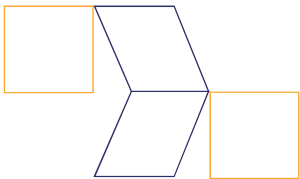


AURTUS UPDATE
BEPS 2.0 – Inclusive Framework Report
on Pillar One - Amount B



February 2024



Pillar One – Amount B: Update

- On 19 February 2024, the OECD/G20 Inclusive Framework (IF) on BEPS released the report on Amount B of Pillar One ('the report'), which provides a simplified and streamlined approach to the application of the arm's length principle to baseline marketing and distribution activities, with a particular focus on the needs of low-capacity countries.
- Content from the report has now been incorporated into the OECD Transfer Pricing Guidelines as Annex to Chapter IV (Administrative approaches to avoiding and resolving transfer pricing disputes). The report provides an optional simplification that jurisdictions can choose to apply to in-scope distributors, sales agents or commissionaires operating in their jurisdiction for fiscal years commencing on or after 1 January 2025.

Background



OECD – Two Pillar Proposals

- In January 2019, the Inclusive Framework embarked on examining proposals in two pillars to provide a consensus solution to tax challenges arising from digitalization. Pillar One addresses nexus and profit allocation, while Pillar Two focuses on a global minimum tax. The G20 endorsed the program of work on Pillar One and Pillar Two in June 2019. Subsequently, in July 2020, the G20 mandated IF to produce reports on the Blueprints of Pillar One and Pillar Two.

Pillar One

- Pillar One adapts the international income tax system to new business models, expanding taxing rights of market jurisdictions and improving tax certainty. It has two elements, Amount A and Amount B.
- **Amount A** addresses the reallocation of taxing rights on a portion of multinational enterprises' profits, emphasizing user participation and marketing intangibles.
- **Amount B** aims to simplify transfer pricing administration, reduce compliance costs, and enhance tax certainty. It standardizes the remuneration of related party distributors engaged in baseline marketing and distribution activities. The IF report on Amount B which provides a simplified and streamlined approach to determine of arm's length margins for baseline distributors.



Consideration for application of Simplified and Streamlined Approach



- The Report provides an option to jurisdictions to apply a simplified and streamlined approach under Amount B to approximate arm's length outcome for in-scope baseline marketing and distribution arrangements. Under this approach, any of the following two options can be considered by the jurisdiction:
 - **Voluntary Election:** A jurisdiction may provide an option to the resident tested parties to elect the simplified and streamlined approach (more akin to a safe harbour, which taxpayer can opt for) when transactions meet the in-scope criteria; and
 - **Mandatory Application:** A jurisdiction may implement the simplified and streamlined approach mandatorily wherever the scope criteria are met.
- The outcome determined under simplified and streamlined approach would be non-binding on the counter party jurisdiction.

In-scope Transactions



- The following controlled transactions could qualify for the Simplified and Streamlined Approach:
 - **Buy-sell marketing and distributions transactions** where the distributor purchases goods from Associate Enterprise (AE) for wholesale distribution to unrelated parties; and
 - **Sales agency and commissionaire** transactions where the sales agent or commissionaire contributes to AE's wholesale distribution of goods to unrelated parties.
- Apart from above, a qualifying transaction must also meet following conditions:
 - Not own unique and valuable intangibles or assume certain economically significant risks.
 - Must exhibit economically relevant characteristics that mean it can be reliably priced using a one-sided transfer pricing method.
 - The tested party in the qualifying transaction must not incur annual operating expenses lower than 3% and greater than a 20% / 30% of its annual net sales.
 - The tested party must not conduct non-distribution activities that cannot be evaluated and priced separately.
 - Tested party should not be engaged in distribution of non-tangible goods, commodities or services.



Application of Method



- Transactional Net Margin Method (TNMM) is chosen as the most appropriate method with Return on Sales as Profit level Indicator. Further, the Report also provides for use of comparable uncontrolled price (CUP) method for pricing the in-scope transactions on exception basis. However, the actual use of this CUP method may be rare – as the distribution of commodities is excluded from the scope.

Determining the return



- In the report, arm's length results have been presented in a matrix form, which provides arm's length return on sales based on following factors: (i) Industry Grouping (3 industry groups provided); (ii) Net Operating Asset Intensity (OAS) and (iii) Operating Expense Intensity (OES).

