

PUBLIC CONSULTATION DOCUMENT

# Pillar One – Amount B

17 July 2023 – 1 September 2023



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## Background

On 14 October 2020, the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (IF) released the report “Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint”. The Blueprint stated that Amount B was intended to streamline the process for pricing baseline marketing and distribution activities in accordance with the arm’s length principle (ALP), thereby aiming at enhancing tax certainty and reducing resource-intensive disputes between taxpayers and tax administrations. The Blueprint additionally noted that Amount B should address the needs of low-capacity jurisdictions (LCJs).

On 8 October 2021 the IF agreed a two-pillar solution to address the tax challenges arising from the digitalisation of the economy. The IF [Statement](#) described Amount B as one of the components of Pillar One, and mandated Working Party No. 6 and the FTA MAP Forum to undertake the technical work to design Amount B.

*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 IF mandate thus means that Amount B needs to simplify and streamline the pricing of in-country baseline marketing and distribution activities, while ensuring outputs consistent with the arm’s length principle for all in-scope transactions. Moreover, a particular concern of LCJs has been the relative unavailability of appropriate local market comparables through which arm’s length prices can be established.

With the benefit of the public consultation in December 2022, the work on Amount B has developed further and the outcome of that is reflected in this document.

## Aim and structure of the document

The scope of Amount B is focused on a set of baseline wholesale distributors that can be reliably priced under a one-sided transfer pricing method by applying the pricing framework in Section 4. In-scope distributors, for instance, should not own unique and valuable intangibles nor should they assume certain economically significant risks. The scope of Amount B allows distributors to perform non-distribution transactions when they can be adequately evaluated and reliably priced on a separate basis under the general principles of the OECD TPG<sup>1</sup>. The Amount B scoping framework also permits the undertaking of *de minimis* retail sales, while excluding the distribution of services and commodities from scope.

To ensure the appropriateness of the scope and pricing framework, further work will be undertaken on the following aspects, where input is requested from stakeholders:

1. The two alternatives to scope that are presented in this document, which broadly represent the current positions of jurisdictions when considering these issues: “Alternative A”, which does not require a separate qualitative scoping criterion to identify and exclude non-baseline contributions, and “Alternative B”, which does require a separate qualitative scoping criterion to identify and exclude non-baseline contributions (in scoping criterion 9.a). Text specific to each alternative is included in the document, italicised and in square brackets. Text specific to Alternative A is

<sup>1</sup> OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (January 2022)

included in [*blue font*], whereas text specific to Alternative B is included in [*green font*]. Moreover, while two alternatives are currently presented with respect to the inclusion of a separate qualitative criterion, this does not preclude the possibility that either alternative might be modified; aspects of the two alternatives might be combined; or that another alternative may ultimately be chosen as the means to determine scope for Amount B, based on stakeholder input and further work to be performed.

2. The appropriateness of:
  - a. the pricing framework, including in light of the final agreement on scope;
  - b. the application of the framework to the wholesale distribution of digital goods;
  - c. country uplifts within geographic markets; and
  - d. the criteria to apply Amount B utilising a local database in certain jurisdictions.

#### **Public consultation instructions**

Members of the Inclusive Framework invite input from stakeholders on the elements identified above, including on the relevant aspects of the design of the scope and pricing methodology, through 1<sup>st</sup> September 2023 with the work on those elements to be completed by year end.

Interested parties are invited to send their comments electronically (in Word format) by email to [transferpricing@oecd.org](mailto:transferpricing@oecd.org) no later than 1 September 2023.<sup>2</sup>

Given that open issues remain, the proposals included in this consultation document do not represent the consensus views of the Inclusive Framework, the Committee on Fiscal Affairs or their subsidiary bodies.

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<sup>2</sup> Please note that all written comments received will be made publicly available on the OECD website. Comments submitted in the name of a collective “grouping” or “coalition”, or by any person submitting comments on behalf of another person or group of persons, should identify all enterprises or individuals who are members of that collective group, or the person(s) on whose behalf the commentator(s) are acting.

The following sections of this report are added to the OECD Transfer Pricing Guidelines as [...].

## *Special considerations for baseline distribution activities*

### DEFINITIONS

The following terms have the meanings set out below solely for the purposes of this guidance.

**Distributor** refers to wholesale distributors, sales agents, and commissionaires involved in the sale of goods, [including the distribution of digital goods].<sup>3</sup> Where applicable, specific references may be made to a wholesale or retail distributor, sales agent, or commissionaire.

**Wholesale distribution** includes distribution to any type of customer except end consumers. For the purposes of this guidance, a distributor that engages in wholesale and retail distribution is deemed to solely carry out wholesale distribution if its annual net retail sales do not exceed 20%<sup>4</sup> of its total annual net sales.

**Retail distribution** is distribution to end consumers, typically through physical or online stores.

**Baseline distribution** refers to activities performed by distributors where such distributors act as tested parties in qualifying transactions under paragraph 5 of this guidance, and where such distributors meet the scoping criteria outlined in paragraphs 8 and 9 of this guidance.

**Core distribution functions** are distribution functions that are typically performed by baseline distributors, depending on the business model of the distributor, i.e. whether it is a buy-sell distributor, sales agent, or commissionaire. Core distribution functions may include buying goods for resale, 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. Core distribution functions may vary in intensity and complexity and specifically exclude non-distribution activities that may render a

<sup>3</sup> The scope of this guidance is limited to wholesale distribution and does not include services (including digital services). Further work will be undertaken to determine the appropriateness of the application of the framework to the wholesale distribution of digital goods.

<sup>4</sup> Further work is to be undertaken by year end to further consider whether this limit of retail sales would affect the reliability of the pricing methodology established in Section 4, and/or whether this threshold would materially limit the set of in-scope distributors operating in certain jurisdictions.

distributor out of scope of the simplified and streamlined approach (see section 2.3.5 of this guidance).

*[Non-baseline contributions are 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 fact that a tested party distributor makes non-baseline contributions to a transaction does not necessarily preclude the use of a one-sided transfer pricing method. However, this should be evaluated in accordance with the guidance in Chapter II of these guidelines.]*

**Non-distribution activities** are economic activities that are distinct from wholesale distribution, including, for example, manufacturing, research and development, procurement or financing that are non-incident to a qualifying transaction. Note that, strictly for the purposes of applying scoping criteria 9.c, non-distribution activities include retail distribution above the *de minimis* threshold noted in the definition of wholesale distribution (in this case, the entire retail distribution is treated as a non-distribution activity).

[Distribution of **digital goods** includes the sale (including the perpetual royalty-free licensing) of e-books, movies, games, music or computer software in digital format. Distribution of digital goods does not include the rental of, royalty-bearing license of, or subscription to such digital content.]

**Global dataset** refers to the set of companies that has been derived from a search of a commercial database containing global company financial data, without application of any geographic filter, and which in part forms the basis for the approximation of arm's length results under the simplified and streamlined approach referenced in section 4.

**Net revenues** refers to an entity's total revenue excluding any sales returns, allowances, and discounts, calculated in accordance with applicable accounting standards.

**Return on sales** refers to the ratio of operating profit (i.e. earnings before interest and tax) to net revenues, expressed as a percentage, and calculated in accordance with applicable accounting standards.

**Net operating assets** refers to the fixed operating assets plus working capital, where working capital is the sum of stock plus debtors less creditors, calculated in accordance with applicable accounting standards.

**Operating expenses** refers to the expenses that a business incurs through its normal business operations, exclusive of the cost of goods sold, calculated in accordance with applicable accounting standards.

**Net operating asset intensity (OAS)** refers to the ratio of net operating assets to net revenue, expressed as a percentage.

**Operating expense intensity (OES)** refers to the ratio of operating expenses to net revenue, expressed as a percentage.

**Industry grouping** refers to the categorisation of specific industries and industry sectors in which in-scope distributors operate into three pre-defined groupings based on the observed relationships between specific industries / products and the profitability attributed to baseline distribution. The industry grouping definitions are included in Annex B and will be periodically updated on the [OECD website].

**Factor intensity classification** refers to the segmentation of different levels of net operating asset and operating expense intensity into five pre-defined classifications based on the observed relationships between asset and expense intensity and the profitability attributed to baseline distribution. The factor intensity classifications are defined in the pricing matrix in figure 4.1 of section 4.

**Qualifying jurisdictions within the meaning of section 4.2.1** refers to jurisdictions where the modified pricing matrix referenced in section 4.2.1 will apply for the purpose of determining arm's length returns for tested parties located in those aforementioned jurisdictions. The list of qualifying jurisdictions will be published and periodically updated on the [OECD website].

**Qualifying jurisdictions within the meaning of section 4.2.2** refers to jurisdictions where the data availability mechanism referenced in section 4.2.2 will apply for the purpose of determining adjusted arm's length returns for tested parties located in those aforementioned jurisdictions. The list of qualifying jurisdictions will be published and periodically updated on the [OECD website].

**Qualifying local dataset<sup>5</sup> within the meaning of section 4.2.3** refers to a local dataset produced by a jurisdiction which is relied upon to produce a local pricing matrix that will apply for the purpose of determining arm's length returns for tested parties located in those aforementioned jurisdictions. The list of jurisdictions with qualifying local datasets will be published and periodically updated on the [OECD website].

**Sovereign credit rating** refers to the publicly available long term sovereign credit ratings periodically assigned to or affirmed for a jurisdiction by an independent credit rating agency(ies).

**Implied Berry ratio result** refers to the return on sales of a tested party calculated in accordance with Section 4.1 and Section 4.2, where applicable, and converted into a corresponding ratio of gross profit to operating expenses.

**Berry ratio cap** refers to the maximum implied Berry ratio result of 1.50 that the simplified and streamlined approach will produce for a given tested party.

**Berry ratio collar** refers to the minimum implied Berry ratio result of 1.05 that the simplified and streamlined approach will produce for a given tested party.

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<sup>5</sup> Further work will be undertaken to determine the limited circumstances upon which a local dataset can be relied upon to produce a local pricing matrix under the simplified and streamlined approach, including the process which will govern its application.

## 1. Introduction

1. Distribution is a necessary function for MNE Groups in successfully realising the value created throughout the different stages of their businesses. In general, the concept of distribution is broad but, at least, encompasses the performance of core distribution activities.
2. Transfer pricing disputes with respect to baseline marketing and distribution arrangements may involve administrative challenges for tax administrations, especially of low-capacity jurisdictions, and result in a compliance burden for taxpayers. Those disputes may arise in relation to the accurate delineation of the arrangement and often focus on whether the arrangement involves “baseline” distribution or whether it involves the performance of more complex activities, for instance, when the distributor develops intangible assets that are related to the products distributed. Disputes may also arise with respect to the pricing considerations of marketing and distribution arrangements, focusing on areas such as the selection of the transfer pricing method, the appropriateness of the benchmarking analysis (especially the identification and selection of non-domestic comparables) or, where necessary, how to make appropriate comparability adjustments.
3. The simplified and streamlined approach articulated in this guidance is grounded in Chapters I-III and aligns with the goals of Section E of Chapter IV of these Guidelines. It contains a simplified and streamlined approach to apply the arm’s length principle to in-scope baseline marketing and distribution activities. It seeks to facilitate compliance, prevent transfer pricing disputes from arising and help resolve those that do arise in a more efficient manner.
4. The simplified and streamlined approach should be regarded as an application of the general principles included elsewhere in these Guidelines specifically to the pricing of in-scope distribution arrangements. The guidance in this [chapter] should not be regarded as a revision of those general principles, nor should it be used to interpret the application of the remainder of these Guidelines with respect to out-of-scope transactions.

