To Tax Treaties, Transfer Pricing and Financial Transactions Division, OECD/CTPA

From KPMG International[1]

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Ref KPMG Comments on Public Consultation Document: Pillar One – Amount B

Thank you for the opportunity to respond to the Public Consultation Document titled *Pillar One – Amount B* (hereafter, the "July Consultation Document").

KPMG strongly supports the efforts of the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting ("IF") to simplify and streamline the process for pricing baseline marketing and distribution activities in accordance with the arm's length principle ("ALP"), which has the potential to be a win-win for taxpayers and tax administrations.

The July Consultation Document clarifies many of the uncertainties and ambiguities of the prior Public Consultation Document titled *Pillar One – Amount B* (hereafter, the "December Consultation Document"), and hence in this regard represents a step forward. However, the July Consultation Document also highlights numerous areas of continued disagreement, such as the two alternative approaches to scope, the treatment of digital goods, and the multiple approaches under consideration to address perceived differences in returns between geographies. We are concerned that it will prove difficult to address these differences, or that differences may be addressed through ambiguous drafting that will lead to disputes when taxpayers seek to apply Amount B.

We continue to believe that the Amount B scope should be as broad as practically possible to maximise the simplification benefits for both taxpayers and tax administrations. However, we also believe it is critical that the IF reaches an agreement on Amount B that is clear and unambiguous, limiting to the greatest extent possible the risk of disputes. Without certainty neither taxpayers nor tax administrations will see the intended benefits.

For this reason, we believe that certainty around the application of Amount B is critical, both with respect to scoping and with respect to the application of the pricing mechanism.

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The divergence in views recognised in both the July and December Public Consultation Documents suggests that different IF members have different views over what constitutes baseline marketing and distribution activities, and how the returns for such activities should be set. This is consistent with our experience today, with tax administrations frequently arguing that the marketing and distribution activities performed in their jurisdiction are unique and valuable or that the jurisdiction itself is unique, and hence warrant a higher return than would be allocated to other jurisdictions. We consider it highly likely that the introduction of Amount B will not (at least initially) resolve such differences of view and the resulting disputes. For this reason, we consider it essential that alongside a conceptual agreement on Amount B, the IF design and implement a tax certainty process through which members can collectively review and approve the application of the Amount B pricing methodology by specific taxpayers. This process could also be made available to taxpayers that do not meet the criteria to apply Amount B, but which have a standardised approach for pricing baseline marketing and distribution activities.

Past efforts to simplify transfer pricing, including the OECD’s work on bilateral safe harbours and the simplification for low value-adding intra-group services, have not led to a meaningful simplification of transfer pricing rules. This contrasts to the significant success achieved by taxpayers and tax authorities through bilateral advance pricing agreement (“APA”) and mutual agreement procedure (“MAP”) programmes. Such programmes have achieved success by establishing processes to ensure that the ALP is applied consistently by the relevant jurisdictions, rather than seeking to define a standardised approach through which it should be applied. It is for this reason that we continue to believe an internationally agreed tax certainty process is core to the effective implementation of Amount B.

There are three other issues that we want to highlight at the outset. First, the implementation status of Amount B, i.e., whether it would be a safe harbour or prescriptive approach, is left unaddressed in the July Consultation Document. We strongly support the application of Amount B as an elective safe harbour for taxpayers, which they would elect into on an entity-by-entity basis. To the extent Amount B is not implemented as an elective safe harbour then we suggest that the framework only apply to tax years beginning 12 months after the IF publishes final guidance on Amount B to provide taxpayers with sufficient time to prepare for its introduction. Second, at present there is limited clarity around the underlying data that supports the approach proposed by the IF, bringing into question whether Amount B is consistent with the ALP. We strongly encourage the IF to further investigate ways to make the data underlying this analysis more transparent. Third, we remain concerned about the complexity of the proposed approach, which will reduce the certainty benefits that Amount B provides to businesses, but also risks limiting the benefits of this proposed simplification for low-capacity jurisdictions that Amount B is intended to support. For this reason, we continue to see benefits in simplifying Amount B, such as by limiting the number of pricing approaches.

The remainder of this response addresses the various issues raised by the July Consultation Document: (1) Transactions in scope; (2) Application of the most appropriate method principle to in-scope transactions; (3) Determining the arm’s length return under the simplified and streamlined approach; (4) Implementation status; (5) Documentation; (6) Transitional issues; and (7) Tax certainty.

1. Transactions in scope

The scope criteria set out in this public consultation represent an improvement on the criteria outlined in the December Consultation Document and the removal of various criteria means it is much more likely that Amount B will apply to a meaningful number of entities. This is critical to ensuring that Amount B meaningfully simplifies the application of the ALP to baseline marketing and distribution activities.

