Connect. Engage. Impact.

1200 G Street, N.W., Suite 300
Washington, D.C. 20005-3814
202.638.5601
tei.org

1 September 2023

Tax Treaties, Transfer Pricing and
Financial Transactions Group
Centre for Tax Policy & Administration
Organisation for Economic Co-Operation
And Development

Via email: transferpricing@oecd.org

RE: Public Consultation Document on Pillar One – Amount B

Dear Sir or Madam:

On 17 July 2023, the OECD published a public consultation document addressing issues under Pillar One – Amount B of its two-pillar solution to the address the tax challenges arising from the digitalization of the economy (the "Consultation Document"). The OECD invited interested parties to submit their comments on the issues identified by the Consultation Document by 1 September 2023. On behalf of Tax Executives Institute, Inc. ("TEI"), I am pleased to respond to the OECD's request for comments.

About TEI

TEI was founded in 1944 to serve the needs of business tax professionals. Today, the organization has 56 chapters in North and South America, Europe the Middle East & Africa ("EMEA"), and Asia. TEI, as the preeminent association of in-house tax professionals, worldwide, has a significant interest in promoting sound tax policy, as well as the fair and efficient administration of the tax laws, at all levels of government. Our approximately 6,500 individual members represent over 2,800 of the leading companies in the world.

TEI Comments

TEI's feedback on tax policy initiatives is driven by four principles that we believe underly all tax policy around the world: clarity, consistency, predictability, and dispute resolution/avoidance. For the Consultation Document, these principles translate into 5 objectives:

- Increasing tax certainty.

- Multilaterally implementing consistent tax rules.
- Simplifying transfer pricing compliance.
- Reducing tax compliance burden.
- Meaningful data transparency.

The Consultation Document introduces a much-welcomed reduction of the compliance burden and a simplification of the transfer pricing compliance with Amount B when compared to the previous consultation document. We value the OECD taking onboard TEI's, and the business community's, comments, and the efforts to unify the Inclusive Framework around a standardized pricing methodology and a practical solution effectively benefiting tax authorities and taxpayers.

We also believe that the additional steps below are necessary to improve the administrative simplicity, support low-capacity countries with streamlining processes under Amount B, and provide tax certainty benefits for tax administrations and taxpayers. Therefore, TEI recommends the OECD to further work on the points below.

TEI trusts the comments below will assist the OECD, collaboratively with the business community, in working towards the effective adoption of a consistent set of guidelines by the OECD/G20 Inclusive Framework on BEPS, under local law.

Amount B as an Elective Safe Harbor

Given the tax uncertainty, the complexity of the design and scoping, and the significant compliance burden of Amount B as currently designed, taxpayers should be given the flexibility to elect being in or out of scope of Amount B. It should also be clear that taxpayers opting out of the Amount B rules should not be forced to comply with the documentation requirements nor see their activities benchmarked by reference to the OECD target ranges. That is, if a taxpayer does not elect into the Amount B regime, then general transfer pricing principles will apply instead of the Amount B benchmark ranges.

Interaction between Amount A and Amount B

Taxpayers within the scope of Amount A should also be within the scope of Amount B irrespective of the nature of products or services distributed. By limiting the scope of Amount B, the effect is to exclude some Amount A taxpayers, thereby frustrating a key objective of Pillar One – tax certainty. These features have long been described as a package of policies that go together to ensure stability and certainty.

Scope of the Definition of Distributor

TEI welcomes the inclusion of digital goods within the scope of Amount B. TEI recommends the OECD further broaden the definition of limited risk distributor to include

services, including digital services. Digital goods and services are pervasive throughout the economy and often sold together. To exclude digital services will undoubtedly shift the nature of disputes from one of determining the appropriate return for a distribution activity, to one determining whether a particular transaction is in Amount B's scope. This would frustrate the goal of reducing the compliance burden and reducing disputes. What matters is that the functions, assets, and risks are those of a distributor, and it should make no difference what product or service the distributor is selling.

Enhance the Mechanisms Available for Dispute Prevention and Resolution

The OECD should acknowledge that traditional dispute mechanisms do not offer a swift and, at times, reliable dispute prevention and resolution. The OECD should therefore consider:

- Ensuring there is a timely and mandatory bi- or multilateral dispute resolution mechanism, including when no double tax treaty applies between the countries of tax residence of the low-risk distributor and the related party supplier.
- Securing a multilateral and consistent implementation of Amount B that binds the IF Members to adhere to, and locally comply with, the scope, pricing methodology, and benchmark ranges of Amount B.

To repeat a few points from our prior Amount B submission, we ask the OECD to consider that:

- There may not be double tax treaties in place between some of the IF Members, which can easily result in double taxation. If no bilateral dispute resolution is implemented as part of Amount B, taxpayers have no mechanism to resolve cross-border disputes. Corresponding adjustments at the level of the low-risk distributor counterparts can also be disallowed,
- Advance pricing agreements ("APA") are often offered as a solution, but not all countries have an APA program or are resourced to adequately address such requests, and
- Where double tax treaties apply, there is no equivalent to mandatory binding multilateral dispute resolution mechanism.