## 2. Transactions in scope

### 2.1. Qualifying transactions

5. The following controlled transactions are qualifying transactions for the simplified and streamlined approach:
  - a. Buy-sell marketing and distribution transactions where the distributor purchases goods from one or more associated enterprises for wholesale distribution to unrelated parties; and
  - b. 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.<sup>6</sup>

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<sup>6</sup> The associated enterprise that engages the sales agent or commissionaire, and which is the counterparty to the sales agent or commissionaire in the potentially qualifying transaction, must sell



6. An accurate delineation of the qualifying transaction should be undertaken in accordance with Chapter I of these Guidelines, considering all five comparability factors and the economically relevant characteristics of the transaction, prior to the application of the scoping criteria.<sup>7</sup> A qualifying transaction, as accurately delineated, will be subject to the simplified and streamlined approach when it satisfies the scoping criteria in section 2.2. Consequently, the information obtained in the accurate delineation of the transaction is to be used to assess whether each of the scoping criteria has been met in order to determine whether a transaction will be subject to the simplified and streamlined approach.

7. The determination of whether a qualifying transaction is within scope is not driven by the adoption of specific labels, but primarily by the functions performed, assets used, and risks assumed by the parties to the qualifying transaction. While this guidance does not attempt to provide an exhaustive list of baseline marketing and distribution activities, it recognises that distributors should perform a set of core distribution functions in relation to in-scope transactions.

## 2.2. Scoping criteria

### Box 2.1. Note to Commentators

One key open issue regarding scope is whether a separate qualitative scoping criterion is required to identify distributors that make non-baseline contributions which cannot be reliably priced under the pricing methodology described in Section 4.

Consequently, two alternative texts are articulated in this document and placed in square brackets for consideration: the first, Alternative A, provides text that could apply in the absence of a separate qualitative criterion; the second, Alternative B, provides text that could apply in the presence of a separate qualitative criterion.

Paragraph 9.a and the associated commentary apply only to Alternative B. It excludes distributors from scope where the accurate delineation of the transaction indicates that they make non-baseline contributions according to the definition of that term articulated in the definitions box and in the commentary. Examples are provided in the commentary to paragraph 9.a, which aim to illustrate how the principles articulated in the definition apply in practice.

Moreover, and depending on the outcome of the validation work, the upper bound of the quantitative filter in scoping criterion 8.b may be amended accordingly.

#### Alternative A

Some jurisdictions take the position that a separate scoping criterion will not improve the reliability of Amount B and will undermine the tax certainty objectives of Amount B, for several reasons. These jurisdictions would define a “baseline” distributor as one that can be reliably priced using a one-sided method (paragraph 8.a.), passes quantitative scoping requirements (paragraph 8.b.), does not involve the distribution of services or the marketing, trading, or distribution of commodities (paragraph 9.b.), and does not

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the goods directly to unrelated parties, i.e. without either it or the sales agent or commissionaire engaging other related parties as intermediaries between it and the unrelated party customers.

<sup>7</sup> Refer also to paragraph 1.34 of these Guidelines, which should be taken into account when applying the simplified and streamlined approach.

carry out non-distribution activities (or such activities could be reliably priced on a separate basis) (paragraph 9.c).

- In their view, baseline distribution can be reliably priced under the Amount B pricing approach (see Section 4 of this guidance) without the need for a separate qualitative scoping criterion. The simplified and streamlined pricing approach (see Section 4 of this guidance) recognises that operating margins for baseline distributors can vary based on certain factors, and appropriately adjusts returns for differences in operating assets, operating expenses, industry, and country. Further, a quantitative scoping criterion can ensure that a tested party's ratio of operating expenses to sales is broadly within the central tendencies of the global dataset, so that the global dataset may be a reliable basis on which to price the tested party; a similar quantitative criterion could be applied for the tested party's ratio of operating assets to sales.<sup>8</sup> They are of the view that further requirements that aim to exclude from scope distributors making "non-baseline" or "above-baseline" contributions are not needed to achieve arm's length pricing (as discussed below) and could inappropriately imply that the simplified and streamlined pricing approach establishes a "floor" on all controlled distributor returns.
- Further, this group of jurisdictions considers that in evaluating the reliability of Amount B pricing for tested parties' transactions that are in-scope under Alternative A, a constructive basis of comparison to consider is how a tested parties' transactions would be priced if considered out-of-scope under Alternative B. These tested parties' transactions likely would be priced by a traditional bespoke comparability analysis. In this regard, this group of jurisdictions points to their experience in audits and in MAP and APA cases showing wide ranges of results within sets of proposed comparables that are typically unexplained, and perhaps not susceptible of explanation given the limited visibility into most proposed comparable companies. This group of tax administrations also points to the overall uncertainty they and their taxpayers currently face in applying the Guidelines to common cases involving distribution, which was a principal catalyst for this project in the first place. This group also considers that the current, bespoke analyses in practice depend on subjective judgments and potential negotiation, both of which can lead to unreliable results in particular cases.
- Finally, this group considers that any potential reduced reliability of Amount B pricing for these cases would fall within a trade-off between reliability and

<sup>8</sup> This group of jurisdictions reasons that differences in the functions performed between enterprises can be, and consistently are, in their experience, reflected in variations in operating expenses, citing paragraph 2.68 of the OECD Transfer Pricing Guidelines in support of their view: "Differences in functions performed between enterprises are often reflected in variations in operating expenses". Jurisdictions favouring Alternative A support an operating expenses to sales maximum ratio lower than 50% in order to exclude distributors with high functionality and for which the Amount B pricing method may not be reliable. However, the specific threshold for the scoping criterion of paragraph 8.b. is subject to further validation work, including further analysis of the definition of "operating expenses." Moreover, given that a functional analysis takes into account assets used and risks assumed in addition to functions (see paragraph 1.51 of the OECD Transfer Pricing Guidelines), the validation phase may also consider whether other quantitative scoping criteria could ensure a higher degree of functional comparability, including the ratio of operating assets to sales.

administrability inherent in the arm's length principle, which is already incorporated into these Guidelines.<sup>9</sup>

- In this regard, these jurisdictions consider that Alternative A is far more administrable than Alternative B. The primary reason for this, in their view, is that it has been quite difficult to define the qualitative test in 9.a sufficiently objectively; as a result, this test in their view could lead to many disputes and uncertainty. Many typical distributor functions could arguably be included in the definition of “non-baseline contributions” as proposed in Alternative B. In addition to eventual disputes, in such cases a taxpayer would not be able to determine with any degree of certainty, at the time it files its tax return, whether it is in scope. An anticipated reduction in disputes around appropriate pricing (see Section 4 of this guidance), but without the benefit of knowing to which transactions such prices should apply, would not satisfy the October IF Statement mandate to simplify and streamline application of the arm's length principle to baseline marketing and distribution activities. In other words, dependence on what these jurisdictions view as subjective, ill-defined scoping judgments that are prone to dispute would perpetuate the problems that Amount B is intended to address and fail to meet a mandate particularly important to LCJs.

### **Alternative B**

Other jurisdictions take the position that, without a separate qualitative scoping criterion being applied to support the definition of what is baseline distribution, Amount B will not reliably produce outcomes aligned to the arm's length principle. They are of the view that the absence of an explicit requirement for qualitative considerations to identify “non-baseline” distributors creates risks of base erosion and profit shifting, and may increase instances where tax administrations assert that distributors which make non-baseline contributions could meet the conditions to apply a two-sided transfer pricing method, potentially increasing disputes. These jurisdictions take the position that a separate qualitative scoping criterion to identify non-baseline contributions that cannot be reliably priced under the pricing methodology described in Section 4 is required for several reasons.

- First, they consider that the qualitative scoping criterion at 8.a, which requires excluding transactions that can be priced using a two-sided method, will not reliably exclude qualifying transactions where non-baseline contributions are made, and which can be priced using a one-sided method. The set of distribution arrangements that can be priced using a one-sided method encompasses a wide range of outcomes, that differ due to several factors, including the economically significant activities undertaken, assets used or contributed, and risks assumed by the parties to the transactions, geographic location, the size of markets, the nature and extent of government regulation of the market, transport costs, the level of market (e.g., retail or wholesale) and any other relevant economic circumstances of the transaction. Nonetheless, as the qualifier “baseline”

<sup>9</sup> This trade-off is first introduced in paragraph 1.7 of these Guidelines. Paragraph 1.6 notes that a comparability analysis “is at the heart of the application of the arm's length principle.” Paragraph 1.7 then provides that “[i]t is important to put the issue of comparability into perspective in order to emphasise the need for an approach that is balanced in terms of, on the one hand, its reliability and, on the other, the burden it creates for taxpayers and tax administrations.” See also paragraph 1.13 and Section E of Chapter IV of these Guidelines.

indicates there is a subset of these arrangements that could be priced by the simplified and streamlined approach (see Section 4 of this guidance). If the scoping criteria falls short of accurately defining and identifying “baseline” distributors, including both below-baseline or above-baseline arrangements, by not including the separate qualitative criterion, the simplified and streamlined approach will not reliably represent an approximation of an arm’s length outcome, as is required under the October mandate. The pricing solution developed under the Amount B work depends on defining the set of distribution arrangements which can be considered as baseline distribution and for which the degree of simplification and streamlining is reasonable. Consequently, in their view, there is a subset of arrangements that can be priced using a one-sided method for which this solution is inappropriate.

