Member Companies
3M
Abbott Laboratories
ADP
Alcoa Corporation
American Express Company
Bank of America Corp.
Boston Scientific Corp.
Carrier Global Corp.
Caterpillar Inc.
Cisco Systems, Inc.
The Coca-Cola Company
Corteva Inc.
Danaher Corporation
Dell Technologies, Inc.
The Dow Chemical Company
DuPont
Eli Lilly and Company
Emerson Electric Co.
Exxon Mobil Corporation
General Electric Company
General Mills Inc.
Google, Inc.
The Home Depot Inc.
Honeywell International Inc.
IBM Corporation
Johnson & Johnson
Johnson Controls, Inc.
JPMorgan Chase & Co.
Kellogg Company
Kimberly-Clark Corp.
MasterCard Inc.
McCormick & Company, Inc.
Morgan Stanley
Oracle Corporation
Otis Worldwide Corp.
PepsiCo, Inc.
Procter & Gamble Co.
Prudential Financial Inc.
Raytheon Technologies Corp.
S&P Global Inc.
State Street Corporation
Texas Instruments, Inc.
United Parcel Service, Inc.
Verizon Communications Inc.
Walmart Inc.
The Walt Disney Company
Zoetis Inc.

September 1, 2023

Tax Treaties, Transfer Pricing, and Financial Transactions Division
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By email: TransferPricing@oecd.org

Re: ACT comments on the OECD Public Consultation Document "Pillar One Amount B"

Dear Sir or Madam,

This letter transmits the attached comments of the Alliance for Competitive Taxation (ACT) in response to the OECD Public Consultation Document "Pillar One — Amount B," dated July 17, 2023. ACT is a coalition of leading American multinational companies from a wide range of industries.

ACT recognizes the work that the OECD Secretariat, the members of the Inclusive Framework on BEPS (the "IF"), the Task Force for the Digital Economy ("TFDE"), and the OECD technical working parties have invested in designing the rules for the implementation of Amount B of Pillar One. The Amount B rules are intended to simplify the transfer pricing rules applicable to baseline marketing and distribution activities with the goal of reducing administration and compliance costs, tax controversies, and uncertainty, while achieving a result that comports with the arm's length standard.

For the reasons discussed in ACT's comments, these highly desirable goals will not be achieved without substantial revisions to the proposed Amount B rules. Importantly, due to the significant variations between the proposed Amount B and current transfer pricing rules and the potential for Amount B to actually increase costs, controversy, and uncertainty, ACT recommends at a minimum that it be clarified that Amount B rules should *only* apply at the election of the taxpayer.

Yours sincerely,

Alliance for Competitive Taxation

cc: Honorable Janet Yellen, Secretary of the United States Treasury
Rep. Jason Smith, Chairman of the House Committee on Ways and Means
Sen. Ron Wyden, Chairman of the Senate Committee on Finance
Rep. Richard Neal, Ranking Member of the House Committee on Ways and Means
Sen. Mike Crapo, Ranking Member of the Senate Committee on Finance

ALLIANCE FOR COMPETITIVE TAXATION COMMENTS ON THE OECD PUBLIC CONSULTATION DOCUMENT "PILLAR ONE – AMOUNT B"

I. INTRODUCTION

Members of the Inclusive Framework on BEPS have invited stakeholder input on the "Pillar One — Amount B" Consultation Document released on July 17, 2023. Comments are requested on the appropriateness of two alternative scoping criteria (A and B), the pricing framework, the application to digital goods, country uplifts, use of local databases in certain jurisdictions, and other relevant aspects of the scoping and pricing methodologies.[1]

The Alliance for Competitive Taxation ("ACT") submits the comments below in response to the Amount B Consultation Document. ACT is a coalition of leading American multinational companies from a wide range of industries.

II. SUMMARY

Amount B aims to simplify the application of the arm's length principle ("ALP") for intercompany transactions associated with in-scope "baseline marketing and distribution" activities. The underlying rationale for this simplification is that distribution arrangements are a frequent focus of transfer pricing ("TP") controversy and are often the subject of dispute between tax authorities that require settlement under the mutual agreement procedure ("MAP"), tying up scarce administrative resources.

