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EBIT's Comments on the Public Consultation Document Pillar One – Amount B (17 July 2023 - 1 September 2023)

Brussels, 1 September 2023

Dear Ms. Corwin,

EBIT's Members[1] thank the OECD for the opportunity to provide comments on the Public Consultation Document – Pillar One – Amount B (17 July 2023 - 1 September 2023) hereinafter 'Consultation Document'. EBIT's Members value the efforts of the OECD/Inclusive Framework (IF) and are supportive of simplifying and streamlining pricing for baseline marketing and distribution activities in accordance with the arm's length principle toward more tax certainty and less disputes. EBIT's Members' comments should be viewed with these goals in mind. There are a number or areas, however, where the Consultation Document in our view does not meet the goals of simplification and streamlining, such as the proliferation of different industry and country ranges, financial analysis and the impact on returns, the lack of clear definitions and transparency leading to potentially more controversy.

In these Comments, we follow the outline of the Consultation Document. EBIT's Members consider this document an important step in the development of transfer pricing.

1. Scope

The scoping criteria should be broad based and provide clear and objective rules that provide taxpayers and tax administrations the certainty needed to benefit from a simplified and streamlined approach. One key aspect is that tax certainty needs to be ensured. The Consultation Document does not contain a solution for the situation where one State claims that the transaction is in scope of Amount B, while another State claims it is not. In that respect, Amount B should also provide for binding solutions as this conflict of views of the States concerned will lead to unresolved double taxation.

EBIT's Members welcome the inclusion of commissionaires and sales agents in the Amount B mechanism. EBIT's Members noticed unfortunately that the definition of qualifying transactions only contains distribution to unrelated parties. Hence, wholesale baseline marketing and distribution activities to related parties are not in scope of Amount B. This means that for these related activities – although likely comparable to baseline marketing and distribution activities with unrelated parties – a full transfer pricing analysis will still need to be performed. This is likely to result in not reaching the aspirational goals of simplification (segmentation needed between related and unrelated parties' transactions), streamlining and increased tax certainty. EBIT's Members consider that related party baseline marketing and distribution transactions should also fall in scope of Amount B. We consider that not including

[1] EBIT's Members include: Airbus Group, BP, Carlyle, Carrier, Caterpillar, Diageo, GSK, Huawei, International Paper, Johnson and Johnson, JTI, PepsiCo, Pfizer, P&G, RELX, RTX, Schroders, SHV Group and Vattenfall. For more information on EBIT see: www.ebit-businesstax.com

related party baseline marketing and distribution activities in the scope would be a missed opportunity.

Core distribution functions would include 'certain after sales services'. EBIT's Members welcome the reference to after sales services but the word 'certain' makes it very unclear which after sales services would be in or out of scope. More guidance on which after sales services would be in or out of scope would be welcomed.

EBIT's Members regret that Amount B would not be applicable to digital goods and services, for which, however, no justification is provided by the OECD/IF.

EBIT's Members take note of the proposed use of qualitative and quantitative filters. We would suggest that the quantitative filters are applied first before any qualitative filters –in line with the accurate delineation of the transaction- are applied. Quantitative filters are objective and easier to apply than qualitative filters (which are more of a facts and circumstance issue). The latter will be foregone anyway if the quantitative filters are not met. EBIT's Members are having concerns, however, that some filters may be too restrictive: for example, the floor of the operating expense intensity filter of 3 % for local operating expenses. The Consultation Document lacks information on how the filters have been determined and might be changed if needed. So further information on this would be welcomed. The overall goal should be to minimize the additional work for companies.

The qualitative filter is based on the accurate delineation of the transaction. The Consultation Document introduces a quantitative filter (operating expenses to sales) to remove distributors with operating expenses that may indicate anomalous or outlier results. Under the premise of a correctly performed functional analysis and accurate delineation of the transaction, such scenarios should already be identified. Such qualitative filter is superfluous and would only lead to more complexity as this filter is not straightforward to perform.

With regard to the application of the quantitative filters, the calculation should be based on at least a three-year weighted average. More guidance is needed on how to calculate the weighted average under specific circumstances, such as shorter or longer accounting periods than a calendar year, mergers or demergers. Useful guidance can perhaps be based (and streamlined) on the guidance already present in, for example, the guidance on BEPS 13 Country-by-Country Reporting. It is important for simplicity that no new criteria as such for Amount B are developed. The use of a three-year weighted average may seem a reasonable approach, but on the other hand, it will of course cause an additional administrative burden to calculate the ratios (in particular when non-segmented balance sheet data is needed) on a consistent segmented basis, in particular when non-segmented balance sheet data is needed.