Quantitative (Alternative A) Versus Quantitative and Qualitative Scoping Criteria

The OECD should rely on objective criteria to determine the companies/activities in scope of Amount B. TEI welcomes and supports the approach defined under Alternative A and recommends:

- The most appropriate method: Paragraph 52 of the Consultation Document indicates that "it is recognised that there may be instances (although these may be rare, as the distribution of commodities is excluded from scope) where the application of the comparable uncontrolled price method using internal comparables could be potentially more appropriate to apply to price in-scope transactions. For those instances, the simplified and streamlined approach provides an exception that enables the taxpayer or tax administration to assert that the comparable uncontrolled price method using internal comparables can be used to reliably price in-scope transactions where that is in accordance with Part II B of Chapter II and A.4.2. of Chapter III of these Guidelines . . . ."

  We recommend simplifying and limiting the method selection for the Amount B safe harbour to the transactional net margin method. A focused approach is likely to reduce controversies about the benchmarking outcome.

- Local comparables: the consultation paper contemplates the possibility of having "Qualifying local datasets" for specific jurisdictions and the possibility of having a "jurisdiction which is relied upon to produce a local pricing matrix . . . ."

  To the extent possible, we recommend implementing a regionally consistent pricing matrix and deviating from adopting local pricing. The pricing matrix included in the consultation paper brings significant simplification to the benchmarking and transfer pricing testing.

  Allowing for local pricing increases the complexity of administering and tracking benchmarking, defeating the objectives the OECD and the IF are looking to achieve under Amount B.

Interaction between Amount B Transfer Pricing and Indirect & Customs Tax Compliance

Finally, as noted in our previous submission, TEI strongly recommends the OECD consider the Amount B's design has on other areas of taxation, namely the interaction between the transfer pricing under Amount B and indirect and customs tax compliance.

The challenges managing the interactions between transfer pricing and customs, value added tax (VAT), or goods and services tax (GST) are well known by tax practitioners.

Amount B's transfer pricing mechanism requires multinational enterprises to, periodically or at year-end, enforce a process to adjust the actual profitability of the local limited risk company to a point of the OECD benchmarked range. This is often a retrospective adjustment, not included in the products' pricing for indirect tax compliance purposes.

Today, most tax administrations lack a coordinated approach between transfer pricing and customs, which often results in an overpayment of custom duties and/or VAT/GST, i.e.:

- transfer pricing retrospective adjustments increasing the limited risk distributor's margin trigger a reduction to the products pricing and an additional corporate tax payment,
- for customs purposes, the reduction to the product pricing should trigger a partial refund of the custom duties paid when the good were imported into the country, and
- similarly, transfer pricing retrospective adjustments decreasing the limited risk distributor's margin would trigger and additional custom duties payment.

While some countries allow obtaining custom duties rulings to facilitate the transfer pricing, in practice taxpayers observe that such rulings work only when they result in additional custom duties payment. Double taxation arises as custom duties refunds are often disallowed.

Determining the Arm's Length Return Under Amount B

Section 4. of the Consultation Document is entitled "Determining the arm's length return under the simplified and streamlined approach." Box 4.1 in Section 4. states:

> The pricing features discussed in section 4 (including the supporting annexes) are subject to stakeholder input as well as further work to be performed by year end. That further work includes but is not limited to consideration of the appropriateness of the pricing matrix, the mechanisms to address geographic differences, the application of the framework to the wholesale distribution of digital goods or the specific timing for the periodic updates.[1]

TEI's feedback to the OECD regarding the pricing features of Amount B is organized around the following points:

1. Disproportionate importance placed on assets employed,
2. Interquartile ranges should be used in the pricing matrix,
3. Adjustments for geographical differences are not necessary,
4. The number of categories in the pricing matrix should be reduced, and
5. The definition of net operating assets should be clarified.

Disproportionate importance placed on assets employed

The OECD Transfer Pricing Guidelines (the "TPG") state: "in delineating the controlled transaction and determining comparability between controlled and uncontrolled transactions

[1] Consultation Document at p. 25.

or entities, a functional analysis is necessary. This functional analysis seeks to identify the economically significant activities and responsibilities undertaken, assets used or contributed, and risks assumed by the parties to the transactions."[2] Stated differently, the functions, assets, and risks must be considered to determine the arm's length compensation for a transaction under consideration.

However, the Consultation Document proposes using the functions performed and the risks undertaken by an associated enterprise as merely a check to determine whether the enterprise's activities qualify as baseline marketing and distribution activities that fall within the scope of Amount B's transfer pricing simplification. Having determined (based on the functions and risks) that the activities of the associated enterprise qualify as baseline marketing and distribution activities, the OECD places a disproportionate amount of importance on the assets employed when divining the simplified arm's length profit.