ACT supports the OECD's aims for Amount B, and properly designed, Amount B has the potential to promote greater certainty, greatly simplify administrative burdens for taxpayers and tax administrations alike, and avoid long and costly disputes. However, for reasons detailed below, the design of Amount B as set forth in the Consultation Document will not achieve the intended policy outcomes. Far from simplifying the application of the ALP, the current design is likely to have the opposite effect – delivering outcomes that are inconsistent with the ALP while increasing uncertainty and tax controversy.

To achieve its aims, Amount B must strike a balance between simplicity and adherence to the ALP and deliver even-handed results as between taxpayers and tax administrators and between market and residence countries. ACT does not believe the Consultation Document achieves a balanced and even-handed approach.

The Consultation Document gives insufficient priority to simplification, for example, in the scoping criteria, which are overly restrictive, ambiguous, and subjective. The likely result will be to convert current controversies over pricing and profit benchmarks into controversies over access to Amount B. Requirements around segmentation, thresholds for allocated expenses, definitional ambiguity, and measurement challenges (detailed below) will add further complexity and associated controversies.

Similarly, the pricing provisions create additional uncertainty and fail to achieve arm's length results. Examples include the possibility of country-specific matrices overriding the global pricing matrix and an ill-founded net risk adjustment based on sovereign credit ratings, each of which can result in profit attribution to a "baseline" routine activity significantly in excess of an arm's length amount. Many of these features appear to favor market countries at the expense of source countries.

The failure to address digitization and the exclusion of services mean that a significant number of companies subject to Amount A would not be in scope for Amount B. Pillar One was intended as part of a larger package of policies to stabilize the international tax system and ACT believes that one part of Pillar One should not be operative without the other. Amount B was expected to apply to a larger base of companies than Amount A. But Amount B's scope as envisioned under the Consultation Document would

[1] OECD, "Public Consultation Document: Pillar One – Amount B," July 17, 2023.

deny the intended benefits of Amount B to companies that will be in scope for Amount A and will have to contend with all of the costs and burdens associated with Amount A.

For all these reasons, ACT does not view the current design as furthering the policy objectives this project set out to achieve. As discussed below, ACT recommends significant changes to the design of Amount B so that it achieves its original objectives. To avoid additional cost, controversy, and uncertainty, ACT recommends the Amount B rules not be applied without the consent of the taxpayer (i.e., Amount B effectively would operate as a safe harbor).

III. Detailed Comments

A. Definitions

In general, ACT does not believe that there is an adequate level of detail and precision in the definition of important terms and concepts. This is necessary to enable a practical application of these concepts by taxpayers in a way that avoids controversy with tax administrations. For instance, many definitions include the phrase "calculated in accordance with applicable accounting standards." This could implicate a variety of generally accepted accounting principles ("GAAP") across the global operations of a multinational enterprise ("MNE"). It is important that taxpayers get clarity on this issue – a different mix of accounting standards can produce very different outcomes and results.

For purposes of return on sales ("ROS"), operating income is defined as earnings before interest and tax, but the definition is silent regarding adjustments for nonoperating items. This needs to be clarified so that there is consistent treatment across jurisdictions and between the tested party and the benchmark companies. For example, detailed guidance is needed with respect to the treatment of such items as stock-option expense, pension mark-to-market costs, leased assets, foreign exchange gains and losses, interest expense and income, etc. These operating assets and expenses determine where a tested party is located in the pricing matrix and, ultimately, whether a tested party is subject to a routine return of 1.5 percent or 5.5 percent.

The definition of "qualifying jurisdictions" is not helpful – it merely references the "modified pricing matrix" that would apply (instead of the global pricing matrix) for such jurisdictions. ACT recommends expanding this definition to cover the safeguards that will be in place to narrow the circumstances under which a jurisdiction will be "qualified" for the application of the modified pricing matrix. Such a definition should include a reference to the peer review process that will apply to the selection and inclusion of comparables from such jurisdiction in the modified pricing matrix.

