

International: OECD issues new public consultation document on Amount B, pointing to January 2024 implementation

In brief

Amount B was introduced as a "fixed return" on "baseline marketing and distribution activities" in the October 2020 Blueprint of Pillar One, and was seen as a critical component of the Pillar One deal.

Following the long-awaited release of the [consultation document](#) on 8 December 2022 ("**December 2022 Consultation Document**") and subsequent [public commentary](#) received, the OECD/G20 Inclusive Framework on BEPS ("**IF**") published a [consultation document](#) on Amount B on 17 July 2023 ("**July 2023 Consultation Document**"), creating renewed momentum and putting Amount B back into the international tax spotlight.

The OECD has [requested input](#) from stakeholders on a number of remaining technical points, with comments to be received no later than 1 September 2023.

Following the public consultation, the OECD intends to finalize the guidance on Amount B and publish it as an addition to the OECD Transfer Pricing Guidelines ("**OECD Guidelines**") in January 2024.

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Key takeaways

- Amount B provides for a simplified and streamlined approach to the application of the arm's length principle to in-country baseline marketing and distribution activities, with a particular focus on the needs of low-capacity countries.
- As outlined in the December 2022 Consultation Document (see our previous client alert [here](#)) and reaffirmed in the July 2023 Consultation Document, the two types of intragroup transactions intended to be in the scope of Amount B include:
 - Buy-sell arrangements with respect to (finished or unfinished) goods for wholesale distribution to unrelated parties; and
 - Sales agency and commissionaire arrangements contributing to one or more associated enterprises' wholesale distribution of goods to unrelated parties.
- Retail activities, unless they fall within the threshold of not exceeding 20% of total annual sales of the distributor, remain out of scope of Amount B.
- When it comes to the distribution of digital goods, while they currently remain out of scope of Amount B, the July 2023 Consultation Document asks for further input from the international community as to their potential inclusion.
- A number of open items remain subject to further input from stakeholders. The main open item is whether a separate qualitative scope criterion is required to identify distributors that make non-baseline contributions which cannot be reliably priced under the suggested pricing methodology. Another remaining open point relates to the threshold applied to exclude qualifying transactions from the simplified regime based on the use of indirect cost allocation keys.
- The proposed pricing methodology is based on the application of the transactional net margin method ("**TNMM**"), considering a global pool of companies involved in baseline marketing and distribution activities.

- The financial information derived from the global dataset was used as the basis for the approximation of arm's length results and presented in the form of a pricing matrix, using a return on sales as the relevant net profit indicator.
- The pricing matrix presented by the IF takes into account three factors to establish the arm's length pricing outcomes for in-scope transactions: (i) the operating asset to sales intensity ("**OAS**") of the tested party; (ii) the operating expense to sales intensity ("**OES**") of the tested party; and (iii) the industry in which the tested party operates.
- While the December 2022 Consultation Document presented a potential alternative approach using regression analysis, such approach has been completely omitted in the July 2023 Consultation Document.
- The documentation approach for in-scope transactions builds on the premise that the current content of the local and master file already includes the items of information and documents which are relevant to examine the taxpayer's position. Therefore, no explicit additional documentation requirements are introduced for the substantiation of the simplified and streamlined approach.
- The July 2023 Consultation Document, however, identifies the minimum information that is required for tax administrations to assess whether the taxpayer's qualifying transactions meet the scoping criteria, and whether the taxpayer applied the pricing methodology properly.

