

September 1, 2023

Centre for Tax Policy and Administration
Organisation for Economic Co-operation and Development
By email to transferpricing@oecd.org

Re: Business Roundtable comments on OECD public consultation on “Pillar One - Amount B”

Dear Sir/Madam,

Business Roundtable welcomes the OECD’s commitment to working multilaterally and with the private sector to ensure sound tax policies and straightforward tax administration, which are essential to protecting investment and economic growth.

On behalf of more than 230 chief executive officers of America's leading companies, Business Roundtable is pleased to submit comments in response to the OECD’s public consultation document of July 17, 2023 on the proposed Amount B rules. We comment in our capacity as a business association.

1. Executive Summary

Business Roundtable welcomes the efforts of the Inclusive Framework (IF) to provide a simplified and streamlined approach to pricing in-country baseline marketing and distribution activities. We believe that Alternative A (that is, an approach that does not require a separate qualitative scoping criterion to identify and exclude non-baseline contributions) provides the best means for advancing the tax certainty objectives of Amount B. Requiring a separate qualitative scoping criterion under Alternative B would introduce subjective judgments and, thereby, create uncertainty for taxpayers, contribute to transfer pricing controversies, limit the scope of the simplified and streamlined approach and frustrate efforts to achieve the policy objectives of Amount B.

Business Roundtable supports the application of the Amount B rules, as a safe harbor, both to the wholesale distribution of digital goods (provided that ‘wholesale’ is not too narrowly interpreted) and to the marketing and distribution of services. Failure to provide a simplified and streamlined approach for the distribution of services would exclude a considerable segment of the global economy from the benefits of Amount B.

Comments on additional issues are provided below.

Section 1 – Definitions and Introduction

Definitions

- **GAAP basis** – A number of the definitions use the phrase “calculated in accordance with applicable accounting standards.” It is unclear whether this would involve a variety of GAAP bases across an MNE’s global operation. If so, it would add a great deal of complexity when calculating the various P&L and balance sheet ratios outlined in the document.
- **Financial definitions** – The Consultation Document provides only high-level descriptions for various financial definitions. For example, it gives only a broad definition of net operating assets. Also, the definition of operating profit excludes interest and tax but does not appear to allow for the exclusion of other non-operating items. Further, the document assumes that Gross Profit is a defined term in all GAAPs. It will be important for financial terms to be more clearly defined.
- **Industry groupings** – The rationale and economic analysis supporting the specific industry sector groupings should be transparent. The document does not use recognized industry classifications so further transparency will be important. In addition, it is unclear which products would fall within certain broad categories such as “healthcare” and “household consumables,” and what approach should be taken if a distributor sells products in multiple categories falling in different industry groups.
- **Digital goods** – It would be useful to include a definition of “distribution of digital goods.”
- **Berry ratio cap** – While we welcome the inclusion of the Berry ratio cap and collar to work as guardrails for economically principled results, defining the “Berry ratio cap” in relation to a Berry ratio result of 1.50 is much too high. We are not aware of empirical data that supports this ratio. The Berry ratio cap should be in line with a point within the interquartile range of results for wholesale distribution activities across industries. If the cap is to be retained, it should not be construed as reflecting arm’s length behavior for any other purpose.
- **Baseline marketing and distribution** – As a general point, further discussion or detail is needed regarding what level of marketing activity is consistent with baseline marketing and distribution.