Scope criteria

Alternative A vs. Alternative B

The consultation document outlines two alternative approaches to scope, Alternative A and Alternative B, with the primary difference the inclusion of criterion 9(a), which is intended to identify where a distributor makes "non-baseline contributions". The commentary to criterion 9(a) recognises that "*it is not feasible to specifically and comprehensively list a set of baseline or non-baseline contributions*" and hence adopts an examples-based approach.

This examples-based approach will be difficult for both taxpayers and tax administrations to apply. The language used in the examples is highly subjective. For example, in example 1B it states, "*where the distributor makes specific contributions that enable market access for the products to be sold by the MNE group to third party customers, and/or makes contributions that generate barriers to entry to the market, the contributions <u>may be non-baseline contributions</u>…*" (emphasis added). As such, the language in the example provides no certainty whether a contribution that enables market access is a baseline or non-baseline contribution. Even more problematic, because there is no comprehensive definition of "non-baseline" contribution there is a risk that if this approach is adopted the IF will be required to continually revisit and revise the examples, increasing uncertainty for taxpayers and tax administrations.

Moreover, we consider that Alternative A, as designed, will address many of the concerns raised by the advocates of Alternative B. These include:

— Tax administrations retain the ability to test whether the transaction has been accurately delineated and a one-sided transfer pricing method can be reliably applied.

— If a controlled transaction cannot be reliably priced using a one-sided method, it will be excluded from scope under 9(a).

— If a tested party engages in a controlled transaction that would qualify for Amount B but also has non-qualifying activities or transactions, Amount B would either apply to just the qualified transaction or the distributor would be out of scope under 9(c).

- If a controlled transaction could be priced using a one-sided method, but the tested party has functionality that extends beyond "baseline" then its operating expense to sales ratio would likely exceed 30% of sales, and hence it would be excluded from scope under 9(b).

- Controlled transactions that could be priced using a one-sided method and are not disqualified under the above criteria could still have different levels of functionality. Greater levels of functionality are likely to be reflected in higher operating assets to sales and operating expenses to sales ratios. This is accounted for in the pricing matrix that will be used to set the Amount B return.

For this reason, KPMG considers that Alternative A is preferable to Alternative B. If the IF decides to continue with Alternative B, it would be preferable to amend criterion 9(a) such that it provides a comprehensive list of activities that are considered to be "non-baseline contributions". Though we recognise that such a list would limit the scope of Amount B, we consider it preferable to have a narrower but clearly defined scope, rather than a potentially broader but less certain scope.

Priced using a one-sided method

The decision to rely on criterion 8(a) as a core part of the Amount B scope criteria represents an improvement on the prior criteria that were confusing and would have resulted in many, if not most, distributors being excluded from scope. We note that the analysis required to determine whether a one-sided method can be used to price a transaction is not always straightforward and that this is an area that can frequently result in disputes with and between tax administrations. The introduction of Amount B may place greater pressure on this determination, as if a taxpayer is able to demonstrate that a one-sided method can be applied, it may then be able to rely on the Amount B pricing methodology. For this reason, the IF work should consider providing additional guidance on the situations when a one-sided method can be applied, in addition to the guidance referenced in the July Public Consultation Document. For this reason, we also continue to believe that an enhanced tax certainty process will be critical if Amount B is going to effectively reduce disputes and increase tax certainty.

Exclusion of services, including digital services

The consultation document seems to conclude that the distribution of services is excluded from the scope of the Amount B, as "*activities required to distribute in-scope goods, compared to services could entail significant differences in the functions performed, assets used, and risks assumed by the parties*." This statement recognises that in some circumstances the activities required to distribute goods and services are similar; indeed, many groups that distribute both goods and services use the same sales team.

We continue to believe it is both feasible and preferable for the distribution of services to be included within scope of Amount B, and strongly encourage the IF to revisit its decision to exclude these activities from scope. However, if this is not possible, we suggest that where a distributor sells both tangible goods and services and can demonstrate that the functions performed, assets used and

risks assumed by the distributor in distributing goods and services are similar, this could provide evidence that the application of the Amount B pricing methodology should be extended to distribution of services in this scenario.

We note that entities that distribute regulated financial services (e.g., banking and insurance) typically have a different functional profile from entities that distribute other services. For this reason, if the decision was taken to include the distribution of services, it would still be appropriate to exclude the distribution of regulated financial services.

