

PUBLIC CONSULTATION DOCUMENT

# Pillar One – Amount B

8 December 2022 – 25 January 2023



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## Background

On 14 October 2020, the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (IF) released the report “Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint”. The Blueprint stated that Amount B was intended to streamline the process for pricing baseline marketing and distribution activities in accordance with the arm’s length principle (ALP), thereby aiming at enhancing tax certainty and reducing resource-intensive disputes between taxpayers and tax administrations. The Blueprint additionally noted that Amount B should address the needs of low-capacity jurisdictions (LCJs).

On 8 October 2021 the IF agreed a two-pillar solution to address the tax challenges arising from the digitalisation of the economy. The IF [Statement](#) described Amount B as one of the components of Pillar One, and mandated Working Party No. 6 and the FTA MAP Forum to undertake the technical work to design Amount B.

*The application of the arm’s length principle to in-country baseline marketing and distribution activities will be simplified and streamlined, with a particular focus on the needs of low-capacity countries.*

The IF mandate thus means that Amount B needs to simplify and streamline the pricing of in-country baseline marketing and distribution activities, while ensuring outputs consistent with the arm’s length principle for all in-scope transactions. Moreover, a particular concern of LCJs has been the relative unavailability of appropriate local market comparables through which arm’s length prices can be established. Amount B aims therefore to specifically address this issue by providing a basis to establish an arm’s length price in all cases using suitable comparables, wherever they are geographically drawn from. In this respect, the proposed simplification and streamlining of the process under Amount B would not only provide benefits to LCJs as improved and harmonised processes would provide tax certainty benefits for all IF jurisdictions.

On September 30, the IF approved revising the timeline for Amount B to align with that of Amount A and to allow for the technical work to be completed by mid-2023. To that aim, the IF will consider public comments to this document with the objective of releasing the final Amount B deliverable by mid-2023.

## Aim and structure of the public consultation document

This consultation document outlines the main design elements of Amount B, i.e. the scope, the pricing methodology and the current status of discussions concerning an appropriate implementation framework, and seeks inputs from stakeholders in a number of specific questions.

The main challenge in designing Amount B relies on the significant linkages across its three main design elements. Jurisdictions recognise that some of the features considered for scoping purposes cannot be decided until further information becomes available in the context of the developing the Amount B pricing methodology, which would itself inform the feasibility of some of the options being considered for implementing Amount B. These interactions need to be borne in mind in the context of the discussions included in this consultation document.

The scope of Amount B defines the controlled transactions that would be subject to Amount B and sets out qualitative and quantitative criteria to help that determination. If the scoping criteria are met and the taxpayer is therefore within the scope of Amount B, the Amount B pricing methodology would be applied to establish the arm's length price for the in-scope transaction, subject to potential exemptions currently under consideration. See Section 3.

On-going work with regards to the Amount B pricing methodology is reflected in Section 4 which describes relevant aspects of the benchmarking criteria, the net profit indicators and the comparability adjustments that would need to be considered in pricing transactions in scope of Amount B. The design of the Amount B pricing methodology has significantly progressed and this consultation document provides a summary of its key features and notes the further analysis that is required to be undertaken.

Upon completion of the design of Amount B, the IF will be in a position to consider the best implementation framework for Amount B. The implementation framework of Amount B refers to the parameters for determining the baseline marketing and distribution activities to which Amount B applies. The appropriate design of the Amount B implementation framework requires consideration of several interrelated aspects. First, the implementation framework will need to ensure that the Amount B objectives stated in the IF [Statement](#) are achieved, in particular with regards to its adherence to the arm's length principle and its capacity to mitigate the risk of double taxation and double non-taxation. Second, the implementation framework will need to consider that IF member jurisdictions have different legal systems, which could have an impact on how Amount B is eventually designed. Against this backdrop, the IF is currently assessing the appropriateness of different means of implementing Amount B with the expectation that the Amount B guidance will have a broad and consistent application amongst jurisdictions. Ideally, this could be achieved through the inclusion of the Amount B guidance in the OECD TPG. However, there is not a common view on the form of the implementation at this stage and other options are being explored, including consideration of the mandatory or elective nature of Amount B. These options range from designing Amount B as a safe harbour (as defined in Chapter IV of the OECD Transfer Pricing Guidelines) to prescribing Amount B as the interpretation of how the arm's length principle applies to baseline marketing and distribution activities. Resolution of these issues can have an impact on the design of certain aspects of Amount B, such as the adoption of the potential exemptions described in Box 3.2, as well as implications in the level of tax certainty attained with Amount B. While this consultation document is not inviting specific comments on any particular implementation option, commentators are invited to indicate whether their answers to certain questions would be impacted by alternative approaches to the implementation of Amount B. If so, commentators are invited to elaborate their answers.

Finally, the IF will also consider the appropriateness of a mechanism to collect information from jurisdictions on the actual application of Amount B to assess its impact and effectiveness.

### **Public consultation instructions**

This is a consultation document released by the OECD Secretariat for the purposes of obtaining input from stakeholders on the technical design of Amount B. It presents the work undertaken to date, which has reached a sufficient level of detail and stability that public comments would be appropriate and helpful, though it does not yet reflect the final views of the IF. IF members have agreed to release this consultation document on

the basis that it is without prejudice to the final agreement on the different design elements of Amount B.

The comments provided will assist members of the IF in completing the work on the technical development of Amount B. Comments are sought with respect to the specific questions outlined in this document and with respect to the overall technical approach to the Amount B design features included in this document. Where relevant, input should refer to the relevant design features. While general comments are invited on any aspect of the design features, input will be most helpful in areas where commentators hold the view that certain specific design feature or features could be modified in a manner that better satisfies the IF mandate as well as input on whether anything is missing or incomplete in the rules.

Interested parties are invited to send their comments electronically (in Word format) by email to [transferpricing@oecd.org](mailto:transferpricing@oecd.org) no later than 25 January 2023<sup>1</sup>

Please note that the proposals included in this consultation document have been prepared by the OECD Secretariat, and do not represent the consensus views of the Inclusive Framework, the Committee on Fiscal Affairs (CFA) or their subsidiary bodies.

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<sup>1</sup> Please note that all written comments received will be made publicly available on the OECD website. Comments submitted in the name of a collective “grouping” or “coalition”, or by any person submitting comments on behalf of another person or group of persons, should identify all enterprises or individuals who are members of that collective group, or the person(s) on whose behalf the commentator(s) are acting.

## 1. Introduction

1. Distribution is a key function for MNEs in successfully realising the value created throughout the different stages of their businesses.

2. In general, the concept of distribution is broad, and comprises the performance of marketing, sales and logistics functions, such as buying goods for resale, performing promotional or advertising functions, warehousing goods, identifying customers, concluding sales and processing orders, invoicing and collection or providing customer support. Distribution may refer to wholesale or retail distribution activities where either activity may represent the last stage of the supply chain for the MNE Group. That would be the case of a wholesale distributor that transfers the title and physical goods to associated retail distribution enterprises or of a retail distributor that transfers goods to independent customers.

3. In the context of the controlled transactions considered within the scope of this document, a common type of distribution arrangement involves an associated enterprise that distributes on a wholesale basis to third parties goods supplied by associated enterprises. While the value-add contribution of the distributor can vary widely, depending on the economic significance of the functions performed, the risks assumed and the assets used, baseline wholesale distribution arrangements refer to those arrangements where the functions performed, assets owned, and risks assumed in relation to the controlled transaction are on the lower portion of the spectrum of the significance of uncontrolled distributors' functions performed, assets owned, and risks assumed in relation to their uncontrolled transactions. The position of the wholesale distributor in this functional, asset and risk spectrum together with other economically relevant characteristics will play a part in determining the appropriate arm's length return, and lower positions in the spectrum are generally associated with lower expected arm's length returns.

4. Transfer pricing disputes are common with respect to such distribution arrangements between related parties. Many of those disputes arise in relation to the accurate delineation of the arrangement and often focus on whether the arrangement involves "baseline" distribution or whether it involves the performance of more complex activities, for instance, when the distributor assumes economically significant risks related to the distribution of the products. Disputes are also common with respect to the pricing considerations of marketing and distribution arrangements, commonly focusing on areas such as the selection of the transfer pricing method, the appropriateness of the benchmarking analysis or the identification of comparables with respect to certain geographical markets or, where necessary, how to make appropriate comparability adjustments.

5. Inclusive Framework (IF) members have consequently identified the need to simplify and streamline the application of the arm's length principle to such in-country baseline distribution arrangements, where the potential for disputes and the compliance burden for taxpayers, and the administrative burden for tax administrations, may be disproportionate to the amounts of tax involved or the relative difficulties and complexities of the transfer pricing issues inherent in the relevant controlled transactions. Such efforts will also focus on the specific needs of Low-capacity Jurisdictions ("LCJs") in administering the application of the arm's length principle to such transactions.

6. This consultation document seeks to outline the progress made in defining what in-country baseline marketing and distribution arrangements are, how they may be identified in practice, and subsequently how in-scope arrangements may be priced in a simplified and

streamlined manner, in accordance with the arm's length principle. It also identifies areas where further work is being undertaken and solicits contributions from the public with respect to certain aspects currently under consideration, but comments on all aspects of the work are welcomed.

## 2. Amount B mandate and goals

7. As made clear by the IF mandate of October 2021, Amount B is intended as a simplification and streamlining measure in applying the arm's length principle based on the guidance provided in the OECD Transfer Pricing Guidelines ("OECD TPG").

8. Amount B first defines a streamlined and simplified approach to appropriately reflect the accurate delineation of in-scope transactions in a set of qualitative and quantitative tests. This is to be achieved through the application of the scoping criteria listed in Section 3, which will be subject to further refinement by IF members in light of the comments submitted by stakeholders. Moreover, Amount B will apply a specific methodology to price such in-scope transactions first by determining the transfer pricing method to utilise, and second by defining the basis through which an arm's length price may be set. Finally, the means of implementation itself will be determined upon completion of the Amount B design. This will be a matter of implementing the simplification measure in a manner that is as easy as possible for jurisdictions to apply in practice, that should lead to maximum consistency in application between jurisdictions, and that leads to the minimum possible uncertainty in applying the criteria in more challenging cases, such that the goals of Amount B may be achieved.

9. Concerning the permissible *degree* of simplification in these areas which is afforded under the OECD TPG, various areas of the OECD TPG highlight the fact that the relationship between reliability and administrability is an important one to be considered when applying the ALP. References to this issue may be found in paragraph 1.7, paragraph 1.13 and in various other areas, including in the discussion in Chapter IV. The application of the relevant specific principles considered in Chapter IV of the OECD TPG should be specifically considered in this discussion, as they evaluate (amongst other things) the application of simplification measures designed at increasing administrability of the ALP. In particular, Section E of Chapter IV of the OECD TPG provides a detailed discussion on how the administrability of the ALP might be eased by the use of certain simplification measures (labelled safe harbours there), the trade-off with accuracy in applying the ALP such measures provide, and what challenges may be found in implementation of such measures. With this relationship in mind, the IF is in the process of developing

- (i) what the ultimate scoping criteria will be for taxpayers intended to be in-scope for Amount B purposes, and how they may be measured so that the accurately delineated controlled transaction qualifies as an in-scope transaction, including due consideration of where qualitative analysis of specific facts of circumstances is required and where quantitative simplifications designed to measure the performance of specific activities are appropriate;
- (ii) the Amount B pricing methodology, and whether any exemptions to applying the Amount B pricing methodology should apply; and
- (iii) what are the feasible means of simplifying the comparability analysis in the Amount B pricing methodology such that it remains aligned with both the OECD TPG and the policy goals of Amount B.

10. For (i), the question of establishing the scoping criteria has been extensively discussed by the IF and the results of those discussions are reflected on a tentative basis in this document. Insights are sought from commentators on certain key questions that aim to support the final determination by the IF of the inclusion or exclusion of certain criteria.

11. For (ii), the Amount B pricing methodology is based on the Transactional Net Margin Method (“TNMM”); however, the IF is considering two exemptions that may impact this policy choice. The first exemption under consideration is whether the Amount B pricing methodology should not be applied when local market comparables are available to price the transaction. The second exemption under consideration would apply if a method other than the TNMM is the most appropriate method (“MAM”) in particular cases. These potential exemptions are discussed in Box 3.2 in Section 3.4.2.

12. For (iii), there is extensive discussion in Section 4 of this document regarding the features and potential design of the Amount B pricing methodology. Under consideration by the IF in developing this design is how the pricing approach will need to optimise the balance between the different goals of Amount B, on one hand requiring adherence to the arm’s length principle, but in a manner that provides for meaningful simplification and streamlining that also satisfies the challenges that LCJs face in administering the arm’s length principle with respect to in-scope distribution arrangements.

13. The design of Amount B requires therefore due consideration of the trade-off between these goals and an appropriate balance to be struck. For example, various areas of the OECD TPG highlight the fact that the relationship between reliability and administrability is an important one to be considered when applying the ALP. References to this issue may be found in paragraph 1.7, paragraph 1.13 and in various other areas, including in the discussion in Chapter IV. The application of the relevant specific principles considered in Chapter IV of the OECD TPG should be specifically considered in this discussion, as they evaluate (amongst other things) the application of simplification measures designed at increasing administrability of the OECD TPG. In particular, Section E of Chapter IV of the OECD TPG provides for a detailed discussion on how the administrability of the ALP might be eased by the use of certain simplification measures (labelled safe harbours there), the trade-off with accuracy in applying the ALP such measures provide, and what challenges may be found in implementation of such measures, all in the context of evaluating their utility in practice.

### 3. Scope of Amount B

#### 3.1. Qualifying transactions and scoping criteria

14. Amount B would apply to the following intra-group transactions, where either category of tested party is referred to collectively as “distributors”:

- a. Buy-sell arrangements where the tested party purchases goods from one or more associated enterprises resident in other jurisdictions for wholesale distribution to unrelated parties primarily in its local market; and
- b. Sales agency and commissionaire arrangements where the tested party contributes to wholesale distribution of goods for a related party and to the extent they exhibit economically relevant characteristics similar to those outlined in the scoping criteria for Amount B. Additional considerations regarding the inclusion of sales agency and commissionaire arrangements in the scope of Amount B are discussed in Box 3.1 in Section 3.4.1.

