

## International: Amount B back in the spotlight as OECD opens consultation on Pillar One's Amount B

### 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. Nevertheless, over the past two years, in respect of Pillar One developments, the focus of the OECD Inclusive Framework members has been primarily on Amount A.

However, on 8 December 2022, the OECD finally released the long-awaited consultation document and hosted a webinar on the proposed design of Amount B, putting Amount B back into the international tax spotlight. The OECD has now **requested input** from stakeholders on the technical design of Amount B, with comments to be received no later than 25 January 2023.

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### In more detail

On 8 December 2022, the OECD published a **public consultation document** on Amount B. It outlines the main design elements of Amount B, consisting of, *inter alia*, the transactions in scope of Amount B and the proposed pricing methodology to determine an appropriate remuneration for the in-scope activities.

Since the publication of the Pillar One Blueprint in October 2020, Amount B has been living in the shadow of Amount A, leading to a great deal of uncertainty about its future amongst the international tax community. The OECD has, up until now, appeared to prioritize the progress of Amount A, placing Amount B in the background. The main points to take away from the original Blueprint were the two components of Amount B, namely:

1. The scope of "baseline marketing and distribution activities" will be eligible for Amount B.
2. A proposed remuneration mechanism for the aforementioned in-scope activities.

With no official developments regarding Amount B since the release of the Blueprint, the launch of the consultation document on 8 December 2022 has been long overdue.

### Key takeaways

- The main design elements of Amount B covered in the consultation document are Scope and Pricing methodology complemented by considerations dealing with Documentation and Tax Certainty in connection with Amount B.
- Two types of intragroup transactions are intended to be in scope of Amount B:
  - Buy-sell arrangements with respect to (finished or unfinished) goods for wholesale distribution to unrelated parties primarily in the local market of the distributor.
  - Sales agency and commissionaire arrangements contributing to the wholesale distribution of goods.
- The Amount B proposed pricing methodology is based on the application of the Transactional Net Margin Method (TNMM), considering a global pool of companies undertaking wholesale distribution as their primary business activity. The arm's length

result(s) could potentially be presented by way of either: (a) a pricing matrix or (b) a mechanical pricing tool, such as a regression formula with different variables.

- The intended timeline for the introduction of Amount B runs concurrent with the timeline for Amount A: It is the aim to complete the technical work and present a final deliverable by mid-2023. Based on this timeline, it is envisaged that a sufficient number of jurisdictions would apply Amount B as of 2024.
- Similar to all previous consultation documents that have so far been released on Pillar One, this consultation document on Amount B is work in progress prepared by the OECD Secretariat and should not to be understood as being reflective of the final views of the Inclusive Framework (IF) members.
- It is not the purpose of Amount B to replace the arm's length principle for the activities in scope. It rather intends to provide a standardized pricing methodology to determine an appropriate remuneration for specific in-scope transactions in line with the established arm's length principle. Hence, the OECD sees no need to amend any double tax treaties in order for Amount B to come into effect.
- The OECD intends to use its Transfer Pricing Guidelines as the Implementation Framework for Amount B. However, it has not yet been decided in which form Amount B should be incorporated into the OECD Transfer Pricing Guidelines. Amount B could potentially be designed as a safe-harbor (similar to the Chapter VII guidance on low value-adding services) or as general interpretation guidance to apply the arm's length principle to the in-scope transactions.

## Scope

- As noted above, two types of intragroup transactions are intended to be in scope of Amount B:
  - Buy-sell arrangements with respect to (finished or unfinished) goods for wholesale distribution to unrelated parties primarily in the local market of the distributor.
  - Sales agency and commissionaire arrangements contributing to the wholesale distribution of goods.
- Whether a transaction is in scope of Amount B is not determined by an exhaustive list, but will eventually depend on the individual facts and circumstances based on the application of the five comparability factors.
- There are several qualitative and quantitative scoping criteria that are currently subject to evaluation:
  - The activities must or should be carried out in line with a (pre-existing) written intercompany agreement corroborating the scoping requirements, while also considering the actual conduct of the parties.
  - Individual local customers may only make up for a certain, as yet undecided, fixed percentage of the tested party's annual net sales.
  - The tested party's function may have to be limited to a core distribution function, i.e., the entity may not engage in any other economic activity that is valuable and remunerable in itself (e.g., regulatory activities or any technical or specialized sales-support activities).
  - The tested party's functional and risk profile may have to be limited so that it does not assume any economically significant risks, does not perform any DEMPE functions leading to the creation of unique and valuable (marketing) intangibles, and does not own any unique and valuable intangible assets.
  - The tested party may only show a specific level of operating expenditures. Any expenses in excess of this level are assumed to be an indicator of "harmful" ancillary activities.
- The consultation document presents two exemptions from the application of Amount B:
  - Existing and new APAs will take precedence over Amount B.
  - Certain products will be excluded such as commodities and digital (non-tangible) goods (e.g., software).

## Pricing Methodology

- The Amount B proposed pricing methodology is based on the application of the TNMM, considering a global pool of companies undertaking wholesale distribution as their primary business activity.