Treatment of distributors that hold regulatory licences

The commentary to paragraph 9(a) highlights a "regulatory licence that is required to access a market" as an intangible that may constitute a "unique and valuable contribution". As highlighted by many commentators in the prior consultation, regulatory licences that limit market access are common across a range of industries and jurisdictions and are frequently neither unique nor endowed with non-routine value. Moreover, as acknowledged in 1.170 of the OECD Transfer Pricing Guidelines, it is important to assess the contributions of relevant entities to obtaining a licence, when assessing the impact of such licences. The ambiguity around the current commentary risks creating unnecessary uncertainty about whether certain industries are included in scope of Amount B.

Treatment of distributors that purchase tangible goods from multiple related parties

The draft does not address the treatment of a distributor that purchases tangible goods from multiple related parties. Further guidance should clarify that such distributors can be in-scope of Amount B.

Any additional guidance on the treatment of distributors that purchase goods from multiple related parties should not require such distributors to segment their balance sheet due to the challenges that such segmentation creates. For example, if a distributor uses the same warehouse to distribute similar products purchased from two different related parties it is highly unlikely it will be able to attribute the carrying value of the warehouse tangible fixed assets between the sale of these two products using anything other than an allocation key (which could be viewed as inconsistent with the administrative guardrail included in paragraph 42 and 43). In addition, we note that where a distributor purchases from multiple related parties and earns an overall return that is consistent with Amount B it may still be subject to adjustment by a tax authority with respect to its intercompany purchases from a single counterparty. In this scenario, the tax authority should be required to make appropriate downward correlative adjustments to one or more other intercompany transactions to prevent the distributor's overall distribution result from exceeding that set by Amount B.

Treatment of distributors that sell to both related and unrelated parties

There are situations where a distributor sells to both related and unrelated parties, for example, where a distributor purchases tangible goods from a principal primarily for resale in its own market, but also sells and ships some goods to related party distributors in neighbouring jurisdictions. In this scenario, providing the taxpayer can reliably segment the sales to related and unrelated parties, it

should be able to apply Amount B to the purchase of tangible goods for sales to unrelated parties. Where the distributor's sales to related parties fall below a de minimis level, e.g., 20% of total sales, it may be appropriate to apply the Amount B pricing methodology to its sales to both related and unrelated parties, as a simplification measure following the approach proposed for de minimis retail sales. Having a degree of tolerance for related party sales will be important to many groups in providing flexibility to manage inventory efficiently and effectively across the group. For example, where demand in a market is unexpectedly high or supply is constrained, it may be expedient to request that the most geographically proximate distributor with available inventory sells some of those goods to the related party distributor with the inventory shortfall.

Treatment of services that are "ancillary" to the sale of goods

The definition of "core distribution function" recognises that baseline marketing and distribution activities include "certain after-sales services" but provides little clarity about what these services may be. It is common for distribution of some products, such as industrial machinery, to provide installation services alongside the goods that they supply. The IF should provide greater clarity around whether such services are in-scope of Amount B and could consider including a monetary threshold similar to the guidance for retail sales, i.e., a distributor would be in-scope of Amount B where its annual net sales of services do not exceed 20% of its total annual net sales.

Treatment of distributors excluded from scope of Amount B

Where a distributor is excluded from the scope of Amount B, there should be no presumption it should be allocated a higher return than prescribed in the Amount B pricing methodology or that the transactional profit split method ("TPSM") is the most appropriate method to price the controlled transactions to which it is party. Instead, taxpayers and tax administrations should continue to apply transfer pricing rules as they do today. The guidance on Amount B should include a specific statement to this effect and Amount B should not operate as a floor or minimum return for distribution activities more broadly.

Definitional issues

Definition of wholesale distribution

Wholesale distribution is defined as "distribution to any type of customer except end consumers" and is contrasted to retail distribution. There may be confusion about what constitutes the "end consumer", for example, whether a business purchasing computers from a third party for use in its own business or a hospital purchases pharmaceutical products that it provides to patients as part of its healthcare services, as opposed to resale, constitutes the "end consumer," and about how a distributor can ascertain its business customers' use for the products sold. This could be clarified by amending the definition to make clear that sales to industrial, commercial, or other professional business customers are not sales to the end consumer.

Net operating asset intensity ("OAS") and operating expense intensity ("OES")

We welcome the decision to use the three-year average OAS and OES to determine whether an entity is in-scope of Amount B and to determine where an entity falls in the pricing matrix, which will help to ensure it can be applied consistently year-over-year. We note that there will be a variety of circumstances where there is uncertainty in how OAS and OES should be determined, or specific conditions that mean OAS / OAS cannot be used to accurately assess whether a distributor should be in-scope of Amount B. An obvious, but extreme example, would be where a distributor of digital goods classifies its purchases of goods or services as operating expenses, rather than cost of goods, and hence has a very high OES. The IF should consider developing a mechanism to provide ad hoc guidance to address such scenarios as they arise, comparable to the clarificatory guidance that has been released on Country-by-Country Reporting ("CbCR").