	Factor Intensity		Industry Grouping 1	Industry Grouping 2	Industry Grouping 3
	OAS	OES			
A	> 45%	Any	3.50%	5.00%	5.50%
B	30% - 44.99%	Any	3.00%	3.75%	4.50%
C	15% - 29.99%	Any	2.50%	3.00%	4.50%
D	<15%	> 10%	1.75%	2.00%	3.00%
E	<15%	<10%	1.50%	1.75%	2.25%

- As can be observed from above matrix, the arm's length return on sales as per the matrix range between 1.50% to 5.50%.
- The above return would be required to be adjusted for the following:
 - **Operating Expense Cap and Collar range:** In case the return on sales of the tested party falls outside the pre-defined operating expenses cap-and-collar range as per the following table.



Factor Intensity as per above table	Default Cap rates	Cap rates for qualifying jurisdictions	Collar rates
High OAS [A]	70%	80%	10%
Medium OAS [B & C]	60%	70%	
Low OAS [D & E]	40%	45%	

- **Sovereign credit rating**– Adjustment factors for different sovereign credit rating are provided in report. The list of qualifying jurisdictions shall be published on OECD portal.
- The report also provides that in case a same company has sales more than 20% in another industry group, then weighted average return should be calculated.

Documentation and Transitional Issues



Documentation

- The report recommends maintaining appropriate documentation to substantiate delineation to the in-scope qualifying transaction, including functional analysis, agreements, calculations of return etc. Further, report also seeks to include a consent from taxpayer to apply the simplified and streamlined approach for three years in its local file, subject to facts and relevant business circumstances remaining constant.
- It also encourages the jurisdictions to simplifying the documentation requirements for small and medium enterprises in order to limit their compliance costs and compliance burden.

Transitional Issues

- The report recognises that some taxpayers may reorganise their arrangements to either to qualify or disqualify for the simplified and streamlined approach. At the same time, it also acknowledges that businesses are free to organise their business operations as they see fit.
- The report notes that tax administration can scrutinise tax implications of such reorganisations. This could particularly be the case where distributor having past losses is restructured to qualify for the simplified and streamlined approach to utilise the past losses.



Tax certainty and elimination of double taxation



- The report also acknowledges that there could be situations of double taxation in view of any primary adjustment made upon application of simplified and streamlined approach by one jurisdiction. In such situations, for most jurisdictions the taxpayers would be required to considering opting for Mutual Agreement Procedure (MAP) to obtain a corresponding adjustment. The positions under a MAP should be determined based on the remainder of the transfer pricing guidelines.
- The next update of the commentary on Article 25 of the OECD Model Tax Convention is expected to align with the agreed wording of the Report. Bilateral or multilateral APAs and MAPs, obtained prior to the implementation of the simplified and streamlined approach, would continue to be valid in relation to the covered qualifying transactions.

India Reservations



- Interestingly, India seems to be the only country which has made several reservations to this report. These reservations primarily pertain to:
 - incomplete nature of the report owing to the non-inclusion of the definitions of ‘low-capacity jurisdictions (LCJs) and ‘qualifying jurisdictions’;
 - an appropriately designed optional qualitative scoping criterion;
 - operating expense cross-check mechanism; and
 - overall design of the pricing methodology.

Implementation



- The IF would continue to work to conclude its work by 31st March 2024, with any additions to be incorporated into the OECD Transfer Pricing Guidelines, primarily to design qualitative criteria for selection of baseline distributors. Simultaneously, the IF will also agree on a list of low-capacity jurisdictions by the same date.
- On the implementation front, the jurisdictions can choose to apply the simplified and streamlined approach for in-scope transactions of tested parties in their jurisdictions for fiscal years commencing on or after 1 January 2025.



What taxpayers should do now?



Conduct high level assessment of functional profile of the existing distributors within to group to assess qualification

Assess the preparedness for data availability and documentation requirements

Conduct mock analysis to gauge the potential impact of implementing the report

Review and potentially recalibrate existing transfer pricing policies related to distribution and marketing functions

Stay vigilant and monitor ongoing progress, updates, and refinements related to Amount B

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