

OECD plans to simplify transfer pricing in marketing and distribution activities 3/18/24



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It's been a while since the Organisation for Economic Co-operation and Development (OECD) drafted its Pillar I report dealing with various issues around the growing economic globalisation and digitalisation. It's also increasingly difficult to determine countries' rights to charge corporate income tax on the profits of multinational enterprise groups. While the project is basically geared towards digital business, one of the solutions the OECD offers may simplify transfer pricing (TP) for a particular group of transactions: baseline marketing and distribution activities.

This initiative aims to promote stability and predictability across the international tax system by prescribing a fixed profit margin for baseline marketing and distribution activities, which will not require benchmarking studies or complex TP analyses. The initiative is set out in the OECD's Pillar I Report on Amount B out on 19 February 2024. The simplified and streamlined approach outlined in the report is expected to improve tax certainty and ease the compliance burden on taxpayers and tax authorities, particularly those in low-capacity jurisdictions facing limited resources.

Qualifying transactions

The report describes and defines a set of transactions qualifying for the simplified and streamlined approach, as well as qualifying distributor characteristics.

Below are the related-party transactions that qualify for the simplified and streamlined approach:

- Buy-sell marketing and distribution transactions where the distributor buys goods from one or more related companies for wholesale distribution to unrelated parties
- Sales agency and commissionaire transactions where the sales agent or commissionaire contributes to wholesale distribution

If a transaction is to qualify for the simplified and streamlined approach:

- It must be possible to document the transaction for TP purposes by using a TP method in which the tested party is a distributor/agent or commissionaire.
- The tested party must cover a level of operational expenses determined as a net revenue percentage and based on weighted average data for three years (there is now a limit between 3% and 20-30%).

And if these conditions are met, the distributors:

- should not own any unique or valuable intangible assets;
- should not take certain economically significant risks;
- should not do retail and at the same time distribute digital goods and commodities and provide services.

The pricing matrix

The simplified and streamlined approach forms the basis for a pricing system in which a 3-step process determines a net profit margin for qualifying distributors. The net margin is the default profitability indicator described in two dimensions: industry grouping and factor intensity.

The pricing matrix contains a total of 15 different target profitability indicators ranging from 1.5% to 5.5%.

Application

Not all countries have to adopt the simplified and streamlined approach because it's optional. A country that does adopt this approach will have two choices:

1. Make it binding on all taxpayers
2. Make it a taxpayer-elected safe harbour

Jurisdictions will be able to choose to apply the simplified and streamlined approach to qualifying transactions of appropriate baseline distributors for financial years beginning 1 January 2025 or later.

Key takeaways

If Latvia chooses to adopt the new approach, it could significantly ease the administrative burden and costs for taxpayers with qualifying controlled transactions in preparing TP documentation and determining TP methodology for those transactions. And a fixed profit margin may create certainty and security in that the SRS will not challenge the TP methodology and the profit indicator applied.

However, this methodology being optional means that companies may not achieve the tax certainty they would have achieved if all the countries were mandated to apply it. Such uncoordinated application may lead to double taxation in a tax dispute if one party is based in a country that adopts the easy approach and the other party's country rejects it.