In addition, we note that where a distributor is in a start-up phase it will not be able to compute its three-year average OAS or OES. Paragraph 19 and footnote 30 indicate that in such scenarios a distributor should be able to compute their OAS and OES for periods for which they have data, however, it may be the case that the OAS and OES data for such period is distortive, e.g., where an entity only makes sales for part of the year but has net operating assets in place for the full period. Furthermore, losses or lower returns may be common at arm's length during a start-up phase. For this reason, such entities should have flexibility in whether they apply Amount B, as the formulaic approach may not always deliver outcomes that are consistent with the ALP.

Treatment of pass-through expenses

The definition of "operating expenses" is "expenses that a business incurs through its normal business operations, exclusive of the cost of goods sold, calculated in accordance with applicable accounting standards." This definition seems likely to extend to pass-through expenses, such as advertising expenses incurred by a local distributor that are ultimately borne by another entity in the group, either because they are directly passed through to that entity or effectively passed because the distributor achieves a targeted operating margin that accounts for these pass-through expenses. Footnote 18 recognises that special attention must be given to the treatment of pass-through expenses, but without clarifying how pass-through expenses should be treated or whether this footnote is relevant for the definition of operating expenses.

We suggest including a clear statement in the definition of operating expenses recognising that these should exclude expenses with respect to which an independent party would agree not to earn a profit element if remunerated with a mark-up on cost. This could be accompanied by a non-exhaustive list of recognised pass-through expenses.

Definition of applicable accounting standard

A number of the definitions, such as net revenues or operating expenses, must be calculated in accordance with "applicable accounting standards." A challenge that groups face today is whether their transfer pricing policies can be determined and set based on the generally accepted accounting

principles ("GAAP") used by constituent entities for consolidated group financial reporting purposes, or whether there is a requirement to use local GAAP. The guidance should clarify that for the purpose of Amount B both group reporting GAAP and local GAAP could be an applicable accounting standard but once a choice is made for an entity this should be applied consistently unless justified by a change in circumstances (e.g., a change of control). Requiring the use of local GAAP would compound the operational transfer pricing challenges associated with Amount B, because multinational groups often are not able to compute their final local GAAP results (and thus the intensity factors utilised under Amount B) until well after the close of a year.

Treatment of extraordinary items

The definitions of return on sales ("ROS") and operating expenses do not exclude extraordinary items, such as abnormal gains or losses, which could distort the application of Amount B to a qualifying transaction (both in terms of whether an entity is within scope of Amount B and whether it meets the required Amount B pricing). Extraordinary items are typically removed when applying the TNMM and hence we suggest they should also be excluded for the purposes of applying Amount B.

2. Application of the most appropriate method principle to in-scope transactions

We welcome the decision to limit the situations where another transfer pricing method can override the application of Amount B to situations where a reliable internal comparable uncontrolled price ("CUP") can be identified. This represents a sensible step-forward from the December Consultation Document.

The July Public Consultation Document anticipates there will only be rare instances where the application of the CUP method (using internal comparables) can be used to price in-scope transactions, given commodities are excluded. It is important that appropriate guardrails are placed around the use of this exception. There are concerns Amount B may have a bearing on tax administrations judgements on whether particular comparables are reliable. Given the lower risk posed by baseline marketing and distribution functions it is important that taxpayers who would be within-scope of Amount B in the absence of internal comparables should not face onerous and disproportionate requests for information on third party agreements where the taxpayer has concluded no reliable internal CUPs exist and followed a reasonable process to arrive at this conclusion.

An internationally agreed tax certainty process will help to alleviate concerns related to disputes over whether reliable internal CUPs exist.

3. Determining the arm's length return under the simplified and streamlined approach

KPMG welcomes the publication of more detailed information on the simplified and streamlined approach that will be adopted to determine the relevant Amount B return. However, we strongly encourage the IF to provide greater transparency on the data that has been used to set the various

pricing approaches as we have identified various elements of the pricing approach that are either unclear, difficult to rationalise or that create additional and potentially unwarranted complexity.

Need for greater transparency

KPMG considers that there should be greater transparency of the data that underlies the pricing matrix set using the global database and any alternative pricing approaches under consideration. We recognise that there are limitations in the data that the IF can publish due to database restrictions; however, we consider that greater transparency is required to ensure the international legitimacy of Amount B and to avoid the criticism that it is being set based on "secret comparables". We would welcome the opportunity to discuss this issue further with the IF or Secretariat to help develop a framework that would support this objective. For instance, while we recognise that it might not be possible to publish the full dataset underlying the pricing matrix, we would urge the IF and Secretariat to publish the names of the accepted comparable companies, their database identifiers, or simply further details on the qualitative screening process to allow stakeholders to subscribe to the Orbis database and obtain the underlying data.

