

OECD Releases Pillar One Amount B

19 July 2023

In brief

On 17 July 2023, the OECD released an updated [public consultation document](#) on Amount B of Pillar One, which attempts to simplify the transfer pricing of certain baseline wholesale marketing and distribution activities by providing agreed returns, as laid out in a “pricing matrix,” to the source country on such activities. The OECD also published a short overview, titled “[Amount B in a Nutshell](#),” to assist stakeholders in understanding Amount B. Comments are due 1 September 2023. The consultation document outlines the design elements of Amount B and identifies aspects which require further work, including:

- Ensuring an appropriate balance between quantitative and qualitative approaches in identifying baseline distribution activities;
- Determining the appropriateness of the pricing framework and its application; and
- Identifying the criteria to apply Amount B utilising local databases in certain jurisdictions.

The IF plans to approve a final report on Amount B and incorporate key content into the OECD Transfer Pricing Guidelines (TPG) by January 2024. It is important to note that the proposals outlined in the consultation document represent the work of the OECD Secretariat, since the IF has not yet reached consensus on them. Their basic design may be subject to change, unrelated to the consultation process.

The takeaway: The potential implementation of Amount B, contingent upon its final scope design, holds out the promise of streamlining existing transfer pricing procedures by taking certain activities and the return due on them out of controversy, by providing certainty on pricing for tax authorities and taxpayers alike. It is therefore crucial for businesses operating with limited risk distributors, commissionaires, and/or sales agents to closely monitor these developments and assess their implications for their current transfer pricing policies. Notably, the proposed outcomes are subject to variations across industries and distributors with slightly different features. Amount B is meant to apply to a large range of industries buying and selling tangible goods, including consumer goods, alcohol and tobacco, construction, vehicles, IT hardware, software and components, textiles, machinery and tools, and pharmaceuticals.

In detail

Overview

The language in the consultation document is drafted for inclusion directly into the TPG. The proposed simplified and streamlined approach demonstrates an application of the general principles of the TPG, covering the scoping criteria for qualifying baseline distribution activities, the selection of the transactional net margin method (TNMM) for the in-scope transactions and the application and specification of a pricing matrix to determine the arm's length return for in-scope activities. The consultation document also discusses documentation requirements, transitional issues related to the adoption of Amount B and tax certainty.

Qualifying Transactions

The scoping criteria for Amount B applies to “qualifying transactions” of the following types:

- Buy-sell marketing and distribution transactions where the distributor purchases goods from one or more associated enterprises for wholesale distribution to unrelated parties; and
- Sales agency and commissionaire transactions where the sales agent or commissionaire contributes to one or more associated enterprises' wholesale distribution of goods to unrelated parties.

Notably, retail business models and the provision of commodities and non-tangible goods and services are outside the scope of Amount B, limiting its potential as a simplification measure. The consultation document also notes that further work will be undertaken to determine the appropriateness of the application of the framework to the wholesale distribution of digital goods and specifically requests stakeholder input on this.

Scoping criteria

There is some good news on scoping criteria for qualifying transactions to be covered under Amount B. The [previous consultation](#) proposed twelve different qualitative and quantitative criteria, but the current document reduces this to four scoping criteria (which are not the subject of the consultation). Specifically, a qualifying transaction must:

- Exhibit economically relevant characteristics that can – under the principles of the TPG – be reliably priced using a one-sided method, with the distributor being the tested party;
- Meet certain quantitative filters based on operating expenses and net sales;
- Exclude the provision of services or distribution of commodities; and
- Demonstrate that non-distribution activities can be accurately delineated and adequately evaluated on a separate basis under the general principles of the TPG.

The consultation document provides an exception to this, where the taxpayer (or a taxing authority) can assert the application of an internal comparable uncontrolled price (CUP) method as the appropriate method (under the applicable principles of the TPG) to exclude from scope of Amount B a transaction that otherwise meets the above scoping criteria.

One of the key questions of the consultation is whether Amount B should also include additional qualitative criteria - labeled “Alternative B” – (i.e., following an examples-based qualitative approach) to identify and exclude non-

baseline contributions. Such qualitative criteria would scope out non-baseline distribution arrangements that can be priced using a one-sided method but would not be reliably priced under a simplified and streamlined approach.

It is clear that some countries do not support having additional scoping-out criteria when scoping-in criteria are well designed and possibly reinforced with quantitative elements (e.g., operating expenses to sales and/or operating assets to sales ratios).