- Second, these jurisdictions consider that no evidence has been found that quantitative metrics applied (together with the other scoping criteria) without a separate qualitative test can reliably identify and exclude distributors that make non-baseline contributions. Specifically, the quantitative scoping filter relating to Operating Expenses to Sales ratio is not appropriate for excluding non-baseline distributors from scope without a separate qualitative test, as the ratio does not show a sufficiently robust statistically significant relationship with functionality and so is not an appropriate proxy for assessing the degree of functional contributions in a qualifying transaction. These jurisdictions also consider that there are a number of factors that support the argument that quantitative metrics should only be used to support the determination of whether a non-baseline contribution is made by a distributor, rather than be the basis of that determination. For example, flexibility in the classification of certain costs (e.g. freight costs, issuance interest, etc.) allowed for by financial reporting standards may lead to differences in reported operating expenses. The ability of businesses to determine this allocation reduces the reliability of the metric as an objective independent amount and also poses the risk of its possible manipulation to target the desired outcome under the simplified and streamlined approach. Furthermore, operating expenses are not reported by many of the distributors found in financial databases. In addition, no theoretical rationale or stable empirical evidence has yet been presented to establish the ratio can be used to ensure that non-baseline contributions are excluded from scope. Such risks can be mitigated through the scoping criterion 9 a.
- Third, they consider that the separate qualitative criterion is necessary to distinguish between distribution arrangements that can be reasonably priced under the pricing solution in Section 4 (i.e., baseline distributors) and those that cannot (i.e., non-baseline distributors). This is consistent with guidance already in the TPG, such as in paragraph 2.37 which describes how a resale price margin for a distributor that does not carry on a substantial commercial activity but only transfers the goods to a third party could be a small one. It explains further that the resale price margin could be higher where it can be demonstrated that the reseller has some special expertise in the marketing of such goods, in effect bears special risks, or contributes substantially to the creation or maintenance of intangible property associated with the product.
- As a result, the jurisdictions favouring Alternative B consider that Alternative A will increase tax planning opportunities and the risk of base erosion. These jurisdictions also consider this will lead to a failure to achieve parity of treatment between MNEs and domestic businesses which could lead to

distortions in their local economies that inappropriately impact competitiveness and international trade.

- Fourth, many of these jurisdictions currently experience a low level of disputes in this area and consider that the increased risk of base erosion will lead to an increase, not decrease, in tax disputes and create uncertainty of outcomes where none may exist today. In their experience, differences in proposed comparable sets in MAP and APA cases generally reflect differences in characterisation rather than where characterisation is agreed. In the latter types of situation, these jurisdictions accept that the simplified and streamlined pricing approach could provide an expedient solution, but will do little to address the former.
- These jurisdictions consider that the implementation of Alternative A will require them to allocate more resources to audits, contrary to the aim of the simplified and streamlined approach. In any case, a qualitative analysis is still required for the purposes of the accurate delineation of the transaction; to confirm that a one-sided method is appropriate; and to inform decisions on segmentation. Therefore, the incremental effort required to distinguish between baseline and non-baseline is relatively low.
- Finally, these jurisdictions consider that this criterion will stabilise the design of Amount B by lessening disputes related to scope, including preventing the unintended consequence of any assertion that the two-sided method is appropriate to price “non-baseline” distributors. These jurisdictions consider that taxpayers and tax administrations are in a position to reach a reasonable accommodation and transactions should not be included or excluded from the simplified and streamlined approach according to a rigid standard without consideration of broader facts and circumstances as required by the arm’s length principle.

8. For a qualifying transaction to be in-scope of the simplified and streamlined approach:

- a. 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.<sup>10</sup>
- b. The tested party in the qualifying transaction must not incur annual operating expenses lower than 3% and greater than [50%] [30%] of its annual net sales.<sup>11</sup>

9. For qualifying transactions that do not fall out of scope of the simplified and streamlined approach under paragraph 8, a qualifying transaction will nevertheless be out of scope if:

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<sup>10</sup> See 2.4, 2.65, 2.66, 2.126, 3.18 and 3.19. Moreover, see Chapter II, Part III, Section B for a discussion regarding the set of economically relevant circumstances under which the Transactional Net Margin method is the most appropriate method. Section 3 of this guidance provides additional discussion on this issue in the context of determination of arm’s length returns under the simplified and streamlined approach.

<sup>11</sup> Where the commissionaire or sales agent is not the entity making the sale, the sales of the counterparty of the commissionaire or sales agent (i.e., whichever entity makes the sale to the third party customer) will be utilised to compute the ratio of operating expenses to sales; however, the net operating expenses of the commissionaire or sales agent are always the sole item included in the numerator of the ratios.

- a. *[The tested party makes non-baseline contributions to the transaction of a manner described in section 2.3.3; or]*
- b. The qualifying transaction involves the distribution of services or the marketing, trading, or distribution of commodities; or
- c. 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, can be reliably priced separately from the non-distribution activities<sup>12</sup>, and meets the administrative guardrail in Section 2.3.5.<sup>13</sup>

## 2.3. Commentary

10. This sub-section seeks to clarify and illustrate the application of the scoping criteria to qualifying transactions.

### ***2.3.1. Scoping criterion 8.a - The qualifying transaction must exhibit economically relevant characteristics that mean it can be reliably priced using a one-sided method, with the distributor being the tested party***

11. Scoping criterion 8.a limits the application of the simplified and streamlined approach to the set of transactions that can be reliably priced using a one-sided method, with the distributor being the tested party.

12. In evaluating whether a qualifying transaction may be within the scope, determining that a two-sided transfer pricing method should not apply is particularly important. Consequently, the first scoping criteria establishes that any in-scope distributor must exhibit economically relevant characteristics such that the qualifying transaction can be reliably priced using a one-sided method. Section 3 of this guidance provides that, of the one-sided methods, the relevant comparison is most reliably performed at the level of net profit indicators, and consequently that the Transactional Net Margin method should be utilised.

13. Chapter II, Part III, Section C.2.2 outlines three key economically relevant characteristics of qualifying transactions that indicate that a one-sided transfer pricing method may not be suitable to apply to establish arm's length conditions for a qualifying transaction. These can be applied to evaluate whether a qualifying transaction is suitable for the simplified and streamlined approach. The first is where the contributions of each party to the qualifying transaction are "unique and valuable", including contributions of unique and valuable intangibles (C.2.2.1).<sup>14</sup> The second is where the distributor and its counterparties carry out functions, use assets and assume risks in the qualifying transaction with such a degree of integration that their contributions cannot reliably be evaluated in isolation from each other (C.2.2.2). The third is where the distributor and its counterparties

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<sup>12</sup> See paragraphs 3.9 - 3.12

<sup>13</sup> Where a tested party in a qualifying transaction carries out non-distribution activities such that scoping criterion 9.c is required to be evaluated, the calculation of any ratios required either to determine whether that qualifying transaction is in scope, or any other ratios that are necessary in the context of the evaluation of the qualifying transaction in this guidance, should be undertaken with regard to the revenues, expenses or assets relevant to the qualifying transaction only.

<sup>14</sup> See Glossary, and paragraphs 2.126, 2.130, and 2.131-2.132. This criterion specifically applies to any situation where the contributions of the distributor to the qualifying transaction are unique and valuable.

share the assumption of one or more economically significant risks to the transaction, or where the various economically significant risks in relation to the transaction are separately assumed by the parties, but those risks are so closely inter-related and/or correlated that the playing out of the risks of each party cannot reliably be isolated (C.2.2.3).

14. The existing examples 1 - 4 in Annex II to Chapter II of these Guidelines provide useful information with respect to the practical application of this scoping criterion. In example 3, the example concludes that the distributor (Company B) makes unique and valuable contributions to the controlled transaction, which would place the distributor out of scope. In example 4, where the example concludes that benchmarking using a one-sided method may be more appropriate than a transactional profit split method, the qualifying transaction may be in scope so long as the distributor satisfies the other scoping criteria.

15. Depending on the accurate delineation of the qualifying transaction, unique and valuable contributions made by a distributor may include, but are not limited to, contributions to the development, enhancement, maintenance, protection, and exploitation of any intangibles that are themselves unique and valuable in the context of the qualifying transaction. Further guidance on the ownership of, and functions, assets, and risks related to intangibles may be found in Chapter VI, Sections B.1 and B.2 of these Guidelines, together with the framework in paragraph 6.34 to be applied for analysing transactions involving intangibles. Moreover, some examples of contributions that may be important are contained in paragraph 6.56 of these Guidelines.<sup>15</sup> Unique and valuable contributions of this nature are equally applicable to evaluate intangibles that are self-generated or acquired by a distributor.

16. Another source of guidance that may be relevant in identifying unique and valuable contributions in the accurate delineation of the qualifying transaction is noted in paragraphs 1.169-1.171 of these Guidelines. This guidance notes that in certain circumstances, a regulatory license that is required to access a market, for example, may be an intangible whose value in the context of the particular transaction will depend upon several factors, including whether the license is readily available and whether it has the effect of restricting the number of competitors in the market. In assessing the impact of contributions made to obtain the license, it is important to consider the contributions of both the distributor and other group members in supplying the capabilities necessary to obtain the license. Chapter VI, Section B, including paragraph 6.34, should be considered and applied in assessing these functions and whether they constitute a unique and valuable contribution.

### *2.3.2. Scoping criterion 8.b – Quantitative filter*

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<sup>15</sup> The examples in 6.56 are, for the purposes of the simplified and streamlined approach, of an illustrative nature, and any conclusion that such contributions are unique and valuable should be based on the accurate delineation of the qualifying transaction. Based on the examples provided in 6.56, contributions that may be unique and valuable in the context of qualifying transactions may include the design and control of marketing programmes, the direction of and establishing priorities for creative undertakings relating to the marketing of the products distributed, the control over strategic decisions regarding development programmes for marketing intangibles, or the management and control of associated budgets. Other relevant contributions may also include important decisions regarding the defence and protection of marketing intangibles, such as trademarks or trade names, and important decisions regarding ongoing quality control over functions performed by independent or associated enterprises that may have a material effect on the value of the marketing intangible under consideration.

17. After the application of scoping criterion 8.a, scoping criterion 8.b acts to exclude qualifying transactions from the scope of the simplified and streamlined approach using quantitative filters.

18. These quantitative filters provide a simplified mechanism for the assessment of whether a tested party is in scope.<sup>16</sup> *[Since a qualitative approach is applied to identify, evaluate, and possibly remove from scope distributors that make “non-baseline” contributions, the upper bound serves to remove from scope only those distributors with levels of operating expenses that may indicate anomalous or outlier results.] [The upper bound acts as a proxy to exclude qualifying transactions from scope where the ratio of operating expenses to sales might indicate high functional intensity suggesting that the pricing methodology of Section 4 of this guidance would have reduced reliability in practice. Consequently, the quantitative filter is applied so that the pricing methodology of Section 4 of this guidance may reliably be applied to establish arm’s length prices for qualifying transactions. Moreover, a quantitative approach is applied as it is not feasible to specifically and comprehensively list a set of contributions that can be applied without ambiguity as scoping criteria for the purposes of the simplified and streamlined approach, given the breadth of activities and business operations undertaken by distributors.]*

#### *Calculating the quantitative filters in 8.b*

19. Given that the values of both operating expenses and net sales will vary over time, this will inevitably entail certain distributors moving in and out of scope. In order to make qualification for scope more consistent, the calculation of the ratio provided above should be based on a three-year weighted average. The three-year weighted average ratio should be calculated on a year-on-year basis for the purposes of determining whether a qualifying transaction is in-scope. For example, for a qualifying transaction in fiscal year  $x$ , the three-year weighted average ratio would be derived by (A) taking the sum of the annual operating expenses for years  $x-3$ ,  $x-2$ , and  $x-1$ , then (B) taking the sum of the annual net sales over the same period, and then dividing (A) by (B) to derive the appropriate percentage.<sup>17 18</sup>

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<sup>16</sup> Quantitative scoping filters are used in the context of the simplified and streamlined approach as a simplification measure and do not provide any further indication of functional intensity or characterisation for distributors that fall out of scope or in general. Where a distributor falls out of scope, this should not be taken as implying any arm’s length price for the controlled transaction, regardless of the scoping criteria used. For the avoidance of doubt, a determination of arm’s length prices in such circumstances should follow the principles articulated in the remainder of these Guidelines. The quantitative filters applied to determine whether a qualifying transaction is within the scope of the simplified and streamlined approach are only used for that purpose, and for not, for example, replicated in the pricing methodology used to establish returns for in-scope distributors.