The Consultation Document contains some guidance on pass-through costs. EBIT's Members opine that they should be addressed more in depth. Pass-through costs should be left out from the operating costs under Amount B. Indeed, the logical conclusion is, for example, that if you qualify as a baseline distributor then any spending with third parties on advertising which builds the marketing intangible of the counterparty controlling that spend must be a pass-through cost. The current discussion in the Consultation Document leaves the inclusion / exclusion of pass-through costs open for interpretation and hence is prone to controversy.

With regard to the question whether Alternative A or B is preferred, it should be noted that neither option is necessary after a proper delineation. EBIT's Members are not in favour of Alternative B as described in the Consultation Document as it adds to the complexity, subjectivity, and compliance burden because of the need to delineate baseline and non-baseline activities. Alternative A provides a certain flexibility while Alternative B goes beyond current TP guidance by setting rigid rules/guidelines around an element where the TP Guidelines currently allow more flexibility/judgement. However, the guidance on the qualitative analysis under Alternative B, indecisive though it is (e.g., paras.25-27), indeed precisely because it is

indecisive, will make this a point of contention, hence little or no simplification is achieved, as taxpayers and tax authorities argue over whether activities are in scope or not.

Alternative B comes very close to a full transfer pricing analysis and so close that it would not appear to be worth the while of a business (in particular a business with sales plus after-sales services) to open a new argument over whether they are in scope. EBIT's Members would prefer in these circumstances to stick with the agreed existing transfer pricing methodology. However, if out of scope, we would not want the Amount B return to be taken as a baseline, on which to build It would seem that Alternative B would not satisfy the Amount B objectives of simplification, streamlining and tax certainty but create even more ambiguity. Alternative A is more mechanical and would lead to enhanced tax certainty and reduced resource-intensive disputes which are objectives of Amount B.

However, some Members of EBIT see merit in Alternative B because it is closer to a full TP analysis allowing to differentiate between baseline marketing and distribution and activities that are not baseline, despite the higher complexity.

EBIT's Members noticed that promotional activity is specifically mentioned in the Consultation Document. No further discussion or detail, however, is given, for example, on what level should the promotional activity take place, or is there a floor or cap on the amount of marketing activity to be consistent with baseline marketing and distribution.

Under § 35 of the Consultation Document, a definition of commodities that are excluded from Amount B is given. The list is very wide and a question that arises is what to do with products derived from those commodities? For example, dairy is excluded. Does this mean that cheese, low fat milk, fruit flavoured yoghurt (potentially excluded twice: dairy and agricultural proceeds), etc. are all excluded? EBIT's Members consider that it cannot be the case that processed goods would be excluded from Amount B. Clarity should be given in that respect.

EBIT's Members opine that distribution activities that do not come into scope of Amount B merit a transfer pricing analysis under the principles of Chapter I – III of the OECD Transfer Pricing Guidelines. It should not and cannot be the case that certain activities would automatically lead to a higher remuneration because they are not (or at least not considered) in scope of Amount B. Amount B should not serve as a floor for those transactions.

EBIT's Members are of the opinion that every industry should be given the possibility to apply Amount B (no exclusion based solely on industry sector) when members of the MNE concerned perform baseline marketing and distribution.

2. Application of the most appropriate method

EBIT's Members note that the Return on Sale ratio (ROS) is being promoted as the primary method. Undoubtedly the ROS is an appropriate ratio in a number of cases but it may not be the most appropriate ratio in a number of other cases such as when the activity does not influence or is not linked to the sales price. Although EBIT's Members welcome the Berry ratio as a cap and collar, it can only still be considered a corroborative method, and not the number one method. For example, there are cases where the baseline marketing and distribution activities may have no relation to sales (commissionaires / sales agents). In that case, ROS may not be the most appropriate method, but the Berry Ratio should be used appropriately. This is also in line with the arm's length principle. In the case of rendering a marketing and distribution 'service' (this word is deliberately used here to draw the attention that services actually should be included – and this is what commissionaires and sales agents actually do) the Berry ratio should become the transfer pricing methodology under Amount B. Useful references can be made to the discussion on the Berry Ratio in the OECD Transfer Pricing Guidelines (§ 2.106 to 2.108). As such, it can also be an appropriate method to include related party wholesale activities into Amount B. Hence, we consider that ROS is the base method, but

for specific and clearly defined cases, as explained above, an alternative method like the Berry Ratio might be more appropriate.