15. When the transaction is of either category described above, a taxpayer or tax administration should review whether the Amount B scoping criteria articulated in the following paragraphs are met. The scoping criteria outline the economically relevant characteristics that a controlled transaction should exhibit to be in scope and, therefore, the determination of whether a transaction is or is not within the scope of Amount B is not driven by the adoption of a specific marketing and distribution business model, but primarily by the level and type of functions performed, assets owned, and risks assumed by the parties to the controlled transaction.

16. The scoping criteria, set out below, aim to reflect the accurate delineation of a controlled marketing and distribution transaction under the guidance in Chapter I of the OECD TPG. With the goal of simplification in mind, it is important to note that the scoping criteria do not provide an exhaustive and comprehensive list of activities that qualify as distribution activities; instead they describe the general features that must be considered in determining whether a distributor performs baseline marketing and distribution activities. Consistent with Chapter I of the OECD TPG, the answer to this question should not be based on labels applied to the specific transaction but on the established facts and circumstances of the counterparties to the transaction.

17. The scoping criteria contain a mixture of qualitative assessments that relate to the economically relevant characteristics of the controlled transaction, as well as quantitative measurements that may be derived from the financial statements of the distributor. Such quantitative measurements may establish permissible thresholds of certain ancillary activities that, if not breached, would be deemed to result in the transaction exhibiting economically relevant characteristics that would be within the scope of Amount B. Moreover, quantitative measurements might be used to evaluate whether a distributor might own economically relevant intangible assets under an accurate delineation of the transaction.

18. The IF is currently evaluating the following set of scoping criteria:

- a. Taxpayers must<sup>2</sup> document their qualifying transactions in a written contract<sup>3</sup> that reflects the division of responsibilities, obligations and rights and the assumption

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<sup>2</sup> Some jurisdictions consider that it should be mandatory for a written contract to be prepared by taxpayers in order to qualify for Amount B. Moreover, they consider that this requirement would provide tax administrations, particularly LCJs, with a starting point to accurately delineate the transaction and consequently would simplify the administration of Amount B. This would include providing a clear indication that the intent of the parties is to meet the scoping criteria, subject to the requirement to accurately delineate the transaction in full per the requirements of Chapter I of the OECD TPG. Other countries consider that the language be modified to “should” to reflect that this is not an essential requirement to accurately delineate the transaction and that taxpayers should not be denied the benefit of qualifying for Amount B in the absence of a written contract, when their accurately delineated transaction is in line with those requirements listed in the scoping criteria. Moreover, they view that the requirement or recommendation for a contract is more of an administrative concern, and consequently should be covered solely in the Amount B documentation requirements. Discussions are ongoing on this issue.

<sup>3</sup>The written contract will be considered as part of the accurate delineation of the transaction, as described in section D.1.1. of Chapter I of the OECD TPG, which in turn will be considered relative to the scoping criteria for Amount B to determine whether the scoping criteria have been met. That analysis will evaluate, among other things, the extent to which the written contract terms are consistent with the economically relevant characteristics of the transaction. In cases where a tax administration asserts that the scoping criteria of Amount B have been met, there may or may not be a written contract. If there is no written contract, the contract terms would need to be deduced from other evidence. In other words, (i) consistent with the accurate delineation guidance under the

of the economically significant risks associated with the distribution activities and should not contain terms that are inconsistent with the other scoping criteria noted below.

- b. The distributor must distribute primarily in its market of residence, where the annual net sales generated by the distributor from customers located in other jurisdictions do not exceed [X]<sup>4</sup> of its annual net sales.
- c. The distributor must not perform any economic activity for which it is, or should be, remunerated at arm's length other than its core distribution function. These disqualifying activities may include any one or a combination of the following:
  - i. Manufacturing activities;
  - ii. Research and development activities;
  - iii. Procurement activities; and
  - iv. Financing activities.

The following indicators in the financial statements of the distributor could be used to support any factual determination regarding whether the activities are performed:

- i. For (c)(i): the existence of manufacturing inventory (direct labour and/or work-in-process inventory) and/or the existence of manufacturing assets (e.g. property, plant, equipment);
  - ii. For (c)(ii): research and development expenses, even if reimbursed;
  - iii. For (c)(iii): commission income on procurement functions; and
  - iv. For (c)(iv): the existence of loan assets.
- d. The distributor must not perform any risk control functions<sup>5</sup> that lead, to the assumption of economically significant risks<sup>6</sup> by the distributor based on an accurate delineation of the transaction, that are associated with the development, enhancement, maintenance, protection or exploitation of unique and valuable marketing intangibles, as understood under Chapters VI and I of the OECD TPG.

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OECD TPG, the terms of a written contract are not presumed to accurately reflect the actual controlled transaction in a case where the taxpayer seeks to apply Amount B or a case where a tax administration seeks to apply Amount B; and (ii) the mere absence of a written contract does not preclude application of Amount B by a tax administration. See also paragraph 28 in this consultation document.

<sup>4</sup> Thresholds in this consultation document are noted as [X] as they are currently under consideration by the IF.

<sup>5</sup> Within the meaning of paragraph 1.65 of the OECD TPG.

<sup>6</sup> Certain aspects of this condition and subsequent conditions in this paragraph are currently under consideration by the IF as an open issue. As distributors can undertake risk control and/or DEMPE functions that do not necessarily lead to the assumption at arm's length of economically significant risks related to the generation of intangible assets, but do provide a contribution to the generation of intangible assets, jurisdictions are considering whether distributors that make such contributions should be out of scope for the purposes of Amount B. The scoping condition now only provides for distributors to be out of scope when they undertake risk control functions that mean they would at arm's length assume economically significant risks, based on an accurate delineation of the transaction. Some jurisdictions, however, consider the performance of risk control functions and/or contributions to the generation of intangibles should render a distributor out of scope of Amount B when they involve entitlement to upside and downside returns under para 1.105 of the OECD TPG. Input from commentators is sought on the relation of this issue to the breadth of the scoping criteria, and is highlighted in the questions in Section 3.5.

- e. The distributor should not undertake activities that relate to creating or obtaining the rights to distribute in the market when the creation or obtaining of such rights would itself be remunerated at arm's length, or perform technical or specialised services for third party customers that itself are valuable and remunerable or would play a significant role in maintaining the customer relationship in the market. For example:
  - i. The distributor should not perform any regulatory activities that are valuable and material to the ability to conduct the distribution activity in the market;
  - ii. The distributor should not perform technical or specialised services that support the sale of the product or are essential to the customer relationship in the market (e.g., the distributor does not derive revenues from annual maintenance contracts)<sup>7</sup>.
- f. The distributor must not perform strategic sales and marketing activities relevant to sales in the market if those activities would, under the accurate delineation of the transaction, themselves generate<sup>8</sup> unique and valuable intangible assets relating to the exploitation of the products sold in the market;
- g. None of the customers of the distributor should represent over [X] % of its net sales;
- h. Certain ancillary activities are allowed to be undertaken within the following permissible thresholds<sup>9</sup>:
  - i. Annual net sales of the distributor to end-consumers (retailing) through physical stores and online stores do not exceed [X]% of its annual net sales;
  - ii. The annual marketing and advertising expenses<sup>10</sup> incurred by the distributor do not exceed [X]% of its annual net sales.

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<sup>7</sup> For the purpose of this condition, it is irrelevant whether the services are remunerated separately or the remuneration is embedded in the price of the products.

<sup>8</sup> Similarly to footnote 6, certain aspects of this condition are currently under consideration by the IF as an open issue. Distributors can undertake strategic sales and marketing activities that do not lead to the generation of valuable intangibles that they themselves exploit based on an accurate delineation of the transaction but which do contribute to the control of economically significant risks. Some jurisdictions consider the performance of these activities should not render a distributor out of scope of Amount B when they do not involve entitlement, based on an accurate delineation of the transaction, to upside and downside returns under para 1.105 of the OECD TPG. Input from commentators is sought on the relation of this issue to the breadth of the scoping criteria, and is highlighted in the questions in Section 3.5.

<sup>9</sup> The issue of how to treat certain expenses that, under an accurate delineation of the transaction, may be treated as “pass-through” expenses when calculating the relevant financial ratios is currently under consideration by the IF. Some jurisdictions consider that such pass-through expenses might be considered under the accurate delineation of the transaction as the liability of another group entity, on the basis that they would not relate to activities undertaken by the distributor other than ancillary administrative activities, and should not therefore be considered as relevant to the distribution function at arm's length.

<sup>10</sup> Should any marketing and advertising expenses be incurred by the distributor that, under an accurate delineation of the controlled transaction, should be treated as ‘pass-through’ costs, such that the actual expenses incurred are at arm's length the liability of the counterparty and not the distributor, then these costs should not be included for purposes of computing this financial ratio. One example of such a situation is illustrated in paragraph 7.34 of the OECD TPG, where the

- iii. Packaging and assembly expenses incurred directly by the distributor in relation to the products distributed do not exceed [X]% of costs.
  - iv. Annual expenses related to after-sales product support (including product warranty), facilitating claims with customers, processing product return or similar support services provided by the distributor do not exceed [X]% of annual net [sales/costs].
- i. The ratio of annual operating expenses over annual net sales of the distributor is in the range of [X]% to [X]%.
    - ii. In line with the limitation on activities that lead to the assumption of economically significant risks with respect to the controlled distribution transaction, the distributor would be expected to not assume economically significant risks<sup>11</sup> above what may be defined to be a limited level, including<sup>12</sup>:
      - i. Limited market risk relevant to the market where the distributor distributes its products and arising from, for instance, changes in demand, market trends, or economic circumstances impacting the level of sales and revenues in the relevant market;
      - ii. Limited or no credit risk relevant to the products sold by the distributor;
      - iii. Limited or no inventory risk, including where excess inventory is due to product obsolescence;
      - iv. Limited or no product liability risk for the goods distributed; and,
      - v. Limited foreign exchange risk relevant to costs of purchases or performance of activities, where those are different to the functional currency in which revenues are generated by the distribution in its market.
  - k. In line with the limitation on activities that lead to the generation of unique and economically valuable intangible assets, the distributor must not own<sup>13</sup> any unique and valuable intangible assets, including marketing intangibles (e.g., data centres, investment in infrastructure, trademark license). Furthermore, the distributor would be expected to have no or limited ownership of market access rights or regulatory licenses, that create barriers to entry.
  - l. Notwithstanding the above, Amount B will not apply to controlled distribution transactions when at least one of the following exemptions applies:
    - i. The qualifying transaction is covered by a bilateral or multilateral advance pricing arrangement in effect for the period in question between the countries of the supplier and the distributor. See Section 3.2.

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distributor may merely be providing an intermediary or agency (or potentially an administrative) function rather than performing marketing and advertising activities itself.

<sup>11</sup> See footnote 5.

<sup>12</sup> In practice, these particular risks could be limited by a contractual arrangement that provides the distributor with a non-contingent remuneration. See OECD TPG paragraph 1.77 (“contractual arrangements that provide non-contingent remuneration for one of the parties implicitly allocate the outcome of some risks, including unanticipated profits or losses, to the other party”). However, the allocation of the assumption of risks at arm’s length should remain consistent with the conduct of the parties in accordance with Chapter I, D.I of the OECD TPG. Moreover, the pricing arrangements adopted in the contractual arrangements alone do not determine which party assumes risk, see 1.81 OECD TPG.

<sup>13</sup> See also footnote 7 above.

- ii. The qualifying transaction involves the distribution of those products within the product-based exclusion discussed in Box 3.2 in Section 3.4.2.

### **3.2. Exclusion from the scope of Amount B when an otherwise in-scope controlled transaction is covered by a bilateral or multilateral advance pricing arrangement between the jurisdictions of the supplier and the distributor**

19. One of the expected advantages of Amount B is that of preventing disputes around the application of the arm's length price to controlled transactions involving baseline distribution activities as reflected by the scoping criteria and, at the same time, ensuring that the profits arising from such transactions are subject to taxation only once. This is also the objective of advance pricing arrangements ("APAs"), which may be concluded on a bilateral or multilateral basis at the request of taxpayers, and which are binding for the jurisdictions involved, entitling taxpayers to the transfer pricing treatment established in the terms of the agreement so long as the agreement is respected.

20. Where associated enterprises have entered into a bilateral or multilateral APA covering controlled transactions involving baseline distribution activities, Amount B will not apply. Accordingly, even if controlled transactions meet the scoping criteria, the terms reflected in the bilateral or multilateral APA will prevail over the Amount B Pricing methodology. This approach is supported by the guidance in the OECD TPG, paragraph 2.11, which states that "*any method should be permitted where its application is agreeable to the members of the MNE group involved with the transaction or transactions to which the methodology applies and also to the tax administrations in the jurisdictions of all those members.*" This approach would apply not only to bilateral and multilateral APAs in effect at the time of the adoption of Amount B, but also to any future bilateral and multilateral APAs, as well as those renewed or negotiated.

21. Additional considerations regarding other potential exemptions to Amount B are discussed in Box 3.2 in Section 3.4.2.

### **3.3. Additional commentary on scope: economically relevant characteristics of qualifying transactions**

22. The commentary in this sub-section seeks to explain, clarify, and qualify certain aspects of applying the Amount B scoping criteria in a manner that reflects the accurate delineation of controlled distribution transactions and which ensures that taxpayers that meet the scoping criteria are those taxpayers intended by the Amount B policy goals.

