30 August 2023

To: Working Party No. 6 and the FTA MAP Forum  
Organisation for Economic Cooperation and Development  
Centre for Tax Policy and Administration  
75775, Paris, Cedex 16, France  
Submitted by email: transferpricing@oecd.org

Re: OECD's Public Consultation on Amount B of Pillar One

Dear Secretariat Team,

PwC International Ltd on behalf of its network of member firms (PwC) welcomes the opportunity to share its views on the OECD’s 17 July 2023 public consultation document “Pillar One - Amount B” (July Consultation Document). The structure of our submission is as follows: a cover letter; an executive summary; and, finally, our detailed comments in an appendix.

We continue to strongly support the stated objectives of Amount B to enhance tax certainty and reduce controversy between tax administrations and taxpayers. To this end, we are pleased to comment on some issues relating to the design of the scope and pricing methodology of Amount B that we believe should be addressed by the Inclusive Framework (IF).

While we are supportive, however, we are also concerned. As set out below, there are a number of major areas which we believe must be addressed if Amount B is to fulfil its stated intent:

- Given the increasing number of options (and ensuing complexity) that may now apply, we believe that Amount B should – at least initially – be an elective safe harbour.
- The scope of what Amount B applies to is still too restrictive, including relating to digital goods and services.
- The provisions on pricing, especially the “qualitative” (i.e., subjective) criteria, could very substantially reduce the simplification benefit of Amount B to both tax authorities and taxpayers alike.

Again, to reiterate, we strongly want Amount B to succeed, but we are concerned that the current draft does not yet provide a sufficient basis for that outcome.

Thank you again for the opportunity to comment on the Amount B rules. We would be pleased to discuss the issues raised in this submission in more detail, if that would be helpful at any point. Please do not hesitate to contact me or any of the individuals set out in the table at the end of this submission.

Yours sincerely,

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EXECUTIVE SUMMARY

Amount B is intended to streamline the process for pricing baseline marketing and distribution activities in accordance with the arm’s length principle (ALP), thereby aiming to enhance tax certainty and reduce resource-intensive disputes between taxpayers and tax administrations. We continue to fully support these objectives.

The July Consultation Document would impose a significant upfront compliance burden on taxpayers attempting to utilise Amount B, but seems unlikely to result in significant improvement over the current rules. As the IF continues its deliberations, we offer the following perspectives on the appropriateness of the scope and pricing framework contained in the July Consultation Document, aimed at enabling Amount B to achieve its stated goals:

● **Implementation** - It is not clear whether Amount B would be mandatory or administered as an elective safe harbour. As adoption of Amount B settles, it would seem sensible to offer taxpayers some transitional support to encourage them to opt-in to Amount B. Viability testing via a pilot programme that taxpayers could elect into could rationally stress test the system to ensure the process and outcome align with the agreed policy objectives and are supported by IF members.

● **Scope** - There are still opportunities to simplify the scoping process. Although a number of scoping exclusions have been removed, the criteria remain overly restrictive. We have concerns that a greater reliance on qualitative and subjective assessments (Alternative B) would shift disputes from pricing to scoping. We also do not see a justification to exclude digital goods and services from Amount B’s scope.

● **Pricing** - We have concerns/reservations that the overrides and adjustments to the global pricing matrix – via the modified matrix for qualifying jurisdictions, or country-risk adjustments or country-specific matrices – introduce unnecessary complexity. The additional steps and distinction are not anchored in empirical support and are likely to undermine the stability of the Amount B regime with distorted incentives for tax administrations and uncertainty for taxpayers. Defined terms require greater clarification and there is an overall lack of transparency around the basis of the pricing matrix, which limits our ability to comment/engage in a more comprehensive and meaningful manner.

● **Administration** - We note that some progress has been achieved in terms of documentation. Nevertheless, we would appreciate more recommendations around documentation simplification, to avoid potential additional documentation requests.

