



25 January 2023

Organisation for Economic Co-operation and Development
Centre for Tax Policy and Administration
Tax Treaties, Transfer Pricing and Financial Transactions Division

Sent via email: tfde@oecd.org

Subject: Comments on OECD Public Consultation Document – *Pillar One – Amount B*

Ladies and Gentlemen:

We appreciate the opportunity to submit these comments on behalf of EY on the OECD's public consultation document, *Pillar One – Amount B*, and to engage with the OECD on this important topic.

We believe it is essential to focus on the important objectives that Amount B is aimed at achieving, which we see as including –

- Achieving results that are broadly aligned and consistent with the arm's length principle, as articulated in the OECD Transfer Pricing Guidelines.
- Reducing the significant administrative costs to both taxpayers and tax authorities in determining distribution returns. Currently, the disputes and associated burdens are often disproportionate to the relative contribution of distributors to the overall value chain.
- Achieving greater certainty for taxpayers and tax authorities alike.
- Meeting the needs of low-capacity jurisdictions, for which the current administrative burdens are particularly acute.

These objectives might best be summarized as achieving an appropriate and sustainable balance between reliability and administrability through a simplified and streamlined approach. We think that this balance is both worthwhile and achievable. As discussed below, we are concerned that the approach reflected in the Consultation Document does not achieve the right balance. However, as also discussed below, we believe that such a balance could be achieved with specific modifications to the approach described in the Consultation Document.

The Consultation Document raises the possibility of greater reliance on quantitative factors and empiricism for both scoping (who is covered) and pricing (what are the distribution returns). A fundamental matter is whether such a simplified and streamlined approach would sufficiently adhere to the reliability touchstone of arm's length results. The appropriate framework for answering this cost/benefit question must be: "compared to what?" A potential simplified and streamlined approach should not be compared to some platonic ideal of hermetically sealed tested parties that unambiguously map to similarly idealized comparables. Instead, a simplified and streamlined alternative should be compared to the status quo of bespoke and time-consuming functional analyses that ultimately apply a small number of comparables to produce results that, as the experience of taxpayers and tax authorities has shown, tend to be fairly similar across the myriad of bespoke analyses through the decades.

Our detailed comments, which should be read in light of this important context, focus on the following main points –

- The scoping criteria in the Consultation Document define a complex set of restrictions that could result in a close to null set of qualifying distributors. Use of a more limited set of qualitative criteria, in combination with quantitative criteria and the risk treatment proposed in the Consultation Document, would allow the application of Amount B consistent with the underlying policy objectives.
- The exclusions for local comparables and alternative methods are inappropriate as they would provide a potential opt-out that effectively would make Amount B a floor rather than the intended simplified and streamlined solution.
- Consideration should be given to the application of Amount B at a segmented level to allow the application of Amount B to the baseline distribution activities of entities with multiple functions.
- Application of Amount B must not operate to create double taxation.
- Clear guidance on the implementation of Amount B will be needed.
- It should be made clear that the arm's length principle would remain fully applicable for any activities or business outside the scope of Amount B.

We also note the importance of continuing the public consultation process as the technical work on Amount B advances in order to obtain feedback from businesses on the operational and compliance implications of the rules being developed.

Detailed comments

Scope

We believe that the scoping criteria for Amount B must be simplified. Frankly, the scoping criteria laid out in paragraph 18 of the Consultation Document are unworkable. Moreover, many of the paragraph's requirements also are not necessary to achieve the important policy objectives of Amount B.

We are concerned that the scoping criteria contained in paragraph 18 define a framework of restrictions, requirements, and analytical examination that, taken together, could produce something close to a null set of qualifying distributors. At the very least, the aggregate criteria in paragraph 18

introduce new sources of potential dispute or exacerbate existing sources of dispute, which would fundamentally undermine the objective of enhanced tax certainty.

The criteria for inclusion in Amount B should be reconsidered in order to ensure a much wider application. While this could be viewed as involving a lower level of precision, it would meet the objectives of providing a significantly higher level of certainty to taxpayers and significantly freeing up resources of tax authorities that could be more productively deployed elsewhere.

We also are concerned that the exclusion for local comparables and the exclusion for alternative methods present a potentially opportunistic opt-out for jurisdictions that effectively would make Amount B a floor rather than a streamlined solution. Such exclusions also would exacerbate current areas of dispute or shift current disputes to different areas. We do agree with the exclusion for commodities, given the reliability of the public data that generally are used under the CUP method for such transactions.

