Pillar 1 Amount B

Main Transfer Pricing Challenges for Taxpayers

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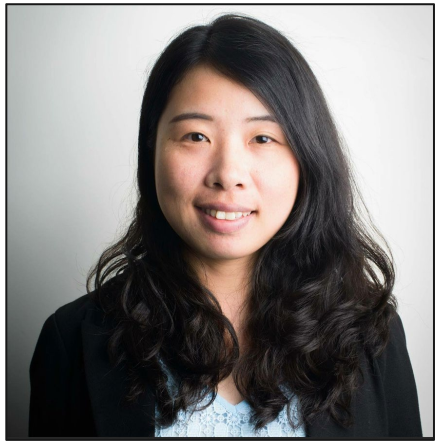

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Context

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- As part of its extensive work on Tax Base Erosion and Profit Shifting, the OECD/G20 Inclusive Framework has agreed on a two-pillar solution for addressing the tax challenges arising from the digitalization of the economy.

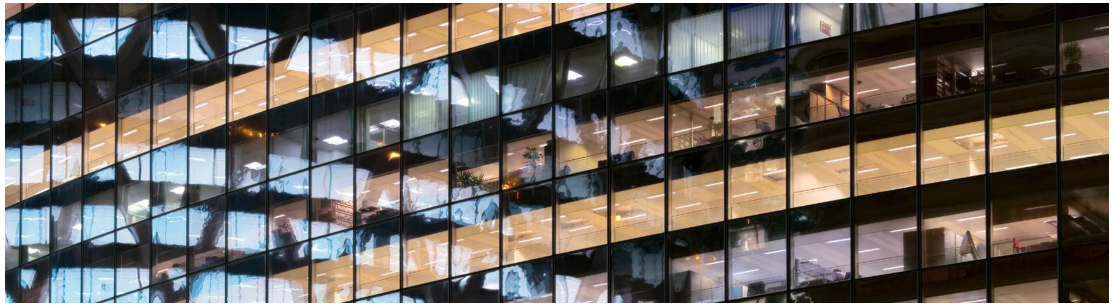
Pillar 1	Amount A	• **EUR 20 billion in revenues and have profitability exceeding 10%.** • Reallocation of taxing rights to market jurisdictions with respect to a share of the profits of the largest and most profitable MNEs operating in their markets and removes DST.
	Amount B	• **No threshold** • Aims to simplify and streamline 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 jurisdictions ("covered jurisdictions").
Pillar 2		• **Consolidated revenues over EUR 750 million.** • Aims to establish a global minimum tax of 15% on the revenues of large MNEs.

- The OECD published a report on Pillar 1 Amount B ("Amount B") on February 19, 2024, incorporated as an annex to Chapter IV of the OECD Guidelines.

- Covered jurisdictions will be able to choose to apply the simplified and streamlined approach for transactions falling within the scope of the tested parties located in their jurisdictions (by allowing or requiring it), for tax years beginning on or after **1 January 2025**.

- As of June 2024, the OECD's Amount B guidance is considered finalized and incorporated into the OECD Transfer Pricing Guidelines, but further work on the framework, including administrative aspects, is still ongoing. Amount B may be implemented with potential adjustments based on ongoing negotiations within the Inclusive Framework, but there are uncertainties around the next steps.

- This webinar is the opportunity to introduce the issues raised by the implementation of the Amount B, as well as the best practices to be followed.



Agenda

1. Scope of Amount B and Special Considerations for the Application of the Approach
2. Determining the Return on Sales Under Amount B
3. Transfer Pricing Documentation
4. Main Challenges
5. Conclusion
6. Q&A

01
Scope of Amount B & Transfer Pricing Methods

Scope of Amount B – Special Considerations for the Application of the Approach

Ultimate Approach

- Redefining EBIT (Earnings Before Interest and Taxes) margins for in-scope companies based on specified criteria without requiring a detailed benchmark analysis.