General comments

- In the introduction, the document states several times that Amount B is a “simplified and streamlined approach.” While we are fully supportive of that aim, there are clearly a number of areas where the proposed rules seem at odds with the goal, including (i) the proliferation of different industry/country ranges, (ii) requirements to prepare more financial analyses and their impact on returns and (iii) potentially more functional analysis than was the case previously (if Alternative B were adopted). This would create a complex process with greater potential for controversy, especially when the lack of clear definitions and transparency throughout the document is taken into account (see additional comments below).
- As discussed below, we believe that more transparency is needed regarding the derivation of the pricing matrix, the determination of industry groupings and dispute prevention and resolution regarding the application of the matrix to a taxpayer.
- Amount B should not be mandatory but instead designed as a taxpayer safe harbor. This is particularly important as the current draft of the Amount B guidelines adds significant complexity.
- The consultation document potentially adds additional points of controversy and allows tax authorities to exercise a significant degree of discretion with no corresponding dispute prevention and resolution mechanisms available to provide certainty.
- Certain after-sales services, which are included in the definition of Core Distribution Functions, need to be defined.
- The scope of Amount B is too narrow, being limited to baseline wholesale distribution of goods. Services (including digital services) are excluded without empirical justification. In addition, MNEs covered by the Amount A rules should be able to use the Amount B rules. The various exclusions will likely reduce the utility of Amount B for many businesses. Additional work is required to ensure Amount B meets its intended purpose.
- Distinguishing between digital goods and digital services will result in additional controversies. Taxpayers in this industry should be given the choice of segmenting digital goods or opt out of Amount B provided it is considered a safe harbor.
- As non-distribution economic activity is out of scope (for example, manufacturing, R&D, procurement and financing), more clarity is required to minimize disputes regarding the segmentation of the P&L and balance sheet.

Section 2 – Transactions in Scope

General comments

We support the inclusion of wholesale distribution of digital goods, provided that ‘wholesale’ is not narrowly interpreted. For example, distribution of digital goods to a business user should be within the scope of Amount B. We also believe that baseline marketing and distribution of services should be within the scope of the Amount B rules. See further perspective in our comments on section 2.3.4, below.

[2.1] Qualifying transactions

The Amount B “qualifying transactions” definition only covers distribution to unrelated parties, without an explanation of why the exclusion of related parties is justified. If the entity qualifies as a baseline marketing and distribution entity, then it should be permitted to sell to both related and unrelated parties. If the current restriction remains, it would require a segmentation of the P&L account and balance sheet to ensure the entity is within the scope of Amount B.

[2.2] Scoping criteria

- **Alternative A versus Alternative B** – Our members unanimously favor Alternative A.
- Alternative A “recognises that operating margins for baseline distributors can vary based on certain factors, and appropriately adjusts returns for differences in operating assets, operating expenses, [and] industry,” and is a better representation of a simplified and streamlined pricing approach, especially since the qualitative review of Alternative B would be highly subjective.
- Taxpayers are already required to assess the boundary between the profit split and the TNMM methods. In order to apply the TNMM method under the existing rules, the taxpayer must not be making unique and valuable contributions. Contributions are deemed to be unique and valuable if, in essence, they represent a source of competitive advantage. If they do not, then they will only attract a routine return and should be benchmarkable. This is recognized by Alternative A, which works with the existing approach. Alternative B, however, would introduce a new threshold, the baseline, which would be “lower” than the current TNMM threshold. This would mean that there would be a new category of activities which are benchmarkable but above the baseline. This is not consistent with the goal of simplifying and streamlining the pricing of marketing and distribution activities.
- It is not clear why the pricing matrix, by including gradated returns based on Operating Expenses and Net Operating Assets, does not already adjust for baseline activities,

assuming they are not “unique and valuable.” If, by contrast, they are unique and valuable, then why is the TNMM an acceptable method? Further, what is the practical difference between the comparables that would be used for the Amount B sets and comparables that would be in a set which might accommodate ‘non-baseline’ functions?