In our view, retention of the entirety of paragraph 18 and the local comparables/most appropriate method exclusions would result in an Amount B that would be worse than the status quo. Rather than pursuing such an Amount B approach, we would encourage the Inclusive Framework to turn its focus to other important work. However, as discussed below, we continue to believe that an Amount B approach that achieves the intended policy objectives can be developed and that continuing work on this would be worthwhile.

It seems to us that the restrictive scoping requirements and exclusions in the Consultation Document may reflect a concern among some that the simplified and streamlined approach under Amount B would not be sufficiently anchored in the arm's length principle or would take away the ability of jurisdictions to apply a bespoke, facts and circumstance approach to every distribution arrangement. With respect to the latter point, the OECD Transfer Pricing Guidelines have never been about exhaustively pursuing theoretical purity, but rather are aimed at accommodating effectively principled outcomes. Accordingly, a truly workable Amount B should require less – potentially significantly less – scrutiny by jurisdictions. Tax administrations and taxpayers both must be prepared to 'let it go' to some extent and be willing to forego granular examination. We think that these benefits could be achieved with Amount B in a manner that allays any concern that the results would not align with the arm's length principle. Specifically, we believe that a robust scoping should be based on quantitative factors that could be derived from the comparables data and the empirical work that has been done, as well as the proposed treatment of risk reflected in the Consultation Document. We believe these tools serve to enhance the judgment necessary to apply Amount B with confidence.

For example, paragraph 18 provides an exhausting, if not exhaustive, list of scoping criteria. Many of the exclusion criteria, including in particular paragraphs 18(e), 18(f), 18(g), 18(f), 18(j) and 18(k), are criteria that apply to, or activities that are performed by, the very comparables used in benchmarking distribution functions under the status quo. The exclusions are accordingly too wide, because what are typically considered routine distribution activities would be excluded.

Paragraphs 25 through 28 of the Consultation Document properly discuss the importance of a clear ex ante division of responsibilities and risks. This clear allocation of risks should allow for a significant narrowing of the paragraph 18 list, as it is clear that the covered distributors would not be assuming any risks beyond those associated with distribution functions and so would have no claim to significant

residual profits. Accordingly, this reduces the need to go through the tortuous functional analyses associated with, for example, who exactly controls what particular risks.

As discussed further below in the pricing section, quantitative screens can be applied to determine the corridor of functionality and adjustments (such as asset intensity or invested capital adjustments) can be made to account for many of the factors in paragraph 18. This also demonstrates that some of the paragraph 18 factors do not in fact drive differences in distributor profitability and so can be eliminated as criteria. In short, the data and continuing empirical work can bear much more of the analytical burden that paragraph 18 strains under.

Proper use of quantitative factors would lead to proper delineation and therefore there is no need for a reference to an open-ended accurate delineation. For all of the reasons discussed above, we believe that the administrative benefits of Amount B do not require such stringent qualitative scoping limitations and that the reach of Amount B can and should be significantly broadened.

The Consultation Document provides for scoping tests for Amount B that are proposed to be applied at an entity level, without the possibility of applying them at a segmented level. In line with the overall policy intention of balancing reliability and administrability, we urge the Inclusive Framework to consider the application of Amount B at a segmented level. This would allow for an entity with multiple functions (e.g., distribution and contract R&D) to create segmented/divisional P&Ls (as they would today under the arm's length principle) and test these two sets of transactions separately, with the possibility that Amount B would apply to the transactions in the distribution segment/division.

The Consultation Document provides that a distributor should not perform any economic activity for which it should be remunerated at arm's length other than 'core distribution' activities. To this end, significant functional restrictions are provided that seem not to be based on reliability considerations (e.g., any loan asset regardless of materiality). These criteria significantly restrict the pool of taxpayers to which the Amount B framework could be applied.

We encourage the Inclusive Framework to give further consideration to including sales agency and commissionaire arrangements within the ambit of Amount B. We believe any concerns about the possibility that their limited functionality could not be properly accommodated under a single scoping framework could be mitigated through adjustments that are part of traditional transfer pricing tools (e.g., asset intensity adjustments). The Inclusive Framework could also consider a phased approach of initially limiting the application of Amount B to taxpayers with a certain functional profile (e.g., limited risk distributors) with a strong commitment to progressively expanding the scope to taxpayers with other functional profiles (e.g., commissionaires and sales agents).