In the absence of the supporting data, it is difficult to comment on whether the proposed pricing matrix derived from the global dataset is appropriate and consistent with the ALP. Similarly, it is difficult to provide meaningful comments on the proposed modified pricing matrix for qualifying jurisdictions or the proposal that a matrix could be based on a local dataset, without further information on the underlying data that supports these matrices (or the matrices themselves).

Greater transparency will also be important to legitimising the periodic updates to the pricing approach proposed in the July Consultation Document, as it will enable stakeholders to see the data that supports any amendment to the pricing methodology.

Industry groupings

The industry groupings outlined in Annex B contain results that are difficult to explain economically. For example, why are the returns for the distribution of "domestic vehicles" lower than the return for "motorcycles"? We recognise that these differences could be explained from the economic data that the IF has relied upon to set the pricing matrix, but it is not clear that the correct conclusions have been drawn from this data. Hence, we again encourage the IF to explore ways to make this data publicly available.

There will be instances when it is difficult to determine which industry grouping a product should be included in, or the industry groupings are unclear. For example, what is the distinction between "household consumables" and "home and office consumables", which are included in Group 1 and Group 2 respectively? We encourage the IF to provide clearer definitions of the various categories of goods and consider including examples to illustrate how the definitions would apply in edge cases.

In situations where the products sold by a distributor fall into multiple categories, for example, a distributor of domestic and used vehicles, to avoid segmentation it would be preferable that the

products are categorized based on the category in which the products predominantly fall and not automatically into Group 2. In addition, where a distributor sells multiple product lines that fall into a single group (e.g., grocery and household consumables), that group should be used rather than the "multiple products lines" category in Group 2.

Application of pricing matrix to multi-function entities and entities with multiple qualifying transactions

Where Amount B applies to a multi-function entity, e.g., an entity that acts as a distributor and manufacturer, or an entity with multiple qualifying transactions, the pricing matrix appears to require the entity to segment its balance sheet in order to determine the operating asset intensity of the relevant distribution activities. The process for segmenting balance sheet data is typically more complex than segmenting the income statement and is more likely to require the use of allocation keys. It is unclear from the current draft whether the "administrative simplification" (i.e., the cap on the allocation of expenses using an allocation key) would also apply when segmenting operating assets. We do not consider that such a cap should apply and that taxpayers should have discretion in how they segment their balance sheet, providing they adopt a reasonable approach.

Mechanism to address geographic differences

As outlined above, we consider it important that the IF publish the data it has collected that demonstrates there are material variations in distribution returns between jurisdictions such that it is appropriate to implement different pricing approaches in different jurisdictions. The proposal that the Amount B pricing mechanisms should have three different approaches to account for geographic variation adds complexity and should only be included if it can be clearly demonstrated that such an approach is required to maintain consistency with the ALP.

Higher risk does not always entail higher returns

The OECD Transfer Pricing Guidelines state that "*in the open market, the assumption of increased risk would also be compensated by an increase in the expected return, <u>although the actual return may or may not increase depending on the degree to which the risks are actually realised</u>*".[2] This reflects the fact that other things being equal, a third party would only agree to take on additional risk if this led to an increase in its expected returns. However, the playing out of this additional risk may mean that the actual return achieved by the third party is higher or lower than the expected return, and that the return is more volatile.

Further, it is important to consider whether a distributor assumes the risk of operating in a jurisdiction, or whether this risk is borne by another entity within the group. For example, where an analysis of the OECD Transfer Pricing Guidelines risk allocation framework in Chapter I indicates that customer credit risk is managed and controlled by a non-resident related party and the transfer pricing policy implemented by the group means that the distributor does not incur the downside

[2] ¶ 1.56 (emphasis added).

consequences of the playing out of the credit risk, it would be inconsistent with the ALP to allocate the distributor a return for this risk on the basis that the risk of customer default in a particular jurisdiction was higher. Such fact patterns are difficult to account for, if a standardised approach for adjusting for geographic differences in returns is adopted.

Modified pricing matrix for qualifying jurisdictions

Before establishing a modified pricing matrix, it will be important for the IF to thoroughly interrogate the underlying data to establish that the variation in returns between a specific country and the global dataset are attributable to geographic differences, not other differences, such as the differences in the functional profile of the distributors.