- The IF is currently considering the reasonableness of utilizing an exemption to applying the TNMM-based Amount B pricing methodology to in-scope transactions where the most appropriate method to evaluate such controlled transactions is different from the TNMM, or when reliable local market comparables are available for the evaluation of the tested transaction within the scope of Amount B.
- The IF is working on developing common standardized benchmarking search criteria to identify independent comparables engaging in baseline marketing and distribution activities.
  - The consultation document provides a snapshot of the preliminary search strategy considered by the IF, although it is still subject to change. A notable step of the initial screening process is that it relies upon keyword searches based on database business descriptions. Furthermore, consideration is being given to the inclusion/exclusion of loss-making entities in/from the pool of comparable companies.
  - Further work will be performed to consider whether, and in what circumstances, comparability adjustments to the selected comparables would be appropriate.
  - Currently, the consultation document does not provide details regarding the population sampled in the preliminary technical analyses conducted (i.e., size of the sample, geographic distribution or profile of the comparable companies). In practice, it might still be the case that the underlying data for the pricing of Amount B (i.e., the information on the potential comparables or a rejection matrix) would not be publicly available for tax administrations and taxpayers due to commercial database license restrictions.
- Based on the preliminary results retrieved from the search strategy, the OECD/IF is currently running several analyses to determine economically relevant characteristics which show a correlation with the entity's profitability. Factors that preliminarily have proven to be of statistical significance for a company's profit level are geography, industry, asset intensity and operating expenses intensity.
- The outcome of these analyses will determine the pool of comparables, and potentially several different sets of comparables will be made available, depending on the relevant geography and industry. These comparables should be used to establish an arm's length (range of) return(s) for baseline marketing and distribution activities. The arm's length result(s) could potentially be presented by way of either: (a) a pricing matrix, or (b) a mechanical pricing tool, such as a regression formula with a number of different variables. In both cases, the application of financial adjustments to improve the reliability of the arm's length results is being considered.
- While the Return on Sales (ROS) is frequently used to determine the arm's length price of purchases from associated enterprises for resale to independent customers, consideration is being given to the use of alternative profit level indicators such as the Berry Ratio (BR) or Return on Assets (ROA).

## Documentation

- The consultation document provides a comprehensive list of information which should be maintained by the taxpayer to demonstrate compliance with Amount B.
- It is envisaged that such information would be included as part of the local file as presented in the OECD Transfer Pricing Guidelines.

## Tax Certainty

- The 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.

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- While the technical analyses being undertaken by the IF for Amount B pricing purposes are based on highly sophisticated statistical analyses for an (arguably) large global sample of functionally comparable companies, one potential consideration relates to the predictability and stability over time of the arm's length results provided by Amount B. This is particularly important for MNEs for purposes of deploying and managing global transfer pricing policies. The periodicity and timing of Amount B pricing updates will also be relevant for other operational and tax aspects of MNEs (such as customs valuations).
- It remains subject to discussion whether sales agents and commissionaires should be in scope of Amount B. Low-capacity jurisdictions appear to be in favor due to the prominence of such arrangements in their markets. Others argue that significant consideration of the individual functional and risk profile of the sales agent/commissionaire would be required. Otherwise there is the risk that sales agents/commissionaires could potentially be over-compensated in comparison to distributors. Against this background, it is also subject to discussion whether the pricing methodology for sales agency/commissionaire should be different than the approach for buy-sell arrangements or whether specific comparability adjustments should be applied.
- Interested parties that have closely followed the developments throughout the year may have already expected that service transactions will not be in scope of Amount B. However, based on the questions posed for public commentary there will likely be more discussions on this topic.
- During the OECD's webinar on 8 December 2022, the speakers acknowledged that there is a trade-off between providing as much certainty as possible by widening the scope of Amount B, whilst providing taxpayers and tax administrations with as much simplicity and administrability as possible by keeping the scope narrow and clear.
- At first glance, the currently envisaged scope of Amount B appears very narrow considering the various qualitative and quantitative limitations. Only so-called "stripped" distributors with a very limited functional and risk profile will fall under Amount B, whereas many groups will have set up their local entities to carry out wider activities for reduced administration, or will have allowed extra distributor functionality or a wider customer base for their distributor entities. An entity with more extensive functions would not qualify for Amount B even if its functions could be split-up in different segments. To what extent ancillary activities will be permissible remains to be seen.
- Overall, the appropriateness of relying on various quantitative criteria could lead to additional complexity. The approach intends to ensure objectivity but in practice the classification of a certain expenditure as "harmless" cost of goods sold (COGS) or as "harmful" operating expenditure (OPEX) is not always consistent and free of subjectivity.
- As noted earlier, the initial screening process to determine appropriate comparables relies, inter alia, on keyword searches based on database business descriptions. For example, it is envisaged to reject companies if they do not indicate wholesale distribution as their main activity or if they indicate more than minority or ancillary levels of additional activities. This could rule out many potential comparables since database business descriptions are often quite broad and general.
- Even if the scope of Amount B appears narrow, it is to be expected that the pricing methodology and (range of) arm's length result(s) will be of considerable significance for transfer pricing purposes. Tax administrations may use it as a benchmark for comparison purposes to assess the appropriateness of the results of a taxpayer that has claimed to be out of scope of Amount B. Against this background, it would therefore be welcome if the OECD is able to publish a further consultation document prior to finalization of Amount B to fully share its detailed search strategies, screening processes and pricing results. In addition, another question that has not yet been addressed is whether a taxpayer that is prima facie in scope of Amount B may opt out of it because the approach developed by the OECD/IF may not be consistent with that taxpayer's overall transfer pricing system and benchmarking processes.

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