<sup>17</sup> When a distributor performs non-distribution activities, and where that distributor remains in scope after applying scoping criterion 9.c, then the ratios described under 8.b should be calculated based on the relevant allocation or apportionment of revenues and expenses to the distribution activity only.

<sup>18</sup> In calculating each ratio, it is important to determine what are the appropriate operating expenses and what are the appropriate net sales that should be accounted for. This determination should be made based on an accurate delineation of the transaction and by applying the principles articulated in Chapter II of these Guidelines. Paragraphs 2.99 and 2.100 of these Guidelines may provide some relevant input to making the determination of the appropriate treatment of operating expenses. Moreover, paragraphs 2.96 and 2.97 of these Guidelines provide some relevant input to making the determination of the appropriate treatment of revenues, rebates, and discounts. Special attention should be made to evaluating the treatment of pass-through expenses in calculating the ratio, which, under an accurate delineation of the transaction, may not in certain cases be taken into account when



Where the qualifying transaction has been in place for two years, a two-year weighted average ratio should be used, and where the qualifying transaction has been in place for only one year the ratio should be calculated based on the financial results for that year.

### **2.3.3. [Scoping criterion 9.a –Non-baseline contributions**

20. *Scoping criterion 9.a applies a separate test to determine whether qualifying transactions should be within the scope of the simplified and streamlined approach, to further enhance the reliability of the pricing methodology described in Section 4.*

21. *Consequently, scoping criterion 9.a removes qualifying transactions from scope that are not already removed through the application of scoping criterion 8, in situations where the tested party makes non-baseline contributions to the controlled transaction. Non-baseline contributions should be specifically identified based on the accurate delineation of the transaction and considering the facts and circumstances of the qualifying transaction (see paragraph 6 of this guidance).<sup>19</sup>*

22. *In applying this criterion, consideration should be given as to whether the non-baseline contributions and the remaining distribution activities are part of separate transactions which can be adequately evaluated and reliably priced separately per the principles in paragraphs 3.9 – 3.12 of these Guidelines and Section 2.3.5 of this guidance. If the non-baseline contributions are made in respect of separate transactions which can be adequately evaluated and reliably priced separately, then the non-baseline contributions need not remove a qualifying transaction from scope; but if they are made under the qualifying transaction, or in the context of a transaction that cannot be adequately evaluated or reliably priced separately from the qualifying transaction, the performance of excluded activities by the distributor will render that distributor out of scope of the simplified and streamlined approach.*

23. *It is not feasible to specifically and comprehensively list a set of baseline or non-baseline contributions that can be deterministically applied as scoping criteria for the purposes of the simplified and streamlined approach, given the breadth of activities and business operations undertaken by distributors. Moreover, it is not feasible to provide a detailed description of every possible factual variation where such contributions may be observed. Consequently, the identification of non-baseline activities follows an examples-based approach. The examples should be interpreted in light of the definition of non-baseline contributions, based on the accurate delineation of the transaction. Taxpayers and tax administrations should exercise judgment in evaluating whether non-baseline contributions are made under the specific facts and circumstances of the qualifying*

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calculating the ratio. It should be noted that reference to paragraphs 2.99 and 2.100 of these Guidelines should not be interpreted as any guidance or indication that cost-based methods may be appropriate methods to evaluate arm's length remuneration of distributors (see paragraph 2.96). Rather, such determination should be made in light of the general principles articulated elsewhere in these Guidelines and the facts and circumstances.

<sup>19</sup> *Some non-baseline contributions may involve cases where the distributor develops, modifies or enhances certain marketing intangibles that it uses in connection with the distribution of goods in the markets it serves. When applying this scoping criterion, consideration should be made as to whether any such functions performed would already render a distributor out of scope in scoping criterion 8.a. Scoping criterion 9.a only excludes distributors that have not already been excluded from scope under criterion 8.a. See paragraphs 6.197 - 6.202, 6.204 - 6.208 for further guidance with respect to transactions for the sale of goods involving the use of intangible assets.*

transaction, or whether the contributions that are made correctly represent non-baseline contributions.<sup>20</sup>

#### *Non-baseline contributions: examples*

*Example 1A: Non-baseline contributions of the nature of technical or specialised support activities, including customisation or modification of the products distributed*

24. *Where the distributor makes contributions of certain technical or specialised support functions, including with respect to customisation or modification of products, for third party customers in conjunction with – and related to – the distribution of goods to those customers,<sup>21</sup> those contributions may be non-baseline contributions. The provision of technical or specialised activities is more likely to represent non-baseline contributions where the provision of those functions requires significant and specialised capabilities that are not routine services easily obtainable from independent suppliers, where the functions are necessary to enable the use of the products distributed, where the ongoing services are connected to the original sale to the customer, and where they are an integral part of ongoing customer relationships. Such functions may include contributions to the content of the additional services to be offered to customers in the markets of the distributor, the acquisition of expertise that is necessary in order to deliver those services to customers in the markets of the distributor, or the exploitation of the potential marketing and sales value of offering such services to customers in the markets of the distributor. Non-baseline contributions with respect to customisation or modification of products may include assessing the necessity or benefit of undertaking customisation or modification of the products of the MNE Group for the markets or particular customers of the distributor, based on a judgement of specific market needs, determining what the customisation or modification of the products should be, and evaluating the effectiveness of the program to customise or modify the products to best serve the needs of the distributor’s markets. However, non-baseline contributions are not merely the capability of having technical understanding of a technical or specialised product that is required to undertake core distribution activities. Moreover, these contributions do not include functions such as translations, packaging and labelling, “break-bulk,” assembly, and cutting products to order, where the customisation or modification is not material and not performed with the objective of satisfying needs specific to the markets customers it serves.*

25. *Assume Distributor Y, which is resident in jurisdiction Y, supplies high-value capital equipment to customers resident in the jurisdiction. Distributor Y purchases the capital equipment from Supplier Z, resident in jurisdiction Z. The capital equipment is distributed to independent manufacturers who use the equipment to manufacture information technology hardware products. The capital equipment requires extensive specialist advice to properly install, use, and maintain. Moreover, the customers require the provision of ongoing highly specialised and customer-specific technical engineering support functions that aim to customise the use of the equipment to new designs of the customers. In this case, as part of the qualifying transaction, these contributions are made by the distributor. The engineers of the distributor support the customers in utilising the*

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<sup>20</sup> See, for example, paragraphs 1.13, 1.51, and 2.11 of these Guidelines.

<sup>21</sup> Note that this presumes that the technical or specialised support activities and the distribution activities cannot be adequately evaluated separately and reliably priced separately but can be adequately evaluated and reliably priced on a combined basis, per the principles in paragraphs 3.9 – 3.12 of these Guidelines and Section 2.3.5 of this guidance.

*capital equipment within their manufacturing processes on a customised basis. The same engineers require specialist knowledge not only of engineering or their own product, but of the manufacturing processes, product designs and research objectives of their manufacturing customers. The same engineers consequently need to work in a highly collaborative manner with the engineers of the manufacturers on-site in order to adequately discharge their support functions.*

26. *Assume the accurate delineation of the controlled transaction indicates that the capabilities of and the contributions made by Distributor Y are a key source of actual and potential benefits to the qualifying transaction that exceed the benefits of the contributions associated with core distribution activities. Under these circumstances, the contributions made by Distributor Y are non-baseline. Consequently, the transaction should not be subject to the simplified and streamlined approach and should be priced in accordance with the remainder of these Guidelines.*

*Example 1B: Contributions of the nature of technical or specialised support activities that are baseline*

27. *If the facts would change such that Distributor Y merely held and communicated a technical or specialised understanding of the capital equipment, and the relevant contributions and capabilities described in example 1A were provided by, for example, Supplier Z, then Distributor Y would not be making non-baseline contributions. Consequently, assuming all other criteria are met, the qualifying transaction should be priced under the pricing methodology outlined in Section 4 of this guidance.*

*Example 2A: Non-baseline contributions specific to highly regulated industries*

28. *Where the distributor makes specific contributions that enable market access for the products to be sold by the MNE group to third party customers, and/or makes contributions that generate barriers to entry to the market, the contributions may be non-baseline contributions in the specific context of the qualifying transaction. Such contributions are complex functions and intangible assets such as know-how, which are necessary to be performed in addition to core distribution functions in order to obtain regulatory approval to distribute products in the markets of the distributor, and/or enable market access. Such contributions may include whether to operate in the relevant markets by achieving regulatory approval, what the strategy should be to achieve the regulatory approval, and whether and how to respond to events associated with the execution of that strategy, i.e. whether to continue with the same strategy, amend it, or terminate the process. They may also include the establishment of negotiation parameters and the subsequent monitoring and review of those parameters with respect to obtaining subsidies for distributing regulated products, where those subsidies have a material impact on the price paid by the consumer and where they materially affect the demand for those products relative to any competing alternatives. Non-baseline contributions do not include functions that merely inform, support, or facilitate the process in achieving regulatory approval. Moreover, the mere fact that a product is regulated or is subject to regulation does not imply that tested parties that distribute such products are out of scope of the simplified and streamlined approach.*

29. *ABC Group, a global developer, manufacturer, and supplier of highly regulated products, has developed and patented a product that it markets for sale under a novel brand. ABC Group supplies this product through wholesale distributors resident in each market, who purchase the finished goods through an associated enterprise resident in jurisdiction Z (Developer Z). ABC Group seeks to distribute this product in jurisdiction Y. The regulatory authorities in jurisdiction Y require regulatory approval to be provided to*

*a domestic enterprise (by providing a license to supply the product) as a pre-condition for supplying the product in the market. Distributor Y, which already operates in jurisdiction Y, seeks to obtain the appropriate regulatory approval. The accurate delineation of the qualifying transaction shows that qualifying for regulatory approval entails navigating a complex and potentially lengthy process where the outcome of obtaining the license to supply has a reasonable probability of failure. Such licenses, while being available to distributors that meet the relevant conditions, requires demonstrating to appropriate government authorities the safety and efficacy of the product. Moreover, achieving a successful outcome requires that sales and marketing personnel build relationships with and educate the relevant authorities within the scope of local market regulations, which Distributor Y does, while market access personnel of Distributor Y engage relevant buyers of the product in the local market adhering to their rules and considerations in an overall effort to bring the product to market. Management of Distributor Y determine and periodically review the strategy to obtain the license, bringing in appropriate external expertise where appropriate.*