- Alternative B conflicts with the goal of simplification and streamlining and would introduce a very substantial additional compliance burden in delineating baseline and non-baseline activities. The inference from the document is that to accept the existing TNMM threshold would risk opportunities for base erosion and profit shifting. An alternative view would be that the BEPS project went to great lengths to define the TNMM/profit split boundary, and that there is nothing in the Alternative A approach which undermines that, or the ability of tax authorities to examine a taxpayer’s efforts to comply.
- There is a serious risk that Amount B pricing would become a floor if Alternative B were adopted. It is essential that the Amount B rules state clearly that where Amount B does not apply, there should be no inference that a lower price would not be possible. It should also be observed that if non-baseline activities are not deemed to qualify for Amount B treatment, there should be no presumption that they would represent an “additional slice” of profit. If activities do not qualify because they are bespoke or otherwise special in nature, it is equally possible that they could represent a detriment to the tested party relative to comparables.
- We note that both 30% and 50% are bracketed as boundaries for scoping. Given the fluctuations that businesses experience, the 50% boundary is the appropriate one to use. We are also concerned about entities that are new entrants into a market. They could have very routine functions (identical to other distributor entities) but have a higher cost to sales ratio for the start-up period. Perhaps there could be a limited time exemption from this rule for new entities?
- The consultation document suggests that, if Alternative B were chosen, technical or specialized support functions could de-scope an entity from Amount B. First, some level of support functions are already seen in comparables, so this exclusion is highly inappropriate, given the goal of achieving arm’s length results. Also, to the extent that these services were in excess of what is normally seen in third parties, the issue could be solved with segmentation, so this is not a reasonable distinction, and is another reason to choose Alternative A over Alternative B.

[2.3.1] Scoping criterion 8.a

- **One sided approach** – In order to qualify for Amount B, the operations of the distributor need to be reviewed and documented in order to determine that a one-sided transfer pricing approach can be applied. This would typically involve a detailed analysis of

functions, assets and risks similar to the one suggested in the later quantitative screen. Based on our comments above, it is important that whatever work is done at this first stage of scoping should be sufficient to also demonstrate that the company qualifies as a baseline distributor. There should be no need for any additional steps or separate analysis.

[2.3.2] Scoping criterion 8.b – Quantitative filter

- **OES screen** – There is an OES screen proposed for screening the tested party to *“remove from scope only those distributors with levels of operating expenses that may indicate anomalous or outlier results”* (paragraph 18). However, if the taxpayer has prepared a functional analysis and correctly delineated the transaction, there should be no such “anomalous or outlier results” and thus this adds yet another unnecessary step in the Amount B process.
- **OES calculation** – The OES calculation is not straightforward to perform. It needs to be calculated on a 3-year weighted average basis and presumably on “relevant GAAP” which could be different in every market. This would add a huge amount of complexity for MNEs. A simplified approach should not require the computation of multiple new ratios.
- **Pass through costs (important for both OES and Berry Ratio)** – We appreciate the consultation document’s recognition of the need to address pass-through costs. However, the discussion in footnote 18 is vague and does not provide sufficiently concrete guidance in terms of defining pass-through costs (e.g., whether marketing execution spend by the distributor at the direction of the foreign principal company would be excluded for the calculation of the ratios). From a functional perspective, it is clear that baseline distributors who incur costs (e.g., advertising costs) at the direction of a related party that reimburses those costs should exclude those pass-through costs from operating expenses for Amount B purposes. This is important both when calculating OES and when applying the corroborative mechanism. Without clear guidance on this point, the application of Amount B will be subject to controversy.
- In any case, when utilizing the quantitative criterion (operating expense to sales ratio), taxpayers should be able to exclude expenses and costs that do not represent distribution functions, such as passthrough costs. If footnote 18 is reaffirming this principle that passthrough costs should be excluded, we agree.
- **Threshold** – It is not clear how the percentage threshold is determined. This needs to be transparent. In addition, regarding sales agency arrangements, it is not clear what the rationale is for setting a minimum threshold of 3% for local operating expenses.

[2.3.3] Scoping criterion 9.a – Non-baseline contributions

- We would appreciate having more examples of the kind of marketing activities which fall within the Amount B baseline. This is a major area of controversy in existing audits and APAs regarding marketing and distribution activities and will continue to be so unless the Amount B rules provide clear guidance.