23. The scoping criteria provided for in the Amount B aims to provide a standardised, streamlined, and simplified set of criteria which are required to be measured as part the requirement to accurately delineate a controlled distribution transaction under the guidance in Chapter I of the OECD TPG. A comparability analysis utilising the pricing methodology set out in Section 4 then would act to establish an arm's length price, which streamlines and simplifies the procedure to establish an arm's length price under the guidance in Chapters II and III of the OECD TPG. It is important to note that the scoping criteria do not provide an exhaustive and comprehensive list of activities that do qualify as baseline, instead describing the general features that must be considered in determining whether a distributor performs baseline distribution and subsequently empirically evaluating whether a particular distribution arrangement exhibits features that do not qualify as baseline. Importantly, the answer to this question should not be based on labels applied to the specific

transaction but on the established facts and circumstances of the taxpayers which are counterparties to the transaction.

24. As a simplification measure, Amount B focuses the delineation of the controlled transaction on whether the tested party qualifies as baseline or not, and subsequently whether the pricing approach described in section 4 is applicable or not (subject to the above exceptions). However, the scoping criteria also provide for situations where the requirements otherwise noted in Chapter I of the OECD TPG will need to be applied in practice, in particular where the facts and circumstances pertaining to the transaction are insufficiently established such that the scoping criteria cannot be properly applied.

### ***3.3.1. Contractual terms***

25. The contractual terms of the controlled transactions are usually explicitly reflected in a written agreement and provide the starting point for accurately delineating the transaction between the associated enterprises (paragraph 1.42 OECD TPG).

26. Taxpayers that assert that they are within the scope of Amount B must document their qualifying transactions in a written contract that reflects the division of responsibilities, obligations and rights and the assumption of the economically significant risks associated with the distribution activities. For the application of Amount B, these elements should be consistent with the scoping criteria outlined in section 3.1 as clarified further in section 3.3. Section 5 provides additional guidance on the recommended elements to be reflected in the written contract.

27. However, as discussed in Section D.1.1 of Chapter I, written terms articulating contractual arrangements between associated enterprises may not always provide information in sufficient detail or may be inconsistent with the actual conduct of the parties. Accordingly, the accurate delineation of the controlled transaction should consider further information contained in other documents, together with the actual conduct of the parties – notwithstanding that such consideration may ultimately result in the conclusion that the contractual form and actual conduct are in alignment – and the operating practice in each specific industry in relation to distribution that generally governs relationships between independent enterprises in comparable circumstances.

28. The absence of a written contract does not restrict the ability of tax administrations in asserting that a controlled transaction is a qualifying transaction if the scoping criteria are met. Equally, tax administrations can challenge the application of Amount B by the taxpayer when there is a written contract in place that captures the scope of qualifying transactions, but the actual conduct of the parties does not conform to the terms of the written contract. Tax administrations can also challenge the application of Amount B when there is a written contract in place that captures the scope of qualifying transactions, but the terms of the written contract are not consistent with the other economically relevant characteristics of the transactions that are economically significant (paragraph 1.140 OECD TPG). Conversely, tax administrations can also assert the application of Amount B when the contractual terms differ from those reflective of an in-scope taxpayer, on similar grounds.

### ***3.3.2. Functional analysis***

29. In accurately delineating controlled transactions, the functional analysis will provide key information to understand the functions performed, risks assumed and assets used by the parties (paragraph 1.51 OECD TPG).

30. While buy-sell arrangements and sales agency and commissionaire arrangements show certain differences discussed below, they both share common features in the context of “baseline” distribution arrangements. Functions performed by the tested party in relation to those qualifying transactions should not be complex in nature and should not result in the assumption of economically significant risks<sup>14</sup> to the specific distribution arrangement. This would imply that the set of functions undertaken by the tested party would entail activities that contribute to sales generation (e.g. such as buying goods for resale, identification of new customers and managing customers’ relationships, support and after-sales services, implementing promotional advertising or marketing activities), as well as other ancillary administrative or supporting activities (e.g. warehousing goods, processing orders and performing logistics, invoicing and collection).

31. Moreover, the performance of functions related to baseline distribution arrangements should not involve the ownership of any unique and valuable intangibles (including marketing intangibles) by the distributor, or the assumption of economically significant risks associated with contributions to the development, enhancement, maintenance, protection and exploitation of such intangibles<sup>15</sup>. Equally, the tested party should not own any asset that is not typical for the independent distributors that form the basis for the return determined in section 4.

32. To assist tax administrations and taxpayers in determining whether a controlled transaction is a qualifying transaction, the following subsections provide specific guidance on the functional profile that the tested party should exhibit. In some instances, the guidance prescribes the use of certain financial ratios to determine whether the tested party meets a specific criterion. Jurisdictions, however, retain the ability to undertake a qualitative assessment of the tested party’s functions, assets and risks to assert that the transaction, as accurately delineated, actually conforms or does not conform with the scoping criteria.

#### *Functions performed by the distributor*

33. As it would be unfeasible to establish an exhaustive list of the functions that the distributor should undertake, the application of Amount B should be guided by the general principle that the distributor may not perform any significant function that is not typical for independent distributors that form the basis for the return established under this approach in section 4. The analysis of whether the distributor meets one or more of the financial metrics in section 3.1 may also require a qualitative assessment. For example, while expenses incurred for marketing activities may be reflected in the financial statements of another associated enterprise, the accurate delineation of the controlled transaction could indicate that the distributor undertakes significant functions related to the development and implementation of the local marketing strategy that relate to economically significant risks associated with DEMPE functions that are assumed by the distributor and, therefore, it would fail to meet all the conditions to be in scope of Amount B.

34. Where the functions of the tested party are limited to, for instance, only the performance of routine marketing activities or the provision of routine after-sales services, the application of Amount B will not be appropriate, and the controlled transactions will need to be priced under the general guidance in in the OECD TPG rather than the specific guidance for Amount B.

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<sup>14</sup> See footnote 5.

<sup>15</sup> See footnotes 5 and 10.

*Risks assumed by the distributor*

35. Under the guidance in Chapter I of the OECD TPG and in order to conform to the policy intention, the distributor should not assume certain economically significant risks arising from the specific distribution arrangement. The distributor would however assume operational and reputational risks related to the performance of its contractual responsibilities and obligations. These risks would be effectively mitigated to some extent by a contractual form that provides the distributor a non-contingent remuneration as specified in Section 5, so long as the non-contingent remuneration is in accordance with what would be implied by the conduct of the parties and the accurately delineated transaction as a whole.

*Assets owned by the distributor*

36. In performing its functions, the distributor may use assets, which it owns or leases (e.g., offices, product displays, premises, warehouse facilities). However, distributors to which the Amount B applies are expected to have no ownership of unique and valuable assets.

**3.3.3. Characteristics of property**

37. The activities required to distribute tangible property compared to services or digital property can entail significant differences in the functions performed, assets used, and risks assumed by the parties. To achieve simplification while ensuring compliance with the arm's length principle, Amount B applies to controlled transactions involving the distribution of products for which there is broad consistency in the overall supply chain and functional analysis. Accordingly, Amount B applies to tangible property, subject to further discussions on product-based exclusions noted in Box 3.2 in Section 3.4.2, and does not capture the distribution and marketing of services or digital property.

38. Given that differences in the characteristics of tangible property are less sensitive in the case of the TNMM, the approach applies to the distribution of both finished and unfinished goods (i.e., components or intermediate goods). Frequently, distributors of finished goods and distributors of intermediate goods exhibit similar functional profiles, minimising the variability of arm's length profit margins. When this is not the case, the distributor should clearly identify the categories of goods pertaining to or utilised in different industries attracting different returns.

**3.3.4. Economic circumstances**

39. As explained in Chapter I of the OECD TPG, arm's length prices may vary across different markets even for the distribution of the same or similar products. This can be due to a number of factors, such as the geographic location; the size of the markets; the extent of competition in the markets and the relative competitive positions of the buyers and sellers; the nature and extent of government regulation of the market; transport costs; the level of the market (e.g., retail or wholesale) and so forth.

40. The industry sector in which the tested party operates will also be relevant in determining whether the controlled transaction is a qualifying transaction. The intensity and efforts required to position and sell products in two different industries may be significantly different. This can be due to a number of factors, such as the number of competitors or the pace of innovation in a given industry.

### 3.3.5. *Business strategies*

41. In determining the application of Amount B, business strategies must also be examined as they influence the profitability of the controlled transaction. MNEs can pursue different strategies, for instance, to enter a new market, position a new product in a given market, expand within a market where they are already present, or maintain its competitive position in the market vis-à-vis new competitors or as a result of an economic downturn. The implementation of these strategies generally affects pricing, either because there is a reduction of the price of products, an increase of costs (e.g. advertising, marketing and promotion costs) or both.

42. Where an MNE Group decides to pursue a specific business strategy in a given jurisdiction, such as market penetration or expansion, the tested party would not be expected to absorb the costs derived from such decision. Under the functional analysis, the tested party to a baseline distributor arrangement is not the decision-making party and does not make material contributions to the strategic sales and marketing functions relevant to sales in the local market that lead to the assumption of economically significant risks. Furthermore, the tested party would be expected to perform limited advertising and marketing activities within the parameters established by the supplier or another associated enterprise within the MNE Group.

## 3.4. Additional considerations on scope for public commentators

### 3.4.1. *Box on specific considerations, context and questions on sales agency and commissionaire arrangements for public commentators*

#### Box 3.1. Specific considerations, context and questions on sales agency and commissionaire arrangements for public commentators

1. There has been discussion between delegates on whether it is appropriate to include sales agency arrangements and commissionaire arrangements within the scope of Amount B. In line with the IF mandate provided in October 2021, many LCJs in particular have highlighted that including such arrangements within the scope of Amount B is essential to ensure its relevance in their jurisdictions, on the grounds that these business models are frequently the basis under which wholesale distribution occurs in their jurisdictions. Moreover, they consider that many sales agents and commissionaires exhibit similar profiles of functions performed, assets owned and risks assumed to wholesale distributors who take title to products, except for the obvious differences that relate to the taking of title, the holding and management of inventory, assumption and management of credit risks and associated administrative activities with respect to these areas. They also consider that the Amount B pricing methodology could take into account any differences in comparability between the comparables used to price in-scope arrangements under the Amount B pricing methodology, and in-scope sales agents and commissionaires, that might affect prices at arm's length. On the other hand, some jurisdictions have considered that it may be inappropriate to include sales agents or commissionaires in the scope of Amount B, since it may lead to overcompensation of parties with relatively simple functionality. These jurisdictions consider that in many cases sales agents or commissionaires do not carry out the same responsibilities or take on the same risks as the wholesale (buy and sell) distributors do based on an accurate delineation of the transaction. They have also raised concerns that the exceptions and adjustments necessary to include sales agents and commissionaires

within the scope of Amount B depart from the accurate delineation of the transactions undertaken by those entities. They consequently consider that using the same scoping criteria for both business models may not be possible as the accurate delineation of the respective transactions would differ. To them, whether or not sales agents or commissionaires should be included in the scope of Amount B should be based on a robust functional analysis in accordance with the guidance in Chapter I of OECD TPG and based on finding suitable compensation under the Amount B pricing methodology.

2. Discussion is ongoing regarding the appropriate arm's length consideration for each type of in-scope transaction, including whether different PLIs and different arm's length returns for wholesale (buy and sell) distribution arrangements and commissionaire and sales agent arrangements may be required, particularly if there is some variance in functional intensity between transactions under each business model, and whether and, if so, what comparability adjustments may be needed to ensure that the consideration is at arm's length, whichever business model is used. Section 4 provides further details on these discussions, including some discussion of options of PLIs under consideration by the IF.
3. Commentators are invited to provide input on these issues as appropriate, including with reference to the specific question outlined in 3.5.4.

### ***3.4.2. Box to public commentators on potential exemptions and product-based and other exclusions from applying Amount B***

#### **Box 3.2. Box to public commentators on potential exemptions and product-based and other exclusions from applying Amount B**

##### **Amount B potential exemptions: most appropriate TP method and local comparables**

1. As the main design features of Amount B are being evaluated, the IF is considering in tandem the question of whether the Amount B pricing methodology should be used to price all in-scope transactions, or whether alternative approaches could be utilised instead of, or in conjunction with, the Amount B pricing methodology.
2. This question is rooted in the consideration of two key issues, which are currently under investigation.
3. First, as regards to the use of the TNMM for the purposes of applying the Amount B pricing methodology, one view is that certain in-scope transactions should be priced using an alternative transfer pricing method to the TNMM, particularly a CUP, in light of the facts and circumstances of the case.<sup>16</sup> This may be viewed as necessary in order to adhere to the arm's length principle and therefore satisfy the Amount B mandate. However, there is also a view that the arm's length principle accommodates that the Amount B pricing methodology, based on the TNMM, should be used to price all in-scope transactions without the necessity of considering alternative transfer pricing methods, on the basis that Amount B represents a permissible administrative simplification to the most appropriate

<sup>16</sup> Paragraph 2.3 of the OECD TPG, for example, provides support for this view, noting that the CUP method is to be preferred as a more direct means of establishing an arm's length price even in circumstances where a CUP or any another transfer pricing method may be applied on an equally reliable basis.

method principle. Under this view, this administrative simplification measure would be in line with the IF mandate on the basis that it is consistent with the guidance in Chapter IV of the OECD TPG. The implication of this would be an expectation that the TNMM within the Amount B pricing methodology should be the most appropriate method in most instances given the scoping criteria considered in Section 3 of this consultation document, provided that the Amount B pricing methodology, once fully-developed, can be used consistently to establish arm's length prices. In addition, taking this position would imply that, to the extent that such methodology might not be the most appropriate method in some cases, such reductions in reliability are likely to be justified by the corresponding benefits in administrability.

4. Second, there are different views on the relevance of *local market*<sup>17</sup> comparables for purposes of applying the Amount B pricing methodology<sup>18</sup>. Jurisdictions often have access to such local market comparables in their jurisdiction that are identified using the five comparability factors outlined in Chapter I of the OECD TPG. Where local comparables are available this view holds that it is necessary to refer to them to ensure parity of outcome with local domestic businesses. This would mean that Amount B would have maximum application only when no local market comparables are available to set arm's length prices in a particular transaction. Another option under consideration is to take the view that the Amount B pricing methodology could in practice incorporate suitable comparables from relevant 'local markets' where they are available, and from other relevant markets, providing for suitable comparability adjustments to derive arm's length results, without needing to provide for an exemption where local market comparables are available. This option would avoid the need to define the circumstances under which an alternative to the Amount B pricing methodology would apply, which could otherwise lead to additional complexities and disputes.