30. *In this example the accurate delineation of the transaction indicates that the contributions of capabilities to obtain the regulatory approval, undertaken together with the distribution and marketing functions, are provided by Distributor Y, and that the contribution of those capabilities create a key source of actual and potential economic benefits that are expected to exceed the economic benefits derived from core distribution functions. Under these circumstances, Distributor Y makes non-baseline contributions to the controlled transaction. Consequently, the transaction should not be subject to the simplified and streamlined approach and should be priced in accordance with the remainder of these Guidelines.*

*Example 2B: Contributions specific to highly regulated industries that are not non-baseline*

31. *Assume now that the accurate delineation of the transaction indicates that key contributions of capabilities to obtain the regulatory approval are provided by Developer Z, including developing the strategy to obtain the approval, monitoring and reviewing the regulatory approval process, and the choice of whether to bring in external expertise and, if so, which experts to utilise. Distributor Y makes more limited contributions, for example with respect to providing more limited market research and data and facilitating meetings to obtain approval under the specific oversight and direction of Developer Z, and consequently plays merely a facilitating role in the regulatory approval process. Under these circumstances, Developer Z is performing the non-baseline contributions with respect to obtaining regulatory approval and maintaining that approval. Distributor Y, on the other hand, performs core distribution functions in addition to providing marketing research support. Consequently, Distributor Y is not making non-baseline contributions and should be priced under the pricing methodology outlined in Section 4 of this guidance.]*

#### **2.3.4. Scoping criterion 9.b –Services exclusion and commodities exclusion**

##### *Services*

32. The simplified and streamlined approach applies to goods and does not capture the distribution and marketing of services. The activities required to distribute in-scope goods, compared to services could entail significant differences in the functions performed, assets used, and risks assumed by the parties. To achieve simplification while ensuring compliance with the arm's length principle, the simplified and streamlined approach

applies to qualifying transactions involving the distribution of goods for which there is broad consistency in the overall supply chain and functional analysis.

### *Commodities*

33. Qualifying transactions involving the trading, marketing or distribution of commodities are specifically excluded from scope. This sub-section articulates the breadth of the exemption and defines the relevant commodities, both using a general principle and listing some specific commodities as examples.

34. The general principle is that the exclusion is broad in nature and encompasses transactions involving the trading, marketing, or distribution of products of a commodity nature, whether or not they have a quoted price, and includes transactions where the commodity has undergone qualifying processing. For the purposes of the simplified and streamlined approach, a commodity may be any of the following:

- a. A renewable or non-renewable physical product that is primarily derived from the earth's crust, land or water. These renewable or non-renewable physical products can be manifested in a solid, liquid or gas state and take various forms such as a hydrocarbon, mineral, mineraloid and agricultural product.
- b. A renewable or non-renewable physical product that has undergone qualifying processing.
- c. A product that is in accordance with the definition of a commodity provided for in paragraph 2.18 of these Guidelines.

35. The definitions of a hydrocarbon, mineral, mineraloid and agricultural commodity are:

- a. Hydrocarbon means any organic compound consisting predominantly of carbon and hydrogen molecules that is in solid, liquid or gaseous form occurring naturally in or on the earth or in the seabed or sub-soil and which was formed by or subjected to a geological process and includes but not limited to crude oil, oil sands, heavy oils and natural gas occurring in a subsurface oil and gas reservoir, deposit, or in a stockpile.
- b. Mineral means any inorganic substance that exhibits crystalline characteristics, in solid form, occurring naturally in or on the earth's crust or in or under water and which was formed by or subjected to a geological process, and includes but not limited to clay, gems, gravel, metal, ore, rock, sand, soil, stone, salt and any such substance occurring in an ore body, ore deposit, or in a stockpile or tailings.
- c. Mineraloid means any substance that does not exhibit crystalline characteristics whether in solid, liquid, or gaseous form, occurring naturally in or on the earth or in or under water and which was formed by or subjected to a geological process, and includes but is not limited to amber, coal, obsidian and opals, and any such substance occurring in an ore body, ore deposit, or in a stockpile or tailings.
- d. Agricultural means any primary product, raw or processed, that is marketed for consumption and includes but is not limited to animal byproducts such as dairy or fibre, livestock, grains, coffee, tea, fishery, forestry, fruit, and vegetables.

36. The term "qualifying processing" means processing undertaken to bond, concentrate, isolate, purify, refine, blend, separate, raise, harvest, produce or liberate a hydrocarbon, mineral, mineraloids or agricultural product. It includes the processing undertaken to produce all intermediate products obtained from a hydrocarbon, mineral,

mineraloids or agricultural product up to and including the following non-exhaustive list of products:

- liquefied natural gas, liquefied petroleum gas and other natural gas liquids, diesel, kerosene, gasoline, and hydrogen.
- metal oxides, metal hydroxides, anodes, cathodes, cast metals, aluminium, and alloys.
- cattle, poultry, swine, sheep, goat, wheat, milk powder, cotton, maize, barley, rice, soybeans, cocoa, corn.

37. To provide additional clarity to the commodity product-based exclusion, a non-exhaustive list of examples of excluded commodities is provided here. Common examples of metals are aluminium, copper, nickel, iron, tin, gold, lead, platinum group metals, silver, manganese, cobalt, molybdenum, lithium carbonate/hydroxide, boric acid, titanium, uranium, and zinc, as well as metal oxides and metal hydroxides. Examples of an anode is copper and graphite anodes. Examples of a cathode is copper, cobalt and nickel cathodes. Common examples of oil and gas products are crude oil, oil sands, heavy oils, natural gas, naphtha, liquefied natural gas, liquefied petroleum gas and other natural gas liquids, diesel, kerosene, gasoline, and hydrogen. Common examples of agricultural products include livestock such as cattle, poultry, swine, sheep, goat, soft commodities such as wheat, cotton, maize, oats, barley, rice, soybeans, cocoa sugar, corn, coffee, and fishery, forestry, fruit, and vegetables.

38. The products listed are typically in the final step of the production process and it is possible that an MNE Group could also sell products that are in an earlier form to this stage i.e. intermediate products. To the extent that intermediate products fulfil the earlier definitions, that would still be captured under the commodity product-based exclusion.

### ***2.3.5. Scoping criterion 9.c - Non-distribution activities separate from the qualifying transaction***

39. Distributors that engage in qualifying transactions sometimes engage in non-distribution activities. Where such a tested party performs non-distribution activities, the qualifying transaction may only remain in scope where, based on an accurate delineation of the transaction, it can be adequately evaluated on a separate basis to any non-distribution transactions, and it can be reliably priced separately from any non-distribution transactions under the principles of paragraphs 3.9 – 3.12 of these Guidelines. In addition, the distributor must meet the administrative guardrail discussed in paragraph 42, described further in paragraph 43, to be in scope. Illustrations of the application of paragraphs 3.9 – 3.12 in the context of the simplified and streamlined approach are provided in paragraphs 44 to 46.

40. Examples of non-distribution activities include manufacturing, research and development, procurement, financing, or retail distribution performed above the threshold considered in the glossary to this guidance. Objective measurements might be used to determine whether the distributor performs these activities. For example,

- for manufacturing, 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);
- for research and development, the incurrence of research and development expenses, even if reimbursed;
- for procurement, the existence of procurement commission income;

- for financing, the existence of loan assets on the balance sheet; and
- for retail, the sales profile of the distributor (for example, evidence of the sales channels of the distributor and extent of sales made to retail customers), or the holding or leasing of retail storefront property.

41. A tested party may undertake a combination of distribution and non-distribution activities for which it does not establish separate prices, and in practice treats these activities as a bundled transaction. For example, a distributor of products might also provide services that are separate to the distribution transaction, but where it only charges one price for the combined supply of products and services as a bundled transaction. Given that these separate (in this case, distribution and services) activities are not separately transacted for with related or unrelated parties and priced at arm's length, the distribution activity might not be able to be adequately evaluated separately or reliably priced separately, given the absence of separate revenue streams for the bundled transaction. Examples of situations where adequate separate evaluation and reliable separate pricing may be challenging are provided in the subsequent sub-section.

### *Administrative simplification*

#### **Box 2.3. Note to Commentators**

The administrative simplification intends to remove from scope transactions where the cost base of the distributor is significantly influenced by indirect allocation keys. Jurisdictions are continuing to evaluate whether, in determining and considering the proportion, the administrative simplification: (i) should evaluate only the proportion of costs of the distribution business segment that are indirectly allocated to the distribution segment based on allocation keys, or whether the proportion of the cost base of the entity that is indirectly allocated should be considered as a means of applying the test; (ii) should be based on the proportion of indirect operating expenses to total costs (of the distribution segment or entity), or of indirect operating expenses to total operating expenses; and (iii) could incorporate appropriate safeguards, which could be developed to address potential manipulation of the means and extent of cost allocation in order to be in or out of the scope of Amount B.

42. As an administrative simplification, a qualifying transaction is out of scope when the tested party performs non-distribution activities and the proportion of [annual indirect operating expenses allocated between the distribution and non-distribution businesses using allocation keys exceeds 30% of the total costs] accrued by the tested party for its total activities.

43. This administrative simplification intends to address scenarios where the high dependence on allocation keys [to apportion indirect costs between the distribution and non-distribution business operations is deemed to materially affect the net profit margin of both sets of activities in a manner that] could render the application of the pricing methodology under Section 4 unreliable.

### *Illustrations of where evaluation of the distribution transaction on a separate basis may be inadequate, or pricing on a separate basis may be unreliable*

44. Paragraphs 3.9 – 3.12 of these Guidelines provide examples where transactions are so closely linked or continuous such that they cannot be adequately evaluated on a separate

basis. Some examples applied to the context of the simplified and streamlined approach are provided below, all of which assume that the threshold in the administrative simplification test in paragraph 42 is not exceeded.

45. Assume that a distributor contributes to the development of manufacturing patents for products that are unrelated to the products distributed. The qualifying transaction would remain in scope provided that the revenues, direct and indirect costs, and assets relevant to the development of the patents can be reliably separated, whether they are attributed or apportioned, from the qualifying transaction so that any remaining revenues, direct and indirect costs, or assets are relevant only to the qualifying distribution transaction.

46. One further example of where both adequate separate evaluation and reliable separate pricing is challenging is where an MNE group bundles the provision of goods and services, where it may be difficult to unbundle these activities and consequently quantify the revenue and profits attributable to each activity. One example of this is where a distributor provides consumer financing (for example, materially deferred payment terms or financing directly related to the sales of products) alongside the sale of physical goods. In such situations, separating out the financial results relating to the distribution of physical goods from the financing could be challenging.<sup>22</sup>

*Guidance relating to the practical allocation of revenues, costs and assets to the distribution activities*

47. Paragraphs 2.83, 2.84, 2.85, 2.86, 2.91 and 2.98, and sections B.2.2.2 and B.2.3 of Chapter VII provide for the general principles relating to the allocation of revenues, costs and assets with respect to a distribution transaction and other transactions. An allocation of assets for the purposes of pricing the in scope qualifying transaction should follow this guidance and the underlying principles, even where assets may not be specifically mentioned in the guidance.