In more detail

Scope

- Amount B provides for a simplified and streamlined approach to the application of the arm's length principle to in-country baseline marketing and distribution activities, with a particular focus on the needs of low-capacity countries.
- The simplified and streamlined approach can generally apply to two types of transactions ("qualifying transactions"), the nature of which is determined based on a functions and risks analysis:
 - Buy-sell arrangements with respect to (finished or unfinished) goods for wholesale distribution to unrelated parties primarily in the local market of the distributor; and
 - Sales agency and commissionaire arrangements contributing to the wholesale distribution of goods.
- While the distribution of digital goods is currently excluded from the guidance on Amount B, further work is being undertaken and the July 2023 Consultation Document has requested input from stakeholders to determine whether a simplified and streamlined approach would be appropriate.
- Amount B does not apply to the distribution of services and the marketing, trading or distribution of commodities. The commentary defines the term "commodities" by reference to paragraph 2.18 of the OECD Guidelines and goes beyond this definition by including physical products of a commodity nature, "whether or not they have a quoted price, and includes transactions where the commodity has undergone qualifying processing". This means that commodities covered by this definition may or may not have a quoted price and can be products either in their final stage of processing or intermediate products. Further detailed examples of what should be considered a commodity are given in the commentary.
- A distributor is considered a wholesale distributor under the simplified and streamlined approach, if its annual net retail sales do not exceed 20% of its total annual sales. Hence, de-minimis retail sales do generally not harm, however, it will be further considered if this de-minimis threshold would affect the reliability of the pricing methodology and/or whether it materially limits the set of in scope distributors in certain jurisdictions. Further, the term 'retail distribution' only captures sales to end consumers, which should mean that any entity making primarily B2B sales is potentially in scope of Amount B.
- Amount B only applies to baseline distributors that carry out core distribution functions. Core distribution functions are those functions that are typically carried out by baseline distributors, such as buying goods for resale and identifying new customers and may include ancillary functions, such as customer relations, after-sales services, certain promotion and marketing services, warehousing and invoicing. However, "core distribution functions" excludes manufacturing, research and development, procurement or financing activities that are non-incidental to a qualifying transaction.
- The July 2023 Consultation Document seeks input on whether additional qualitative criteria are needed to define the in-scope transactions and offers two alternatives: Alternative A (which does not require a qualitative test) and Alternative B (which sets out the qualitative criteria to be applied). To be generally in scope, both alternatives require that:

- the qualifying transaction consists only of baseline distribution functions so that the transaction can be reliably priced by using a one-sided transfer pricing method, namely the TNMM, using the distributor as tested party. Because the qualifying transaction must be priced on the basis of a one-sided method, any transaction for which a two-sided method is the appropriate transfer pricing method is out of scope. Consequently, the commentary refers to Chapter II, Part III, Section C.2.2, which gives examples of transactions for which the transactional profit split method is the most appropriate method; and
- the tested party may not incur annual operating expenses lower than 3% of its annual sales and greater than 30% in the event Alternative A applies and 50% in the event an additional test based on qualitative criteria is undertaken in Alternative B. The July 2023 Consultation Document recognizes that the parameters to calculate this ratio can vary over time, making it likely that distributors may move in and out of scope and therefore, applies a three year weighted average that is calculated on an annual basis. For distributors that act as commission agents who do not make the final sale to the customer, the annual sales of the sales making entity are to be used. In the case where distributors carry out non-distribution functions and unless these non-distribution functions lead to the inapplicability of the simplified and streamlined approach (*see below*), the operating expense to sales ratio should be computed based on the relevant allocation or apportionment of revenues and expenses to the distribution activity only.
- If distributors also carry out non-distribution functions and provided all other conditions are met, the simplified and streamlined approach remains applicable provided these functions can be reliably segmented from the distribution functions in accordance with the guidance given in paragraphs 3.9-3.12 of the OECD Guidelines and the proportion of the annual indirect operating expenses allocated between the various businesses using allocation keys does not exceed 30% of the total costs. The latter criterion is still subject to discussion, especially in relation to how the proportion should be calculated (indirectly allocated costs of the entire business or the distribution segment), which cost basis should be used (the cost base of the entire business or only of the distribution activities) and whether additional safeguards are needed. As a general rule, the Amount B rules do not apply, where the distributor treats the distribution and non-distribution functions as a bundled transaction and charges only one single price.
- The main open item of the scoping section of the July 2023 Consultation Document is whether additional qualitative criteria should apply to determine the in-scope transactions. Only Alternative B requires additional scoping criteria, which seek to identify non-baseline contributions that make the application of the simplified and streamlined approach unreliable, even though the one-sided method is generally an appropriate method to determine the arm's length remuneration of such activities. Non-baseline contributions are defined as "functions and assets that represent a key source of actual or potential economic benefits in the qualifying transaction and are contributions whose benefits are expected to exceed the actual or potential economic benefits typically derived from core distribution functions". The July 2023 Consultation Document cautions tax administrations to exercise judgment in evaluating whether non-baseline contributions are in fact made. Especially where contributions are made that result in the creation, enhancement or modification of marketing intangibles a footnote remarks that these transactions would likely be out of scope because the one-sided approach might not be appropriate. The document refrains from giving strict criteria as to what constitutes non-baseline contributions and instead opts for examples.
- The first example removes a transaction from the scope of Amount B, where the distributor through its own qualified personnel provides certain technical or specialized support functions that require significant and specialized capabilities, that are connected to the original sale and are part of the ongoing customer relationship. These activities are to be differentiated from a mere technical understanding of a technical or specialized product that is required to perform the core distribution activities. Also, ancillary services, such as translations, packaging, labelling and the alike do not constitute non-baseline contributions. Therefore, if a distributor renders specialized services such as customization, specialist advice to install, use, and maintain the purchased equipment as well as specialized ongoing engineering advice and/or modification of products for its customers, these activities would constitute non-baseline contributions. If the specialized non-baseline activities exceed the benefits of the core distribution activities, the transaction is out of scope of Amount B. The transaction would remain in scope if the personnel of the distributor only communicated with customers and provided specialized advice given by the supplier from which the distributor procures the products.
- The second example refers to a highly regulated industry, where the distributor through its own personnel makes contributions that enable market access for the products and/or generate barriers to entry in the market. Such activities usually consist of complex functions and intangible assets and go beyond the mere support or facilitation of the regulatory approval process. Therefore, a transaction is out of scope if the distributor enters into a complex and lengthy regulatory approval process, the outcome of which is uncertain, and requires intimate knowledge of the local market regulations and intensive communication with and training of the regulatory authorities. These facts indicate that the non-baseline