B. Qualifying transactions and scope

1. General comments (complexity and unintended consequences)

If the scoping criteria for Amount B are properly defined, allow for broad inclusion, and are anchored in objective data, the result can be a powerful tool to promote the goals of simplicity and certainty. However, the current scoping criteria as framed in the Consultation Document fail to meet these objectives.

The Consultation Document, while not excluding certain industries per se (except for commodities), significantly limits the scope of marketing and distribution activities that can benefit from Amount B. As a result, the scoping criteria will convert current controversies over pricing and profit benchmarks into controversies over access to amount B. The requirement under Section 2.2 that for a qualifying transaction to be in scope it must "exhibit economically relevant characteristics that mean it can be reliably priced using a one-sided method," is subjective and makes the application of Amount B uncertain. While Alternative A is described as a quantitative approach to scoping and Alternative B as qualitative, ACT is of the view that there are qualitative aspects within both approaches that create uncertainty about scoping. The scoping criteria should be more objective and as quantitative as possible to ensure that disputes do not simply shift from current controversies to scoping controversies.

Amount B should not require different analytical frameworks to determine an appropriate return for tangible and digital goods. This will lead to disparate treatment of similar transactions involving similar functions, assets, and risks. No justification has been provided for this distinction. This can result in countries asserting taxing rights on digital goods in excess of an arm's length return. It is clear that digital goods and services are already confronting the prospect of extensive extraterritorial taxation, and Amount B should not provide any additional affirmation – in form or appearance – for countries to increase further the taxing rights on the very companies for which Amount B was meant to provide certainty. The failure to account for digitization in the design of Amount B will result in companies bearing the additional costs of Amount A without getting the promised simplification benefits of Amount B.

Where Amount B does not apply, there should be no inference that out-of-scope transactions (and associated non-baseline activities) warrant higher returns. Amount B is not and must not become a floor for arm's length returns. The pricing of those transactions needs to be governed by the ALP.

2. Alternative A versus Alternative B

The objectives of Amount B have always been rooted in bringing more stability to the international tax system by promoting simplification and certainty. Objective, quantitative measures accomplish those goals whereas an open-ended approach would not. To the extent Amount B is retained in its current form, ACT believes that Alternative A is the more appropriate approach. Alternative A relies more on objective and standardized measures of functional intensity. In contrast, Alternative B would require significant judgment on the part of taxpayers and tax authorities alike. The facts-and-circumstances approach in Alternative B would create substantial disputes around whether non-baseline activities are performed and could result in an incorrect attribution of profits related to other (non-distribution) value drivers (e.g., intangible property) to market jurisdictions – a result that is not consistent with the ALP.

The Consultation Document fails to address why the pricing matrix, by including gradated returns based on factor intensity (i.e., a combination of operating expense and operating asset intensities), does not inherently adjust for activities that are intended to be addressed by Alternative B. Moreover, it is not clear what, if any, practical differences exist between the benchmark companies that would be used for the Amount B sets and those that would be in a set that might accommodate "non-baseline functions" (intended to be scoped out under Alternative B). Viewing all parts of Amount B's elements holistically, including scoping criteria and the pricing outcomes, may help the OECD and the IF design Amount B so as to ensure internal consistency and completeness. For instance, it may be possible to demonstrate that the concerns underlying Alternative B (e.g., the presence of after-sales support or services) can be accommodated under Amount B via the pricing matrix (to the extent such activities are actually found to be reliably associated with differentiated returns) rather than via an exclusion from scope.

3. Services exclusion

The Consultation Document suggests that there could be significant differences in the functions, assets, and risks of distributors of services. These concerns have not been explained or supported by any data. As such, we request that further detail be provided on the specific concerns. Similar functions are required in the distribution of digital goods or services as tangible goods, and the business community has provided data showing that relevant benchmark returns are within similar ranges. If there are concerns that the distribution of digital goods or services excludes inventory risk and functions related to physical logistics, reliable adjustments can be made. Moreover, the pricing matrix itself can account for such differences via the graded returns based on factor intensity (which includes operating asset intensity). In fact, the risk profile may be more similar to commissionaires, which *are* in scope of Amount B. If instead the concern is that services may be customized, it should be recognized that many businesses provide services with little or no customization. For the subset of companies that have incremental customization services, these may be segmented from the baseline distribution functions. Additionally, some de minimis threshold of 'bundled' distribution transactions (i.e., where goods and related services are sold together) should be permitted under Amount B.