48. Tax administrations will require various information to assess the reliability of the allocation or apportionment of revenues, costs, and assets, and taxpayers should prepare that information under the documentation requirements considered in Section 5. In particular, tax administrations may need to evaluate internal financial reporting, the organisation chart of the entity and the management structure of the entity, over several financial periods. Tax administrations may also need to review whether the allocation or apportionment of revenues, costs and assets has been performed consistently.

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<sup>22</sup> Per Section D.8 of Chapter I, and paragraph 1.179, of these Guidelines, MNE group synergies may arise in the context of controlled transactions, for which specific compensation at arm's length may be justified. These principles are also relevant to consider in this simplified and streamlined approach. For example, where a distributor makes contributions to create such MNE group synergies, or where a non-distribution economic activity undertaken within the same MNE as the distributor leads to similar contributions being made that benefit the distributor, this may lead to challenges in the adequate separate evaluation of the qualifying transaction, on the basis that compensation may need to be imputed with respect to the creation of the synergy.



### 3. Application of the most appropriate method principle to in-scope transactions

49. The selection of a transfer pricing method always aims at finding the most appropriate method for a particular case. However, in evaluating the choice of method for in-scope transactions, it is neither necessary to prove that a particular method is *not* suitable under the circumstances, nor is it necessary that *all* transfer pricing methods should be analysed in depth or tested in each case in selecting the most appropriate method.<sup>23</sup>

50. Based on the economically relevant characteristics of in-scope transactions and the information available on comparable uncontrolled transactions, the Transactional Net Margin Method is appropriate to price in-scope transactions in a manner that satisfies the criteria established in paragraph 2.2 of these Guidelines.<sup>24</sup>

51. Under the guidance in Chapter II, Part B of these Guidelines, the Transactional Net Margin Method is considered as the most appropriate method for the purposes of applying the pricing methodology in Section 4 to in-scope transactions for the following reasons:

- a. An in-scope distributor does not make any unique and valuable contributions to the qualifying transaction, nor does the qualifying transaction exhibit other economically relevant characteristics that would make a two-sided transfer pricing method typically appropriate to utilise as the most appropriate method<sup>25</sup>;
- b. Net profit indicators are less affected by transactional differences than is the case with price, as used in the CUP method, and may be more tolerant to functional differences than methods that utilise gross profit margins,<sup>26</sup>;
- c. It is simpler, more streamlined, and more practical to examine a financial indicator for only the tested party, particularly when the counterparty may be particularly complex and engaged in various other economic activities, which may be transacted for or on their own account<sup>27</sup>;
- d. The pricing methodology in Section 4 follows the detailed guidance for establishing comparability for the transactional net margin method, as outlined in paragraphs 2.74 - 2.81 of these Guidelines; and
- e. The pricing methodology for the simplified approach is appropriate to apply to any transaction that meets the scoping criteria of the simplified and streamlined

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<sup>23</sup> See paragraphs 2.2, 2.8 of these Guidelines.

<sup>24</sup> Namely, (i) the respective strengths and weaknesses of the OECD recognised methods; (ii) the appropriateness of the method considered in view of the nature of the controlled transaction, determined in particular through a functional analysis; (iii) the availability of reliable information (in particular on uncontrolled comparables) needed to apply the selected method and/or other methods; and (iv) the degree of comparability between controlled and uncontrolled transactions, including the reliability of comparability adjustments that may be needed to eliminate material differences between them.

<sup>25</sup> See paragraphs 2.65-2.66, 2.119, 2.126, Chapter II, Section C.2.2.2 of these Guidelines.

<sup>26</sup> See paragraph 2.68 of these Guidelines.

<sup>27</sup> See paragraph 2.69 of these Guidelines.

approach<sup>28</sup>, taking into account the principles of Part B.3.2 and Part B.3.3 of Chapter II of these Guidelines.

52. However, it is recognised that there may be instances (although these may be rare, as the distribution of commodities is excluded from scope) where the application of the comparable uncontrolled price method using internal comparables could be potentially more appropriate to apply to price in-scope transactions. For those instances, the simplified and streamlined approach provides an exception that enables the taxpayer or tax administration to assert that the comparable uncontrolled price method using internal comparables can be used to reliably price in-scope transactions where that is in accordance with Part II B of Chapter II and A.4.2. of Chapter III of these Guidelines and both the comparables and any information utilised to determine that the application of the comparable uncontrolled price method is more appropriate are readily available to tax administrations and taxpayers.

## 4. Determining the arm's length return under the simplified and streamlined approach

### Box 4.1. Note to Commentators

The pricing features discussed in section 4 (including the supporting annexes) are subject to stakeholder input as well as further work to be performed by year end. That further work includes but is not limited to consideration of the appropriateness of the pricing matrix, the mechanisms to address geographic differences, the application of the framework to the wholesale distribution of digital goods or the specific timing for the periodic updates.

Stakeholders' input is welcome on all aspects of the current pricing framework. Commentators are encouraged to include any empirical data and analysis in support of their comments where possible.

### 4.1. Pricing matrix

53. Application of the relevant benchmarking search criteria as well as additional screening and qualitative review to reflect the scoping criteria has led to the development of a global dataset of companies involved in baseline marketing and distribution activities. The financial information derived from that global dataset has in part formed the basis for the approximation of arm's length results which has been translated into a pricing matrix.<sup>29</sup>

54. The approximation of arm's length results has been presented as matrix segments according to the following factors: operating asset to sales intensity (OAS), operating expense to sales intensity (OES) and industry.

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<sup>28</sup> No aspect of this guidance should be taken as implying or determining that the particular transfer pricing method and profit level indicators used in section 4 of this guidance to price in-scope transactions, should also apply to transactions that are out of scope of the simplified and streamlined approach.

<sup>29</sup> See Annex A for further details.

55. For the purposes of the simplified and streamlined approach, return on sales has been applied as the net profit indicator for the purpose of establishing arm's length pricing outcomes for in-scope transactions.

**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	<b>3.50%</b> +/- 0.5%	<b>5.25%</b> +/- 0.5%	<b>5.50%</b> +/- 0.5%
[B] Med/high OAS / any OES 30%-44.99%/any level	<b>3.25%</b> +/- 0.5%	<b>3.50%</b> +/- 0.5%	<b>4.50%</b> +/- 0.5%
[C] Med low OAS/any OES 15%-29.99%/any level	<b>2.75%</b> +/- 0.5%	<b>3.25%</b> +/- 0.5%	<b>4.25%</b> +/- 0.5%
[D] Low OAS / non-low OES <15%/10% or higher	<b>2.00%</b> +/- 0.5%	<b>2.25%</b> +/- 0.5%	<b>3.00%</b> +/- 0.5%
[E] Low OAS/low OES <15% OAS/<10% OES	<b>1.50%</b> +/- 0.5%	<b>1.75%</b> +/- 0.5%	<b>2.25%</b> +/- 0.5%

56. In order to determine the arm's length return for a tested party involved in in-scope transactions for the relevant period, a tax administration and taxpayer will apply the following 3-step process:

- a. Step 1 - determine the relevant industry grouping of the tested party from the three possible groupings (i.e. industry grouping 1, 2 or 3) and identify the applicable vertical column of return on sales in the pricing matrix in figure 4.1 that correspond to that industry grouping.
- b. Step 2 - determine the relevant factor intensity classification of the tested party from the five possible classifications (i.e. factor intensity classification A, B, C, D, and E) and identify the applicable horizontal row of return on sales in the pricing matrix in figure 4.1 that correspond to that factor intensity classification. The factor intensity classification of the tested party should be calculated based on a weighted average of the most recent three-year financial period.<sup>30</sup>
- c. Step 3 - identify and apply the arm's length range from the pricing matrix segment that corresponds to the intersection of the industry grouping and the factor intensity classification of the tested party.

57. For the purposes of the simplified and streamlined approach, taxpayers will apply and test the actual outcome of in-scope transactions to demonstrate the conditions of these transactions were consistent with the arm's length principle on an *ex post* basis (i.e. the

<sup>30</sup> Where the qualifying transaction has been in place for two years, a two-year weighted average ratio should be used, and where the qualifying transaction has been in place for only one year the ratio should be calculated based on the financial results for that year.

arm's length outcome-testing approach). Such test typically takes place as part of the process for establishing the tax return at year-end.<sup>31</sup>

58. In asserting the application of the simplified and streamlined approach to in-scope transactions, tax administrations should bear in mind the guidance in paragraph 3.60 of these Guidelines regarding controlled transactions that are within the arm's length range. Moreover, when the margin reported by the taxpayer falls outside the arm's length range resulting from the application of the simplified and streamlined approach, tax administrations should use the midpoint of the aforementioned range to adjust the margin of the controlled transaction.

59. The methodology and guidance included throughout section 4, including the referenced annexes, are specific to the application of the simplified and streamlined approach and are not applicable for the purpose of informing arm's length pricing for out-of-scope transactions.

## 4.2. Mechanism to address geographic differences

60. The reliance on the pricing matrix in Section 4.1 is intended to appropriately balance the objectives of achieving simplification while maintaining reliability in the application of the arm's length principle to baseline distribution activities. Based on econometric analysis of the Inclusive Framework, geographic differences have been observed to influence the profitability of baseline marketing and distribution entities in a small number of jurisdictions for which relevant data is available.

61. On this basis, a modified approach and an adjustment mechanism are established below to account for geographic differences that have been identified in qualifying jurisdictions.<sup>32</sup>

### 4.2.1. Modified pricing matrix for qualifying jurisdictions<sup>33</sup>

62. In order to ensure the simplified and streamlined approach takes account of geographic differences in accordance with the arm's length principle, a modified pricing matrix has been established based on the observed differences in profitability between qualifying jurisdictions and the global dataset.

63. For qualifying jurisdictions, the modified pricing matrix in figure 4.2 below supersedes the pricing matrix in figure 4.1 of section 4.1 and will apply for the purpose of identifying the arm's length return for in-scope transactions involving a tested party located in an aforementioned qualifying jurisdiction.

### Figure 4.2 – Modified pricing matrix (return on sales %) for tested parties located in qualifying jurisdictions

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<sup>31</sup> See paragraph 3.70 of these Guidelines.

<sup>32</sup> See paragraphs 1.164 and 1.130 of these Guidelines.

<sup>33</sup> See Annex C for additional information.

Industry Grouping	Industry Grouping 1	Industry Grouping 2	Industry Grouping 3
<b>[A] High OAS / any OES</b> >45%/any level	x.x% +/- 0.5%	x.x% +/- 0.5%	x.x% +/- 0.5%
<b>[B] Med/high OAS / any OES</b> 30%-44.99%/any level	x.x% +/- 0.5%	x.x% +/- 0.5%	x.x% +/- 0.5%
<b>[C] Med low OAS/any OES</b> 15%-29.99%/any level	x.x% +/- 0.5%	x.x% +/- 0.5%	x.x% +/- 0.5%
<b>[D] Low OAS / non-low OES</b> <15%/10% or higher	x.x% +/- 0.5%	x.x% +/- 0.5%	x.x% +/- 0.5%
<b>[E] Low OAS/low OES</b> <15% OAS/<10% OES	x.x% +/- 0.5%	x.x% +/- 0.5%	x.x% +/- 0.5%

64. Notwithstanding that for qualifying jurisdictions the modified pricing matrix in figure 4.2 supersedes the pricing matrix in figure 4.1 of section 4.1, the three-step process included in section 4.1 will apply for the purposes of applying and administering the modified pricing matrix.