contributions exceed the economic benefit of the baseline distribution functions. The transaction would remain in scope if the regulatory approval process was in fact led by the manufacturer and the distributor only makes limited contributions, such as providing limited market research and data facilitating meetings with the regulator.

Pricing Methodology

- The proposed pricing methodology is based on the application of the TNMM, considering a global pool of companies involved in baseline marketing and distribution activities. There is a possibility that countries might advocate for local country pool comparable. This is a topic that is expected to receive input during the public commentary.
- The financial information derived from the global dataset was used as the basis for the approximation of arm's length results and presented in the form of a pricing matrix, using a return on sales as the relevant net profit indicator.
- The pricing matrix presented by the IF takes into account three factors to establish the arm's length pricing outcomes for in-scope transactions: (i) the OAS of the tested party; (ii) the OES of the tested party; and (iii) the industry in which the tested party operates.
- Three industry groupings have been devised under the simplified and streamlined approach. Each industry grouping represents a column in the pricing matrix. Similarly, five operational intensity levels have been identified for different levels of OAS and OES. Each level represents a row in the pricing matrix.
- The intersection of each industry grouping and operational intensity level provides a range of approximated arm's length returns on sales for baseline marketing and distribution activities. Figure 4.1 from the July 2023 Consultation Document presents the pricing matrix derived from the global dataset:

Figure 4.1 – Pricing Matrix (return on sales %) derived from the global dataset

Industry Grouping Factor intensity	Industry Grouping 1	Industry Grouping 2	Industry Grouping 3
[A] High OAS / any OES >45%/any level	3.50% +/- 0.5%	5.25% +/- 0.5%	5.50% +/- 0.5%
[B] Med/high OAS / any OES 30%-44.99%/any level	3.25% +/- 0.5%	3.50% +/- 0.5%	4.50% +/- 0.5%
[C] Med low OAS/any OES 15%-29.99%/any level	2.75% +/- 0.5%	3.25% +/- 0.5%	4.25% +/- 0.5%
[D] Low OAS / non-low OES <15%/10% or higher	2.00% +/- 0.5%	2.25% +/- 0.5%	3.00% +/- 0.5%
[E] Low OAS/low OES <15% OAS/<10% OES	1.50% +/- 0.5%	1.75% +/- 0.5%	2.25% +/- 0.5%