Other jurisdictions see the additional scoping-out criteria as important to ensure there are no incentives to shift profits and base erode. These jurisdictions aim at keeping the scope of Amount B as narrow as possible; they believe Amount B can only apply to a subset of arrangements that can be priced using a one-sided method.

Observation: It seems that were additional scoping-out criteria to be adopted, that would require companies to replicate a large part of the delineation work that today creates a lot of uncertainty. If the scoping-in criteria are well-designed from the onset, it is difficult to understand why a simplification approach would need additional scoping-out criteria. This is compounded by the fact that the proposed additional qualitative criteria are subjective in nature and by the fact that low-capacity jurisdictions will find it difficult to work with such subjectivity. As such, some of the benefits of simplicity and tax certainty that were the original objectives of Amount B could be negated.

Pricing Matrix

The entire section on pricing is subject to consultation and it is useful to see that the note encourages commentators to include empirical data and analysis in support of their comments. The pricing matrix is the heart of Amount B because it provides the agreed returns on the marketing and distribution activities that are intended to recompense source countries and provide certainty to taxpayers.

This is particularly important as the consultation document presents for the first time the pricing matrix based on return on sales (ROS) for Amount B. The pricing matrix has two dimensions – industry grouping and factor intensity. There are three industry groupings and five factor intensity categories with each such factor intensity category representing a combination of asset intensity (i.e., operating asset to sales ratio) range and operating expense intensity (i.e., operating expense to sales ratio) range. The pricing matrix thus has a total of 15 distinct target ROS outputs (each with a band of +/- 0.5 percent), ranging from 1.5% to 5.5%. There is a Berry ratio floor (1.05 of the Amount B approach) and ceiling (1.5) that applies equally to all industries.

To apply the pricing matrix to an in-scope qualifying transaction, the tested-party distributor would be mapped to the appropriate target ROS within the pricing matrix based on its industry category and the factor intensity combination. The specified target ROS +/- 0.5 percent would serve as the applicable arm's length range for the tested party distributor. The tested party distributor's ROS result would need to be calculated on a weighted average basis covering the most recent three-year financial period.

The basic or default pricing matrix is superseded for two types of jurisdictions, which would instead rely on a modified pricing matrix. The first type of jurisdiction is one that uses a "qualifying local dataset" (produced by the tax administration) with certain conditions. The consultation document notes that a list of jurisdictions with qualifying local datasets will be published and periodically updated. It also specifically requests stakeholder input on the appropriateness of the criteria to apply Amount B utilising a local database in certain jurisdictions.

The second type of jurisdiction is one with a sovereign credit rating below BBB. For these jurisdictions, the ROS results of the basic/default pricing matrix can be increased through a formula. This "net risk adjustment" allegedly seeks to accommodate the higher return that an investor would require to invest in a riskier economy.

The pricing matrix will be updated every five years.

Observation: While it is useful to see the pricing matrix to understand the ranges of returns considered by the IF, there is not much detail on how the figures have been determined. A description of which empirical and econometric models were applied to the dataset would be important to assess the robustness of the returns presented in the consultation document. Additionally, the net risk adjustment specified in the pricing matrix approach could be significant for some countries (given the spread in sovereign credit ratings). Support for this adjustment could help promote transparency and stakeholder buy-in.

Documentation

The consultation document suggests that the current content of the local file should largely contain the relevant information necessary to satisfy documentation requirements. However, when the taxpayer seeks 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; if a shorter term is needed, the taxpayer should provide an explanation.

Dispute resolution

Primary transfer pricing adjustments under Amount B will be subject to verification and corresponding adjustment through mutual agreement procedures. The consultation document notes that more work is to be done on this and other points, such as the degree to which the approach will dictate dispute resolution (e.g., whether the approach may also be considered by competent authorities in resolving mutual agreement procedures even though neither the taxpayer nor the tax administrations of the jurisdictions involved have asserted it). The consultation document also provides that bilateral APAs entered into prior to the final adoption of Amount B would continue to be valid throughout the duration of the APA.

PwC's Tax Readiness Webcast: The current state of the OECD's two-pillar solution

While there is uncertainty around Pillar One (both on the timeline and on whether a critical mass is achievable), many countries have begun implementing Pillar Two, and the OECD IF continues to release substantive guidance in key areas. Join our CPE-eligible webcast for the latest updates on the OECD's two-pillar solution.

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Let's talk

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

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