#### 4.2.2. Data availability mechanism for qualifying jurisdictions

65. Whereas the modified pricing matrix discussed in section 4.2.1 is intended to account for observed geographic differences based on available local data, the data availability mechanism is intended to account for cases where there is no or insufficient data in the global dataset for a particular tested party jurisdiction but there exists evidence of country risk in that jurisdiction that may influence arm's length returns attributable to baseline marketing and distribution activities.<sup>34</sup>

66. Country risk can be defined as the risk induced by the country location of a business activity rather than the fundamental nature of the activity. This risk may derive from the political or economic environment in which that business operates. The data availability mechanism is intended to recognise that a distributor operating in a "high country risk" jurisdiction is entitled to higher returns, relative to a distributor operating in a "low country risk" jurisdiction, all other things being equal. Under the data availability mechanism, the sovereign credit rating of the jurisdiction represents an approximation that is used to derive this relative difference in returns.

67. Where a tested party is located in a qualifying jurisdiction, its exposure to a higher level of country risk relative to the global dataset requires an adjustment to the return initially determined under section 4.1. A tested party in an aforementioned qualifying jurisdiction will earn an adjusted return in accordance with the following formula:

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

Where –

<sup>34</sup> See paragraph 1.167 of these Guidelines.

- UROS<sup>TP</sup> is the unadjusted return on sales percentage of the tested party calculated in accordance with Section 4.1.
- NRA<sup>J</sup> is the net risk adjustment percentage for a given jurisdiction derived from figure 4.3 below, where the applicable category is determined by reference to the sovereign credit rating of the jurisdiction of the tested party applicable at the time of the relevant period.
- OAS<sup>TP</sup> is the net operating asset intensity percentage of the tested party for the relevant period but will not exceed 85% for the purpose of computing the adjusted return on sales of the tested party.

**Figure 4.3 – Net risk adjustment percentage to be applied to the NOA of a Tested Party in qualifying jurisdictions<sup>35</sup>**

Sovereign Credit Rating Category		Net risk adjustment %
Investment grade	BBB+	0.0%
	BBB	0.1%
	BBB-	0.4%
Non-investment grade	BB+	0.7%
	BB	1.3%
	BB-	1.9%
	B+	2.8%
	B	3.9%
	B-	4.9%
	CCC+	6.0%
	CCC	7.6%
	CCC- (or lower)	8.6%

#### **4.2.3. Application of the simplified and streamlined approach using a qualifying local dataset**

68. The purpose of the local dataset approach is to address any potentially material data availability gaps that may exist in the global dataset owing to lack of country coverage of the underlying commercial database used to generate the global dataset.

69. A qualifying local dataset will be produced by a relevant tax administration using a similar methodology used to produce the global dataset and will be translated into a local pricing matrix that conforms to and supersedes the pricing matrix in figure 4.1 of section 4.1. In advance of publication, the qualifying local dataset and the local pricing matrix will

<sup>35</sup> The methodology applied to calculate the net risk adjustment percentages in figure 4.3 comprises determining the five year average sovereign debt default spread for each credit rating grade (sourced from data compiled by Aswath Damodaran, NYU Stern School of Business) less a double counting adjustment that seeks to approximate for the existing country risk present in the global dataset.

be verified by the Inclusive Framework to the same standard as the global dataset to ensure consistency with the criteria in Annex A and the design principles of the pricing matrix under section 4.1.

70. The local pricing matrix will be published prospectively by the relevant tax administration and it will apply for the purpose of identifying the arm's length return for in-scope transactions involving a tested party located in the aforementioned jurisdiction.

71. Notwithstanding a local pricing matrix using a local dataset approach supersedes the pricing matrix in figure 4.1 of section 4.1, the guidance in section 4.1 will apply for the purposes of applying and administering any such local pricing matrix.

### 4.3. Corroborative mechanism to address low and high functionality

72. Baseline distributors may exhibit different functional profiles and operating expense intensities and the dimensions of the pricing matrix will generally accommodate this. However, certain arrangements may be at risk of being over or under-remunerated for their functional contributions under a return on sales net profit indicator.

73. For the purposes of the simplified and streamlined approach, a Berry ratio cap-and-collar approach is applied as a corroborative test and guardrail within which the primary return on sales net profit indicator is applied. The guardrail is intended to prevent particularly low operating expense intense entities from being over-remunerated under the simplified and streamlined approach and conversely, particularly high operating expense entities from being under-remunerated under the approach.

74. Accordingly, where the application of the return on sales net profit indicator produces a Berry ratio result outside of the pre-defined cap-and-collar range, the profitability of the tested party will be adjusted to the nearest edge of the Berry ratio cap-and-collar range.

75. The corroborative mechanism applies to all in-scope transactions and requires a tax administration and taxpayer to apply the following 3-step process:

- a. Step 1 - a tax administration and taxpayer will determine the return on sales for the tested party in accordance with the guidance in section 4.1 and section 4.2, where applicable, and compute an implied Berry ratio result derived from that return.
- b. Step 2 - the tax administration and taxpayer will perform a corroborative test to measure the implied Berry ratio result of the tested party against the Berry ratio cap-and-collar range.
- c. Step 3 - where the implied Berry ratio result of the tested party falls within the Berry ratio cap-and-collar range, no further adjustment is required to the return on sales calculated in Section 4.1 and 4.2, where applicable. However, where the implied Berry ratio result of the tested party exceeds the Berry ratio cap, the return on sales of the tested party will be adjusted downwards until it results in an implied Berry ratio result equal to the Berry ratio cap. Conversely, where 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 the Berry ratio collar.

#### 4.4. Periodic updates

76. In order to simplify compliance burdens associated with administering the simplified and streamlined approach, the analysis supporting the determination of arm's length ranges referenced in section 4.1, section 4.2.1 and section 4.2.3 will be updated every five years unless there is a significant change in market conditions that warrants an interim update.

77. The financial data and other datapoints referenced in section 4, including the net risk adjustment percentage (section 4.2.2) and the Berry Ratio cap-and-collar range (section 4.3) will be updated annually.

#### 4.5. Implementation considerations<sup>36</sup>

78. [PLACEHOLDER]

#### 4.6. Illustrative examples

79. [PLACEHOLDER]

### 5. Documentation

80. In general, transfer pricing documentation ensures that tax administrations have access to the necessary information to conduct risk assessment processes and/or to audit the taxpayer's transfer pricing practices<sup>37</sup>. In the case of the simplified and streamlined approach, documentation is important to ensure that tax administrations have sufficient and reliable information to assess whether taxpayers' qualifying transactions meet the scoping criteria.

81. This section identifies the main items of information in the local file that can be useful in substantiating the taxpayer's position on the applicability of the simplified and streamlined approach and provide tax administrations with the relevant information. When considering the introduction of targeted documentation requirements for the simplified and streamlined approach, jurisdictions may consider simplifying such requirements for small and medium enterprises to limit their costs and compliance burden.<sup>38</sup>

82. The three-tiered approach to transfer pricing documentation described in Chapter V includes a local file, which provides detailed information on the taxpayer's specific intercompany transactions. The documentation approach for the simplified and streamlined approach is built on the premise that the current content of the local file (see Annex II of Chapter V) includes the items of information and documents which are relevant to examine the taxpayer's position.

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<sup>36</sup> Upon completion of the further work to be undertaken by year end, further consideration will be given to the different means of implementing Amount B (e.g. designing Amount B as a safe harbour, prescribing Amount B, etc.).

<sup>37</sup> See paragraphs 5.5 and 5.6 of these Guidelines.

<sup>38</sup> See paragraph 5.33 of these Guidelines.



83. The following items of information may already be included in the local file and can be particularly relevant and useful to tax administrations in assessing whether the taxpayer's qualifying transactions meet the scoping criteria, and, if the taxpayer applied the pricing methodology, whether it did so properly:

- a. An explanation on the delineation of the in-scope qualifying transaction, including the functional analysis of the taxpayer and relevant associated enterprises with respect to the in-scope transactions, and the context in which such transactions take place (e.g. whether there are any other commercial or financial relations between the tested party/taxpayer with other associated enterprises that may influence the accurate delineation of the qualifying transaction potentially in scope)
- b. Written contract or agreements concluded governing the qualifying transaction and supporting the explanation on the delineation of the in-scope qualifying transaction described in a).
- c. Calculations showing the determination of the relevant revenue, costs and assets allocated or attributed to the in-scope transaction;
- d. Information and allocation schedules showing how the financial data used in assessing the applicability of the simplified and streamlined approach and applying the transfer pricing method ties to the annual financial statements.

84. In relation to the information item in (b), where it is consistent with the scoping criteria and the conduct of the parties, the provision of a written contract would ease the administration of the simplified and streamlined approach when a taxpayer is seeking to apply the approach to a qualifying transaction. However, regardless of whether a written contract is in place, tax administrations or taxpayers can assert or challenge the approach based on the accurate delineation of the transaction performed under the principles articulated in Chapter I of these Guidelines.<sup>39</sup>

85. Financial information on the tested party is needed to understand whether the qualifying transaction meets the scoping criteria, irrespective of whether the tested party is a domestic or foreign entity.<sup>40</sup> Accordingly, the taxpayer will also need to provide the annual financial accounts of the tested party for the relevant fiscal years.

86. Where one or more items of information relevant to assess the application of the simplified and streamlined approach are not included as part of the transfer pricing documentation, tax administrations may require taxpayers to provide them upon request. Importantly, making this information available to tax administrations as part of the annual transfer pricing requirements or upon request may translate into fewer follow-up requests for information and audits for the taxpayer, as well as in a more efficient use of tax administrations' resources.

87. In addition to the information in the local file, taxpayers and tax administrations should leverage on the information provided in the master file to support their position with regards to the application of the pricing approach. In particular, the master file can provide valuable information on the MNE Group's business, such as main products, main geographic markets, pricing policy or the general strategy of the MNE Group for the development, ownership and exploitation of intangibles. As a matter of good practice, to avoid excessive compliance burden for taxpayers, when evaluating the applicability of the simplified and streamlined approach to qualifying transactions of a given taxpayers, tax

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<sup>39</sup> See paragraph 1.49 of these Guidelines.

<sup>40</sup> See paragraph 3.22 of these Guidelines.

administrations should refrain from requesting the taxpayer to produce or submit information already in the hands of the tax administration.

88. The fact that the taxpayer has prepared and submitted the above information to the tax administration does not prevent the tax administration from examining the taxpayer's self-assessment on whether the scoping criteria are met and the pricing methodology has been applied properly.