Annex C indicates that jurisdictions will be eligible for the modified pricing matrix when "more than half of the companies in a jurisdiction have a return which does not fall within the interquartile range of returns of all the companies in the corresponding asset, expense and industry group." It is important that as part of this assessment consideration is given to whether results are statistically significant, i.e., whether the number of companies in a jurisdiction are sufficient to conclude that the returns of those companies exceed the average. As part of this analysis, the IF should review whether the statistical approach it has adopted to distinguish between jurisdictions is appropriate, or whether other methods, such as a T-test, would be more appropriate.

Data availability mechanism for qualifying jurisdictions

We are concerned that a blanket application of the proposed adjustment mechanism is inconsistent with the ALP. We recognise that higher costs of capital increase the operating profit margin a third party would need to earn to match its cost of capital. However, the blanket application of this adjustment fails to account for whether the relevant distributor actually incurs these capital costs and assumes the associated risk, which in many cases such distributors will not do. This is our primary concern with this proposed approach. In addition, we note that no economic data has been published to demonstrate that such an adjustment is consistent with the ALP, so again, we strongly encourage the IF to publish the underlying data that shows this approach is supported by data.

If this approach is pursued by the IF, we are particularly concerned about the application of this approach to jurisdictions with low sovereign credit ratings, for example due to the risk of default, where the sovereign credit rating will not accurately reflect the credit rating of a baseline distributor operating in the jurisdiction. At a minimum, further consideration should be given to the application of this approach in such jurisdictions, for example, by capping the interest rate by reference to the private cost of capital.

Local dataset

There is a risk that the data included in local datasets is gathered using a method that is not consistent with that used to gather data for the global dataset, and hence that variations in returns

are driven by differences in the underlying approach, rather than genuine differences in the returns earned by distributors in different jurisdictions.

To avoid providing a potential advantage to some jurisdictions with local data (which is unlikely to be low-capacity jurisdictions) the IF should establish a clear and transparent process for approving local datasets. This should include a period of public consultation, where external stakeholders can provide feedback on the approach proposed by a jurisdiction, and transparency into the proposed dataset and how it was compiled. It is our experience that some tax administrations rely heavily on local companies that are purportedly comparable to the tested party, including secret comparables, to argue that distributors in their jurisdiction are entitled to higher returns than those in other jurisdictions (with limited evidence of this assertion). This is already an issue that gives rise to significant disputes that Amount B would fail to address if it included an exemption based on the existence of local comparables. As we noted in our prior consultation response in our experience there is little variation in returns to marketing and distribution across geographic regions or jurisdictions. Moreover, it seems unlikely that there would be sufficient data in local databases to fully replicate the pricing matrix set using global data, raising questions about reliability.

Berry ratio cap-and-collar

As drafted, Amount B will include in scope distributors that perform limited functions, where setting the Amount B return using a ROS would result in the distributor realising more than an arm's length return. In such scenarios, the Berry ratio is frequently selected as the most appropriate profit level indicator ("PLI") to test the remuneration of such entities. For this reason, we strongly support the inclusion of a corroborative Berry ratio cap and collar mechanism.

It is currently proposed that the Berry ratio cap is set at 1.50. We note that where taxpayers apply the Berry ratio to establish the arm's length return for a low function distributor the arm's length Berry ratio is frequently less than 1.50 and hence it may be appropriate to set the cap at a lower level. Again, we encourage the IF to provide more transparency on how the Berry ratio cap of 1.50 was determined.

The IF should provide greater clarity on how the Berry ratio cap will apply. For example, it is unclear whether the cap is determined from the Amount B return established using the relevant pricing matrix, or the top and bottom of the acceptable range of returns that will be deemed consistent with ALP. If the former approach is adopted, it is unclear whether the Berry ratio cap will establish a single return that an entity needs to achieve or whether there will be a range of results that are deemed to be acceptable.

Treatment of low-margin groups

As drafted, Amount B will apply to groups that consistently and structurally earn low profits margins, such as original equipment manufacturers ("OEMs") and groups in the automotive industry. We continue to believe that such groups should either be excluded from scope of Amount B, or the Amount B return should be capped based on a group overall profit margin (over a three- or five-year

period). For example, the Amount B return should not exceed an agreed percentage of a group's overall operating profit margin. We consider that this would help to ensure that Amount B does not result in outcomes that are inconsistent with the ALP by over-remunerating distributors and hence under-remunerating entities within the group that perform other activities. This issue could also be addressed if Amount B were an elective safe harbour.