<sup>17</sup> As a technical matter, the term "local market" comparable would mean that the independent distributor acting as the potential comparable undertakes its economic activities under similar economic circumstances to that of the tested party to the transaction, and in particular that the tested party and the proposed comparable have comparable markets for the goods distributed. An analysis of the comparability of markets may include various features of the market, such as those described in paragraph 1.130 and 1.132. As a practical matter, a "local comparable" of a tested party may be considered to be an independent distributor that is resident in the same geographic market as the tested party, or may be considered in a separate, but homogenous market, on the presumption that the broader economic circumstances for the tested party and the comparable are themselves comparable based on an accurate delineation of the transaction.

<sup>18</sup> The way in which such an exemption may be designed and how it would operate in practice is under consideration. For purposes of the exemption, and as discussed in this section, it must be determined whether a "local comparable" needs to be in the same jurisdiction as the tested party, or whether it may be in a jurisdiction with similar market characteristics or considered as the same market for the products distributed ("homogeneous" market). For a comparable in the same jurisdiction, consideration would need to be given of whether an evaluation of whether the comparable faced similar market conditions as the tested party is required (which might not be the case if, for example, the comparable is in a different industry). Moreover, it is necessary to determine whether this exemption would apply only to local comparables under the TNMM, or also to local comparables under other methods. Finally, if the exemption applies, the arm's length price would, as noted, be determined by a full analysis under the TPG, but, again as noted in this section, a simplified approach may apply to identifying local market comparables based on the application of the Amount B benchmarking search criteria to out of scope transactions. These and other issues noted in this section are under consideration. Commentators are invited to express views on the best way to design the exemption. Also, if the answers to certain questions posed below would depend on the design of this exemption, commentators are invited to elaborate their responses.

5. As the final design features of the Amount B scoping criteria and pricing methodology have not been finalised, it is premature to fully evaluate the relevance or usefulness of applying either potential exemption. However, the broad features of each exemption and how they might be applied is presented and considered in this consultation document.

**Exemption from applying the Amount B pricing methodology when another transfer pricing method is the Most Appropriate Method (“MAM”)**

6. The principal considerations in assessing the appropriateness of this exemption are (i) the extent to which other recognised transfer pricing methods (in particular, the CUP) should in certain circumstances be preferred to be used over the TNMM for transactions within the scope of Amount B, in order to remain aligned with the arm’s length principle, and (ii) the extent to which the requirement that a MAM be chosen on a case-by-case basis for each in-scope transaction can be simplified and streamlined while remaining consistent with the arm’s length principle.
7. Assuming that an alternative method may provide for an arm’s length price for certain transactions within the scope of Amount B depending on the facts and circumstances of the particular case, even if they could be rare, the TNMM under the Amount B pricing methodology could be utilised on a “rebuttable presumption” basis, meaning that either taxpayers or tax administrations could rebut the application of the Amount B pricing methodology on the grounds that another transfer pricing method would be more appropriate to deliver an arm’s length price, including, per paragraph 2.3 of the OECD TPG, where another (traditional transaction method and particularly a CUP) could equally be applied given the facts and circumstances of the case.
8. Ultimately, the assessment of the merits of this exemption can only be made once the Amount B pricing methodology has been fully developed. However, the OECD TPG can be applied to provide necessary context to making this judgement, in particular to consider the trade-off between the assessing whether there are circumstances under which the application of the exemption may be required to ensure the accuracy of the arm’s length price and the resources that tax administrations and taxpayers could otherwise save by not requiring a case-by-case assessment of the transfer pricing method that should apply to price in-scope transactions. For example, see Paragraphs 2.2, 2.3, 2.8, 2.11 and 3.4 of the OECD TPG.
9. With these considerations in mind, the reasonableness of utilising an exemption to applying the Amount B pricing methodology to in-scope transactions where another method may be the MAM as well as the probable design of any test or set of tests to make this determination, is currently being considered by the IF.

**Exemption from applying the Amount B pricing methodology when there are local market comparables**

10. The economic circumstances of the transaction, and in particular, the features of the market of the tested party relative to that of the potential comparables, should be evaluated in establishing the arm’s length price of an in-scope transaction, both when accurately delineating the controlled transaction and performing a comparability analysis.
11. The OECD TPG provide context for the importance and relevance of this issue and provide guidance on how the relevant evaluation of the economic circumstances pertaining to the market of the tested party and comparables may take place. It establishes that the prices for otherwise identical goods and services sold in otherwise identical economically relevant circumstances may vary between different markets if those markets have different economic circumstances in the context of the transaction, and those differences have a material effect on prices. If comparability is to be achieved, the markets

in which potential comparables and associated enterprises operate should not have differences that materially affect the pricing of the transaction,<sup>19</sup> or, if so, appropriate and reliable adjustments to pricing should be made to account for those differences.

12. Making this determination in the context of a controlled in-scope transaction would typically involve the review of several factors related to the markets in question<sup>20</sup> and the broader facts and circumstances of the transaction. This does not mean that local market comparables are preferred over comparables from other jurisdictions that meet other relevant comparability criteria: instead, it highlights the relevance of judging the effects of the market or markets of the tested party on the pricing and on returns of the controlled in-scope transactions relative to that of the comparables, in order to reliably set prices that are aligned with the arm's length principle.
13. The performance of such an analysis may be complex in practice in some cases. The relevant information might often be unavailable to tax administrations, especially those in LCJs, and even if the information is available, it may be unreliable or require further validation. Making conclusions based on this information may require subjective judgements to be made which might be prone to dispute; however, due consideration of these factors is a requirement to accurately delineate a transaction under the arm's length principle. For example, the use of local market comparables resident in the same jurisdiction as the distributor might be appropriate in practice, so long as those comparables are judged under an accurate delineation of the transaction to be operating in a comparable market as the tested party<sup>21</sup>. Alternatively, the definition of what is a local market comparable may, using similar principles, be extended to those covering homogenous markets<sup>22</sup>, often defined based on a consideration of whether a certain region or group of countries reliably represents a homogeneous or single economic market, which might include the judgement that a particular jurisdiction is part of a larger homogenous market. However, it is also feasible to use comparables drawn from outside the market of the distributor, with or without adjustment depending on the facts and circumstances of the case, based on an assessment of the relevance of the five comparability factors in establishing an arm's length price. This is sometimes borne out of practical necessity given a lack of local market comparables, or in other situations based on a judgement that returns may not in practice vary between markets. This judgement may include the view that, the "baseline" nature of the transactions might mean that differences in returns for independent distributors that are comparable to the scoping criteria may not materially vary across markets (but may vary with respect to other comparability criteria). This implies a preference for the use of a consistent basis to price in-scope transactions for Amount B, using the Amount B pricing methodology, so long as the price determined under that methodology provides for arm's length prices in all situations.
14. With this in mind, the arm's length principle allows for the use of judgement in the context of what level of detailed analysis is required to establish an arm's length price. The IF has been exploring the influence that the differences in markets have on returns with a view to establishing how the Amount B pricing methodology should take this issue into

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<sup>19</sup> The pricing potentially being evaluated by references to rates of return to a transaction under a TNMM or other transfer pricing method.

<sup>20</sup> See, for example, OECD TPG paragraphs 1.130 and 1.132.

<sup>21</sup> See the earlier discussions of local comparables.

<sup>22</sup> Paragraph 1.132, OECD TPG.

account. This evaluation includes consideration of whether it may be beneficial to allow for flexibility for jurisdictions to utilise either the Amount B pricing methodology, or alternative approaches rooted in the use of local market (or homogenous market) comparables in establishing arm's length prices for in-scope transactions, within or external to the application of Amount B.

15. In considering the potential pros of having an exemption, it may be pragmatic to use local or homogenous market comparables to price in-scope transactions where they are available and are found to meet all five factors of comparability. This is on the basis that the use of available local market comparables would provide for a reliable arm's length price and displacing them might lead to inefficiencies in pricing in scope transactions. In such cases, the use of local market comparables could be preferable to the need for the Amount B pricing methodology to account for any variance in returns observed between comparables from different markets. Incorporating this exemption would require a definition of what a local market comparable is, and the approach that should be followed to identify such comparables. As a simplification, one suggestion is that the identification of such comparables may, for example, utilise common benchmarking search criteria identified under the Amount B pricing methodology and that local market comparables be defined as those resident in the same market as the tested party or, alternatively, to the same or a homogeneous market as that of the tested party. The former approach may make such a definition easier to administer and utilise as it refers to comparables resident in the jurisdiction only, and not those from homogenous markets.
16. Alternatively, considering the cons of having an exemption, and consequently applying the Amount B pricing methodology in all cases, the Amount B pricing methodology could be presumed to provide for a reliable arm's length price and account for any relevant market-linked variation in returns, when they are substantiated to exist. Such an approach would offer greater simplification benefits, would further streamline the application of the arm's length principle, and might improve tax certainty benefits relative to the available alternatives. With this in mind, it is noted that the definition of local comparables (including complications with respect to if they are only in relation to a particular geographic market or from homogenous markets), whether any local market comparables found are in fact comparable, and which comparables are identified using a range of existing approaches may be subjective or contested, and might cause challenges in implementation related to that definition, such as determining who might make that determination and when, and under what circumstances such a determination might be made, which in turn may reduce the simplification and streamlining effects of Amount B, including how they relate to achieving improvements in tax certainty. It is important that any exemption designed, if found necessary, should be designed in a manner that could prevent disputes arising with respect to these issues.

#### **Product-based exclusions from the scope of Amount B: commodities and non-tangible goods**

17. The IF is currently considering whether the distribution of all materials, goods and services may be included within the scope of Amount B, or whether certain limitations to scope should apply. During these discussions, the IF has specifically evaluated the cases of commodities and digital goods.
18. As outlined in Section 4, the Amount B pricing methodology relies on the TNMM to establish the arm's length price for in-scope transactions. However, it is observed in practice that the arm's length price for the distribution of certain materials, goods or products in the commodities industry is commonly established through utilising the Comparable Uncontrolled Price ("CUP") method. This aspect requires consideration of

whether such distribution transactions should be removed from the scope of Amount B given the application of the CUP method to achieve the intended and necessary administrative simplification goals and to support the proper application of the Amount B pricing methodology.

19. The distribution of commodities is often undertaken through centralised commodity marketing hubs that reside outside the jurisdiction in which the commodity was extracted from and the market jurisdiction the commodity is ultimately sold to. Resource rich developed and developing countries have witnessed BEPS risks (under-pricing of the commodity, excessive service payments, minimal substance, business restructures etc) associated with some centralised commodity marketing hubs and including them within the scope of the Amount B may not lead to the policy intent of simplifying and streamlining of in-country baseline marketing and distribution activities. Even though centralised commodity marketing hubs may be excluded from scope given that they may distribute the commodities to multiple markets outside their country of residence, this may not be true in all cases. Centralised commodity marketing hubs are seen as being outside of the Amount B mandate provided in the IF Statement as they may undertake non-baseline activities.
20. Moreover, for the Amount B pricing methodology to properly apply, it is necessary that in-scope distribution arrangements of all relevant materials, products and services reflect the economically relevant characteristics covered under Amount B. If this is commonly not the case for the distribution of certain materials, goods or services, then the distribution of those materials, goods or services may be excluded from the scope of Amount B in order to again achieve the intended and necessary administrative simplifications and to support the proper application of the Amount B pricing methodology. In this context, the IF is considering the case of the distribution of non-tangible goods and services, where the nature and intensity of the economically relevant characteristics of the typical transaction may materially differ from those typically applicable to distribution transactions in tangible goods.
21. In the process of evaluating these issues, the IF is considering whether such “product-based” exclusions from scope are warranted in these two broad sets of circumstances. Consequently, the first such scoping exclusion would apply when the product distributed is a commodity whereas the second such scoping exclusion would apply when the property distributed is not a tangible good, within the meaning of the definitions provided below.
22. In addition to considering whether these limitations to being within the scope of Amount B should apply in these specific circumstances, the IF is also evaluating the specific degree of the limitation that should be provided.
23. In the first such scoping exclusion, the specific degree of the limitation is to be provided with the definition of which specific commodities will be excluded from the scope of Amount B. For the second such scoping exclusion, the degree of limitation would require assessing whether the distribution of tangible goods only should be within the scope of Amount B, or whether the scope may be extended, for example, to the distribution of software or digital goods should the economically relevant characteristics of distribution of those non-tangible goods result in an accurately delineated transaction that would otherwise fall within the Amount B scoping criteria.
24. These determinations will be made on the basis of further work to be performed by the IF and in light of the inputs submitted by commentators.