Also, in the case of chain transactions (for example, a buy-sell wholesale distributor buying from a related party and on-selling wholesale to a related party) the Berry Ratio could be an appropriate methodology.

At several instances in the Consultation Document, a reference is made to 'a two-sided method'[2], i.e., a profit split method (since that is the only two-sided method described in the OECD Transfer Pricing Guidelines). The approach is that in particular in evaluating whether a qualifying transaction may be within the scope of Amount B, determining that a two-sided method should not apply is particularly important. This approach could easily be wrongly interpreted and claimed that when the transaction is not in scope of Amount B, a two-sided method (profit split) should be applied. It should therefore be made clear that when a baseline marketing and distribution activity is not within scope of Amount B, it should not be automatically presumed that a two-sided method would be appropriate. Rather the guidance on the accurate delineation of the transaction, selection of the method (in particular the situation where a profit split method is appropriate) and comparability analysis should be followed (application of the Chapters I – III of the OECD Transfer Pricing Guidelines) in that case.

The Consultation Document refers in its § 16 to regulatory licenses to access a market. This is particularly true for the pharmaceutical industry, but also, for example, in the health and beauty industry. With regard to the regulatory license the activities may be performed, and risks assumed, by a different entity than the distributor (for example by the principal), although the distributor may be the legal regulatory license holder, in particular for legal or administrative purposes. EBIT's Members would welcome additional guidance in that area. Although such license could be viewed as an intangible, it is generally not viewed as a valuable contribution from the distributor.

In the same vein, EBIT's Members believe that intangibles that are inherent to distribution activities (for example, customer lists, marketing and distribution know-how, and technical and scientific expertise associated with the distributed products, etc.) form part of the normal and usual business assets of a (low risk or baseline) distributor and should not dismiss a one-sided method, make it unsuitable or would preclude the application of Amount B. Without these contributions the distributor could not properly perform its distribution activities.

3. Determining an arm's length return

EBIT's Members are in favour of a single limited matrix (for example based on industry intensity). However, more guidance is needed on how to define operating income (earning before interest and tax) and non-operating income or costs that needs to be involved in the analysis. Further, issues can arise on how to determine income for commissionaires and sales agents that have no third party sales as such. As mentioned above, a Berry Ratio could offer an elegant solution.

With regard to how the matrix is determined, EBIT's Members urge the OECD/IF for more clarity and transparency. We are not in favour of using local datasets. Should, however, the OECD/IF decide to incorporate such datasets, care should be taken that this does not lead to an approach that is comparable to secret comparables. Indeed, clarity and transparency are absolutely key in the composition of the matrix, for example through making public the search process, the elements used and their determination or rejection criteria, and the companies in the final set. Related to that, it seems also more useful to add any acceptable comparables to the global set and have this applied everywhere, instead of creating separate country sets.

[2] For example, on pages 10, 12, 13, 24.

As an alternative, the matrix could include gradual returns based on operating expenses and net operating assets to adjust for differences in activities.

The Consultation Document identifies three very broad industry groups (lower levels of return, significant relation to levels of return, higher levels of return), divided over different categories of goods. It would seem to EBIT's Members that the composition of the groups is performed on a rather subjective basis and more transparency on how the groups are composed would be welcomed. It is also unclear how qualifying distributors that would fall into multiple categories or different business or product lines would be treated. The Consultation Document does not use recognized industry classifications which is another reason why more details are needed.

Certain groups mention categories of goods such as animal feeds, agricultural supplies, tobacco, hides, furs, jewellery (gold, silver, diamond), lubricants, etc. EBIT's Members want to point out in this context the ambiguity between the industry grouping and the exclusion of commodities. More clarity in that respect would be welcomed.

The need for more clarity can also be illustrated by the following simple example. Under Group 1, household consumables are mentioned. Group 2 mentions home consumables. It is unclear what is meant (differences and / or similarities) under those terms for Group 1 and Group 2. Therefore, more guidance on what is precisely meant under the groups is welcomed and can only lead to more certainty.

EBIT's Members are concerned that the possibility that countries may determine and use a separate matrix (modified pricing matrix - see the comment on secret comparables as well), will be detrimental to the goals of simplicity, streamlining and certainty under Amount B. If that route is pursued, transparency on how the 'individual' matrix is determined and replicability is absolute key, but EBIT's Members are certainly not in favour of such an 'individual' approach. Should the OECD / IF consider that such exceptions are needed, the results should be significantly different from the general set over a sustained period of time. Further, EBIT's Members suspect that the separate sets will only lead to a higher local result, and that any sustainable lower rates would not be considered in the equation (meaning a lack of balance in the approach).