The failure to include services is a serious weakness in the Consultation Document. The scoping criteria's segregation of services from the sale of tangible goods will likely result in countries, incorrectly, requiring a higher ROS than comparable activities. The distinction between tangible goods and services falsely signals to tax authorities that the latter are not baseline distribution activities.

4. Digital goods and services

ACT believes the Amount B framework is appropriate for the wholesale distribution of digital goods and supports the inclusion of digital goods in Amount B's scope. Furthermore, and for the reasons discussed above, ACT recommends that the distribution of digital services also be included in scope for Amount B.

5. Form of consideration received by a distributor

While the Consultation Document requests input from commentators regarding the inclusion of digital goods within Amount B, the definition of digital goods specifically excludes the "rental, royalty-bearing license of, or subscription to…digital content." ACT does not believe that such a distinction with respect to the form of consideration, i.e., how a third-party customer pays a distributor for the digital goods (e.g., e-books, movies, games, music, software, etc.), is relevant in determining scope inclusion or exclusion. Fundamentally similar distribution activities can involve different forms of payment (e.g., one-time upfront payment versus a royalty over time) received by the distributor. The pricing under different forms of payment is not significantly different in terms of their net present values. In many instances a customer may decide late in the sales process to either pay up front or over time and the distributor may be indifferent to such alternative forms of consideration. As such, ACT is of the view that the distribution of goods via lease, license, rental or installment sale should not impact eligibility for Amount B.

For example, some taxpayers in the business of distributing music, film and other media content to customers may rely on two different models at the same time: (a) titles available for purchase (in a physical medium or download); and (b) titles offered as part of a library available as part of a subscription. Under the proposed rules of the Consultation Document, the first category of transactions would be eligible for Amount B while the second would not, even though the taxpayer's efforts to market, promote, and distribute the items may be undertaken by the same legal entity and be substantially the same or identical for both offerings. This produces an illogical result where the taxpayer is denied tax certainty on account of the method or means of how it has chosen to distribute some of its product.

6. Segmentation, quantitative filters, descriptions, and measurement challenges

Amount B's design requires the calculation of certain quantitative ratios, including operating expense to sales ("OES"). This is relevant for the quantitative scoping criteria as well as in the application of the pricing matrix, which additionally requires the calculation of an operating asset to sales ratio ("OAS"). ACT has concerns with the lack of clarity about how taxpayers are expected to compute these ratios as well as the complexity these computations may entail. The OES calculation needs to be undertaken on a three-year weighted average basis and presumably using "relevant GAAP," which could differ by market jurisdiction. A simplified approach should not require multiple new ratios. ACT recommends taxpayers be provided some flexibility in the calculation of these ratios; for example, the discretion to apply the applicable accounting standard used for the consolidated financial statement or those used for the distribution entities.

There should be transparency around the rationale for quantitative thresholds that determine scope. For example, it is not clear why a three-percent threshold for OES serves as the floor for scope when transactions related to commissionaires and sales agents are "qualifying transactions" for purposes of Amount B. Sales agents and commissionaires are expected to incur much lower expenses than distributors.

The narrative on the treatment of pass-through costs is vague (e.g., whether marketing execution spend by the distributor at the direction of a foreign principal company would be excluded from the calculation of the ratios). As this affects all the financial analyses relevant to the application of Amount B – from scoping criteria to the pricing matrix – it is critical that clearer guidance be provided on this issue.

In several instances (e.g., non-distribution activities) taxpayers will be required to segment financial statement items. This may create significant complexity for taxpayers and may require expensive business restructuring to achieve certainty under Amount B. Reliably segmenting balance sheet data is likely to be extremely challenging and the general guidance referenced in the Consultation Document is not helpful in this regard. ACT recommends the OECD and IF provide simpler options and flexibility to taxpayers in this regard. For example, the use of an entity-level OAS as a taxpayer-elective safe harbor or specified safe harbor allocation keys could help avoid the need for time-intensive segmentation of balance sheet items and reduce the risk of controversy.