### *Commodities*

25. The proposed definition of a commodity is broader than the definition in paragraph 2.18 of the OECD TPG which focuses on a physical product for which a quoted price is used as a reference price to set prices in uncontrolled transactions. There may be commodities that do not have a quoted price or transparent price as per the definition in the OECD TPG due to a variety of commercial factors. These include private arrangements between the buyer and seller with the pricing terms and conditions not being publicly available, vertically integrated producers with minimal third-party sales of intermediary products and certain commodities do not have a quoted price. BEPS risks can be associated with commodities that have confidential pricing structures due to the lack of accurate pricing data. For the product-based exclusion to achieve its intent the definition of a commodity would have to be broader than paragraph 2.18 of the OECD TPG to ensure that all relevant products are being excluded for Amount B purposes.
26. For the purposes of considering a product-based exclusion from the scope of Amount B, an excluded commodity may be any of the following:
- a. A renewable or non-renewable physical product that is primarily derived from the earth's crust, land or water. These renewable or non-renewable physical products can be manifested in a solid, liquid or gas state and take various forms such as a hydrocarbon, mineral, mineraloid and agricultural product. or
  - b. A renewable or non-renewable physical product that has undergone primary processing to procure a basic sellable commodity; or
  - c. A product that is in accordance with the definition of a commodity provided for in paragraph 2.18 of the OECD TPG.
27. With respect to the definition of an excluded commodity in Paragraph 26:
- a. **Hydrocarbon** means any organic compound consisting predominantly of carbon and hydrogen molecules that is in solid, liquid or gaseous form occurring naturally in or on the earth or in or under water and which was formed by or subjected to a geological process and includes crude oil, oil sands, heavy oils and natural gas occurring in a subsurface oil and gas reservoir, deposit, or in a stockpile.
  - b. **Mineral** means any inorganic substance that exhibits crystalline characteristics, in solid form, occurring naturally in or on the earth's crust or in or under water and which was formed by or subjected to a geological process, and includes clay, gems, gravel, metal, ore, rock, sand, soil, stone, salt and any such substance occurring in an ore body, ore deposit, or in a stockpile or tailings.
  - c. **Mineraloid** means any substance that does not exhibit crystalline characteristics whether in solid, liquid, or gaseous form, occurring naturally in or on the earth or in or under water and which was formed by or subjected to a geological process, and includes but is not limited to amber, coal, obsidian and opals, and any such substance occurring in an ore body, ore deposit, or in a stockpile or tailings.
  - d. **Agricultural** means any primary product, raw or processed, that is marketed for consumption and includes but is not limited to livestock, grains, coffee, fishery, forestry, fruit, and vegetables.

- e. **Primary Processing** means the processing undertaken to concentrate, isolate, purify, refine, blend, harvest, produce or liberate a hydrocarbon, mineral, mineraloids or agricultural product from its natural state to produce a basic sellable commodity.

### *Non-tangible goods*

28. For the purposes of considering a product-based exclusion from the scope of Amount B, the distribution of non-tangible goods would fall out-of-scope, where tangible goods could be defined for the purposes of Amount B as any physical good that is not defined as a commodity for Amount B purposes.
29. One reason for this exemption is predicated on the basis that the distribution of non-tangible goods such as software or digital goods occurs under materially different economically relevant circumstances to those that apply to tangible goods, such that accurately delineated “baseline” distribution transactions for non-tangible goods would fall out of the Amount B scoping criteria or that non-baseline activity would potentially fall within the scoping criteria. This rationale is however open to discussion amongst delegates and comment is sought from commentators on this issue, as highlighted in the questions in Section 3.5.

### **Exclusions from the scope of Amount B: certain specific activities**

30. Paragraph 18 specifically sets out certain activities that, if performed by a distributor, would lead to it falling out of the scope of Amount B.<sup>23</sup> Notwithstanding the earlier summary of key considerations regarding the excluded activities in general, one view is that the exclusions noted in paragraph 18(e) would, in particular, have the unintended consequence of excluding distributors which are broadly comparable in their functional profile to the distributors who are in scope, and that the excluded activities, if performed at a low functional intensity, might be termed ancillary activities similar to those excluded under paragraph 18(h). Consequently, it may be possible that the performance of such activities, if performed under a certain threshold or below a certain functional intensity, would not have a material effect on arm’s length prices and consequently that the current restriction may be excessive.
31. However, there is another view that considers the performance of such activities described in sub-paragraph 18(e) as not being ancillary to the distribution function especially as they should qualify as economically valuable activities in order for the exclusion to apply. Consequently, such conditions may be necessary to exclude distributors that perform such value-add activities from the scope of Amount B.
32. Views are sought from commentators regarding whether the restrictions in paragraph 18(e) may be represented as ancillary activities.

<sup>23</sup> Sub-paragraphs 18(c), paragraph 18(d), paragraph 18(e) and paragraph 18(f).

### 3.5. Specific questions on scope for public commentators

3.5.1. *Do you consider that any of the individual scoping criteria would be unlikely to be observed when reviewing the economically relevant characteristics of otherwise comparable independent enterprises on the basis that sufficiently detailed information is not available? Moreover, do you consider that such differences in observation could materially affect the ability to use those comparables in establishing arm's length prices?*

3.5.2. *Do you consider that any other financial indicators may be utilised to measure the performance of certain functions, ownership of certain assets, or assumption of certain risks relevant to the scoping criteria other than those already described above? Moreover, do you consider that any financial or non-financial quantitative metrics may be utilised in order to reliably and objectively determine if the scoping criteria are met, for example with reference to the limited assumption at arm's length of economically significant risks?*

3.5.3. *Do you consider that the Amount B scoping criteria could reliably incorporate retail distributors as well as wholesale distributors? If so, do you consider that any modifications might be necessary to the Amount B pricing methodology being developed, in order to appropriately establish arm's length prices for accurately delineated retail distribution transactions, compared with wholesale distribution transactions?*

3.5.4. *In your practical experience in delineating baseline marketing and distribution transactions that you judge to be within the scoping criteria outlined in this consultation document:*

- a. *Do you observe in practice that there exist transactions that meet the scoping criteria in both categories of in-scope transactional structures explained in paragraph 14, and which, based on an accurate delineation of the transaction, exhibit substantially the same economically relevant characteristics? This is excepting, for the second category, any scoping criteria directly related to the taking of title and the holding of inventory and assumption of credit risks, as well as ancillary administrative functions related to the same.*
- b. *Moreover, are there other qualitative or quantitative indicators that would be useful in order to reflect those commissionaires and sales agents that do have similar economically relevant characteristics to wholesale distributors, relative to those commissionaires and sales agents that do not? If so, please explain the indicators and how they achieve the desired objective.*
- c. *In practice, to what extent do you use independent buy-sell distributors to price transactions involving sales agents or commissionaires? What are your reasons for doing so or not doing so?*

3.5.5. *Do you consider that distributors that otherwise meet the scoping criteria, but which also distribute tangible products to markets other than their market of residence exhibit materially different economically relevant characteristics than distributors that only distribute to their market of residence, such that arm's length pricing may be affected? If so, please demonstrate the reasons why you consider this to be the case.*

3.5.6. *In any of the quantitative metrics outlined within the scoping criteria, do you perceive that the level of thresholds set should vary based on specific criteria, e.g., the industry of the distributor, the market of residence of the distributor or other criteria, in order to be aligned with the arm's length standard? If so, please demonstrate the reasons why you consider this to be the case.*

3.5.7. *Do you consider that the derivation of the data or other information required to substantiate any of the scoping criteria outlined above would result in a meaningful simplification and streamlining of compliance activities based on what is currently required to be prepared and retained? Please demonstrate the reasons why you consider or do not consider this to be the case.*

3.5.8. *Do you consider that the product-based exclusions outlined achieve the intended goal of excluding certain transactions in the distribution of commodities from being within the scope of Amount B? Please outline the reasons why you consider or do not consider this to be the case. Moreover, do you consider that the scope should include the distribution of software? If yes, can you please outline why you think software should be included in the scope; your explanation would require an analysis that demonstrates that the economically-relevant characteristics of the distribution of software are broadly comparable to the economically-relevant characteristics of the distribution of tangible goods.*

3.5.9. *Do you consider that a controlled distributor that (i) contributes to strategic marketing functions or to control of risk but does not, under the accurate delineation of the transaction, assume the associated risks, or (ii) contributes to the generation of marketing intangibles but does not, based on an accurate delineation of the transaction, assume the significant risks associated with those intangibles, should necessarily be out of scope for Amount B? Please outline the reasons why you consider or do not consider this to be the case. Moreover, do you consider that entities which do not assume economically significant risks related to development, enhancement, maintenance, protection or exploitation of marketing intangibles, but do make some contribution to risk control functions that may warrant compensation at arm's length per paragraph 1.105 of the OECD TPG, should be out of scope? If so, please outline the reasons why you consider this to be the case.*

*3.5.10. General views are also sought from commentators regarding the exemptions from applying the Amount B pricing methodology related to the most appropriate method and the use of local market comparables.*

## 4. Amount B pricing methodology

### Box 4.1. Box to public commentators on the Amount B pricing methodology

The Amount B pricing methodology is being designed to deliver on the mandate of the IF Statement of October 2021 to simplify and streamline application of the arm's length principle to in-country baseline marketing and distribution activities, considering the specific needs of low-capacity countries. The pricing methodology will rely on the application of common benchmarking search criteria to identify comparable entities performing baseline marketing and distribution activities drawing upon publicly available corporate financial information. The Amount B pricing methodology will include the common benchmarking search criteria (Section 4.2.1) and the economically relevant characteristics that are observed to correlate with profitability (Section 4.2.2) to produce either a pricing matrix or a mechanical pricing tool (Section 4.2.3).

While its design and final form is still under consideration by the IF, including with reference to extensive and detailed analysis on the various features the pricing methodology will ultimately have, the Amount B pricing methodology is intended to lead to the determination of arm's length results for baseline marketing and distribution activities. These will take account of the economically relevant characteristics of the in-scope tested party and the comparables, including the relative significance to which those characteristics correlate with profitability and how such information could reliably improve or simplify the determination of arm's length results.

The technical work of the IF on pricing remains on-going and the outcome of that work as well as inputs from stakeholders is expected to further inform design decisions to be incorporated into the Amount B pricing methodology.

While notable progress has been made to date in developing a broad architectural framework for the Amount B pricing methodology, including establishing a broad global pool of independent distributors using common benchmarking search criteria, and the development of various econometric models upon which to test the existence of statistically significant correlations between identifiable economic characteristics of independent distributors and profitability, there remains a number of challenging technical issues to be tackled – as summarised in Section 4.2.2 of this consultation document.

In this regard, input is sought from public stakeholders on the current architecture of the Amount B pricing methodology and specific technical considerations discussed herein.

### 4.1. Introduction

43. The Amount B pricing methodology specifically seeks to provide effective means of tackling challenges that commonly arise in pricing baseline marketing and distribution

activities. These challenges primarily relate to the resource-intensive and subjective nature of current benchmarking practices, the risk of time-consuming disputes, the limitations in available comparables in certain geographical markets, and wider resource constraints that are particularly relevant to low-capacity jurisdictions.

44. The Amount B pricing methodology is being developed by the IF through an iterative process, and will be under-pinned by a comparables search deploying common benchmarking search criteria, selection and analysis of independent comparables reflecting the scoping criteria in Section 3.1, and taking account of economically relevant characteristics.

45. There have been various technical and econometric analyses performed by the IF to date on a broad pool of independent distributors to understand contributing factors to distributor profitability. The technical work is on-going to further refine and establish the basis of certain design features to most efficiently determine arm's length pricing for in-scope transactions. However, there remain a number of technical challenges to be overcome before the Amount B pricing methodology can be successfully developed. The current status of the IF technical work including a brief summary of the challenges faced are discussed below in Section 4.2.2.

46. Feedback from stakeholders is sought to inform the design features of the Amount B pricing methodology by reference to open market information and the experience of businesses practitioners in pricing similar transactions in practice.

47. While critical components of Amount B design remain in progress, the Amount B pricing methodology currently builds upon the following objectives:

- To rely on financial information of comparable independent entities drawn from commercial databases<sup>24</sup> through the application of commonly agreed search criteria;
- To provide arm's length results that account for the relevant economic characteristics of the tested party and the comparables; and
- To publish and periodically update the arm's length results.

48. The implementation of the Amount B pricing methodology based on the broad architectural framework discussed herein is hoped to achieve the following benefits.

- a. **Reduce resource constraints** – can help alleviate the resource burden of conducting benchmarking analyses for in-scope activities at both the tax administration and the taxpayer level;
- b. **Ensure consistency and mitigate risk of disputes** – the application of a standardised and globally consistent pricing solution can help reduce transfer pricing disputes that commonly arise relating to disagreements over benchmarking search criteria, the selection and rejection of comparables, application of comparability adjustments, etc.;

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<sup>24</sup> The BvD Orbis database has been used for the technical and econometric analysis performed by the IF to date.

- c. **Readily available and up to date** – the underlying benchmarking data can be readily updated to reflect latest available data derived from commercial databases;
- d. **Adaptability** – the Amount B pricing approach can provide flexibility to take account of economically relevant characteristics of the controlled transaction under review such as geographic filters, industry filters or other relevant factors.

## 4.2. Key design features

### *4.2.1. Common benchmarking search criteria*

49. The Amount B pricing methodology is intended to establish clearly defined guidance on the benchmarking search criteria that will be used to identify a set of independent companies that perform baseline marketing and distribution activities consistent with those performed by taxpayers whose activities are in line with the scoping criteria.

50. The current work to develop the Amount B pricing methodology leverages on previous work of the IF to identify and align international benchmarking search practices as well as further technical work, including econometric analyses, that the IF is currently undertaking to identify correlations between the economically relevant characteristics of in-scope transactions and their expected impact on profitability.

51. Agreement on the application of common benchmarking search criteria would provide a standardised process to identify comparable entities in the context of Amount B as an initial step to minimise varying and subjective approaches to conducting benchmarking searches that in many instances lead to disputes. Additionally, these common search criteria would be used to underpin the Amount B pricing solution under the different forms that are currently being considered by the IF (See Section 4.2.3). For further detail on the common benchmarking search criteria currently considered by the IF, please refer to the Annex A. It should be noted that the search criteria currently referenced in Annex A represents the foundational search process and it is anticipated that the criteria will be supplemented with additional quantitative and qualitative screens to reflect the scoping criteria in Section 3 when finalised.

### *4.2.2. Technical analyses being undertaken by the IF*

#### *Producing the global dataset used for Amount B*

52. The data being analysed by the IF for Amount B pricing purposes has drawn upon BvD Orbis database using search criteria designed to produce a dataset that represents the available population of businesses that undertake wholesale distribution as their majority business activity. See Annex A for further details.

#### *Technical analysis*

53. The dataset is subject to econometric analysis to define the economically relevant characteristics reliably observed to correlate with levels of profitability. The IF is performing this analysis with two focusses:

- a. understanding how returns vary with geographic region, or jurisdiction, considering the relationships between profit levels and location but also between profits and country level factors which may be indicative of

jurisdiction-specific risk areas. See Annex A for details of these factors. The goal was to investigate the extent to which jurisdiction level quantitative criteria have a relationship to profit levels, and therefore whether jurisdiction or region is a determining factor in comparability between businesses in scope of Amount B.