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Our detailed comments are organised under these categories in the Appendix that follows and cover the relevant sections of the July Consultation Document.
APPENDIX: DETAILED COMMENTS

Implementation

As a gating matter, it is unclear whether Amount B will be mandatory for in-scope entities, or if it will operate as an elective safe harbour. A pilot programme that allows taxpayers to elect Amount B for their distribution activities may provide some transitional relief, and allow for some time to evaluate the pros/cons of the different implementation means in practice.

Scope

Amount B is intended to foster ease of compliance/administration and avoid controversy. We support these objectives, but for Amount B to deliver on its stated goals, simplicity must be prioritised and the interests of the relevant stakeholders must be balanced. The proposed design of the scoping criteria in the July Consultation Document remains overly restrictive and introduces potentially ambiguous and subjective elements.

Several exclusions from the previous consultation document have been removed, but the types of “baseline distribution” activities that are considered qualifying transactions are still limited. For example, only sales to unrelated parties are covered under Amount B, but in many cases a controlled distributor sells to both unrelated and related parties.

There is also still a question as to whether Amount B should include digital goods while services have been excluded outright from scope. The July Consultation Document does not provide any clear justification for a distinction between tangible and digital goods. In our view, distribution activities relating to tangible goods, digital goods and services may not materially differ and do not require different analytical frameworks to determine an appropriate return. Segregating tangible goods from services under Amount B is likely to introduce avoidable complexity and also limit the scope of Amount B. Further, such a segregation may create an incorrect connotation that the distribution of services is intrinsically “non-baseline.”

For purposes of scoping, we recognize that some level of qualitative assessment in any case may be appropriate, as in the accurate delineation of the transaction proposed under both Alternative A and Alternative B – although quantitative (objective) measures should always be the default approach. However, the facts and circumstances approach in Alternative B may be overly complicated and subjective. This would undermine simplification and create substantial disputes. We fully support the use of objective measures (i.e., quantitative filters) to facilitate scoping and administrative simplification, and recommend increasing reliance on these to reduce subjectivity in scoping. However, the proposed quantitative filter, operating expenses divided by net sales (operating expense intensity ratio) requires further clarifications/definitions for the following reasons:

- Accounting standards have not been specified. Without these, financial inputs (e.g., operating expenses) can produce very different outcomes.
- The lower limit set for the operating expense intensity ratio (3%) may be overly restrictive given sales agent and commissionaire arrangements are qualifying transactions and typically less cost intensive. Importantly, it is not clear how the bounds have been set.
While we agree that the operating expense intensity screen can be an accurate representation of a distributor's functional intensity, greater transparency is needed around the OECD's empirical methods and justification for the threshold values.

Finally, while we welcome that segmentation between distribution and non-distribution activities is now possible, there is insufficient guidance around segmentation and thresholds for allocated expenses are overly restrictive. For bundled transactions, similar to a de minimis threshold used for retail sales of a distributor, some level of ancillary services with distribution activities should be allowed. Performance of a level of services does not differentiate a controlled distributor from its uncontrolled peers, and still allows a distributor to be benchmarked by the recommended method. More concrete guidance would also be appreciated to clearly establish how the practical allocation of revenues, costs, and assets can be achieved. While income statement segmentation is fairly common, there are no established practices for balance sheet segmentation. To address this, we recommend including safe-harbour type allocation keys to allow some flexibility and optionality for taxpayers.

Pricing

Our comments below focus on the determination of arm’s length returns under Amount B, in light of the overarching objectives of simplicity and certainty.

- We support the adoption of a single pricing matrix and limiting its dimensions (i.e., factor intensity and industry) as proposed. However, clarity is needed around the definition of operating income (defined as earnings before interest and tax) and any non-operating items that may need to be considered. Additionally, the overall approach to the construction of the pricing matrix lacks transparency. The construction of the dataset is only partially described in the July Consultation Document and there is no clarity about the empirical methods used to obtain various key figures. Any process for identifying comparables should be replicable. The OECD could ease the process if they disclosed the precise methods they have used to build their database and to conduct the empirical analysis so that stakeholders could determine the underlying statistical reliability of the model.