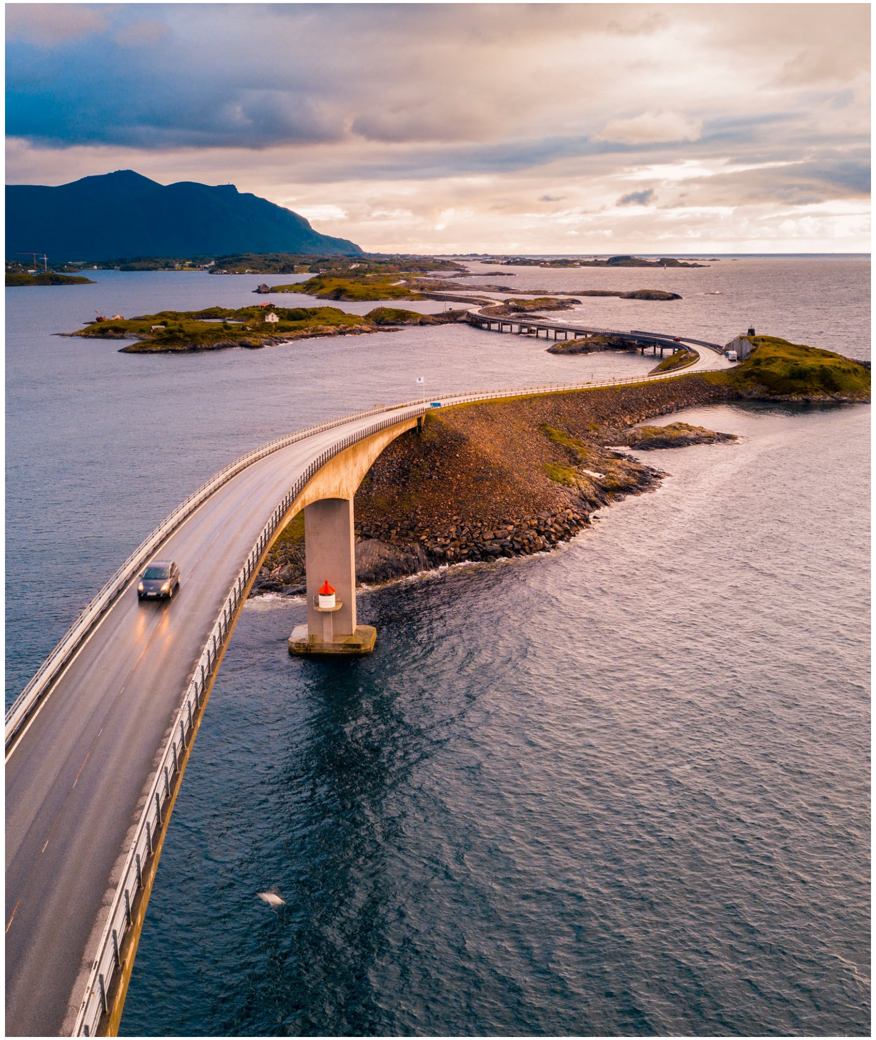
2 Options for Jurisdictions

- A jurisdiction that chooses to apply the simplified and streamlined approach can choose to apply it using one of two options:

Option 1: Possibility to apply Amount B	Option 2: Obligation to apply Amount B

Special focus: *the result determined under the simplified and streamlined approach by one jurisdiction <u>will not be binding</u> on the jurisdiction of the counterparty.*

*Also, taxpayers **should not apply the approach** to justify the arm's length nature of the remuneration when filing their tax returns in jurisdictions that do not apply the simplified and streamlined approach.*



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Scope of Amount B – Special Considerations for the Application of the Approach

Covered Jurisdictions

List of Covered Jurisdictions for the Inclusive Framework political commitment on Amount B – June 2024

- Albania
- Angola
- Argentina
- Armenia
- Azerbaijan
- Belarus
- Belize
- Benin
- Bosnia and Herzegovina
- Botswana
- Brazil
- Burkina Faso
- Cabo Verde
- Cameroon
- Congo
- Costa Rica
- Côte d'Ivoire
- Democratic Republic of the Congo
- Djibouti
- Dominica
- Dominican Republic
- Egypt
- Eswatini
- Fiji
- Gabon
- Georgia
- Grenada
- Haiti
- Honduras
- Jamaica
- Jordan
- Kazakhstan
- Kenya
- Liberia
- Malaysia
- Maldives
- Mauritania
- Mauritius
- Mexico
- Moldova
- Mongolia
- Montenegro
- Morocco
- Namibia
- Nigeria
- North Macedonia
- Pakistan
- Papua New Guinea
- Paraguay
- Peru
- Philippines
- Saint Lucia
- Saint Vincent and the Grenadines
- Samoa
- Senegal
- Serbia
- Sierra Leone
- South Africa
- Sri Lanka
- Thailand
- Togo
- Tunisia
- Ukraine
- Uzbekistan
- Viet Nam
- Zambia

The list of 66 covered jurisdictions[1] will be reviewed every five years. The purpose of this mechanical review will be to reconfirm the low- and middle-income status of covered jurisdictions based on the latest World Bank classifications.

The first five-year period of the Inclusive Framework policy commitment will run from 1 January 2025 (the earliest date on which the Amount B will take effect) to 31 December 2029.

The final list of covered jurisdictions is expected to be published in October 2024.

[1] The instruction Defining the jurisdictions concerned as part of the political commitment on Amount B, published on 17 June 2024..

Scope of Amount B – Special Considerations for the Application of the Approach
Qualifying transactions

The following controlled transactions are qualifying transactions:

Buy-sell marketing and distribution transactions where the distributor purchases goods from one or more associated enterprises for wholesale distribution to unrelated parties.