Cliff-edges and return on asset

There are situations where the current Amount B pricing matrix creates a significant cliff-edge effect. For example, when applying the proposed pricing matrix based on the global dataset, a distributor in Industry Grouping 2 with an OAS of 45% will be expected to achieve a ROS of 5.25%, whereas a distributor with an OAS of 44% would only be expected to achieve an ROS of 3.50%. We recognize that these cliff-edges effects may be partly mitigated by allowing distributors to achieve an operating margin that is 0.5 percentage points above or below the fixed return, but that none the less such differences are significant.

Some of these cliff-edges are connected to the decision to use OAS as a core parameter within the pricing matrix. The outcomes delivered by the Amount B pricing matrix appear inconsistent with the fact that the design of the matrix seems to recognise that distributors with lower OAS should be allocated a lower return due to their lower opportunity cost. However, the proposed pricing matrix leads to situations where distributors with low levels of assets achieve much higher returns on operating assets ("ROA") than distributors will high levels of assets. For example, a company in C3 could earn a ROA of up to 28.3% (between 14.2% and 28.3%), while a company in A3 could earn a maximum ROA of 12.2%. This result is counterintuitive and again emphasizes why we consider it important that the OECD provides greater transparency about the data that has been used to set the pricing matrix.

Operationalising Amount B and transfer pricing adjustments

In some jurisdictions, tax administrations have historically focused on price setting as opposed to price testing. We note that paragraph 57 of the Public Consultation document suggests that taxpayers will apply and test the actual outcome of in-scope transactions on an "ex post" basis (i.e., the arm's length outcome testing). We suggest clarifying that taxpayers can also use the Amount B pricing methodology as part of their price setting process, and for this reason it would be important that the pricing methodology is available before the start of the relevant financial period and that the same pricing methodology is used to set and test prices.

In addition, where a distributor initially achieves a transfer pricing return that falls outside the Amount B range, it will be required to make either an upwards or downwards transfer pricing adjustment to achieve a result in the range. In many instances today, taxpayers are not permitted by law to make downwards[3] transfer pricing adjustments or do not make such adjustments due to the obstacles they face from tax administrations in making such adjustments. The guidance on Amount B should confirm that where such adjustments are required and are made to both sides of the transaction,

[3] Downward transfer pricing adjustments are adjustments which reduce taxable profits (or increase allowable losses).

they will be respected. To achieve Amount B's aim of simplifying the application of the arm's length principle, no secondary adjustments should be required in connection with adjustments made pursuant to Amount B.[4]

Periodic updates

The July Consultation Document indicates that the financial data and other datapoints referenced in section 4, including the net risk adjustment percentage and Berry ratio cap-and-collar range will be updated annually. We consider that such frequent updates will create additional complexity and uncertainty for taxpayers, and at the same time are unlikely to result in material changes to the Amount B pricing methodology. For this reason, we suggest that all analysis, data and datapoints are subject to a five-year update, unless market conditions warrant an interim update. This caveat about market conditions provides the IF with flexibility to deal with exceptional circumstances, such as the Covid-19 pandemic.

Interaction with indirect taxes and customs

The price of controlled transactions is relevant for both direct taxes, such as corporate income tax, and indirect taxes, notably customs. Today, some tax administrations require that different methods are used to price the transfer of goods and services for transfer pricing and indirect tax purposes, and where there is an adjustment in the pricing for direct tax there is no guarantee this will be respected for indirect taxes (or vice versa). This is potentially a broader area of work for the IF, but in the short-term the IF could enhance tax certainty by agreeing that the Amount B pricing methodology would be respected for both direct and indirect tax purposes, and that any transfer pricing adjustments made pursuant to Amount B should be respected for customs purposes. This work should also address how downwards transfer pricing adjustments would be treated from an indirect tax standpoint.

4. Implementation status

There remain questions about whether any of the Amount B pricing methodologies can achieve consistency with the ALP in every scenario. It seems likely that, at least in some scenarios, the relevant Amount B pricing methodology will not be consistent with the ALP. For this reason, we strongly support the application of Amount B as an elective safe harbour for taxpayers, rather than a prescriptive approach.

We note that the economic analysis used by the IF to set the Amount B returns uses economic data from 2017 to 2019, excluding years that had been impacted by the COVID-19 pandemic. This implicitly recognises that external economic factors can affect the pricing of transactions between independent parties in a way that cannot be reflected in a standardised approach to benchmarking the returns achieved by third party distributors.

[4] Alternatively, if secondary adjustments are required, they should be permitted via interest-free repatriation payments without any withholding tax consequences.

It is important that the timeline for the implementation of Amount B provides taxpayers with sufficient time to adjust their transfer pricing policies, if required, to align with Amount B. We suggest that to the extent Amount B is not implemented as an elective safe harbour then the framework only apply to tax years beginning 12 months after the IF publishes final guidance on Amount B. This should provide taxpayers with sufficient time to prepare for its introduction.

