Bloomberg Tax

Tax Management
International Journal™

June 20, 2024

Reproduced with permission from Tax Management International Journal, 6/20/2024. Copyright @ 2024 by Bloomberg Industry Group, Inc. (800-372-1033) http://www.bloombergindustry.com

Mortar in the Cracks: New Amount B Guidance

Thomas Bettge, Jessie Coleman, Alistair Pepper, and Phil Roper*
KPMG

Recent guidance from the OECD/G20 Inclusive Framework fills gaps in the Amount B architecture and provides valuable insight into which jurisdictions may implement Amount B, say KPMG practitioners.

In February 2024, the OECD/G20 Inclusive Framework on BEPS ("Inclusive Framework") published the final Amount B guidance in an agreed consensus document, with reservations from India. The February release was at once a significant achievement — the first final product arising from the Inclusive Framework's multi-year effort to simplify and streamline transfer pricing for baseline marketing and distribution activities — and something of a headscratcher: the version of Amount B it envisioned was optional for jurisdictions to implement, and was not accompanied by a public announcement on potential adopters. Without sufficient adoption, this version of Amount B could increase uncertainty and complexity rather than simplify and streamline related transfer pricing.

Public comments by policymakers since February indicate that a revised Amount B framework is in the works, which would be mandatory for adopting jurisdictions and hence deliver both greater simplification and certainty for taxpayers. This work is tied to the Amount A Multilateral Convention, which — as of the time of going to press — the OECD still hopes to have ready by the end of June.

* Thomas Bettge is a senior manager, Jessie Coleman is a principal, and Alistair Pepper is a managing director in the KPMG LLP's Washington National Tax practice of the Economic Valuation Services group. Phil Roper is a partner at KPMG UK.

The information in this article is not intended to be "written advice concerning one or more Federal tax matters" subject to the requirements of section 10.37(a)(2) of Treasury Department Circular 230. The information contained herein is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser. This article represents the views of the authors only, and does not necessarily represent the views or professional advice of KPMG LLP.

Additional guidance published by the OECD on June 17 (the "June guidance") provides little additional clarity on the key question of implementation, but rather adds mortar to three definitional cracks left by the February guidance:

- "low-capacity jurisdictions" that would benefit from having Amount B respected by counterparty countries;
- "qualifying jurisdictions" that would benefit from favorable (from the tax authority's perspective) treatment under the operating expense cross-check mechanism; and
- "qualifying jurisdictions" that would benefit from the favorable (again for the tax authority) data availability mechanism.

The new guidance fills — and in one case, reshapes — the gaps initially left in the February guidance.

Covered Jurisdictions

The most foundational of the items left undefined in February was "low-capacity jurisdictions." Because in the absence of an additional implementation agreement, Amount B is optional, the fact that one jurisdiction chooses to apply it does not entail that the counterparty jurisdiction must accept the outcome of Amount B's application in the first jurisdiction. Absent widespread adoption of Amount B, this threatens to complicate rather than simplify transfer pricing compliance for baseline distribution: taxpayers will be applying Amount B in some jurisdictions and go through the traditional transfer pricing exercise of benchmarking and documenting in others, all for the same transactions.

The one exception to this system envisioned in February was for "low-capacity jurisdictions." If a jurisdiction fell into that category, its application of Amount B to a transaction would have to be respected in the counterparty jurisdiction, subject to that jurisdiction's "domestic legislations and administrative practices." What, exactly, the caveat means is unclear: Türkiye, for instance, has indicated that it can only respect a jurisdiction's application of Amount B if it has a bilateral tax treaty with that jurisdiction. Nonetheless, the basic idea is clear: Amount B would be respected when applied by a certain subset of jurisdictions (although individual jurisdictions could extend this on a bilateral basis).