- b. considering quantitative factors that might have a relationship with profits for (i) wholesale goods distribution and (ii) commissionaire or other similar arrangement that facilitates such distribution. This approach explores a variety of criteria (See Annex A for a list) to identify those factors which have a reliable correlation to profit levels and can therefore be used to identify businesses which are comparable to a tested party in scope of Amount B.

54. The outcome of this technical analysis is intended to be a pool of comparable companies by reference to which in-scope transactions would be priced. Further, if sufficiently reliable correlations are identified, this work may allow consideration as to whether or not mechanical approaches could be developed, such as an econometric model or adjusted net profit indicators, to determine profit levels by reference to those identified factors without the requirement to refer directly back to comparables. In particular, and subject to completion of on-going work and determining the statistical reliability and explanatory power of the econometric modelling, the regression analysis could lead to: (i) an evidence-based list of indicators of returns in the global population of distributors, and (ii) identification and quantification of any adjustment required such as country risk, which would directly inform the design of the pricing matrix or mechanical pricing tool to generate arm's length profitability outcomes for all in-scope activities. Further discussion on these potential output options is provided in Section 4.2.3 below.

#### *Current status of the technical analysis*

55. The IF has, through various iterations, refined the global dataset through quantitative and qualitative review, expanded the variables analysed, built analytical tools and addressed practical problems, and performed regressions, equality of means tests, and descriptive analysis.

56. While good progress has been made to date, there remains a number of points of further analysis before the Amount B design can be finalised. These include:

- a. The current econometric modelling to date has been able to account for a small portion of the variation in operating margin. While factors may continue to be identified and the explanatory power may continue to improve, at this point, it is not possible to determine whether the outcome will support a regression-based pricing tool as envisaged in Section 4.2.3 below.
- b. Differing reporting requirements across jurisdictions mean that there are differing levels of publicly available data for this analysis. This is equally an issue for any transfer pricing comparability analysis and not specific to Amount B, but underlying assumptions will need to be outlined about the applicability of findings in a dataset which includes jurisdictions where data is available publicly to those jurisdictions which are not represented in it for Amount B purposes.

- c. There are time intensity and data availability challenges associated with determining strict comparability in context of the baseline marketing and distribution scoping criteria in such a large dataset and further refinement to the set will be needed as the scope of Amount B is refined.
- d. Commercial database license restrictions and the availability of publicly available data will be increasingly important issues as the analysis of common search criteria is finalised and the design of a pricing solution and underlying comparable data / audit trail information requirements become clearer. It may for example be the case that the underlying data (i.e. the information of the potential comparables or a rejection matrix) is not publicly available for tax administrations and taxpayers.

57. Recognising that the technical analysis of the IF is on-going, the observations outlined below are preliminary in nature, will require further analysis as the scope of Amount B and the dataset of potential comparables is refined, and remain subject to change. The preliminary observations<sup>25</sup> from the econometric analysis to date are as follows:

- a. **Geographic relevance** – several of the country level factors in Annex A consistently show significant relationships with profitability. The number of significant factors, as well as the level of significance, varies depending on the model specification (number of explanatory variables included) and sample size used.
- b. **Industry relevance** – several of the industries show a significant relationship with profitability. The number of significant industries, as well as the level of significance, varies depending on the model specification and sample size.
- c. **Asset intensity** – modelling conducted to date has broadly indicated a statistically significant relationship between asset intensity (the ratio of operating assets to revenue) and operating profitability such that companies with higher operating assets to sales ratios typically earn a higher operating margin.
- d. **Operating expense intensity** – similarly, current modelling has broadly indicated a statistically significant relationship between operating expenses and operating profitability such that companies with higher operating expenses to sales ratios typically earn higher operating margins.

58. The IF considers further technical work, with input and suggestions from commentators as part of this public consultation, can help address the challenges identified above, and lead to the development of an Amount B pricing methodology that delivers a simplified and streamlined approach to the application of the arm's length principle for baseline marketing and distribution activities.

#### ***4.2.3. Potential outputs of the Amount B pricing methodology***

59. Application of the common benchmarking search criteria as well as additional screening and qualitative review to reflect the Amount B scoping criteria is expected to

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<sup>25</sup> The preliminary observations refer in part to “statistical significance”. Statistical significance is a widely used and recognised term in the context of statistical data analysis and refers to a conclusion or determination that a relationship between two or more variables is caused by something other than chance.

lead to the development of a set of baseline marketing and distribution comparables. Taking account of the outcome from the technical analyses currently being undertaken by the IF, the financial information derived from that set would then be translated into arm's length results tailored where possible to the characteristics of the tested party and made available for use by tax administrations and taxpayers.

60. While the final output and form is still under consideration, the IF is currently exploring two output options as follows: (i) a pricing matrix approach, and (ii) a mechanical pricing tool approach. Both output options, discussed briefly below, will broadly rely on the same underlying benchmarking and technical analyses.

#### *Pricing matrix*

61. Subject to the outcome of on-going technical work of the IF, the output from the common benchmarking search criteria may be presented as a matrix of arm's length pricing outcomes where comparable marketing and distribution entities would be grouped in subsets according to their relevant economic characteristics.

62. For example, if it were observed that asset intensity and operating expense to sales ratio were the two most economically relevant characteristics correlating to profitability amongst baseline marketing and distribution entities, then the pricing matrix could be constructed as follows<sup>26</sup>:

**Figure 4.1. Illustration of a stylised pricing matrix**

		Asset Intensity		
		X < [%]	[%] < X < [%]	X > [%]
OPEX to Sales ratio	X > [%]			
	[%] < X < [%]			
	X < [%]			

<sup>26</sup> While this example refers to only two characteristics to construct a pricing matrix, it is possible that additional and/or alternative characteristics may ultimately be selected. Therefore, the criteria shown in the example are for illustrative purposes only.

63. It should be noted that while a larger number of characteristics (i.e. comparability criteria) might be considered to derive a higher degree of comparability to the in-scope controlled transaction, the application of excessive criteria could result in a large number of matrix segments and reduce the number of observations in any given segment. Another potential issue with a pricing matrix approach is the risk of a “cliff effect” whereby a small variation in the tested party could cause the tested party to be in a different matrix segment and be assigned a substantially different return. It will therefore be important to consider how to design the matrix dimensions / criteria in a manner that addresses these potential issues while not compromising the Amount B objective of achieving simplification.

64. The precise variables to be included in the pricing matrix are being identified based on statistically observed relationships between economically relevant characteristics and expected profitability for independent distributors on the basis of the on-going econometric work of the IF. It is possible that using quantitative factors (such as asset intensity) as the basis for adjustments, rather than as criteria for a matrix dimension, may address some of the potential issues identified above, and allow use of primarily qualitative factors for the matrix dimensions.

#### *Mechanical pricing tool*

65. The IF continues to identify and test drivers of profit with econometric modelling. Should the work continue to identify statistically significant relationships among certain distributor characteristics and profitability, an alternative mechanical pricing method may be possible. This approach would allow a “translation” of the underlying data derived under the common benchmarking search criteria into mechanical pricing tools such as a formula or a set of quantitative adjustments, to reliably derive arm’s length profitability returns adapted to the economically relevant characteristics of the tested party.

66. There are various mechanical or formulaic approaches that could be adopted to determining the return of a tested party. For instance, one such approach would involve developing a regression equation to estimate the returns of independent distributors based on certain financial data and other relevant characteristics of the distributors, and then determining the return of a tested party by applying the regression equation to the tested party’s corresponding financial data and relevant characteristics. Another such mechanical approach could involve application of particular net profit indicators(s) with possible adjustments to improve the reliability of the arm’s length result based on the financial or other characteristics determined by the statistical analysis to have an impact on distributor profitability.

### **4.3. Technical considerations in designing the Amount B pricing methodology**

67. The design of any of the potential outputs of the Amount B pricing methodology outlined above requires consideration of additional technical features, which are discussed in this section.

#### *4.3.1. Selection of the net profit indicator*

68. In applying the TNMM, the selection of the most appropriate net profit indicator should take account of:

- the respective strengths and weaknesses of the various possible indicators;

- the appropriateness of the indicator considered in view of the nature of the controlled transaction, determined in particular through a functional analysis;
- the availability of reliable information (in particular on uncontrolled comparables); and
- the degree of comparability between controlled and uncontrolled transactions, including the reliability of comparability adjustments that may be needed to eliminate differences between them<sup>27</sup>.

69. A net profit indicator of net profit divided by sales, or net profit margin, is frequently used to determine the arm's length price of purchases from an associated enterprise for resale to independent customers. This is consistent with commonly observed pricing approaches presently adopted by taxpayers and tax administrations with respect to in-scope transactions. Further the scoping criteria applied in section 3 (e.g., limitations on operating expense levels in relation to sales) may reduce the variation in the impact on profit margins from the functions performed by an in-scope entity, and therefore may improve the reliability of the net profit margin. Without prejudice to further consideration of alternative net profit indicators, operating margin or return on sales is considered the most appropriate net profit indicator in most instances that are within scope of Amount B.

70. Notwithstanding the above, some members of the IF have suggested consideration of alternative net profit indicators including the following:

- Berry Ratio* – certain distribution arrangements such as commissionaires and sales agency arrangements may exhibit different economically relevant characteristics in practice and may be overly remunerated for their functional contributions under a return on sales. A Berry ratio may be more appropriate than return on sales where the value of the functions performed in the controlled transaction (taking account of assets used and risk assumed) is proportional to the operating expenses and is not materially affected by the value of the products distributed, i.e. it is not proportional to sales. Alternatively, it could be argued that such entities fall short of meeting the baseline distribution scoping criteria set out in section 3 and therefore, are not within scope of Amount B.
- Return on sales with a Berry ratio cap-and-collar* – A Berry ratio cap-and-collar approach could be applied as a guard rail within which the primary return on sales metric would be applied. Where application of a return on sales metric produces a Berry ratio result outside of a pre-defined range, the result would be adjusted to an appropriate point within the Berry ratio range. This guard rail would prevent particularly low-functioning in-scope entities from reporting excessive mark-ups on costs resulting from a return on sales metric.
- Return on assets* – Acknowledging relevant guidance in the OECD TPG in paragraphs 2.92 and 2.103, returns on assets could also be an appropriate base in cases where assets (rather than costs or sales) are a better indicator of the value added by the tested party if the technical work of the IF demonstrates a

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<sup>27</sup> See paragraph 2.82 OECD TPG.

statistically significant relationship between operating profit and operating assets. A Return on assets could be established, consistent with the use of that net profit indicator in other cases where, as with Amount B, the entities are low risk and do not own unique or valuable IP.

- d. *Use of a combination of net profit indicators* - subject to tests for reliability, an average of profit results derived from the application of a combination of net profit indicators (i.e. return on sales, Berry ratio, return on assets) would seek to recognise the common application of a sales based metric for distribution functions, as well as take account of the influence of asset- and functional-intensity on profits.

#### **4.3.2. Selecting the most appropriate point in the range**

71. As described in Section 4.2.3, the Amount B pricing methodology will lead to the generation of arm's length outcomes for in-scope activities either in the form of a pricing matrix or through development of a mechanical pricing tool. Those outcomes may be presented as a range of results or a point estimate.

72. In accordance with existing OECD transfer pricing guidance, *“in determining the point, where the range comprises results of relatively equal and high reliability, it could be argued that any point in the range satisfies the arm's length principle. Where comparability defects remain, it may be appropriate to use measures of central tendency to determine this point (for instance the median, the mean or weighted averages etc., depending on the specific characteristics of the data set), in order to minimise the risk of error due to unknown or unquantifiable remaining comparability defects.”* See paragraph 3.62 OECD TPG.

73. With the objective of achieving simplification and tax certainty in mind, the IF is currently assessing the potential benefits of developing an Amount B pricing methodology that would consider a specific arm's length result or some very narrow range of results (e.g., smaller than the interquartile range) under both the pricing matrix or the mechanical pricing tool. However, further consideration is needed to understand the practical implications for both taxpayers and tax administrations to targeting a specific arm's length result for Amount B pricing purposes.

#### **4.3.3. Comparability adjustments**

74. In accordance with existing OECD transfer pricing guidance in paragraph 3.50, *“comparability adjustments should be considered if (and only if) they are expected to increase the reliability of results. Relevant considerations in this regard include: the materiality of the difference for which an adjustment is being considered, the quality of the data subject to adjustment, the purpose of the adjustment, and the reliability of the approach used to make the adjustment”*.

75. Given that Amount B pricing methodology will draw upon a comprehensive pool of data and will take account of on-going technical work of the Inclusive Framework to define relevant economic characteristics, it is expected that the comparable companies identified for the purpose of generating the pricing matrix or constructing the mechanical pricing tool, will be suitably comparable in terms of those characteristics that are observed to influence profitability.

76. Nevertheless, further work is required to consider in what circumstances comparability adjustments may still be appropriate, whether such adjustments can be

demonstrated to increase the reliability of results, and whether adjustments can be practically applied in a manner that does not undermine the policy aims of achieving simplification and tax certainty.

77. Specific adjustments that IF members have identified requiring further consideration include the following;

- a. Inventory, working capital, operating asset, total asset intensity adjustments;
- b. Functional intensity adjustments;
- c. Country risk adjustments and industry risk adjustments;
- d. Commissionaire / sales agent adjustments comprising:
  - i. adjustments to reflect different risk characteristics of commissionaires / sales agents relative to baseline buy/sell distributors;
  - ii. third party revenue gross-up adjustment to reflect sales generated by commissionaires / agents but not recorded in the relevant entity's financial statements.

78. However, some delegates have expressed a view that comparability adjustments are not commonly used in their jurisdictions as they do not observe improved comparability resulting from the adjustments, which is necessary for adjustments to be appropriate under the OECD TPG. While other delegates state that various comparability adjustments (such as for asset levels) have a sound basis in economic theory, and that the adjustments, once agreed as part of the Amount B pricing method, would be relatively easy to apply in practice.