- Identification of new customers and managing customers' relationships, certain after-sales services, implementing promotional advertising or marketing activities, warehousing goods, processing orders or performing logistics, invoicing and collection.

and/or

Sales agency and commissionaire transactions where the sales agent or commissionaire contributes to one or more associated enterprises wholesale distribution* of goods to unrelated parties.

Wholesale distribution* *includes distribution to any type of customer, with the exception of final consumers.*

Key points:

- The wholesale distribution activity is included in the scope and not retail.
- In the case of mixed activity, a de minimis threshold of 80% for wholesale (20% for retail) is applied.
- Functional profile of distributors: limited-risk distributors; (full-fledged distributors are therefore excluded from the scope of Amount B.)

Scope of Amount B – Special Considerations for the Application of the Approach
Qualifying transactions

Cumulative criteria

- A qualifying transaction is within the scope of the simplified and streamlined approach when it satisfies the following criteria:
  1. The qualifying transaction must exhibit economically relevant characteristics that mean it can be reliably priced using a one-sided transfer pricing method, with the distributor, sales agent, or commissionaire being the tested party; **and**
  2. The tested party in the qualifying transaction must not incur annual operating expenses lower than 3% or greater than an upper bound of between 20% and 30% of the tested party's annual net revenues.

Out of Scope criteria

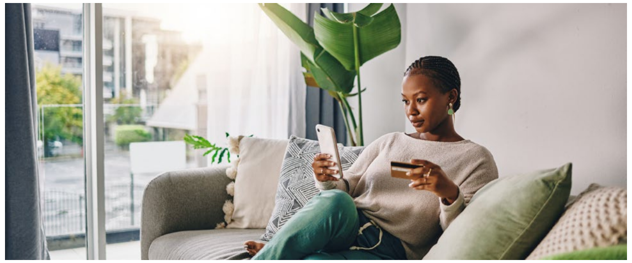
- A qualifying transaction will be outside the scope if:
  a. The qualifying transaction involves the distribution of non-tangible goods, services or the marketing, trading, or distribution of commodities; **or**
  b. The tested party carries out non-distribution activities in addition to the qualifying transaction, unless the qualifying transaction can be adequately evaluated on a separate basis and can be reliably priced separately from the non-distribution activities.
  c. Qualifying transactions involving the trading, marketing, and distribution of commodities are excluded from scope.

Scope of Amount B - Special Considerations for the Application of the Approach
Industry Grouping

Classification of products into 3 categories for positioning in the pricing matrix

Group 1

- Perishable foods, grocery, household consumables, construction materials and supplies, plumbing supplies, and metal.



Group 2

- IT hardware and components, electrical components and consumables, animal feeds, agricultural supplies, alcohol and tobacco, pet foods, clothing footwear and other apparel, plastics and chemicals, lubricants, dyes, pharmaceuticals, cosmetics, health and wellbeing products, home appliances, consumer electronics, furniture, home and office supplies, printed matter, paper and packaging, jewelry, textiles hides and furs, new and used domestic vehicles, vehicle parts and supplies, mixed products, and products and components not listed in group 1 or 3.

Group 3

- Medical machinery, industrial machinery including industrial and agricultural vehicles, industrial tools, industrial components miscellaneous supplies.

02

Determining the Return on Sales Under Amount B

Determining Arm's Length Remuneration
Pricing matrix

Part 1 – Pricing Matrix (return on sales %) derived from the global dataset

Industry Grouping	Industry Grouping 1	Industry Grouping 2	Industry Grouping 3
Factor Intensity			
(A) OAS 45% or more, any level of OES	**3.50%**	**5.00%**	**5.50%**
(B) OAS 30% to 44.99%, any level of OES	**3.00%**	**3.75%**	**4.50%**
(C) OAS 15% to 29.99%, any level of OES	**2.50%**	**3.00%**	**4.50%**
(D) OAS less than 15%, OES 10% or more	**1.75%**	**2.00%**	**3.00%**
(E) OAS less than 15%, OES less than 10%	**1.50%**	**1.75%**	**2.25%**

- Determining the return on sales for a tested party involved in in-scope transactions based on a 3-step process:
  - Net operating asset intensity (**OAS**)
  - Operating expense intensity (**OES**)
  - Industry grouping (according to the 3 groups).
- **Return on sales** has been applied as an **indicator of net profit** to establish pricing outcomes for in-scope transactions.
- Range from the pricing matrix segment that corresponds to the intersection of the industry grouping(s) and the factor intensity classification of the tested party plus or minus 0.5%.

