Grant Thornton

Japan Tax Bulletin

Pillar One Amount B released by OECD

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On February 19, 2024, the Organization for Economic Cooperation and Development (OECD) published its final report on Pillar 1 Amount B to simplify and streamline the application of the arm's length principle to baseline marketing and sales activities, with a focus on the needs of countries or regions with low tax enforcement capacity.

The Amount B approach, unlike the other BEPS 2.0 approaches, does not have a set of sales thresholds and is expected to be applicable to many multinational enterprises. Each jurisdiction can choose to apply the Amount B approach for fiscal years commencing on or after 1st January 2025.

1. *Covered qualified transactions*

- Buy-sell or distribution transactions in which goods are purchased from one or more related parties for wholesale distributions to unrelated parties
- Sales agent and commissionaire transactions in which one or more related parties contribute to wholesale distributions of goods to unrelated parties.

However, the following cases are excluded from the Amount B approach.

- Distributions or marketing activities of non-tangible goods and services, including digital goods and services
- Transactions for marketing, trading, or sale of commodity products
- Non-sales activities such as manufacturing activities and research and development activities are conducted

Furthermore, even among qualified transactions, the following two requirements must be met.

- The tested party in the qualifying transactions must not book operating expenses less than 3 % of the tested party's annual net revenues. In addition, the tested parties annual operating expense upper limit must be between 20 % and 30 % of the tested party's annual net revenues.
- If the distributors engage in wholesale and retail sales, net retail sales must be less than or equal to 20 % of total net sales on a three-year weighted average basis.

Application of the most appropriate method

The Transactional Net Margin Method (TNMM) is considered the most appropriate method under the simplified and streamlined approach. Meanwhile, the use of the Comparable Uncontrolled Prices Method (CUP) is also allowed on an exceptional basis when internal comparable transactions are available for which the arm's length price of a qualifying transaction can be reliably determined.

Determining the return under the simplified and streamlined approach

The calculation of the profit return level using the Amount B approach consists of the following three steps.

2. *Pricing matrix*

A relevant ROS (return on sales: EBIT to net revenues) is identified with reference to OAS, OES and industry groupings under the pricing matrix.

【The Pricing Matrix】

Factor intensity	Industry Grouping 1	Industry Grouping 2	Industry Grouping 3
[A] High OAS ≧ 45% Any OES	3.50% (±0.5%)	5.00% (±0.5%)	5.50% (±0.5%)
[B] Med/High OAS 30-44.99% Any OES	3.00% (±0.5%)	3.75% (±0.5%)	4.50% (±0.5%)
[C] Med/Low OAS 15~29.99% Any OES	2.50% (±0.5%)	3.00% (±0.5%)	4.50% (±0.5%)
[D] Low OAS<15% Non-low OES≧10%	1.75% (±0.5%)	2.00% (±0.5%)	3.00% (±0.5%)
[E] Low OAS<15% Low OES<10%	1.50% (±0.5%)	1.75% (±0.5%)	2.25% (±0.5%)

* OAS (Net Operating Asset Intensity)
= Net Operating Asset/Sales

* OES (Operating Expense Intensity)
= Operating Expense/Sales

Industry group

- Group 1; perishable food, grocery, household consumables, construction materials and supplies, plumbing supplies and metal
- Group 2; IT hardware and components, electrical components and consumables, animal feeds, agricultural supplies, alcohol and tobacco, pet foods, clothing footwear and other apparel, plastics and chemicals, lubricants, dyes, pharmaceuticals, cosmetics, health and wellbeing products, home appliances, consumer electronics, furniture, home and office supplies, printed matter, paper and packaging, jewelry, textiles, hides and furs, new and used domestic vehicles, vehicle parts and supplies, mixed products and products and components not listed in Group 1 or Group 3
- Group 3; medical machinery, industrial machinery including industrial and agricultural vehicles, industrial tools, industrial components and miscellaneous supplies

3. Operating expense cross check

If an operating expense to EBIT ratio that is outside of the cap and collar, the ROS is adjusted accordingly. The EBIT will be adjusted with the nearest edge of the range. EBIT is (a tested party's operating expense) x (pre-defined operating expense cap rate).

The cap-and-collar rates are as follows.

Factor intensity	Default Cap Rates	Alternative Cap Rates for Qualifying Jurisdictions	Collar Rate
High OAS [A]	70%	80%	10%
Medium OAS [B+C]	60%	70%	
Low OAS [D+E]	40%	45%	

4. Data availability for qualifying jurisdictions

In addition, the final report provides for an adjustment mechanism in cases where there is no data or insufficient data in the global dataset for a particular qualifying tested party jurisdiction.

With respect to the Pricing Matrix and the cap-and-collar rates, the following points should be noted

(1) ROS of the tested companies is considered acceptable if it is within 0.5% of the value determined by the pricing matrix

(2) The pricing matrix and the operating expense cap-and-collar rates will be updated every five years.

(3) OAS and OES of the tested companies are calculated based on the weighted average of the last three years.

5. Documentation obligation

In order to utilize the simplified and streamlined approach of the above pricing matrix, it is assumed that the transfer pricing documentation (the so-called local file) includes the following contents. However, this does not apply if there have been material changes in business or if the subject transactions no longer exist.

- Description of qualifying transactions and Background of the qualifying transactions,
- Contracts related to qualifying transactions,
- Supporting documents and data related to qualifying transactions when taxpayers decide the amount of sales, expenses, asset allocations, and others,
- Information on financial data used in the application of the Simplified and Rationalized Approach and the Transfer Pricing Methodology,
- The company agrees to apply the simplified approach for at least three years consecutively.

6. Future development

The adoption of the Amount B approach is optional in each tax jurisdiction. Countries and regions that will adopt Amount B approach are going to be announced by the OECD in near future. In addition, each country will be encouraged to develop legislation to enable the optional application of this approach from the fiscal year beginning on or after January 1, 2025.