When the qualified distributor's margin falls outside the range of Amount B, the Consultation Document seems to allow both upward and downward adjustments and suggests a correction to the midpoint. It is unclear why this measure of central tendency is used and no correction is performed to the point closest in the range as advocated by the OECD Transfer Pricing Guidelines and the arm's length principle.

EBIT's Members also have concerns with regard to the net risk adjustment for qualifying jurisdictions (i.e., countries with a credit rating below BBB+). EBIT's Members understand that this adjustment is meant to cover the higher risk associated with the qualifying countries. However, this will lead to a higher profit margin, while at arm's length, likely no such risk adjustment would be performed (open market principle, because of price discrimination the prices in the countries concerned are lower). More clarity and transparency are needed on the net risk adjustment. The adjustment is solely based on the credit rating of the country, excluding the circumstances under which a certain industry operates in that country.

Further, it would seem that § 65 of the Consultation Document is contradictory. On the one hand, the Consultation Document states that there is no or insufficient data in the global dataset for a particular tested party jurisdiction. On the other hand, it states that there exists evidence of country risk in that jurisdiction that may influence arm's length returns attributable to baseline marketing and distribution activities. This approach seems subjective. The question is how the metrics are going to be determined. There should be an economic rationale to linking the risk profile of qualifying distributors to sovereign debt ratings, which for the time being is lacking. Baseline distribution is almost by definition low risk. The risk resides with the

principal, who makes the choice of which market to sell into, controls and manages that risk. It is not at all clear what risk adjustment is applicable to the in-country distributor based on country risk. If a country's credit rating were downgraded, it seems patently wrong that all distributors in that country would suddenly see a leap in profitability.

The Consultation Document indicates that the price-setting is a part of establishing the tax return at year end. EBIT's Members feel that the IF disregards the complexity of the suggested process (segmentation of data, possibly reconciliation in local GAAP). In light of these difficulties of price setting, more significant year-end adjustments may be the result (including spill-over effects to customs and VAT). Given the fact that some countries disallow year-end adjustments which result in a lower profit, EBIT's Members request that such downward adjustments are mandatorily accepted for Amount B qualifying transactions.

Finally, it should be made clear that Amount B does not become a floor; there should be no inference that lower arm's length results would not be possible.

4. Documentation

The overarching objective should be to avoid any increase in the documentation burden to companies, given that Amount B aims for process simplification. EBIT's Members recognise the fact that tax authorities need access to meaningful documentation and information (for example, risk assessment and audit procedures). Nevertheless, EBIT's member want to mention that:

- In order to be useful and with the aim of simplification countries should have local file requirements in accordance with the relevant OECD guidance in their domestic legislation. EBIT's Members observe differences on local file requirements in domestic legislation;
- The master file could contain a reference that the group will use the Amount B approach (in case Amount B indeed applies to all marketing and distribution affiliates);
- The need for a written contract prior occurrence the qualifying transaction seems to be overly formalistic, in particular because the reference is made at several occasions in the Consultation Document to the accurate delineation of the actual transaction. Further, nothing indicates that Amount B would not be applicable to a permanent establishment (PE). As indicated in the Authorized OECD Approach, contracts between a head office and a PE usually do not exist;
- The level of detail in the local file, however, may not be sufficient for Amount B purposes and therefore could still result in a heavier documentation burden.

5. Tax certainty

EBIT's Members welcome the attention of the OECD and IF on tax certainty, one of the goals of Amount B. Unfortunately, the Consultation Document only mentions the corresponding adjustment under Article 9(2) OECD Model Convention and the Mutual Agreement Procedure (MAP) under Article 25 OECD Model Convention. This tax certainty discussion only gives rise to *ex post* solutions (except for existing APAs that should be respected). The Consultation Document does not discuss the possibility of early certainty under Amount B. In the light of the complexity of the proposed rules, EBIT's Members would strongly encourage the IF to consider also *ex ante* solutions, for example advance scoping agreements, agreements to confirm in which industry group the multinational enterprise belongs.

