the comparable uncontrolled price (CUP) method "can be applied more reliably than the SSA," however, the SSA will not be treated as the best method. The condition as provided in the OECD Report may be interpreted as allowing, but not requiring, an exception to the SSA in favor of the CUP method when suitable

internal comparable transactions exist. At the end of the Notice, Treasury and the IRS specifically solicit comments on whether the application of the SSA should be at the exclusive election of taxpayers or whether the IRS may impose the SSA in the absence of a taxpayer election.

Observation: The ability for either tax authority to override the election of the SSA with internal CUPs may inject subjectivity into the analysis and undermine the value of a straightforward safe harbor.

Qualification

The Notice outlines several requirements for the SSA to be elected:

1. The controlled transaction must fit within a category of qualifying transactions (within the meaning of section 3.1 of the OECD Report).
2. A qualifying transaction also must be an in-scope transaction. Determining whether a qualifying transaction is an in-scope transaction requires reference to the operating expenses-to-revenues scoping criteria within paragraph 13.b of the OECD Report.
3. If a qualifying transaction is determined to be an in-scope transaction, a taxpayer must make an election by filing a statement with its tax return indicating the transaction(s) to which the SSA is elected.
4. The taxpayer must maintain permanent books of account and records substantiating its application of the SSA "to allow verification that the taxpayer properly determined its income under the SSA."

Application

Where a controlled transaction qualifies for SSA treatment, the appropriate return to the tested party is determined mechanically by reference to a pricing matrix in section 5 of the OECD Report. If the tested party's reported return on sales (ROS) falls within the relevant range within the pricing matrix, no adjustment will be made by the IRS. Where the ROS results fall outside of the relevant range, the IRS may adjust the income of the tested party as required for the ROS of the tested party to equal the ROS specified in the applicable pricing matrix as depicted in the OECD Report.

Section 482 adjustments

The IRS may challenge whether the transaction is an in-scope transaction, whether an election to apply the SSA has been properly made, and whether the income allocation has been properly calculated under the SSA. If a transaction is determined not to be an in-scope transaction, general Section 482 principles and the best method rule of Reg. 1.482-1(c) apply in the determination of an arm's-length result.

Where the SSA is properly elected (e.g., the transaction is in-scope) and applied (e.g., taxpayer makes valid election) and where no internal comparable can be applied more reliably than the SSA, the IRS is limited in making an adjustment under Section 482 to (1) the amount charged for the in-scope transaction to the amount properly determined under the SSA and (2) any related amounts properly determined under other rules under Section 482.

***Observation*:** For a controlled transaction that is an in-scope transaction and for which a proper election of the SSA is made, potential transfer pricing adjustments may be restricted to the correct application of the pricing matrix.

Competent authority considerations

Because the SSA remains optional for countries to adopt, the Notice cautions taxpayers that the competent authority of one government cannot support a taxpayer's position based on the SSA if the other government has

not implemented the SSA or agreed to accept the application of the SSA in that case (this is consistent with section 8 of the OECD Report). It also instructs taxpayers to carefully consider potential inconsistencies between jurisdictions' policies with respect to the SSA in deciding (1) whether to elect the SSA under US law or foreign law, (2) whether to otherwise rely on the SSA, or (3) the extent and nature of documentation to create and maintain.

Observation: A transfer pricing outcome under Amount B in an adopting jurisdiction will not be binding on a non-adopting counterparty jurisdiction. However, the OECD IF made a political commitment to respect the outcome determined under the SSA to in-scope transactions where such approach is applied by "Covered Jurisdictions." According to Footnote 6 of the Notice, the United States intends to respect the proper application of the SSA by US taxpayers regardless of whether the Distributor Country is a Covered Jurisdiction.

According to the Notice, the mere fact that an activity does not qualify for the SSA should not be interpreted to mean that such activity generates lower or higher returns than is permissible under the SSA "or that the returns provided by the SSA for in-scope taxpayers represent a 'floor' or a 'ceiling' for returns to distribution activities in general."

OECD updates

On December 19, the OECD released a 'pricing automation tool' and fact sheets related to Amount B. The Excel-based pricing automation tool automatically computes the Amount B return for an in-scope tested party, and will be updated annually to reflect any changes to the pricing matrix and other relevant data points. Inputs required include certain income statement and balance sheet items over a three-year period, as well as industry grouping information. The fact sheets provide a high-level overview of the mechanics of Amount B.

The OECD also announced that it will hold a technical webinar on February 11, 2025 on the latest developments relating to Amount B, including a demonstration of the tool. We will share registration details once available.

Let's talk

For a deeper discussion of how the Amount B Notice might affect your business, please contact:

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