5. Documentation

We welcome the simplification of the Amount B documentation requirements vis-à-vis those suggested in the prior consultation document, but still strongly suggest that the IF consider further simplifying the documentation requirements for those entities in-scope of Amount B.

For example, the consultation document suggests that a group would only be able to apply Amount B if it anticipated being in-scope for three or more years. Where an entity is deemed to be within scope of Amount B in Year 1, its documentation requirements for Years 2 and 3 could be limited to providing the financial information that demonstrates that it continues to meet the quantitative Amount B scope criteria and comply with the Amount B pricing approach.

The consultation document does not provide certainty on whether a standardised written contract could be used to establish eligibility for Amount B or whether it would apply as an additional criterion, in addition to accurately delineating the transaction and determining that a one-sided transfer pricing method can be appropriately applied. We continue to see merit in such an approach, though we recognise that this should not be a mandatory requirement, due to the non-tax constraints that may prevent taxpayers from implementing such contracts. Irrespective of the approach chosen by the IF, it is critical that taxpayers have certainty on how they must demonstrate eligibility for Amount B. If there is no consensus support for the option of adopting a standardised contract then it may be simpler to abandon this requirement although, rather than provide tax administrations with the option to require such contracts.

6. Transitional issues

We welcome the IF's decision to remove the restrictive transitional rules that were contemplated in the December Consultation Document and agree that no additional constraints should be imposed on taxpayers reorganising to be eligible for Amount B, or to fall outside the scope of Amount B, beyond the existing rules around business restructurings provided in Chapter IX of the OECD Transfer Pricing Guidelines and relevant domestic law provisions. As a practical matter, we note that where taxpayers do reorganise their operations in response to Amount B, such reorganisations may be limited and hence not require remuneration under either Chapter IX of the OECD Transfer Pricing Guidelines or relevant domestic law provisions.

7. Tax certainty

As outlined above, the July Consultation Document highlights the continuing divergence between IF members on what transactions should be covered by Amount B and how the Amount B pricing

methodology should apply. Though we recognise that the IF is seeking to resolve these issues by the end of the year, achieving an agreement remains challenging and there may be a temptation to rely on ambiguities in drafting to achieve consensus. This has the potential to be the worst outcome for taxpayers and tax administrations, as it will create uncertainty for taxpayers seeking to apply Amount B, discouraging them from undertaking the additional steps required to demonstrate eligibility and hence rendering Amount B ineffective. At worst, Amount B could increase rather than alleviate uncertainty regarding the treatment of baseline marketing and distribution activities.

It is for this reason that we continue to believe a robust tax certainty process is a necessary feature for the successful implementation of Amount B, not an optional extra. Though we recognise that existing APA and MAP processes could be used as part of this tax certainty process, we believe that many taxpayers will want to apply Amount B on regional or global basis and hence an effective multilateral tax certainty process would be more valuable that the existing bilateral dispute prevention and resolution mechanisms, which will not apply to all in-scope transactions due to significant gaps in existing treaty networks. We encourage the IF to explore how the existing OECD International Compliance Assurance Programme ("ICAP") could be used as part of this process, though note to be effective it would be important to provide taxpayers with greater certainty that they are within scope and can apply Amount B than is currently provided by the ICAP outcome letters. This could be accomplished by including in the final Amount B guidance and any domestic counterparts adopted by jurisdictions a commitment to abide by the outcome of an ICAP-style Amount B process. Successful resolution experiences with synthetic bilateral or multilateral APAs provide a helpful precedent here.

We note that a limitation of Amount B is that, as currently drafted, it will not apply to the baseline marketing and distribution of services. We note that an improved tax certainty process could be made available to taxpayers that cannot avail themselves of Amount B, but which apply a globally or regionally consistent approach to pricing baseline marketing and distribution activities over which they want additional assurance. This would help to achieve greater support for Amount B from the international business community, many of whom stand to gain little for Amount B as currently drafted.

Finally, we note that the July Consultation Document provides comfort to taxpayers that existing APAs for transactions that would otherwise qualify for Amount B will be grandfathered. We consider that there would also be merit in specifically permitting bilateral or multilateral APAs to vary from the Amount B pricing methodology, where a taxpayer and the relevant tax administrations consider this appropriate. This is particularly important for cases where an APA process (including a renewal of an existing APA) has been initiated, and where relevant an application fee has been paid, but the APA has not been concluded prior to the adoption of the Amount B into the OECD Transfer Pricing Guidelines. Without this clarification, in the short-term Amount B would reduce tax certainty by discouraging taxpayers and tax administrations from pursuing APAs, in which all parties may already have invested significant time and effort.

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