ACT questions the rationale for the "administrative simplification" wherein a qualifying transaction would be scoped out of Amount B if the distribution entity also performs non-distribution activity (which in itself is not viewed as a problem) and the proportion of "indirect operating expenses" shared between the distribution and non-distribution activities based on allocation keys exceeds 30 percent of total costs (of the combined entity). This measure seems arbitrary and without any underlying empirical support, especially if the allocation keys used follow the ALP (as would be expected as a general matter).

7. Other comments

a. Intangibles

Assessing whether any contribution of the distributor is unique and valuable will likely be a source of contention. There are potentially valuable and unique contributions that are inherent to the distribution activities such as customer lists, goodwill, know-how, and technical and scientific expertise. The existence of such intangibles should not preclude a distributor from being eligible for the simplified and streamlined approach under Amount B. ACT recommends that this point be made explicit in the guidance on Amount B.

b. Intercompany sales

ACT recommends there be an allowance for a de minimis threshold to include intercompany sales.

C. Pricing

1. General comments

ACT is concerned with the lack of transparency regarding the underlying data and methodology used to construct the pricing matrix. Taxpayers should be able to replicate the results using the same data and applying the same methodology as used in the Consultation Document. The range of ROS results presented in Figure 4.1 are higher than what we have observed from other analyses. For instance, a study undertaken by KPMG shows a median return of 2.5 percent (and an interquartile range from 1.3 percent to 4.4 percent) across industries and geographies. The returns in Figure 4.1 appear on the very high end of benchmarking sets for the wholesale function.

The overall construct of the pricing section in the Consultation Document is problematic. The construct starts with a global matrix (with returns already on the higher side as noted above) but then (1) overrides it with a modified matrix for qualifying jurisdictions or a country-specific matrix based on local country data, and (2) augments it with a country risk adjustment for select countries. This approach is not simple and cannot be expected to achieve certainty for taxpayers. It creates incentives for tax administrations in market countries to drive higher ROS results under Amount B by selectively using data for local

benchmark companies that cannot be independently or objectively verified. This will compromise the ALP.

There are no true limiting principles on the use of local comparables, and jurisdictions will be incentivized to publish local comparables that exceed the returns provided for under Amount B broadly. This lack of safeguards around the local comparables is extremely concerning. While there is a peer review process for local comparables where a global dataset "lacks country coverage," based on the returns provided in Figure 4.1., it is doubtful that this process, which is undefined, will be sufficient to ensure the ALP is followed.

2. Construct and design elements

a. Global pricing matrix

ACT is of the view that Amount B should be implemented based on the global pricing matrix without exceptions. This is in line with the stated goal of simplifying the application of the ALP. Differentiated results are not necessary as the data do not show meaningful geographic differences. Opening the possibility for use of local data sets creates greater complexity and risks inconsistent processes around data. Therefore, ACT recommends against the use of local comparables and, instead, recommends a more consistent, standardized approach.

b. Modified pricing matrix for qualifying jurisdictions

If the use of a modified pricing matrix (as described in section 4.2.1) is essential to achieving consensus among the IF members, ACT recommends there be clear qualification criteria. To qualify, the sample size of observable results of individual territories should be large enough to be statistically significant as well as significantly different from the global set over a sustained period of time. There is a risk that there will be insufficient observations within the data for the subset of qualifying jurisdictions to populate all segments of the pricing matrix accurately (i.e., all 15 factor intensity and industry grouping combinations) or avoid outlier results in particular segments of the grid. The OECD should provide guidance to assure that the dataset underlying any modified matrix is large enough to be reliable. If not, the global pricing matrix should be the default.

