

TECHNICAL NOTE

CBT/TN/10/22

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AN AFRICAN ANALYSIS OF THE
OECD SECRETARIAT'S PROGRESS
REPORT ON AMOUNT B
OF PILLAR ONE



AFRICAN TAX
ADMINISTRATION FORUM

FORUM SUR
L'ADMINISTRATION
FISCALE AFRICAINE

1 INTRODUCTION

This Technical Note is the tenth in the ATAF Technical Note series on the tax challenges arising from the digitalisation of the economy and has been designed to provide ATAF members with an overview of the *OECD Secretariat Progress Report on Amount B of Pillar One* published on the 8th December 2022.

The OECD Report notes that on 30th September 2022, the Inclusive Framework (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 Inclusive Framework will consider public comments on this document with the objective of releasing the final Amount B deliverable by mid-2023.

It should be noted that the OECD Report states, "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."

This Technical Note will assist ATAF members in deciding the further input they make into the Inclusive Framework work on the design of Amount B, which is due for completion by the middle of 2023.

African and other developing countries have reported that they consider Amount B might be of considerable benefit to them if appropriately designed, and ATAF is working closely with African Inclusive Framework members to assist them in the Inclusive Framework negotiations on the design of Amount B.

On 8th October 2021, the Inclusive Framework agreed to a two-pillar solution to address the tax challenges arising from the digitalisation of the economy. The Inclusive Framework Statement notes that "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 statement means that Amount B needs to simplify and streamline the pricing of in-country baseline marketing and distribution activities while ensuring outputs are consistent with the arm's length principle for all in-scope transactions.

2 KEY DESIGN FEATURES OF AMOUNT B

As set out in the OECD Progress Report, there are a number of key design features for Amount B where the Inclusive Framework is seeking input from public commentators. This Technical Note highlights the design features ATAF considers

of most importance if Amount B is to maximise benefits to African countries by increasing tax certainty for both African governments and multinational enterprises (MNEs) operating in Africa.

2.1. SCOPE OF AMOUNT B

The OECD Report proposes that Amount B would apply to the following intra-group transactions, where either category of the 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. The Report sets out for discussion some additional considerations regarding the inclusion of sales agency and commissionaire arrangements in the scope of Amount B.

The Report sets out the Amount B scoping criteria, which outlines 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.

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.

The Inclusive Framework is currently evaluating the following set of scoping criteria:

- a. Taxpayers 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 and should not contain terms that are inconsistent with the other scoping criteria.

- 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]% 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 that lead to the assumption of economically significant risks by the distributor based on an accurate delineation of the transaction that is 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 Transfer Pricing Guidelines (OECD TPG).

- 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).

- 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 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:

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 incurred by the distributor do not exceed [X]% of its annual net sales.

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]%.
j. 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 above what may be defined to be a limited level, including:

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 is 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 any unique and valuable intangible assets, including marketing intangibles (e.g., data centres, investment in infrastructure, and trademark license). Furthermore, the distributor would be expected to have no or limited ownership of market access rights or regulatory licenses, which 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.

ii. The qualifying transaction involves the distribution of those products within the product-based exclusion.

2.1.1. IS IT APPROPRIATE TO INCLUDE SALES AGENCY ARRANGEMENTS AND COMMISSIONAIRE ARRANGEMENTS WITHIN THE SCOPE OF AMOUNT B?

The OECD Report notes that 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.

Many developing countries 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 the OECD TPG and based on finding suitable compensation under the Amount B pricing methodology.

Discussion is ongoing regarding the appropriate arm's length consideration for each type of in-scope transaction, including whether different Profit Level Indicators (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.