- Currently, the applicable ranges for a given tested party can extend from a minimum of 1.00% (1.50% - 0.5%) (i.e., applicable to industry group 1 entities with low asset and operating expense intensity) to a maximum of 6.00% (5.50% + 0.5%) (i.e., applicable to industry group 3 entities with high asset expense intensity).
- The current prescribed margins at each operational intensity level and industry pairings allow for $\pm 0.5\%$ variation, representing an arm's length range of returns to demonstrate that the conditions of the tested transactions were consistent with the arm's length principle on an ex-post basis. If at year-end the margin reported by the taxpayer falls outside the applicable arm's length range provided by the matrix, tax administrations should use the midpoint of the range to adjust the margin of the controlled transaction.
- Moreover, the IF has proposed a modified approach and an adjustment mechanism to account for geographic differences identified in certain qualifying jurisdictions. The list of qualifying jurisdictions has not yet been issued. It is intended that for tested parties located in the identified qualifying jurisdictions, a modified pricing matrix will apply, superseding the pricing matrix generated from the global set of companies.
- An alternative risk adjustment mechanism has been proposed by the IF to account for exposure to country risk in certain qualifying jurisdictions that may influence arm's length returns attributable to baseline marketing and distribution activities. Here too, the list of qualifying jurisdictions to which such risk adjustment mechanism will apply has not been issued.

- When local datasets are available, the current rules allow for a qualifying local dataset to be produced by a relevant tax administration provided that the approach follows a similar methodology used to produce the global dataset. Such set will then be translated into a local pricing matrix that conforms to and supersedes the pricing matrix from the global set.
- For the purposes of the simplified and streamlined approach, a Berry ratio cap-and-collar approach has been devised as a corroborative test. The test consists of ensuring that in all cases the implied Berry ratio of a tested party always falls within a range of 1.05x and 1.50x .
- Concretely, if the implied Berry ratio exceeds the cap level, the return on sales of the tested party will be adjusted downwards until it results in an implied Berry ratio result equal to 1.50x. Conversely, when the implied Berry ratio result of the tested party falls below the Berry ratio collar, the return on sales of the tested party will be adjusted upwards until it results in an implied Berry ratio result equal to 1.05x.
- The set of comparable companies underlying the arm's length ranges will be updated every five years (unless there is a significant change in market conditions that warrants an interim update), while the financial data of the comparable companies and other datapoints including the risk adjustment percentages and the Berry Ratio cap-and-collar range will be updated annually.

Documentation

- The documentation approach for in-scope transactions builds on the premise that the current content of the local and master file already includes the items of information and documents which are relevant to examine the taxpayer's position. Therefore, no explicit additional documentation requirements are introduced for the substantiation of the simplified and streamlined approach.
- The July 2023 Consultation Document, however, identifies the minimum information that is required for tax administrations to assess whether the taxpayer's qualifying transactions meet the scoping criteria, and whether the taxpayer applied the pricing methodology properly.
- This minimum information includes a description of the delineation of the in-scope qualifying transaction, relevant written contracts or agreements, calculations showing the determination of the relevant revenue, costs and assets allocated or attributed to the in-scope transaction, as well as the application of the pricing matrix.
- When a taxpayer is seeking to apply the simplified and streamlined approach for the first time, the taxpayer should apply the approach for a minimum of 3 years, unless transactions are no longer in scope during that period, in which case the taxpayer should notify the tax authorities of the jurisdictions involved in the qualifying transaction.
- While specific local documentation requirements may be introduced at a local level in particular jurisdictions for the simplified and streamlined approach, the current rules require jurisdictions that opt to do so, to consider simplifying such requirements for small and medium enterprises to limit their costs and compliance burden.

Tax Certainty

- The July 2023 Consultation Document states that Amount B is expected to improve tax certainty and reduce disputes with respect to transactions involving baseline marketing and distribution activities.
- Taxpayers can rely on existing mechanisms for obtaining transfer pricing certainty and dispute resolution, including APAs and MAPs, to obtain tax certainty and prevent or resolve tax disputes arising from the application of Amount B.
- To the extent that an APA has already been concluded with respect to a qualifying transaction, and its critical assumptions hold, the terms and conditions of such APA should remain valid for its duration. The July 2023 Consultation Document points out that, in the case of unilateral APAs, the counterparty taxing authority may be in a position to audit the qualifying transaction.