79. It should be noted that database license restrictions associated with the centralised use and dissemination of data derived from commercial databases relied upon for Amount B pricing purposes may prevent tax administrations and taxpayers from applying adjustments to comparable companies based on the financial characteristics of any particular tested party. A mathematically equivalent result would involve adjusting each independent distributor's operating margin to a level corresponding to zero operating assets, based on an appropriate return to a distributor's operating assets in each jurisdiction, then determining the median of these adjusted operating margins. Then, for a given tested party, adjusting the operating margin from that median value to reflect the tested party's operating assets, using a return to assets that is appropriate to the distributor's jurisdiction.

#### ***4.3.4. Purchases from multiple related party suppliers***

80. Acknowledging that the Amount B scoping criteria seeks to exclude multi-function entities, unless where they perform ancillary activities below a certain de minimis threshold as described in Section 3.1, it seems reasonable that a baseline distributor that is involved in multiple controlled transactions involving purchases from multiple related party suppliers would not be precluded from Amount B if the entity meets the Amount B scoping criteria with respect to its activities performed on each controlled transaction. Some additional complexity arises from evaluating such a scenario, for example, where the controlled transactions involve purchases of product with materially different gross or net margin profiles, and whether the baseline distributor is also purchasing from unrelated parties.

81. The OECD transfer pricing guidelines suggests in paragraph 2.84 that “*an appropriate level of segmentation of the taxpayer’s financial data is needed when determining or testing the net profit it earns from a controlled transaction or from transactions that are appropriately aggregated*”. In accordance with paragraph 3.9, “*there are often situations where separate transactions are so closely linked or continuous that they cannot be evaluated adequately on a separate basis*”, for example, “*pricing a range of closely-linked profits (e.g. in a product line) when it is impractical to determine pricing for each individual product or transaction...such transactions should be evaluated together using the most appropriate arm’s length method*”. Where an in-scope entity purchases from multiple related party suppliers (or is involved in multiple controlled transactions with a single related party supplier) and meets the Amount B scoping criteria with respect to its activities performed on each controlled transaction, it is necessary to consider how Amount B can be applied to achieve arm’s length pricing on each controlled transaction.

82. The IF is considering whether a specific simplification measure could be developed for Amount B. For instance, Taxpayers could adopt a reasonable allocation methodology to attribute an in-scope baseline distributor entity’s operating profit across multiple controlled transactions (i.e. for the purpose of determining the inter-company price from the perspective of each related party supplier). The OECD TPG does not preclude the use of allocation keys so long as such an approach is capable of producing charges that are commensurate with the actual or reasonably expected benefits of the recipient (see paragraphs 7.23 and 7.24). To satisfy the arm’s length principle, the allocation method chosen must lead to a result that is consistent with what comparable independent enterprises would have been prepared to accept.

#### **4.4. Specific questions on the Amount B pricing methodology for public commentators**

*4.4.1. Do you have any comments on the proposed architecture of the Amount B pricing methodology for baseline marketing and distribution entities?*

*4.4.2. Can you share your observations of arm's length results for independent baseline marketing and distribution entities and provide any available supporting analysis or market data evidencing such observations?*

*4.4.3. Recognising that the initial search criteria in Annex A relies upon keyword searches based on database business descriptions, how would you develop the search criteria further to more accurately identify baseline marketing and distribution comparables – i.e. what quantitative screens should be applied to help take account of the functional, asset and risk profile described in section 3.1?*

*4.4.4. What commercial databases do you use for performing transfer pricing analysis?*

*4.4.5. A limitation of using any global database is the absence of uniformity in information collected because of divergent financial reporting standards across jurisdictions. This impacts the types and effectiveness of the quantitative screens used in data analysis. What are your suggestions to overcome this limitation?*

*4.4.6. In terms of giving further consideration on how and what to disseminate to tax administrations and taxpayers to facilitate the application of the Amount B pricing methodology, as well as to consider the impact of possible restrictions on publication of company data, what is the minimum level of comparable data or benchmarking audit trail information that is needed in order for taxpayers to administer and rely on the Amount B pricing methodology, explaining the implications of not having access to such information?*

*4.4.7. Taking into account the objectives of Amount B to simplify and streamline the application of the arm's length principle for baseline distribution, and the breadth of financial and other characteristics of potentially in-scope taxpayers, do you think there are circumstances whereby application of alternative net profit indicators should be considered? If so, please provide an outline of those circumstances, the appropriate net profit indicator, and the rationale.*

*4.4.8. Recognising the objective of achieving simplification and tax certainty while maintaining accuracy in outcomes, in what circumstances do you consider comparability adjustments (if any) are needed for Amount B?*

4.4.9. *With reference to the discussion above in Section 4.3.4, what are your views on the proposal to use allocation keys in terms of the practical application of Amount B in cases where the baseline distributor is involved in in-scope controlled transactions with multiple related party suppliers?*

## 5. Documentation requirements

83. The design of robust and comprehensive documentation constitutes an essential element of Amount B. In general, transfer pricing documentation ensures that tax administrations have access to the necessary information so that tax administrations can conduct risk assessments and make an informed decision on whether to perform an audit of the taxpayer's tax practices and positions<sup>28</sup>. In the case of Amount B, documentation requirements are important to ensure that tax administrations have sufficient, relevant and reliable information to inform the assessment of whether a taxpayer's controlled transactions are in-scope and, therefore, can price the controlled transaction in accordance with the Amount B pricing methodology.

84. Chapter V provides detailed guidance on the three-tiered approach to transfer pricing documentation, consisting on the master file, local file and the country-by-country report and underlines the advantages of adopting such approach. Paragraph 5.49 recommends to jurisdictions the implementation of the master file and local file elements, but it is acknowledged that they have discretion to decide whether to introduce documentation requirements, and if so, their scope, the items of information to be prepared by the taxpayer, and all related compliance issues ranging from the timing of the preparation of the documentation to the language in which the information should be provided. See section D of Chapter V of the Guidelines.

85. Having said that, in the context of Amount B, a consistent approach to the items of information that can substantiate the taxpayer's position on the applicability of this approach can yield significant benefits for both taxpayers and tax administrations. For taxpayers, it would provide a common approach to demonstrate compliance with Amount B and produce the specific items of information to support their position in relation to the applicability of Amount B. For tax administrations, it would ensure access to the relevant information and that all tax jurisdictions have the same level of information to allow an informed assessment of whether Amount B applies.

86. Building on the existing documentation requirements in Chapter V, this section describes the additional items of information specific to Amount B that could be included as part of the local file.

### 5.1. Amount B documentation requirements

87. Taxpayers with controlled transactions in scope of Amount B should produce the following specific items of information to demonstrate compliance with Amount B and provide it to tax administrations as part of the local file:

- a. A statement declaring the information provided to support compliance with Amount B is true, accurate and complete to the best of the MNE's knowledge.

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<sup>28</sup> Paragraph 5.5 and 5.6 of the Guidelines.

- b. Explanation on the delineation of the in-scope controlled transaction, including the functional analysis of the taxpayer and relevant associated enterprises with respect to the in-scope transactions, and explanation on the fulfilment of the scoping criteria, including a breakdown of (i) financial information by key customer type (e.g. government entities, government contractors, large customers); (ii) sales made to associated enterprises and third party customers per product and jurisdiction; and, (iii) sales to end-customers and wholesalers/retailers.
- c. Identification and explanation of other commercial or financial relations between the tested party/taxpayer with other associated enterprises in the MNE group that may influence the accurate delineation of the controlled transaction potentially in scope of Amount B. For instance, the existence of a license agreement between the tested party and another associated enterprise for the use of intangibles.
- d. Annual financial accounts of the taxpayer for the fiscal year concerned;
- e. When the taxpayer is not the tested party, annual financial accounts of the tested party for the fiscal year concerned;
- f. Annual financial accounts of the taxpayer for the [three/five] fiscal years prior to the first fiscal year in which the taxpayer reports controlled transactions in-scope of Amount B;
- g. When the taxpayer is not the tested party, annual financial accounts of the tested party for the [three/five] fiscal years prior to the first fiscal year in which controlled transactions are in-scope of Amount B.
- h. Information and allocation schedule showing how the financial data used in assessing the applicability of Amount B may be tied to the annual financial statements.
- i. An explanation of the application of the Amount B pricing methodology to the controlled transaction and the results of that application; and,
- j. When relevant, an explanation of the treatment of transitional issues (such as business restructurings or intangible transfers in the present or immediately past year) and an explanation of those aspects of such transactions affecting the local entity and the application of the Amount B pricing methodology.
- k. The written contract governing the qualifying controlled transaction. The written contract should include the following relevant information on the in-scope controlled transaction:
  - i. Identification of the parties to the controlled transaction;
  - ii. Identification of the controlled transactions covered by the agreement;
  - iii. Identification of the products for which the baseline distribution activities are performed;
  - iv. The duration of the contractual arrangement;;

- v. The nature of the distribution agreement (e.g. exclusive, non-exclusive);
- vi. The geographical territory covered by the agreement;
- vii. The description of the responsibilities, obligations and rights of the supplier and the distributor, which should be consistent with the information provided in item (a). In particular, the written contract will be expected to recognise that the counterparty to the tested party:
  - a) assumes the economically significant risks associated with the distribution of the products;
  - b) owns any unique and valuable intangible property used by the tested party or arising from activities of the tested party during the term of the agreement;
  - c) compensation in accordance with the Amount B pricing methodology outlines in Section 3 and currency in which the remuneration is determined and paid;
- viii. Information to be produced and maintained by the parties to the agreement for reporting, regulatory and any other purposes;
- ix. Performance metrics related to the distributor's activity; and
- x. Circumstances under which the agreement may be terminated.

With regards to the written contract, when the taxpayer already has in place written contractual arrangements, those may be sufficient if the terms set out above are already contained therein. Otherwise, the taxpayer can supplement or modify the existing written contractual arrangements providing for those terms not covered by the original arrangement.

- l. A copy of existing unilateral and bilateral/multilateral APAs and other tax rulings to which the local tax jurisdiction is not a party and which are related to in-scope transactions.

88. This approach to documentation requires the taxpayer to prepare information which is already requested under the local file described in Annex II to Chapter V, limiting the number of new additional items of information to be prepared specifically for purposes of Amount B. It is expected that making this information available to tax administrations will introduce benefits in terms of alleviating the overall compliance burden for taxpayers in relation to in-scope transactions. For instance, the fact that tax administrations have access to targeted and specific documentation on the taxpayer's marketing and distribution activities can better inform the tax administration's risk assessment. This, in practice, may translate in fewer follow-up requests for information and audits for the taxpayer, as well as in a more efficient use of tax administrations' resources.

89. In addition to the information in the local file, taxpayers and tax administrations should leverage on the information provided in the master file to support their position with regards to the application of the Amount B pricing approach. In particular, the master file can provide valuable information on the MNE group's business, such as main products, main geographic markets, pricing policy or the general strategy of the MNE group for the development, ownership and exploitation of intangibles. Equally, the information provided by the country-by-country report can be useful for risk assessment purposes, as it provides certain indicators of the location and type of economic activity of individual entities within the MNE group. As a matter of good practice, to avoid excessive compliance burden for

taxpayers, when evaluating the applicability of Amount B to controlled transactions of a given taxpayer, tax administrations should refrain from requesting the taxpayer to produce or submit information already in the hands of the tax administration, or to submit it in a different format.

90. It is important to underline that the fact that the taxpayer has prepared and submitted the above information to the tax administration does not prevent the tax administration from examining the taxpayer's self-assessment on the application of Amount B.

91. Finally, some jurisdictions may wish to introduce a procedure whereby taxpayers are required to notify the first time their transactions fall in scope of Amount B. As part of the first-time notification procedure, tax administrations could require the taxpayer to provide the items of information listed in paragraph 87.

## 5.2. Transitional issues

92. Amount B has potential to generate numerous benefits not only to tax administrations, but also to taxpayers. As discussed in this guidance, Amount B can afford taxpayers with significant cost-savings in terms of the resources and time that, absent Amount B, would be necessary to comply with the arm's length principle for in-scope transactions. This, coupled with the additional tax certainty that the approach offers, may lead to some MNE groups to reorganise their distribution business models between associated enterprises with the aim of meeting the necessary conditions to be in-scope of Amount B.

93. Equally, there may be MNE groups that for various reasons (e.g. commercial, operational, tax compliance, group-wide policy) may decide to restructure its distribution arrangements with associated enterprises and third parties to ensure that controlled transactions involving the distribution of products are not in-scope of Amount B.

94. As stated clearly in paragraph 9.34, MNE groups are free to organise their business operations as they see fit and tax administration do not have the right to dictate to MNE groups how to design its structure or where to locate its business operations. Tax administrations, however, have the right to determine the tax consequences of the structure resulting from the reorganisation. In this regard, the guidance in Chapter IX applies to understand the changes to the functions, risks and assets before and after the restructuring, assess whether the relevant parties have been compensated at arm's length for the restructuring itself and evaluate whether the controlled transactions resulting from the reorganisation are priced in accordance with the arm's length principle (including when this results in the application of the Amount B pricing methodology). For this purpose, paragraphs 9.34-9.38 of the OECD TPG apply to accurately delineate and, where appropriate, recognise business restructurings. The fact that Amount B is applicable to the pre-restructuring or post-restructuring controlled transactions does not affect the relevance of the transfer pricing analysis prescribed in Chapter IX.