[2.3.4] Scoping criterion 8.a – Services exclusion and commodities exclusion

- We strongly believe that there are no objective, data-driven reasons to exclude services from Amount B. The consultation document suggests that there could be significant differences in the functions, assets and risks of distributors of services. This is not consistent with the experience of our members. These concerns have not been explained or demonstrated in the data, so we request that further detail be provided on the specific concerns. Similar functions are required in the distribution of services, and the business community has provided data that relevant comparables are within similar ranges. If concerns are about the absence of inventory risk, reasonable adjustments could be made. It is also worth noting that the risk profile may be more similar to commissionaires, which remain in scope. If the concern is, instead, that services may be customized, many businesses provide services with little or no customization, and for the subset of companies that have incremental customization of services, it will likely be possible to segment those results out from the baseline distribution functions.
- It is particularly concerning that the exclusion of services would mean that a large portion of companies subject to Amount A would not be in scope for Amount B. These features of Pillar One were always intended as part of a larger package of policies to stabilize the international tax system. One should not be operative without the other.
- Further, existing certainty processes would not be sufficient for Services distributors, as currently designed, because they rely on bilateral treaties to resolve disputes, and there are many cases where these are not in force. Therefore, the scope of Amount B should be extended to services to bring the promised level of certainty for those companies subject to Amount A.

[2.3.5] Scoping criterion 9.b – Non-distribution activities separate from the qualifying transactions

- Overall, we think it is positive that segmentation is now permitted where the separate activities can be separately evaluated and priced. However, there could be considerable hurdles to segmenting, particularly of the balance sheet, which might force companies to undertake expensive restructurings just to get certainty.

- **Segmented P&L indirect allocations** – Paragraph 42 discusses excluding from the Amount B rules any transactions where the indirect Operating Expenses allocation is more than 30% of total costs. It is unclear what the rationale is for this exclusion, as a reasonable allocation methodology is suitable for wider transfer pricing purposes (e.g., for Local File documentation). We would strongly suggest removing this 30% restriction.
- **Segmented Balance Sheet** – Many MNCs will face a particular challenge with respect to segmenting the balance sheet to get to the asset/sales ratio. While a segmented P&L is more commonplace, there is rarely a requirement to segment the balance sheet and there are no established processes for this. As a transitional measure we suggest that the requirement to go back three years is made optional for the first 3 years and the taxpayer can elect to use only prior year information.

Section 3 – Application of the most appropriate method principle to in-scope transactions

General comments

- **Accurate Delineation** – See our comments on paragraph 8a, above. In our view it is reasonable to perform this review as it is already a necessary part of transfer pricing compliance. However, this same exercise should provide the data to fully satisfy any questions about whether an entity is in scope; there should be no requirement for a separate functional scoping exercise.

Section 4 – Determining the arm's length return under the simplified and streamlined approach

[4.1] Pricing matrix

- **Qualitative screen** – In our members' experience the various qualitative screens that can be performed do little to change the outcome of the range. In the spirit of simplification and transparency these subjective screens should be eliminated, which would also make it easier for the datasets to be replicated and updated on a regular basis.
- **Results** – Full transparency is necessary regarding the process that produced the results to drive acceptance of the baseline distribution results.
- **Key drivers of the matrix** – It is unclear how the thresholds within the matrix have been determined. For example, were there a number of similar observations within each segment of the pricing matrix, or were there distinct jumps in the global dataset at certain points? It is also unclear how the industry groupings have been determined (see our comments on Annex B, below).

- **3-year weighted average ratios** – Paragraph 56b discusses the use of 3-year weighted average for the OES and OAS ratios. This may be a reasonable approach in theory but as noted earlier it would be burdensome to calculate the ratios (particularly in relation to the balance sheet) on a consistent and segmented basis for all of the entities over 3 years. We suggest that there is an option to use one year of past data in the first year of application, adding another for the second and building up to a 3-year history.
- **Adjusting to the mid-point** – At the end of paragraph 58, the consultation document discusses adjusting to the mid-point if one falls outside the range in the pricing grid, rather than adjusting to the nearest point within the range. It is not clear why the mid-point is more appropriate than the point in the range closest to the result.
- **Timing for price setting** – Paragraph 57 discusses testing the price-setting as part of completing the tax return process at year-end. Given the complexity of the suggested process (e.g., in terms of segmented financial data, potentially on a local GAAP basis), it may be practically difficult to prospectively set distributor prices to achieve the targeted return.
- **Year End Adjustments** – This complexity will naturally lead to more significant post year-end adjustments as the appropriate ROS is calculated based on the local GAAP balance sheet and profit and loss account. This could have impacts on customs duties and VAT. Moreover, some countries refuse to accept year end transfer pricing adjustments which result in a reduction or profit, even in a limited risk distributor. All IF members should be required to accept downward profit adjustments for all Amount B qualifying transactions.