Transitional issues

- This section of the July 2023 Consultation Document focuses on analyzing the tax consequences resulting from business restructurings that might impact the application of the simplified and streamlined approach by, for example, turning non-qualifying transactions into in-scope transactions, and vice versa.
- In all circumstances, the guidance in Chapter IX will remain relevant in assessing whether the simplified and streamlined approach is applicable to the pre-restructuring or post-restructuring qualifying transactions.

- However, when Associated Enterprises attempt to artificially reorganize their arrangements to derive tax advantages from the application of the simplified and streamlined approach, these reorganizations may come under greater scrutiny by tax authorities to prevent the use of the approach for tax planning opportunities and jurisdictions may adopt targeted approaches to address these concerns.

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- The current scoping rules intend for Amount B to apply to wholesale distributors as well as wholesale agents and commissionaires. Taking note that the functional intensity and cost structure of wholesale distributors vs. agents/commissionaires will be different, it should be further explored whether two distinct pricing matrices should be outlined, one for wholesalers and one for agents/commissionaires. This may be particularly relevant for the application of the Berry Ratio cap-and-collar approach.
- In relation to the segmentation of activities at the level of the distributor which is engaged in more than wholesale distribution activities, we generally see this as a positive development which will provide companies with additional flexibility to scope activities in vs. carve certain activities out of scope of Amount B. With this additional flexibility, companies will still need to determine an arm's length remuneration for the out of scope activities, which might also require changes to the contractual arrangements.
- The question of whether additional qualitative criteria are needed to define the in-scope transactions and the two alternatives proposed: Alternative A (which does not require a qualitative test) and Alternative B (which sets out the qualitative criteria to be applied) is a pivotal technical point requiring further attention before Amount B can move forward with implementation. The *"separate qualitative criterion"* under Alternative B may be interpreted as going over and beyond the qualitative comparability analysis based on the existing OECD guidance in Chapter I of the OECD Guidelines. Further, the July 2023 Consultation Document also does not clarify at what point the economic benefit of the non-baseline contribution exceeds the economic benefit of the baseline contribution, and therefore this could lead to divergent views in terms of interpretation of how the Alternative B should be implemented in practice, thus leading to increased controversy.
- The pricing matrix introduced in the July 2023 Consultation Document provides more clarity in terms of how Amount B would be applied in practice, including the differentiated returns expected across industry groups and levels of OES and OAS intensity. Based on our initial review of the pricing matrix, we highlight the following observations:
 - A pricing matrix with five categories of OES / OAS ratios, while working with +/- 0.5% increments for ROS, may lead to a large number of "clusters" and could lead to higher burden for companies. It should be further evaluated whether to reduce the number of categories and/or provide more flexibility with the +/- ROS increments.
 - Companies with low OES intensity (irrespective of the asset intensity) are very likely to default to the cap Berry Ratio of 1.50x.
 - For "borderline" OES intensity companies, it may be possible that they will witness (high) fluctuations in their actual ROS. For example, for an Industry Group 3, level A company, the pricing matrix prescribes a margin of 5.5%. Assuming an OES ratio of 8% for this company, such company will always default to the Berry Ratio cap mechanism, and its implied OPM (due to the Berry Ratio cap) would be capped at 4.00% (equivalent to a Berry Ratio of 1.5x). If the OES would instead be 10%, the Berry Ratio cap will not apply and the ROS will be 5.5%. This means that by increasing OES by 2%, the implied ROS increases by 1.5%. This illustrates the potential for high fluctuations when it comes to application of Amount B.
 - It may be counter-intuitive that in a situation of economic downturn, whereby sales are expected to decrease, and whereby operating expenses or asset base remains relatively stable, higher OAS ratios command higher expected ROS, based on the pricing matrix.

Next steps

The OECD has requested input from stakeholders on the remaining technical points, with comments to be received no later than 1 September 2023. Following the public consultation, the OECD intends to finalize the guidance on Amount B and publish it as an addition to the OECD Transfer Pricing Guidelines in January 2024.

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