This is evident by the pricing matrix in Figure 4.1 of the Consultation Document entitled "Pricing Matrix (return on sales %) derived from the global dataset" (the "Pricing Matrix").[3] The Pricing Matrix provides that the operating margin for an associated enterprise in a certain industry group depends on its operating asset to sales intensity ("OAS") and operating expense to sales intensity ("OES"). In the Pricing Matrix, a higher OAS and OES result in a higher operating margin for the tested party. This approach to determining the arm's length profit – a disproportionate emphasis on assets employed vis-à-vis functions performed and risks assumed – is inconsistent with the TPG.

The OECD should therefore remove the OAS/OES categories from the pricing matrix and replace it with a lower-quartile/upper quartile range approach for each industry group, as detailed below.

Further, if the OECD does continue to believe there is a correlation between operating assets and profitability, the data supporting that conclusion should be released, including the names of the comparable companies supporting that analysis. We do not see that correlation in the data, so for transparency and to support the legitimacy of these design features, the data should be made public so stakeholders can see what assumptions and results are driving these decisions.

Interquartile ranges ("IQR") should be used in the pricing matrix

The Pricing Matrix in the Consultation Document shows a fixed operating margin plus or minus 0.5% for by industry group and OAS/OES value. This narrow range over a fixed operating margin may have the effect of truncating the arm's length IQR (IQR: lower quartile – median – upper quartile) and may therefore result in artificially increasing the operating margin for each of the combination of industry grouping and OAS/OES value in the Pricing Matrix.

[2] TPG at paragraph 1.51.

[3] Consultation Document at p. 26.

The OECD should instead use the entire IQR for each combination of the industry group and OAS/OES. This will ensure that the arm's length operating margin determined in the Pricing Matrix is in line with the TPG.

Additionally, under the proposed tight operating margin range (+/- 0.5%) in the Consultation Document, the taxpayer will need to make transfer pricing adjustments, on an *ex-poste* basis, if its operating margin falls outside the tight ranges suggested in the Pricing Matrix. If the IQR is used instead, it will provide more flexibility to the taxpayers in their operational transfer pricing processes and help reduce unnecessary burden of adjusting the transfer prices when tested party profit falls within the arm's length range, which is consistent with the TPG.

Adjustments for geographical differences are not necessary

If the proposed Amount B rules is truly to represent a simplification, any geographic differences should be captured within the IQR (as suggested above) for each combination in the Pricing Matrix. Therefore, there should not be a need to perform separate adjustments for the different geographic regions. Adding a country risk premium adjustment in relation to certain jurisdictions goes against the simplicity principles.

Operating in a high-risk country does not mean an associated enterprise takes on higher risks – especially if it makes a stable assured margin – or performs additional functions. The associated enterprise should therefore not necessarily be entitled to a higher operating margin, in accordance with the TPG.

It is the group entrepreneurs, and not the associated enterprise performing baseline marketing and distribution activities, that take the market risk in high-risk countries. Therefore, rewarding the associated enterprise with higher profit margins will further reduce the entrepreneur's profits attributable to their additional risks, which is inconsistent with sound economic principles.

The number of categories of OAS and OES should be reduced

The OECD should reduce the number of categories of OAS and OES to just three OAS categories – high, medium, and low, as shown below.

Industry Grouping **Factor intensity**	**Industry Grouping 1**	**Industry Grouping 1**	**Industry Grouping 1**
High OAS	LQ – median - UQ	LQ – median - UQ	LQ – median - UQ
Medium OAS	LQ – median - UQ	LQ – median - UQ	LQ – median - UQ
Low OAS	LQ – median - UQ	LQ – median - UQ	LQ – median - UQ

Clarify the definition of net operating assets

The Consultation Document defines net operating assets as "fixed operating assets plus working capital, where working capital is the sum of stock plus debtors less creditors, calculated in accordance with applicable accounting standards."[4] The OECD should consider further defining fixed operating assets and working capital and try to align the definitions with commonly defined terms in IFRS or equivalent accounting standards. If there is any room for interpretation for any of the finance terms used in the pricing matrix, it will lead to uncertainty in the application of the proposed.

• • •

TEI appreciates the opportunity to provide our comments on the Consultation Document. TEI's comments were prepared under the aegis of its EMEA Direct Tax Committee, whose Chair is Sandra Esteves of Qlik. Should you have any questions regarding TEI's comments, please do not hesitate to contact Ms. Esteves at sandra.esteves@qlik.com or +31 625 003 174, or Benjamin R. Shreck of TEI's legal staff at bshreck@tei.org or +1 202 464 8353.

Respectfully submitted,

Sandhya Edupuganty

Sandhya Edupuganty
International President
TAX EXECUTIVES INSTITUTE

[4] Consultation Document at p. 5.