BEPS 2.0 Pillar 1:

Amount B - Simplified Approach

Introduction

On 19 February 2024, the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (BEPS) released a report, streamlining the approach and application of Amount B, a key component of Pillar One.

This newly issued report provides guidance designed to simplify the application of Transfer Pricing (TP) rules to baseline marketing and distribution activities, with a particular focus on the needs of countries with low-capacity tax administrations or jurisdictions lacking local comparables. A particularly cardinal milestone for the TP landscape for most developing African countries which account for a majority of the low capacity jurisdictions.

Reports from some low-capacity jurisdictions estimate that TP disputes relating to distribution activities represent between 30% and 70% of all of their TP disputes.

With a more simplified and streamlined approach, the guidelines are expected to enhance the concept of tax certainty and reduce the aforementioned TP dispute statistics, as well as relieve compliance burdens for taxpayers and tax administrations. These take effect from 1 January 2025.

Background of Pillar 1

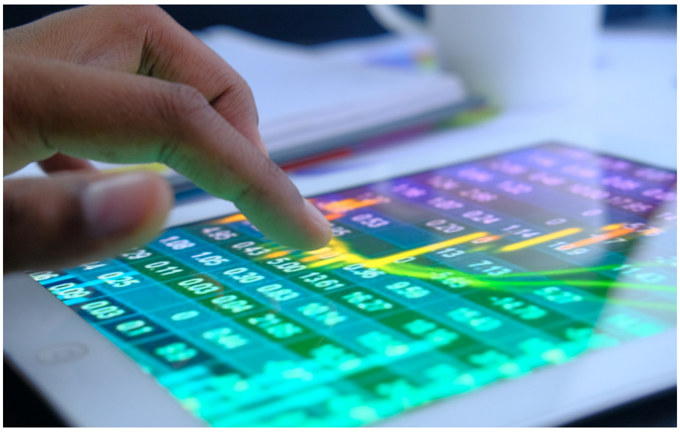
Pillar 1 is the OECD's first step in the two pillar approach aimed at addressing the tax challenges arising from the digitalisation of the economy.

The concept of Pillar 1 borders on reallocating taxing rights to market jurisdictions where Multinational Enterprises (MNE's) have no physical presence but participate significantly in their sales/consumer activities.

In essence, Pillar 1 focuses on reallocating a portion of the MNE group's consolidated profits to jurisdictions where sales functions occur (Amount A) as well as encourages a standardised remuneration for routine marketing and distribution activities (Amount B).

Amount B in a nutshell

Amount B, a critical component of Pillar 1, was intended to simplify the existing TP rules for all taxpayers involved in the wholesale distribution of goods, including commissionaires and sales agents. Specifically, it is focused on the application of TP rules to 'baseline' marketing and distribution activities taking into account the challenges that low-capacity jurisdictions face such as the lack of comparable data and limited financial resources in applying TP.



What transactions are in scope of Amount B?

The OECD's Consultation Document acknowledges that the precise definition of what constitutes 'baseline' distribution is subject to further consideration. Nonetheless, it provides that common features of 'baseline' distribution would include the absence of unique and valuable intangibles or certain economically significant risks.

The performance of services and distribution of commodities are explicitly excluded from scope.

What is the simplified pricing framework for in-scope transactions?

For transactions that meet the above criteria, the pricing is to be done with reference to a pricing matrix, except for situations where internal comparable uncontrolled prices (CUPs) are available.

The pricing matrix provides a grid of arm's length returns expressed as returns on sales. To get the appropriate arm's length return, the distributor's specific features such as the level of operating assets, operating expense and the industry are taken into account. Specifically, the matrix refers to operating assets to sales intensity (OAS), operating expense to sales intensity (OES) and industry, as shown below, and provides the expected remuneration for the transaction.

For the purposes of the simplified and streamlined approach, return on sales has been applied as the net profit indicator to establish the arm's length pricing outcomes for in-scope transactions.

Fig. 1: Pricing Matrix (Return on Sales %)

Industry Grouping / Factor Intensity	Industry Grouping 1	Industry Grouping 2	Industry Grouping 2
[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

Key takeaways from the new guidelines

1. The identified set of controlled transactions within scope of this simplified and streamlined approach have been more clearly identified.
2. The characteristics under which a distributor is within scope of Amount B is now clearly outlined.
2. Cases in which a distributor is allowed to perform certain non-distribution activities, such as manufacturing, are highlighted.
3. The activities that may exclude a distributor from the scope of the simplified and streamlined approach are outlined (i.e. the distribution of commodities or digital goods).
4. The report provides guidance on documentation, transitional issues, and tax certainty considerations.

Implementation of the streamlined approach

Countries that opt to implement the streamlined approach have been given two options intended to simplify the pricing of in-scope transactions. That is:

- **Option One:** A jurisdiction can permit tested parties resident within its jurisdiction to elect to apply the simplified and streamlined approach.
- **Option Two:** The approval of the tax administrators in that jurisdiction must be sought, where the scoping criteria is met.

The simplified approach is designed to provide a solution that resembles an arm's length outcome within the jurisdiction of the tested party and as such must be applied in conjunction with an appropriate TP method. For these purposes, the Transactional Net Margin Method (TNMM) has been chosen as the most appropriate method.

Conclusion

Pillar 1 seeks to tackle tax challenges related to digitalisation by shifting taxing rights to market jurisdictions where MNEs engage in sales/consumer activities without a physical presence.

Amount B streamlines current tax rules for taxpayers engaged in wholesale distribution of goods, such as commissionaires and sales agents. It applies tax rules to marketing and distribution activities described as 'baseline', taking into account challenges faced by low-capacity jurisdictions. This pricing framework for in-scope transactions utilises a pricing matrix, with return on sales as the net profit indicator.

International cooperation will play a key role in the successful implementation and will aim to minimise tax disputes in low-capacity jurisdictions.

For a further discussion please feel free to contact us.

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