Although EBIT's Members welcome references to the MAP and corresponding adjustments, we are concerned about the length of time that the procedure still may take. Further, one of the goals of Amount B is precisely to reduce the number of cases under MAP. Therefore, consideration must in our view be given to fast-track solutions such as a fast-track MAP under

Amount B. If a transaction is a qualifying transaction under Amount B, it should be automatically accepted by the tax authorities involved. Under § 96 of the Consultation Document, the bracketed text contains the term 'endeavour', which still leaves the possibility that no agreement is reached, which is against the principle and the aim of tax certainty.

6. Implementation

The question that arises with regard to implementation is whether Amount B would be considered a Safe Harbour (SH) in view of the references to Chapter IV, Section E, of the OECD Transfer Pricing Guidelines in the Consultation Document, or whether its application would be mandatory when the qualitative and quantitative filters are met.

EBIT's Members favour an elective approach for the taxpayers concerned. When the filters are met, and the taxpayer has opted for amount B, the tax authorities would be able to check the application but should not be able not to accept it. If the taxpayer does not elect Amount B, and hence opts for a full transfer pricing analysis, the tax authority should not impose Amount B, nor use it as a benchmark.

It would be useful that the OECD / IF develops draft legislation to introduce Amount B in the legislative system of countries.

It goes without saying that Amount B can only work if a major number of countries – including emerging and developing economies – sign up to applying the system. Experience with the low value-adding intra-group services shows that signing up to some common system rendering transfer pricing simpler and more efficient from a taxpayer and tax authority perspective, remains difficult for certain countries. Hence, EBIT's Members request the IF to embrace this simplification measure and go further than a non-binding soft law publication in the OECD Transfer Pricing Guidelines.

EBIT's Members recognize that the OECD / IF has no competence in the area of Customs. Nevertheless, we would urge the OECD / IF to flag and address – likely in collaboration with the World Customs Organisation – the effect of Amount B on customs and its acceptance by custom administrations. Similar spill-over effects may exist for VAT, and EBIT's Members hope that VAT issues can be addressed within the OECD.

7. An alternative approach: a multilateral instrument on Amount B?

After reflecting as a group of day-to-day practitioners on possible alternative ways of introducing Amount B, a possible way forward could be to introduce Amount B through a multilateral instrument. Whilst MNEs perform their activities in a multi cross-border way, countries are mainly or remain focused on domestic approaches and/or bilateral issues, hence the risk of failing to match the multi-cross border approach of MNEs. What is lacking today is a real multilateral approach and response to the multilateral needs of tax authorities and MNEs.

One of the downsides of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (the BEPS MLI), and also of the provision on the Subject to Tax Rule under Pillar Two, is that it modifies existing tax treaties only. It does not create or allocate taxing rights and rules to (or limits those rights and rules between) States between which no treaty exists. The suggested alternative approach would precisely be aimed at covering the gaps in the treaty network by introducing a limited multilateral instrument for Amount B, even in the absence of a bilateral treaty. We believe that this is also what the Multilateral Instrument on Amount A is trying to achieve for Amount A purposes.

Importantly, this does not entail incorporating Amount B in the Amount A Multilateral

Convention that is currently being developed. We understand that the work on Amount A is advancing and introducing a new element may jeopardize the timeline of Amount A. Instead, it is suggested that a new limited instrument on Amount B would be developed separately covering i.a,:

- Scope
- Definitional issues
- The allocation of taxing rights under amount B (including reference to the ALP in accordance with Article 9 OECD MC)
- Application of Amount B in the case of permanent establishments
- Principles of the Methodology and remuneration (matrix – the matrix itself could possibly be reviewed from time to time and added as an annex)
- Dispute prevention and resolution, including mandatory resolution
- Exchange of information
- …

The Amount B instrument could then be accompanied by further guidance, interpretational notes and commentaries.

Such instrument would translate and endorse the political agreement reached on Amount B into a technical and legally binding instrument. Countries might be more inclined to ratify the commitment undertaken and introduce the mechanism into the legal order of the signatory / ratifying states. Although such process would take a bit more time (drafting, signature, ratification, …) it would increase the certainty for both tax authorities and taxpayers alike that the mechanism would be applied and respected. Before ratification, countries could commit to apply the Amount B mechanism based on the guidance that the OECD/ IF is currently developing.

EBIT's Members trust this contribution is helpful to you.

Yours sincerely,

European Business Initiative on Taxation – September 2023

For further information on EBIT, please contact EBIT's Secretariat via Bob van der Made, Telephone: + 32 472 745 631; Email: bob@vandermadeconsulting.com).

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