Pricing

We think that the technical analysis described in the Consultation Document is solid in approach and would ultimately support a greater reliance on quantitative factors for both scoping and pricing. Our experience also supports the empirical relevance of geography, industry, and asset intensity in driving distributor profitability.¹ When relying on quantitative factors for scoping, we believe that asset

¹ With respect to operating expense intensity, we take the point that this might provide some insight into functional intensity, but we are concerned that the line between operating expenses and COGS is not clear given some ambiguities as to which cost category expenses fall into. This is why, for example, Berry Ratios can in practice be difficult to apply.

intensity adjustments (and other similar measures such as invested capital and working capital intensity) can be particularly helpful in determining the quantum of Amount B. Asset intensity adjustments are rooted in solid economic theory and have been used in transfer pricing for decades to account for different relative levels of assets used to support pricing of distribution activities. All else equal, the greater the amount of assets, the greater the carrying costs of supporting those assets (e.g., borrowing costs to fund assets or capital required to be tied up in those assets). Asset intensity adjustments are used to account for differences in profitability depending on whether the tested party's asset intensity is higher or lower than the comparables. With scoping based mainly on quantitative factors, together with the proposed treatment of risk reflected in the Consultation Document, many of the functional and operational distinctions currently reflected in the document's scoping section would inherently have measurably different levels of asset intensity. Asset intensity and similar adjustments could account for those differences.

There are areas that we think warrant further exploration by the Inclusive Framework jurisdictions, as we believe that they would be empirically supportable. For example, both the pricing matrix (which serves to narrow potential comparables) and the mechanical pricing tool (which employs an econometrically derived input/output framework) are supportable. Consideration should be given to using both together: for example, using a pricing matrix to narrow the comparables, and using the mechanical pricing tool to make standard adjustments. Similarly, we think that there tends to be more robustness in larger size comparables sets, as they are less sensitive to disputes over inclusion or exclusion of specific comparables.

Because the strict criteria for application of Amount B are already meant to ensure increased reliability, we believe that any point in the range would satisfy the arm's length principle (in line with paragraph 3.62 of the OECD Transfer Pricing Guidelines). Accordingly, provided that the criteria for applying Amount B are met, the taxpayer should not be subject to challenges or questions as to the point in the range.

Finally, we encourage the Inclusive Framework to provide clear guidance on the process for updating the benchmarking studies to be used in pricing under Amount B.

Tax certainty

We urge the Inclusive Framework to ensure that taxpayers can apply Amount B without concern about double taxation deriving from its application across the value chain. For example, the transactional counterparty of a routine distributor in country X may be an entity in country Y that performs a routine activity as well, transacting with another related party, based in country Z, that is the residual profit taker in the value chain. The determination of the remuneration of the routine distributor through Amount B would ultimately impact the remuneration of the residual profit taker. It is not sufficient that the authorities in countries X and Y agree on the application of Amount B; country Z must also be aligned. It should be made clear that the application of Amount B should not lead to double taxation.

It also should be made clear that Amount B would only be applied in a prospective, not retroactive, manner. Furthermore, taxpayers should be able to establish the application of Amount B at the

beginning of their fiscal year, in order to ensure appropriate monitoring of the conditions to be met for such year.

Implementation

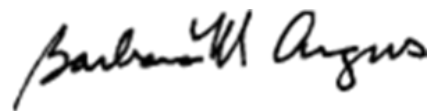
As regards the implementation of Amount B, we believe that the Inclusive Framework should carefully evaluate the manner in which jurisdictions would apply the principles to be set out by the OECD Transfer Pricing Guidelines, including addressing situations in which domestic transfer pricing legislation overrides this guidance so as to prevent needless future controversy.

Finally, we think it is important to be clear that the arm's length principle, as documented in the OECD Transfer Pricing Guidelines, would remain fully applicable for any activities or business outside the scope of Amount B. Moreover, the exclusion of a distributor from the scope of Amount B should not be viewed as necessarily implying the existence of an intangible or premium in excess of Amount B. Rather, the effect of the exclusion from scope should merely be that the arm's length remuneration of controlled transactions is to be determined in accordance with the OECD Transfer Pricing Guidelines. The return that would result under Amount B if it were applicable should have no relevance in situations that fall outside the scope of Amount B.

The global EY team that prepared this submission welcomes the opportunity to discuss these comments in greater detail and to continue to participate in the dialogue as the Inclusive Framework advances the work on this important project.

If there are questions regarding this submission or for further information, please contact Mike McDonald (michael.mcdonald4@ey.com), Ronald van den Brekel (ronald.van.den.brekel@nl.ey.com), Tracee Fultz (tracee.fultz@ey.com), or me (barbara.angus@ey.com).

Yours sincerely, on behalf of EY,



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