[4.2] Mechanism to address geographic differences

- There should be no exceptions to the use of the global set as a proliferation of sets adds to the complexity of Amount B.
- However, if it is necessary to have exceptions in order to achieve consensus on the Amount B rules, there must be unanimous acceptance from the IF members and clear criteria to determine when a country qualifies for a modified pricing matrix. To qualify, the observable results of individual countries should be large enough data sets to be statistically significant in their own right, and significantly different from the global set over time. The differences should not be capable of explanation by reference to geographic differences in operating expenditure and asset intensity, which is already accommodated in the grid.
- If there are exceptions, they should exist both where the returns are materially lower for a country versus the global set and where the returns are materially higher for a country.

[4.2.1] Modified pricing matrix for qualifying jurisdictions

- **Double counting** – To the extent that countries have their own pricing matrix, then these comparables must be excluded from the global set; otherwise, their results would impact the return for other markets.

[Figure 4.2] Modified pricing matrix (return on sales %) for tested parties located in qualifying jurisdictions

- **Small sample sizes** – In creating a tailored pricing matrix for a specific territory, there would be a risk of not enough observations to accurately populate all segments of the pricing grid, or obvious outlier results due to small sample sizes in particular segments of the grid. Guidance would be needed regarding how to ensure that local datasets are large enough to be reliable; otherwise, the global set should be the default.

[4.2.2] Data availability mechanism for qualifying jurisdictions

- **Concept of using country credit ratings** – This is theoretically flawed, in our view. In order to be within the scope of Amount B, the distributor cannot bear any material risks in the supply chain – it gets a fixed return, and this by definition passes a large amount of the risk to the counterparty. If this is the case, why would distribution in riskier territories warrant a higher return? In addition, there does not appear to be a meaningful correlation of country credit ratings and median distributor profit by country in the analyses that our members have performed.
- **Application of using country credit ratings** – It is unclear how the formula for the risk adjustments (bottom of page 28 in the consultation document) was derived. The formula could result in an adjustment up to 7.3% (85% OAS * 8.6%), which is significant and unjustified if the market risk is passed back to the foreign counterparty.

[4.2.3] Application of the simplified and streamlined approach using a qualifying local dataset

- **Local databases** – Where countries are not covered in the global dataset, the draft permits the use of local databases. It is critical that “secret comparables” not be permitted, and that any process to identify comparables from local databases be transparent and fully replicable. However, if there is a recognized local database which is also available to companies, it seems reasonable to apply the exact same search criteria with full transparency to get a local sample.
- **Additive Approach** – Any local sample produced under the above principles should be added to the global dataset instead of creating a standalone set for a specific market.

[4.3.] Corroborative mechanism to address low and high functionality

- **Berry cap & collar** – The use of the Berry ratio is a welcome feature of the Amount B framework. However, the Berry ratio cap is set at a level too high to protect high volume entities from being remunerated above an arm's length return relative to the level of operating expense.
- **Pass through costs** – The definition and treatment of these costs is an important issue when calculating the Berry ratio to apply the cap and collar, and guidance clarifying that pass-through costs should be excluded would be welcomed.

[4.4] Periodic updates

- **Periodic updates of the pricing matrix** – The consultation document suggests the pricing grid would be updated every five years unless there were a significant change in market conditions. This approach is not aligned to current transfer pricing best practice. There should at least be a 'roll-forward' of the results, similar to the process that would be undertaken in regular benchmarking studies. In addition, removing the subjective website reviews from the process would make it less onerous for the OECD to produce a new set.