The June guidance not only provides the list of those jurisdictions; it alters and expands the rule to eliminate the implicit assumption that a jurisdiction would need to have low tax administration capacity. The defined term in the new guidance is therefore no longer "low-capacity jurisdictions," but "covered jurisdictions." These are defined as low and middle income jurisdictions per World Bank classifications if they meet one of the following requirements:

- The jurisdiction is an Inclusive Framework member but not an EU, OECD, or G20 member;

- The jurisdiction is a member of both the Inclusive Framework and the OECD and/or the G20, as long as it expressed a willingness to apply Amount B by March 2024; or
- The jurisdiction is not a member of the Inclusive Framework, the EU, the OECD, or the G20 but expresses a willingness to apply Amount B (without any date restriction), upon approval by the Inclusive Framework.

The guidance contains a list of over 60 jurisdictions that satisfy this definition, with a commitment to review the list every five years. Most significant is the second category: Argentina, Brazil, Costa Rica, Mexico, and South Africa have made the requisite expression of interest, and therefore appear likely to apply Amount B even in the current optional form. For companies with distribution entities in these markets, this is significant news.

Qualifying Jurisdictions

The February guidance used the "qualifying jurisdictions" term in two distinct places, and it was not clear whether the same subset of jurisdictions was intended in each instance. The June guidance clarifies that it was not: qualifying jurisdictions for purposes of the operating expense cross-check and qualifying jurisdictions for purposes of the data availability mechanism are different (but significantly overlapping) sets of over 130 jurisdictions each, both of which will be updated every five years.

The operating expense cross-check mechanism provides a corroborative check on the standard Amount B pricing matrix, increasing the Amount B return if the tested party's markup on operating expenses falls below a collar (10%) and decreasing it if that markup exceeds a cap. The standard cap varies between 40% and 70% based on operating asset intensity, and the standard cap rates are increased to between 45% and 80% in qualifying jurisdictions — in other words, those jurisdictions have a less restrictive cap and thus fare better (from the tax administration perspective) under the cross-check mechanism.

For this purpose, a jurisdiction is a qualifying jurisdiction under the new guidance if the World Bank classifies it as low, lower-middle, or upper-middle income. The guidance clarifies that the use of alternate cap rates is a political compromise between competing views of the role for the cross-check mechanism.

After applying the cross-check, a tested party's Amount B return may still be increased if it is located in a jurisdiction that is a qualifying jurisdiction for purposes of the data availability mechanism. This mechanism is intended to address situations in which insufficient data for a jurisdiction exists in the global dataset underlying the Amount B pricing matrix and there is reason to believe — based on the jurisdiction's sovereign credit rating — that the jurisdiction presents increased risk and should receive a commensurately increased return.

Under the new guidance, these jurisdictions are defined as non-EU jurisdictions that have (i) a long-term sovereign credit rating from a recognized rating agency of BBB+ (or equivalent) or lower, and (ii) fewer than five comparables in the global dataset. For these

jurisdictions, the data availability uplift is equal to a net risk adjustment (which is tiered based on credit rating) multiplied by the tested party's ratio of operating assets to sales (capped at 85% for this purpose). Jurisdictions with fewer than five comparables and no available credit rating also qualify if they are classified as low, lower-middle, or upper-middle income by the World Bank, in which cases the mechanism operates by assuming an average net risk adjustment of 4.13% (the average net risk adjustment percentage for all non-investment grades set forth in the February 2024 report).

Often, the impact of the data availability mechanism will be modest, but in some cases it can be very material. The highest net risk adjustment, for qualifying jurisdictions with a sovereign credit rating of CCC- or lower, is 8.6%, which at the highest possible level of operating asset intensity translates to an increase of 7.3% — which would be added to "baseline" Amount B return. For this reason, modeling the impact of this adjustment is essential.

Conclusion

The June guidance is an important step forward, but it is the pending publication of the Amount B framework that will ultimately determine the impact of Amount B. While proponents of Amount B will continue to hope for mandatory implementation across the Inclusive Framework, this is complicated, at present, by its ties to Amount A and the latter's clouded prospects for implementation. The recent guidance not only fills in three gaps in the edifice laid out in February but strengthens it, particularly in the expansion of the "covered jurisdiction" concept and in the confirmation that material market jurisdictions such as Brazil and Mexico have an interest in adopting Amount B.

This article does not necessarily reflect the opinion of Bloomberg Industry Group, Inc., the publisher of Bloomberg Law and Bloomberg Tax, or its owners.