

Inclusive Framework BEPS Agreement

Public Consultation on Pillar One Amount B – January 2023

Policy Perspectives Update – the Hong Kong SAR



Public consultation on Amount B under Pillar One

On 8 December 2022, the OECD published a public consultation document on Amount B under Pillar One. The consultation document can be accessed via this [link](#). The objective of Amount B is to simplify and streamline the application of the arm's length principle to in-country “baseline marketing and distribution activities” based on the guidance provided in the OECD Transfer Pricing Guidelines.

Amount B under Pillar One

Amount B is designed to address the challenges faced by low-capacity jurisdictions in applying transfer pricing rules and reduce the compliance costs incurred by businesses due to transfer pricing disputes. Unlike Amount A of Pillar One, the application of Amount B is **not limited to groups above a certain revenue or profitability threshold**. Thus, it is expected that Amount B will have a broader application. The consultation document contains four substantive sessions as set out below.

1. Scope of Amount B

- The session discusses how “baseline marketing and distribution activities” would be defined by using a set of qualitative and quantitative criteria.
- Amount B would apply to buy-sell arrangements where the tested party purchases goods from a related party for wholesale distribution to unrelated parties. The consultation document seeks views on whether Amount B should also apply to sales agency and commissionaire arrangements.
- For simplicity, it is proposed that Amount B would only apply to controlled transactions involving the distribution of tangible property, but not to the distribution and marketing of services (including financial services) or digital property (e.g. software).
- There are a number of qualitative and quantitative scoping criteria to determine whether Amount B is applicable to the distributors meeting the proposed definitions. Under the qualitative criteria, in-scope distributors should not undertake certain value-adding activities (e.g. important technical or specialised services and owning / generating unique and valuable intangible assets) whereas the quantitative criteria include limits on proportions of marketing and advertising expenses, packaging and assembly costs, and support services.
- Despite the introduction of Amount B, the terms of existing Advance Pricing Agreements (APAs) would be respected.

2. Amount B pricing methodology

- The proposed Amount B pricing methodology applicable to in-scope transactions aligns with current transfer pricing practices. It is proposed that a benchmarking analysis would be performed based on a set of publicly available comparable financials.
- The documents currently sets out the following two potential pricing methodologies:

1. **A pricing matrix approach** – An approach to set out a range of profitability figures against two or more statistically significant quantitative measurements (e.g. the ratios of asset intensity and operating expenses to sales); or
 2. **A mechanical pricing tool** – A tool using an econometric model to translate the benchmarking data that would apply based on the financial data of the tested party.
- The Amount B return would generally be calculated using operating margin (net profit divided by sales) as the Net Profit Indicator (NPI), though the Berry Ratio (gross profit / operating expenses) or a combination of NPIs could possibly be used as well.

3. Documentation requirements

- The objective of the documentation requirements is to ensure the tax administrations have sufficient information to determine whether a taxpayer's controlled transactions are in-scope and can be priced under the Amount B pricing methodology.
- The proposed Amount B documentation requirements retain and build upon the transfer pricing documentation standards for master and local files as set out in the OECD Transfer Pricing Guidelines.
- However, certain proposed documentation requirements stated in the document exceed the OECD's recommended requirements for local files and some additional documents (e.g. a copy of any bilateral APAs) are required to be retained.

4. Tax certainty

- Concerns about the application of Amount B include some tax administrations may choose not to apply it and others may seek to apply it beyond its intended scope.
- The document outlines how the existing Mutual Agreement Procedure and treaty arbitration provisions could be used to resolve disputes and eliminate any double taxation arising from the application of Amount B.

What's next

The consultation document was released for seeking public comments and does not reflect the final views or consensus of the members of the OECD/G20 Inclusive Framework (IF) on BEPS. Further changes to the conceptual framework may be required to complete the work on the technical development of Amount B. Interest parties are invited to submit their comments no later than **25 January 2023**.

The OECD's objective is to reach agreement on Amount B by mid-2023, allowing it to come into effect in 2024 alongside Amount A.

Hong Kong business considerations

The consultation document is the first document which provides detailed insights into how the IF considers Amount B should operate since the Pillar One Blueprint was published in October 2020.

Amount B may provide significant benefits to both taxpayers and tax administrations if it is scoped, priced and administered appropriately. Business groups in Hong Kong carrying out in-scope transactions under Amount B should closely monitor the developments in this area in the coming few months. They should also consider taking the opportunity of the OECD's public consultation to voice out their concerns and submit their recommendations.

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