89. Finally, when the taxpayer is seeking to apply the simplified and streamlined approach for the first time, the taxpayer should 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 3 years, unless transactions are no longer in scope during that period, there is a significant change in the taxpayer's business, and notify that circumstance to the tax authorities of the jurisdictions involved in the qualifying transaction. As part of the first-time notification procedure, tax administrations could require the taxpayer to provide some or all of the items of information listed in paragraph 83. In addition, tax administrations may require taxpayers seeking to apply the simplified and streamlined approach to provide a written contract signed prior to the occurrence of the qualifying transaction. The preceding sentence is not intended to change in any way the role of a written contract in the accurate delineation of the transaction, as discussed in Section D.1 of Chapter I.

## 6. Transitional issues

90. MNE Groups may reorganise their distribution business models and, as result, conclude qualifying transactions that meet the conditions to be in-scope of the simplified and streamlined approach. Equally, there may be MNE Groups with in-scope transactions which, following the restructure of their distribution arrangements, no longer meet the conditions to apply the simplified and streamlined approach.

91. As stated in paragraph 9.34, MNE Groups are free to organise their business operations as they see fit and tax administrations do not have the right to dictate to MNE Groups how to design their structure or where to locate their business operations. Tax administrations, however, have the right to determine the tax consequences resulting from the reorganisation. In this regard, the guidance in Chapter IX remains relevant whether the simplified and streamlined approach is applicable to the pre-restructuring or post-restructuring qualifying transactions.

92. Some Associated Enterprises may attempt to artificially reorganise their arrangements to derive tax advantages from the application of the simplified and streamlined approach. Such scenarios 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.<sup>41</sup>

93. In some instances, the simplified and streamlined approach may apply to a restructured distributor with built-in losses from prior fiscal years. The tax treatment of such losses, in particular whether they are available or can be deductible, depends on each

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<sup>41</sup> Any business restructuring should be properly documented in the master file and the local file. See paragraphs 9.32 - 9.33 of these Guidelines.

jurisdiction's domestic legislation and administrative procedures and is not within the scope of this guidance.

## 7. Tax certainty

94. As with any transfer pricing matter, there may be instances where the different parties take diverging views on whether the taxpayer has appropriately applied the simplified and streamlined approach. Where one of the tax administrations makes a primary adjustment resulting in double taxation of the profits derived from the relevant qualifying transaction, a corresponding adjustment can mitigate or eliminate double taxation by adjusting downwards the tax liability of the associated enterprise in a second tax jurisdiction. Some jurisdictions may be able to remedy economic double taxation through unilateral corresponding adjustments making use of provisions in their domestic laws.<sup>42</sup> However, most jurisdictions would only be able to consider corresponding adjustments as part of a mutual agreement procedure.<sup>43</sup>

95. When the corresponding adjustment in paragraph 2 of Article 9 is invoked, the Commentary on Article 9 and Article 25 of the OECD Model Tax Convention, as well as the guidance in Chapter IV of the OECD Transfer Pricing Guidelines are relevant. Importantly, when the primary transfer pricing adjustment asserts the application of the simplified and streamlined approach, the jurisdiction considering the corresponding adjustment has the ability to verify whether the qualifying transaction meets the conditions to apply the approach and whether the approach has been applied correctly in determining the amount of the primary adjustment.<sup>44</sup>

96. In mutual agreement procedures regarding the application of the simplified and streamlined approach, competent authorities should consider its objectives, that is to say, the simplification and streamlined application of the arm's length principle to in-scope qualifying transactions. [Accordingly, where the primary transfer pricing adjustment asserts the application of the simplified and streamlined approach and the qualifying transaction meets the conditions for the application of such approach, competent authorities shall endeavour to resolve the dispute by applying the pricing determined under Section 4. The simplified and streamlined approach may also be considered by competent authorities in resolving mutual agreement procedures even though neither the taxpayer nor the tax administrations of the jurisdictions involved have asserted the application of the simplified and streamlined approach, subject to the qualifying transaction meeting the conditions for application of such approach.]<sup>45</sup>

97. Any agreement reached under a mutual agreement (including APAs cases as well as mutual agreement cases) prior to the adoption of the simplified and streamlined approach should prevail in relation to the covered qualifying transactions. This approach prevents creating uncertainty as to whether disputes already settled between competent

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<sup>42</sup> See Commentary to Article 25, para. 12.

<sup>43</sup> See paragraph 4.32 of these Guidelines.

<sup>44</sup> See guidance in paragraphs 5 and 6 of the Commentary on Article 9 and Section C.2 of Chapter IV of these Guidelines.

<sup>45</sup> The final wording of the bracketed text is contingent upon further discussions on the means of implementation of Amount B.

authorities may be subject to review and reassessment and enhances predictability for concerned taxpayers.

98. Finally, in some cases the taxpayer may have entered into APAs (unilateral, bilateral or multilateral) covering qualifying transactions prior to the adoption of the simplified and streamlined approach. In the absence of a breach of the critical assumptions or an agreement of the parties to cancel or renew the APA, the terms and conditions of such APAs would continue to be valid throughout the duration of the APA. In the case of unilateral APAs, the tax administration of the counterparty to the qualifying transaction covered by the APA has the capacity to raise a transfer pricing adjustment with respect to such transaction. Accordingly, the terms the qualifying transaction agreed under a unilateral APA may be still subject to review in the context of a mutual agreement procedure.

## Annex A. Relevant benchmarking search criteria

This Annex describes the relevant benchmarking search criteria applied for the purposes of identifying companies involved in baseline marketing and distribution activities and relied upon to establish the global dataset which in part forms the basis for the approximation of arm's length results under the simplified and streamlined approach.

### Database filtering

Moody's BvD Orbis database<sup>46</sup> was used for the initial research of defining relevant benchmarking search criteria and only the following criteria were considered initially. Other filters may be applied in later stages as the work develops, such as screening out of loss makers and businesses in a start-up phase.

1. Active companies
2. Companies with primary NACE codes 45 - Wholesale and retail trade and repair of motor vehicles and motorcycles and 46 - Wholesale trade except of motor vehicles and motorcycles<sup>47</sup>
3. Companies with consolidated accounts, or unconsolidated only where the company is known to own less than 50% of any subsidiaries
4. Companies with no shareholders with ownership of more than 50% of the shares of the company
5. Companies with operating revenue and EBIT data available for 2017, 2018 and 2019
6. Companies with operating revenue average of at least EUR 2 million for 5 years (2015-2019)
7. Companies with a website address
8. Companies with business overview information available in the database
9. Excluding companies with R&D to sales ratio of more than 3%<sup>48</sup>

### Qualitative review of company data selected

After the filtering described above, a qualitative review of the companies was performed.

This review aimed at rejecting from the final data set any companies undertaking more than baseline wholesale marketing and distribution activities based on scoping criteria outlined in Section 2.

Initially, keyword searches were used to make rejections of company data, and then manually reviewed the companies in the dataset using only the descriptive information on businesses activities provided in the database.

Initial qualitative reviews included -

- Rejection of companies with the following terms in their business overview:

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<sup>46</sup> There are database license restrictions associated with the use and dissemination of detailed data and company information and further consideration is needed to determine the implications for the Amount B pricing outputs currently being considered.

<sup>47</sup> Noting further refinements through the qualitative review outlined in the next section.

<sup>48</sup> This is an initial database search criteria, later refined through the manual rejection of companies described as carrying out research and development activities in their business descriptions.

- “design and manufacture”,
- “financ”,
- “insurance”,
- “manufacture “,
- “research”, “software d” and “system integrat”.
- Rejection of all companies that do not describe wholesale distribution as their main activity.
- Rejection of companies which describe any development, research or manufacturing activity, or more than minority or ancillary levels of additional activities such as retail, repairs and maintenance, and other services.

Companies in the resulting smaller dataset have been subject to further high-level qualitative checks of company website and internet information to further refine the dataset to those companies most likely to have a predominant activity of wholesale distribution and other activities such as retail distribution and provision of services only as ancillary activities to that distribution.

Further quantitative and qualitative screens will be considered where appropriate as part of the further work to be undertaken by year end.

## Annex B. Industry groupings

Initial consideration of industry categorisation found that the industry code did not reliably relate to the actual distribution activities of the companies in many cases. For this reason, the products distributed by a company were analysed as a more reliable means of categorisation through the revision of information available in companies' websites and in other website information.

The products distributed by companies were then classified into a number of industry categories, identified from the details of the companies themselves and not necessarily based on any industry code definitions. Each of these categories considered individual industries in comparison with the remaining global set to identify any statistically significant differences in levels of return between the industry categories. This resulted in three industry groupings:

- Group 1 – industry categories which have a statistically significant relationship to lower levels of return;
- Group 2 – industry categories which do not show a statistically significant relationship to levels of return;
- Group 3 – industry categories which have a statistically significant relationship to higher levels of return.

The categories of goods falling into each of the three industry groups are:

### *Group 1*

Perishable foods, animal feeds, agricultural supplies, Grocery, household consumables, alcohol and tobacco, pet foods, construction materials and supplies, plumbing supplies, metal, paper and packaging.

### *Group 2*

Domestic vehicles, IT hardware, software and components, electrical components and consumables, clothing and apparel, textiles, hides, furs, jewellery, plastics and chemicals, lubricants, dyes, home appliances, consumer electronics, furniture, home and office consumables, printed matter, mixed goods, multiple products lines, assorted supplies, any other goods and components not listed under Group 1 or Group 3.

### *Group 3*

Medical machinery, pharmaceuticals, medical, health and wellbeing miscellaneous supplies, industrial machinery, industrial tools, industrial components and miscellaneous supplies, industrial, agricultural and used domestic vehicles, motorcycles, vehicle parts and supplies.

## Annex C. Background to the modified pricing matrix

One of the challenges of designing the simplified and streamlined approach has been the feasibility of establishing a globally standardised pricing methodology for baseline distribution. Based on econometric analyses, geographic differences have been observed to influence the profitability of baseline distribution in a small number of jurisdictions for which relevant data is available.

By examining the companies in the global dataset and comparing country specific returns to the returns observed from the global dataset, the pricing work on Amount B will continue to consider whether these geographic differences are material to the pricing model throughout the further work to be undertaken by year end. For the purposes of the initial analyses done so far, a difference has been considered material where more than half of the companies in a jurisdiction have a return which does not fall within the interquartile range of returns of all the companies in the corresponding asset, expense and industry group. Where the majority of companies fall above the IQR in some cells but below in others, these results are netted off. Differences represented by a single company in a cell have not been taken into account in this process.

Subject to further work to be undertaken by year end, including consideration of potential further qualitative and quantitative reviews, it will be established if there is sufficient evidence to support the use of the modified pricing matrix referenced in section 4.2. If so, the modified pricing matrix would reflect the effect of observed differences through an adjusted operating margin return in each cell of the 16 cell matrix when compared to the pricing matrix referenced in section 4.1.