The results in any modified pricing matrix should not be on account of geographic differences in factor intensity (i.e., operating expense and operating asset intensities) or industry because those determinants already are reflected in the design of the pricing matrix. The jurisdictions should provide an economic rationale for observed differences. Furthermore, similar exceptions should apply on a symmetric basis if the returns are materially lower for a country. Finally, to the extent that the “higher than average” countries have their own pricing matrix, these comparables must be excluded from the global set otherwise their higher results will be double-counted in other markets.

c. Adjustment for country risk

ACT questions the premise and basis for the net risk adjustment that is based on sovereign credit ratings. Consistency with the ALP requires that there be empirical support for the specific relationship that is posited in the Consultation Document (i.e., between sovereign credit ratings and the ROS of routine distributors). Nothing in the Consultation Document, or the econometric analyses referenced therein, suggests any such empirical evidence. The Consultation Document states that this adjustment is intended to cover jurisdictions where “there is [sic] insufficient data but there exists evidence of country risk” influencing the arm’s length returns attributable to baseline distribution activities. We fail to see how there can both be insufficient data and evidence of country-specific risk.

ACT also believes this risk adjustment is theoretically flawed. A distributor in scope of Amount B is in effect a limited risk distributor (LRD) and is unlikely to be exposed to significant risks in the supply chain. By definition, its entitlement to a fixed return (via the transfer pricing) passes a large amount of the risk to

the counterparty. In that case, it is the counterparty that is largely exposed to the risk of a market jurisdiction and there is little to no basis for a distributor in a jurisdiction with high country risk being entitled to a higher return. This is supported by the absence of any meaningful correlation between country credit ratings and median distributor profit in the analyses seen by ACT. Finally, the formula, whose derivation has not been explained, could result in an adjustment up to 7.3 percent (85 percent OAS * 8.6 percent) that is unjustified if a significant part of the risk is passed back to the foreign counterparty.

d. Local pricing matrix using a local dataset

ACT does not support pricing matrices based on local country-level datasets. As noted above, this creates a perverse set of incentives for tax administrations in market jurisdictions that will severely undermine the stability of Amount B and any certainty it may offer to taxpayers. It allows tax administrations to create a local dataset of undisclosed or non-verifiable comparables with little or no relevance left for the global matrix. ACT does not believe this can be adequately policed and therefore recommends this aspect be dropped in its entirety from the pricing section of Amount B. To the extent any local sample is produced it should satisfy the requirements and criteria of the global sample (for reliability, transparency and consistency) and added to the global dataset instead of creating a standalone set for a specific market. It is critical that "secret comparables" are not permitted and any process needs to be transparent and fully replicable.

e. Net profit indicator (NPI) for commissionaires and sales agents

The Consultation Document does not directly address how the ROS for a tested party commissionaire or sales agent should be calculated. This is a critical issue because, by definition, the third-party revenues impacted by a commissionaire or a sales agent are recorded by another entity. In such cases, the financial statement of the commissionaire or sales agent will not have in-scope third-party revenues. While in some cases it could be possible to allocate or 'attribute' third-party revenue to such an entity to calculate a ROS, ACT believes that such an approach would introduce additional complexity and controversy. A preferred approach would be to apply the rationale underlying the Berry ratio cap and collar to commissionaires and sales agents but where the Berry ratio is directly used as the applicable NPI instead of the ROS. The ROS pricing matrix can be 'translated' or 'mapped' – with the same factor intensity and industry grouping dimensions – into an equivalent Berry ratio pricing matrix that would apply for in-scope commissionaires and sales agents. In fact, this approach can apply to any group entity that meets the threshold criteria of "baseline" distribution but does not book third-party revenues.

3. Benchmarking and industry groupings

The OECD should provide greater transparency around the data and methodology used to construct the global pricing matrix. Comments on the benchmarking approach described in Annex A and the related industry groupings in Annex B are provided below and support ACT's observation that the ROS results are on the high end compared to other analyses.

a. *Benchmarking*

- A €2 million average revenue minimum threshold is too low and may result in the dataset being dominated by small companies, which tend to have volatile results and may skew the range.
- The use of "software d" as a keyword screening criteria inappropriately would remove companies that sell software developed by someone else.
- The rejection of all companies that do not describe wholesale distribution as their main activity is a faulty screening criterion, as many companies use different language to describe their operations and may not use "wholesale" (e.g., this is often the case in the software/ IT industry).

