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South Centre Comments on Pillar One – Amount B

I. Background

The South Centre is the intergovernmental organization of developing countries that helps developing countries to combine their efforts and expertise to promote their common interests in the international arena. The South Centre has 55 Member States coming from the three developing country regions of Africa, Asia, and Latin America and the Caribbean. It was established by an Intergovernmental Agreement which came into force on 31 July 1995. Its headquarters are in Geneva, Switzerland.

The South Centre in 2016 launched the South Centre Tax Initiative (SCTI). This is the organization's flagship program for promoting South-South cooperation among developing countries in international tax matters.

The South Centre submits the following comments and recommendations to the OECD Secretariat on Pillar One – Amount B.

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II. Comments and recommendations

i. Amount B Mandate and Goals

a. *Definition of "Low Capacity Jurisdictions"*

This term is not defined anywhere in the document. Low Capacity Jurisdictions (LCJ) could imply jurisdictions lacking administrative capacity and/or lacking local comparables. The two are not the same. The key issue that led to Amount B was the problems arising from lack of local comparables. Hence, this term needs definition to give sharper focus to the design of Amount B.

Recommendation: The term "Low Capacity Jurisdictions" should be defined.

b. *Reference solely to OECD Transfer Pricing Guidelines*

The document only refers to OECD Transfer Pricing Guidelines (TPG). However, as was mentioned by the South Centre in a prior Statement, "profit allocation under the OECD's transfer pricing guidelines allocate profit to jurisdictions based entirely on supply factors of Functions, Assets and Risks (FAR), through the Authorized OECD Approach (AOA). In practical terms this meant developed, industrialized jurisdictions with high value exports were privileged in profit allocation. This also disadvantaged market jurisdictions, which are largely developing countries, and often net importers, especially of high value goods and services, and capital."[1]

Further, some Members of the IF do not follow the OECD TPG and rely more on other approaches, such as those in the UN Transfer Pricing Manual.

Recommendation: Amount B design should be in line with both the United Nations Transfer Pricing Manual and OECD TPG.

ii. Scope of Amount B

a. *Should sales agency and commissionaire arrangements be included?*

These are common distribution models used to eliminate or minimize tax in market jurisdictions while still conducting through MNE group members most if not all

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1 https://www.southcentre.int/wp-content/uploads/2021/07/SC-Statement-on-IF-Two-Pillar-Solution-FINAL.pdf

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distribution functions within the jurisdiction. Further, in practice their functions are similar to "baseline" marketing and distribution activities, with the main difference being that such entities do not assume title of goods/inventory. Their inclusion will enhance the impact of Amount B for developing countries.

Recommendation: Sales agency and commissionaire arrangements should be included

b. *Should different Profit Level Indicators (PLIs) and arm's length returns be used for wholesale (buy and sell) distribution arrangements and commissionaire and sales agent arrangements?*

Actual distribution and related functions performed within the jurisdiction by MNE group members will not significantly differ irrespective of the legal form of the contractual relationship (i.e. distributor, sales agent, or commissionaire). The legal form is often primarily motivated to reduce or avoid taxes. Further, such a bifurcation may create additional complexity.

Recommendation: There should not be any difference in the Amount B pricing between distributors and sales agents and commissionaires.

c. *Should Amount B only be used when local comparables are not available?*

As mentioned in the initial point on "Low Capacity Jurisdictions", Amount B was primarily meant to address the problem of lack of comparables. It must thus operate accordingly.

Recommendation: Amount B should be used only when local comparables are unavailable.

d. *Can comparables from similar markets be used?*

The document suggests drawing on comparables from similar market conditions. This is welcome and developing countries can yield better comparables from each other than from a 'global' comparison or market condition agnostic comparison. Such an approach is also in alignment with existing transfer pricing guidelines which lay emphasis on economically relevant characteristics as a comparability factor.

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Recommendation: When local comparables unavailable, similar markets (e.g., in terms of size of the economy, market participation, per capita GDP) can be used for deriving suitable comparables.

e. *What can be the "Most Appropriate Method"?*

The document proposes Transactional Net Margin Method (TNMM) on a rebuttable presumption basis as the Most Appropriate Method (MAM), but also asks whether other methods or a combination of methods is appropriate.

Recommendation 1: For administrative simplicity, calculation of a distributor's profits should be as objective as possible and subject to only one designated pricing method.

Recommendation 2: Given routine nature of most distributor operations, and relatively wide use of TNMM, it is a suitable choice for MAM.

Recommendation 3: Power of rebuttal should only be with tax administration, not taxpayer, as taxpayers will rebut whenever they have an economic incentive.

f. Should retail distributors be covered?

Since Amount B is meant to cover situations where there are lack of comparables, it can cover retail as well as wholesale distributors.

Recommendation: Retail distributors should be in-scope.

iii. Amount B Pricing Methodology

a. *Issues with Methodology*

It may be quite challenging to arrive at a 'global' pricing solution given the limited uniformity in data available across jurisdictions and reliance on one commercial database to arrive at a solution expected to apply for the whole world. Any Amount B pricing solution should include differentiation along the lines of geography as well as industry.

Recommendation: The country and industry-specific factors outlined in para 57 of the document are more suitable than attempts to formulate a 'global' solution.

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b. Selection of Net Profit Indicator (NPI)

Para 69 of the document proposes operating margin or return on sales as the most appropriate net profit indicator. Alternatives provided in para 70 include Berry ratio, return on assets, etc.

Recommendation: Return on sales is the most appropriate NPI. The other indicators may not be reflective of true profits given the nature of operations undertaken by marketing and distribution entities.

c. Selection of most appropriate point in the range (4.3.2)

The outcomes of the pricing matrix or mechanical tool may be either a range of values or a point estimate. The question is what can be the most appropriate point in the range.

Recommendation: Median can be the most appropriate point in the range

d. Comparability Adjustments (4.3.3)

The OECD TPG are cited to argue "comparability adjustments should be considered if (and only if) they are expected to increase the reliability of results."

Recommendation: Since Amount B is essentially meant to ease administration and act as a simplification measure, a direct trade-off is involved with reliability. Hence, such indirect adjustments can further complicate the process and would not be necessary if the geographic (based on homogeneity of markets) and industry wise classifications are made in the pricing model.

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