- We are concerned that the proposed rules on industry categorisation may be both unnecessarily ambitious in their scope, as well as generally difficult to administer and comply with. For example, it is unclear how an in-scope entity should establish its own industry when implementing the pricing matrix. The July Consultation Document hints that the industry groupings have been determined on the basis of factors other than standard industry classifications but offers no further details. Any subjective approach to industry classification should be eliminated, given the aim of Amount B is to reduce uncertainty.

- A critical question that is not sufficiently addressed is how the return on sales (ROS) for a tested party commissionaire or sales agent should be calculated. By definition, the third-party revenues impacted by a commissionaire or a sales agent are recorded by another entity. While it could be possible to allocate or “attribute” third-party revenue to such an entity to be able to calculate a ROS, we believe that such an approach would introduce an additional element of complexity and source of controversy. A preferred approach for commissionaires and sales agents would be to apply the principle/rationale underlying the Berry ratio cap and collar, noting the following considerations:
  - An additional pricing matrix could be constructed using the Berry ratio as the applicable NPI, with the same factor intensity and industry grouping dimensions as the ROS pricing matrix.
The Berry ratio pricing matrix would ensure consistency between the pricing approaches for commissionaires/sales agents and buy-sell distributors. This approach could apply to any group entity that meets the threshold criteria of “baseline” distribution but does not book third-party revenues (e.g., our prior comment letter elaborated on how some MNEs may have baseline sales, marketing and distribution activities for specific markets that are not fully self-contained within one entity and in fact are dispersed across different entities across different jurisdictions).

We also have concerns/reservations with respect to the overrides and adjustments to the global pricing matrix. The study “Global Distribution Benchmarking Analysis prepared for Procter & Gamble” dated January 2023 and provided as Appendix B to our prior comment letter shows that geographic differences do not produce sufficiently differentiated outcomes to warrant the concept of a modified pricing matrix. In particular, allowing countries to rely on their own pricing matrix undermines the simplification and certainty purpose of Amount B. This holds true especially if the dataset underlying the overall original pricing matrix contains a sufficient number of observations for that specific country. In our experience, some jurisdictions may display higher returns because of a sample bias in the underlying database. When the number of firms reported is small, the average profitability tends to be higher because in a smaller dataset, larger, more profitable firms are more likely to be reported. In this case, using a global average or median return is likely more reliable than country-specific returns. Overall, there is no clear empirical support for country-specific matrices if the main empirical analysis is conducted on one of the most comprehensive albeit not perfect dataset.

Finally, we question the premise and basis for the net risk adjustment which is based on sovereign credit ratings. For this adjustment to be consistent with the ALP, there needs to be empirical support for the specific relationship that is posited in the July Consultation Document, namely between sovereign credit ratings and the ROS of routine distributors. Nothing in the July Consultation Document or the econometric analyses referenced therein suggests any empirical evidence/support for this relationship. The net risk adjustment can yield untenable results such that profits attributed to “baseline” distribution and marketing activities exceed what we have typically seen as arm’s length amounts. In many instances, this may leave little or no profits for other value-added activities. There is a problematic scenario, for example, where a multinational group has an overall ROS of 5%, but Amount B requires a ROS of 10% in a country with high credit risk.

Administration

We understand that transfer pricing documentation ensures tax administrations have access to information to conduct risk assessment processes and/or to audit a taxpayer’s transfer pricing practices. As set forth in the July Consultation Document, the proposed documentation requirements do not appear to be a significant simplification relative to what is currently required. As additional documentation requests could arise in practice, we would appreciate more recommendations around documentation simplification (e.g., reliance on a form in years subsequent to the initial year that Amount B applies assuming no material factual changes).

We believe that a well-designed Amount B can greatly improve tax certainty and appreciate the confirmation that existing advance pricing agreement (APA) and mutual agreement procedure (MAP) results remain valid. However, the interaction of Amount B with other tax areas has not been addressed. For example, the July Consultation Document does not consider the “knock-on” effects of making certain determinations revising transfer pricing
outcomes for suppliers and distributors. This could have significant customs implications, especially if prices are reduced or refunded resulting in changes in customs duties. As stated in our prior comment letter, to ensure a holistic approach to certainty and avoid chaos between trading partners, clarification on how transfer pricing adjustments should be treated from a customs perspective would be welcomed.

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