Determining Arm's Length Remuneration
Pricing matrix

Part 2 – Operating expense cross-check

- **An operating expense cross-check is applied as a guardrail** within which the primary return on sales net profit indicator is applied.

- Where the application of the return on sales net profit indicator produces a result outside of the pre-defined operating expense cap-and-collar range specified in table below, the profitability of the tested party will be adjusted accordingly.

	Operating expense cap-and-collar range		
Factor intensity	Default cap rates	Alternative cap rates for qualifying jurisdictions	Collar rate
High OAS (A)	70%	80%	10%
Medium OAS (B+C)	60%	70%	
Low OAS (D+E)	40%	45%	

- Specific list published by the OECD of qualifying jurisdictions for the adjustment of the operating expense cap-and-collar range (within the meaning of 5.2 of the Amount B report).

Determining Arm’s Length Remuneration
Data availability mechanism for qualifying jurisdictions

Part 3 – Data availability mechanism for qualifying jurisdictions

- The data availability mechanism is intended to account for cases where there is no or insufficient data in the global dataset.
- Where a tested party is located in a qualifying jurisdiction, an adjustment will be made to the return initially determined as follows:

$$\textbf{Adjusted return on sales} = ROS^{TP} + (NRA^{J} \times OAS^{TP})$$

ROS^{TP} is the operating margin as a percentage.

NRA^{J} is the net risk adjustment ratio for a given jurisdiction (see opposite).

OAS^{TP} is the tested party's net operating asset intensity ratio for the relevant period, which may not exceed 85% for the purposes of calculating the tested party's operating margin.

List published by the OECD of qualifying jurisdictions for the adjustment of the data availability mechanism (within the meaning of 5.3 of the Amount B report).

Sovereign Credit Rating Category		Net risk adjustment %[39]
Investment grade	BBB+	0.0%
	BBB	0.0%
	BBB-	0.3%
Non-investment grade	BB+	0.7%
	BB	1.2%
	BB-	1.8%
	B+	2.8%
	B	3.8%
	B-	4.9%
	CCC+	5.9%
	CCC	7.5%
	CCC- (or lower)	8.6%

03

Transfer Pricing Documentation

Transfer Pricing Documentation
Consent and notification

- Transfer pricing documentation detailing the analysis of amount B must be prepared, **valid for a period of 5 years unless there is a major change** and updated annually based on the latest financial data of the tested party.

- Where the taxpayer wishes to apply the simplified and streamlined approach for the first time, it **must include in its local file, or in any other documentation** relevant to the application of the approach, a **consent to apply the approach for a minimum of three years**, unless the transactions no longer fall within the scope during this period, or there is a significant change in the taxpayer's business, and **notify this circumstance to the tax authorities of the jurisdictions concerned** by the qualifying transaction.

- As part of the first notification procedure, the tax authorities may ask the taxpayer to provide some or all of the information listed above.

04

Main Challenges

Main Challenges

Dispute Resolution Mechanism

- Risk of double taxation in the event of divergent application by two jurisdictions:
  - Primary adjustment made by the counterparty jurisdiction based on the other provisions of the OECD Guidelines while the other jurisdiction has applied the simplified approach.
- Request for corresponding adjustment made to the jurisdiction where the simplified and streamlined approach applies.
- Failing this, elimination of the double taxation via the mutual agreement procedures when possible.

Tax and Accounting Issues

- Amount B requires strict and auditable income statement or/and segmented balance sheet and income statement approach.
- Local accounting standards versus group accounting standards.
- There is a possibility of additional CIT in the Covered Jurisdictions;
- Group's effective tax rate may rise or fall.
- Year-end adjustments should be carefully monitored (Customs, VAT effects).
- Foreign currency risk is an important criteria for baseline activity. Companies should not incur any risk factor.

05

Conclusion

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- The Amount B, as an integral part of the OECD Guidelines, is likely to change the transfer pricing landscape over the next few years.
- Amount B can be anticipated to shift how tax auditors approach certain taxpayers. For baseline sales and marketing companies, the entire process leading to the applied margin will be a potential audit point, not just the applied margin itself. Therefore; it should not be considered as a tax audit shelter.
- Dispute resolution mechanisms such as MAPs and APAs will play a crucial role in the effectiveness of this approach. Taxpayers should manage their internal resources for the operational management of Amount B, while all countries, regardless of their classification as covered or not, should work on enhancing the effectiveness of dispute resolution mechanisms.
- The application of Amount B will require precise and detailed documentation to justify its application and net margin calculations.
- The Amount B will trigger a certain number of impacts, from a financial and tax perspective. The main consequences need to be anticipated as soon as possible, through financial simulations to determine prospective solutions to limit their negative effects.
- Particular attention should be paid to the publications on the OECD website in the coming weeks to ensure that the definitive list of jurisdictions covered is available.

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Q&A

Thank you for your participation!