Section 5 – Documentation

General comments

- **Transfer pricing documentation** – Paragraph 83 discusses the information that may already be included in local file documentation. The level of detail at which this is currently provided in Local File documentation, particularly in relation to financial data and allocation schedules, may not be sufficient for Amount B purposes (e.g., it may not show what proportion of expenses are allocated with indirect allocation keys). Therefore, it appears that Amount B will result in a heavier documentation burden and not the promised simplification. The existing local file should be sufficient for all Amount B requirements.
- **Notification procedure** – There is a brief mention of a first-time notification procedure in paragraph 89 of the consultation document. Again, it is unclear how extensive the documentation requirements will be, but Amount B should aim to reduce any administrative burden or provide for a simplified approach in the following years.

Section 6 – Transitional issues

General comments

Although we welcome the recognition in the consultation document that companies are free to restructure, it's important that over complexity and the increased compliance burdens of Amount B do not **force** companies into costly restructuring. Moreover, the comment raising concerns about artificial restructurings is confusing and more clarity is required on the concern from IF members, since open-ended anti-abuse provisions will only create more disputes around scope.

Section 7 – Tax Certainty

General comments

- **APA coverage** – The consultation document mentions that agreed APAs should be upheld subject to the critical assumptions not being breached. This is definitely a positive step to provide certainty. Given the significant potential for controversy under the latest Amount B proposal it is important not only to recognize existing APAs but to allow for future APA applications covering baseline marketing and distribution activities.
- **Interactions with other taxes** – The consultation document is currently unclear on how Amount B will interact with other tax areas, particularly for Pillar 2 and customs purposes (e.g., whether the Amount B pricing process would be accepted as a valid way of pricing for customs duty purposes). Further guidance would be helpful.
- **Inclusion of Amount B in MLC** – It is acknowledged that while some countries may resolve economic double taxation through unilateral corresponding adjustments, most would only be able to do so under MAP procedures. We have concerns that MAP is not always available (either because of a lack of an in-force treaty or decisions of one of the MAP jurisdictions), so again we believe this is another reason that including Amount B in the MLC would be preferable or maintain access to APAs or otherwise develop a binding, coordinated agreement and procedure to relieve economic double taxation.

Annex

Annex A – Relevant benchmarking search criteria

- **Benchmarking search strategy** – Certain parts of the Annex A search strategy differ from the way in which many MNEs perform benchmarking. These differences may have very little impact on the results, but it is difficult to stress-test the process without full transparency on the benchmarking process described in the consultation document. The more notable differences include:
 - No IP screen;
 - Unclear whether the 50% ownership rule includes ownership by individuals; and
 - Some of the rejection words could be quite broad (e.g., ‘finance’).

Annex B – Industry groupings

- **Industry grouping** – The industry grouping definitions provided in Annex B are unclear, regarding:
 - **Industry groupings** – It is difficult to see how the boundaries of the industry groupings have been determined. Moreover, the description of “statistically significant relationships to level of returns” is vague. More information is needed about how these groupings were determined so the process is transparent, and we can comment on whether it is reasonable.
 - **Categories within Industry Groupings** – Some of the category descriptions are broad and open to interpretation, potentially leading to controversy. For example, household consumables, mixed goods, health & wellbeing and miscellaneous supplies all need to be clearly defined with examples of specific products covered. This is particularly important for Group 3 products, which have a significant uplift in the returns.
 - **Multiple Product Lines** – Some MNEs have distribution entities that sell multiple product lines, which could fall into different groups. To avoid more complex segmentation, we suggest that there be a safe harbor threshold—for example, a company mainly in Group 1 could have up to, say, 25% of its sales in Group 3 and still be treated as entirely in Group 1.

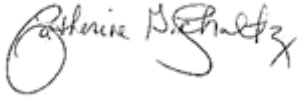
Annex C – Background to modified pricing matrix – no further comments

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Business Roundtable appreciates the opportunity to comment on the Amount B consultation document. We would be happy to discuss these comments or any other matters you may find helpful. Please contact Catherine Schultz, Vice President of Tax and Fiscal Policy at cschultz@brt.org.

Sincerely,

A handwritten signature in black ink, appearing to read "Catherine Schultz". The signature is fluid and cursive, with the first name "Catherine" written in a larger, more prominent script than the last name "Schultz".

Catherine Schultz
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Business Roundtable
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