- The high-level qualitative checks based on websites and the internet are unlikely to be sufficient to develop a robust set. A more comprehensive analysis should be used in the construction of the final set of benchmark companies.
- The screening criteria appear to have applied the qualitative scoping criteria of Alternative B in determining whether the comparables were comprised of pure distributors. This may result in unreliable and higher returns than if the quantitative standards of Alternative A were utilized. It is not clear from Annex A what qualitative criteria were specifically applied in the selection of the final set of benchmark companies.
- It is not clear whether or how appropriate adjustments for nonoperating items were made for the benchmark companies when deriving the ROS ranges shown in Figure 4.1.

b. Industry groupings

- More information should be provided about how industry groupings were determined so that the process is transparent and its reliability can be assessed. The description of "statistically significant relationships to level of returns" is vague in this regard.
- Some of the category descriptions are broad and open to interpretation and controversy. For example, "household consumables, mixed goods, health & wellbeing, miscellaneous supplies" all need to be clearly defined with examples of specific products covered. This is particularly important for Group 3, which has the highest ROS results, as there will be an incentive for tax administrations to map tested party distributors to this group.
- Some MNEs sell multiple product lines that could fall into different groups. To avoid the complexities of segmentation, ACT recommends a threshold or other simplification measure be applied. For example, a company mainly in Group 1 might have up to 20 percent of its sales in Group 3 and still elect to be fully in Group 1.
- It is not clear how effective the search and review process was in excluding the results of non-distribution activities (that may be performed by companies that do distribution and that are included in the final set used to construct the pricing matrix). For example, distributors of certain types of durable goods may also – as a separate activity – perform service and repair. From a comparability standpoint, such non-distribution activities should be segmented and excluded in the calculation of a tested party's ROS from baseline distribution. The profits associated with those types of activities, to the extent also performed by some of the comparable companies, should be similarly excluded when calculating the ROS attributable to baseline distribution for inclusion in the pricing matrix. This may be especially important because some of those non-distribution activities may be associated with higher margins than baseline distribution.

4. Other issues related to pricing

Unlike the normal application of the TNMM, which allows for an arm's length range of profit benchmarks applicable to a tested party distributor, the streamlined approach under Amount B will only allow for a narrow band of 50 basis point around a fixed point. Furthermore, this narrow target for a tested party in-scope distributor varies by factor intensity – which will not be known with certainty before year-end. As a consequence, Amount B will naturally lead to more significant post year-end adjustments given the narrower range and mapping to a specific cell within the pricing matrix. This could have ramifications for customs duties and value added taxes. Some countries do not accept year-end TP adjustments which result in a reduction of profit, even for a limited risk distributor. Some coordination between taxing authorities should be undertaken to accept such downward profit adjustments for all Amount B qualifying transactions.

The Consultation Documents envisions adjusting an in-scope distributor's ROS result to the midpoint of the specified range if the preadjustment result falls outside the range in the pricing grid. We recommend this be changed so that the adjustment is to the point within the range closest to the preadjustment result.

The Consultation Document suggests the pricing matrix be updated every five years unless there is a significant change in market conditions. This approach is not aligned with current transfer pricing best practices. There should at least be a 'roll-forward' of the results, similar to the process that would be undertaken in regular transfer pricing benchmarking studies.

D. Documentation

If Amount B is truly a simplification over existing rules, taxpayers should not expect a greater documentation burden than what is currently required as part of a local file prepared in accordance with the OECD transfer pricing guidelines ("TPG"). The Consultation Document discusses the information that may already be included in local file documentation. The level of detail at which this is currently provided, 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). In line with Amount B's objectives, the documentation requirements should be simplified.

Relatedly, there is a brief mention of a first-time notification procedure. It is unclear how extensive the documentation requirements and the associated administrative burden will be for this. More clarity needs to be provided in this regard.

E. Implementation

ACT believes that if the OECD and IF proceed to implement Amount B in the TPG the new regime should be in the form of a taxpayer-elective safe harbor rather than prescriptive. The TPG should make this clear. Furthermore, the TPG should make it clear that there should be no presumption on the part of tax administrations regarding the applicability of any of Amount B's design features (e.g., the pricing matrix, industry groupings, country risk adjustment, etc.) to transactions outside of the taxpayer-elected safe harbor.