95. In principle, the fact that an MNE group has intentionally reorganised its distribution arrangements to meet the scoping criteria should not prevent the application of Amount B to price the qualifying transactions. To the extent the controlled transactions exhibit the economically relevant characteristics described in section 2.2 as explained further in section 2.3, the qualifying transactions should be subject to Amount B and priced

in accordance with the methodology described in section 3. Conversely, the fact that an MNE group has reorganised itself to fall out of scope of Amount B should not prevent tax administrations from applying the Amount B approach if the distributor still meets the scoping criteria. Taxpayers are expected to take consistent positions from one year to the next in relation to the application of Amount B. However, certain jurisdictions have expressed concerns that, through successive reorganisations, MNEs may take in practice inconsistent positions regarding the application of Amount B over time. Such scenarios may come under greater scrutiny by tax authorities to prevent the use of Amount B for tax planning opportunities. In addition, the IF may consider adopting a specific approach to address these concerns, such as limiting the application of Amount B for a certain number of fiscal years following the reorganisation of all or part of the taxpayer's business or when the reorganisation results in the bifurcation of the taxpayer's commercial activities in a given jurisdiction.

96. As with any business restructuring, relevant information on business restructurings should be included in the master file and the local file. In particular, it is recommended that MNE groups document the decisions that lead to the transfer of economically significant risks or unique and valuable intangibles (which may result in an entity meeting the criteria to apply Amount B), and explain the consequences on profit potential of significant risk allocations and intangible transfers resulting from the restructuring (which may have consequences for the application of the Amount B pricing approach; see paragraphs 9.32 - 9.33).

97. Some jurisdictions have raised concerns with respect to situations where, as a result of a restructuring, Amount B applies to a restructured distributor with built-in losses from prior fiscal years. The tax treatment of such losses, in particular whether they should be deductible, depends on each jurisdiction's domestic legislation and administrative procedures and is not within the scope of this guidance.

### 5.3. Specific questions on documentation for public commentators

5.3.1. *Do you think the proposed documentation approach for the application of Amount B strikes the right balance between the additional burden for taxpayers and the need to ensure that tax administrations obtain the necessary information to evaluate the taxpayer's application of Amount B?*

5.3.2. *In relation to the specific items of information to support the application of Amount B listed in paragraph 87 please indicate if:*

- a. *There are items of information which are not relevant for purposes of evaluating the taxpayer's compliance with Amount B. If your answer is yes, please elaborate why such items of information would not be relevant.*
- b. *There are items of information currently not listed in paragraph 87, which should be incorporated to the Amount B specific items of information in the local file. If your answer is yes, please elaborate why such items of information are relevant and should be part of the local file.*

## 6. Tax certainty

98. It is expected that Amount B will improve tax certainty and reduce disputes involving in-scope baseline marketing and distribution transactions. First, Amount B provides a common and consistent framework to identify transactions involving baseline marketing and distribution arrangements. Second, by providing a pricing methodology, Amount B will reduce the risk of disputes regarding aspects such as the selection of the transfer pricing method, the net profit indicator or the specific remuneration of an in-scope taxpayer.

99. However, as with any transfer pricing matter, the application of Amount B to a controlled transaction requires the exercise of judgement by both tax administrations and taxpayers<sup>29</sup>. In the context of Amount B, disagreements between the taxpayer and the tax administration, or between tax administrations, may exist regarding whether a transaction involving the performance of marketing and distribution activities qualifies as an in-scope transaction, in particular regarding the interpretation of the facts and circumstances of the case that may lead to different conclusions as to whether the taxpayer's controlled transaction meets the economic relevant features described in Section 3 and it is, therefore, covered or not under Amount B. It is expected that a robust and comprehensive documentation package prepared by the taxpayer in accordance with Section 5 will assist tax administration in reaching a common understanding of the facts and circumstances of the case and therefore minimising potential disputes.

100. To address those situations, taxpayers can avail themselves of the different existing mechanisms aimed at preventing and resolving disputes, which can be also applied in the

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<sup>29</sup> See paragraph 1.13 of the Guidelines.

context of Amount B. This section provides an overview of those mechanisms and makes considerations relevant for the application of Amount B.

### **6.1. Amount B and dispute prevention**

101. Taxpayers can make use of the mechanisms available to avoid future disputes in relation to the application of Amount B. The most well-known instrument to provide tax certainty and prevent transfer pricing disputes is the advance pricing arrangement (“APA”), which is extensively discussed in Chapter IV (and accompanying Annex II) of the OECD TPG. While APAs may be more suitable for controlled transactions with a greater level of complexity and sophistication than those targeted by Amount B, nothing prevents taxpayers from seeking to obtain tax certainty in relation to the application and effects of Amount B in relevant jurisdictions. As explained in paragraph 4.141, there is a preference for bilateral or multilateral APAs, as these can ensure that “the arrangements will reduce the risk of double taxation, will be equitable to all tax administrations and taxpayers involved and will provide greater certainty to the taxpayers involved”.

102. The mutual agreement procedure also constitutes an effective instrument for jurisdictions to discuss any disagreements arising from the application of Amount B. In accordance with Article 25, paragraph 1, the taxpayer can start a mutual agreement procedure when he considers that the actions of one or both of the contracting states will result in taxation not in accordance with the convention, i.e. prior to the existence of double taxation.

### **6.2. Amount B and dispute resolution**

103. Due to the reasons explained in 99 above, there may be instances where the taxpayer suffers double taxation when a tax administration makes a primary adjustment affecting the price of the controlled transaction covered by Amount B. In these circumstances, the taxpayer in the counterparty jurisdiction can request a corresponding adjustment to eliminate the double taxation, and the guidance in paragraphs 5 and 6 of Commentary on Article 9 and Section C.2 of Chapter IV of the OECD TPG are relevant.

104. Where there is a dispute between the parties concerned over the character and/or the amount of the appropriate adjustment, the mutual agreement procedure provided for under Article 25 should be implemented<sup>30</sup>. For these purposes, the Commentary to Article 25 of the Model Tax Convention and the guidance in Section C of Chapter IV of the OECD TPG are applicable.

105. In some cases, a primary adjustment and corresponding adjustment to a controlled transaction to which Amount B applies may affect the pricing of other controlled transactions that one or both of the parties may have with other associated enterprises of the MNE group. In this scenario, it is useful to underline that Article 25 would allow a multilateral resolution of the case under paragraphs 1 and 2, to the extent there are bilateral tax conventions concluded among the different jurisdictions concerned<sup>31</sup>.

106. In relation to the interaction between Amount B and MAP, any agreement reached prior to the adoption of Amount B under a MAP should prevail in relation to controlled transactions involving baseline distribution activities. This approach prevents creating

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<sup>30</sup> See paragraph 11 of the Commentary to Article 25 OECD Model Tax Convention.

<sup>31</sup> See paragraphs 38.1 and 38.3 of the Commentary to Article 25 OECD Model Tax Convention.

uncertainty as to whether disputes already settled between competent authorities may be subject to review and reassessment, and enhances predictability for concerned taxpayers.

107. However, in the case of ongoing and prospective MAP cases, the guidance on Amount B should be considered. This is in line with the guidance in paragraph 17 of the OECD TPG, which state that the Guidelines are “intended primarily to govern the resolution of transfer pricing cases in mutual agreement proceedings between OECD member countries and, where appropriate, arbitration proceedings.”<sup>32</sup> Furthermore, unlike bilateral or multilateral APAs, where the guidance in paragraph 2.11 applies, the agreement reached in the context of MAP by competent authorities is binding on both jurisdictions, but is not on the taxpayer, who may decide to pursue other dispute procedures available under domestic law.

108. Article 25 entails only a duty for competent authorities to negotiate and use their best endeavours to resolve the dispute, but not to achieve results<sup>33</sup>. Where competent authorities are not able to reach an agreement under MAP, the taxpayer, under certain conditions, may be able to request arbitration of unresolved issues in relation to the application of Amount B, as it constitutes the only treaty-based mechanism that can ensure resolution of the case and eliminate double taxation.

### 6.3. Specific questions on tax certainty for public commentators

*6.3.1. Do you think the current tax certainty framework described in this section is sufficient to prevent or address potential disputes arising in relation to the applicability and/or operation of Amount B?*

*6.3.2. Is there any other approach that could supplement this framework to enhance tax certainty and reduce the risk of double taxation and/or double non taxation arising from the application of Amount B, subject to a jurisdiction’s availability of resources? For instance, should the work on Amount B include, for interested jurisdictions, the design of an elective early certainty program to provide a specific early (pre-audit) certainty (e.g. streamlined APA-type process) or an indication of the compliance risk inherent to controlled transactions regarding the application of Amount B and its pricing methodology?*

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<sup>32</sup> This assertion is premised on the assumption that the guidance on Amount B will be part of the OECD Transfer Pricing Guidelines.

<sup>33</sup> See paragraph 37 of the Commentary to Article 25 OECD Model Tax Convention.

## Annex A.

This Annex describes the common benchmarking search criteria currently being considered by the IF for the purposes of Amount B.

The analysis initially relied on a broad dataset of distributors with a wide range of business models in order to fully investigate a range of quantitative indicators. As the work on scope progresses, the dataset will be refined further to match the specific scope criteria of Amount B.

### 1. Database filtering

Moody's BvD Orbis database<sup>34</sup> was used for the initial research of defining common benchmarking search criteria and only the following criteria were considered initially. Other filters may be applied in later stages as the work develops, such as screening out of loss makers and businesses in a Start-up phase.

1. Active companies
2. Companies with primary NACE codes 45 - Wholesale and retail trade and repair of motor vehicles and motorcycles and 46 - Wholesale trade except of motor vehicles and motorcycles<sup>35</sup>
3. Companies with consolidated accounts, or unconsolidated only where the company is known to own less than 50% of any subsidiaries
4. Companies with no shareholders with ownership of more than 50% of the shares of the company
5. Companies with operating revenue and EBIT data available for 2017, 2018 and 2019
6. Companies with operating revenue average of at least EUR 2 million for 5 years (2015-2019)
7. Companies with a website address
8. Companies with business overview information available in the database
9. Excluding companies with R&D to sales ratio of more than 3%<sup>36</sup>

### 2. Qualitative review of company data selected.

After the filtering described above, the IF considered a qualitative review of the companies.

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<sup>34</sup> There are database license restrictions associated with the use and dissemination of detailed data and comparables information and further consideration is needed to determine the implications for the Amount B pricing outputs currently being considered by the IF

<sup>35</sup> Noting further refinements through the qualitative review outlined in the next section

<sup>36</sup> This is an initial database search criteria, later refined through the manual rejection of companies described as carrying out research and development activities in their business descriptions.

This review aimed at rejecting from the final data set of potential comparables any companies undertaken more than baseline wholesale marketing and distribution activity based on scoping criteria outlined in Section 3.

While consideration is being given to whether further qualitative review is appropriate in light of the Amount B goal of simplification, so far the IF has used key word searches to make rejections potentially non comparable company data, and then manually reviewed the companies in the dataset using only the descriptive information on businesses activities provided in the database. Further quantitative filters are being considered to streamline the qualitative review of the potential comparables.

The IF qualitative reviews have included -

- Rejection of companies with the following terms in their business overview:
  - “design and manufacture”,
  - “financ”,
  - “insurance”,
  - “manufacture “,
  - “research”, “software d” and “system integrat”.
- Rejection of all companies that do not describe wholesale distribution as their main activity.
- Rejection of companies which describe any development, research or manufacturing activity, or more than minority or ancillary levels of additional activities such as retail, repairs and maintenance, and other services.

### 3. Firm level factors included in the dataset<sup>37</sup>

#### 3.1. General data, not year-specific:

- Company name
- BvD ID number
- Orbis ID number
- BvD independence indicators
- Last update to BvD independence indicator
- Country ISO code
- NACE Rev. 2 core code (4 digits)

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<sup>37</sup> This analysis is ongoing and further factors will be considered.

- US SIC primary code(s)
- Full overview
- Main products and services
- Trade description (English)
- Main brand names
- Turnover for last available year
- Number of subsidiaries
- Status
- Status updated date
- Consolidation code
- Information provider
- Standardised legal form

### **3.2. Financial data (for each of 2014-2019 unless otherwise noted):**

- Turnover (operating revenue) (for each of 2012-2019)
- Cost of goods sold
- Other operating expenses
- EBIT (operating P/L) (for each of 2012-2019)
- Operating margin (for each of 2012-2019)
- Costs of employees
- Depreciation & amortization
- Research & development expenses
- EBITDA
- Fixed assets
- Current assets
- Stock
- Debtors
- Cash & cash equivalent
- Total assets
- Shareholders' funds
- Non-current liabilities
- Current liabilities
- Creditors

- Total shareholder funds & liabilities
- Working capital
- Net current assets
- Number of employees
- Enterprise value
- Work in progress
- Net property, plant & equipment
- Total buildings depreciation
- Investments
- Berry ratio
- Gearing (%)

### ***3.2.1. Country level factors included in analysis***

- Standard and Poor's end-of-year country sovereign credit ratings
- Sovereign credit default swap (CDS) rates
- World Bank annual inflation data
- The OECD's GDP and GDP per capita data

### ***3.2.2. Region to which the country belongs, according to:***

#### *United Nations sub regions:*

- North America
- Eastern Asia
- Western Europe
- South-eastern Asia
- Northern Europe
- Sub-Saharan Africa
- Southern Asia
- Southern Europe
- Latin America and the Caribbean
- Australia and New Zealand
- Western Asia

- Eastern Europe

*World Bank regions*<sup>38</sup>

- East Asia and Pacific
- Europe and Central Asia
- Latin America and Caribbean
- Middle East and North Africa
- North America
- South Asia
- Sub-Saharan Africa

Data points have been used in the analysis as standalone indicators but have also been combined to produce factors for the analysis, e.g ratios such as Operating Assets to Sales, and continuous variables for regression analysis, in the case of variables such as sovereign credit ratings.

***Industry categories identified from the dataset and used to categorise companies in the dataset***

Uncategorised activity

Perishable foods (and bulk agricultural products)

IT hardware and electrical components

Construction materials and supplies

Industrial machinery and supplies

Agricultural supplies and equipment

Alcohol and tobacco products

Oil and gas

Clothing

Medical and health

Metal

Grocery and household consumables

Plastics and chemical

Automotive

Home appliances, furniture, home and office supplies

Paper and packaging

Jewellery

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<sup>38</sup> World-by-region-map.pdf (worldbank.org)

Textiles, hides and furs

Scrap and recycling materials

Ores

Multiple product categories