
# Response to the OECD Public Consultation on Pillar One – Amount B

**25 January 2023**

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## 1. About the Irish Tax Institute

The Irish Tax Institute is the leading representative and educational body for Ireland's Chartered Tax Advisers (CTA) and is the country's only professional body exclusively dedicated to tax.

The Chartered Tax Adviser (CTA) qualification is the gold standard in tax and the international mark of excellence in tax advice. We benchmark our education programme against the very best in the world. The continued development of our syllabus, delivery model and assessment methods ensure that our CTAs have the skills and knowledge they need to meet the ever-changing needs of their workplaces.

Our membership of over 5,000 is part of the international CTA network which has more than 30,000 members. It includes the Chartered Institute of Taxation UK, the Tax Institute of Australia, and the Taxation Institute of Hong Kong. The Institute is also a member of the CFE Tax Advisers Europe (CFE), the European umbrella body for tax professionals.

Our members provide tax services and business expertise to thousands of Irish owned and multinational businesses as well as to individuals in Ireland and internationally. Many also hold senior roles in professional service firms, global companies, Government, Revenue, state bodies and in the European Commission.

The Institute is, first and foremost, an educational body but since its foundation in 1967, it has played an active role in the development of tax administration and tax policy in Ireland. We are deeply committed to playing our part in building an efficient and innovative tax system that serves a successful economy and a fair society. We are also committed to the future of the tax profession, our members, and our role in serving the best interests of Ireland's taxpayers in a new international world order.

**Irish Tax Institute - Leading through tax education**

## 2. Executive Summary

The Irish Tax Institute welcomes the opportunity to contribute to the OECD Inclusive Framework public consultation on Pillar One Amount B. We note that the Consultation Document[1] does not reflect the consensus views of the Inclusive Framework, the Committee on Fiscal Affairs (CFA) or their subsidiary bodies.

Amount A and Amount B constitute Pillar One of the OECD/G20 Inclusive Framework Two Pillar Solution to Address the Tax Challenges of Digitalisation[2] (Two-Pillar Solution).

Amount A provides for the new taxing right for allocating residual profits to market countries where a multinational enterprise (MNE) operates without having a physical presence, while Amount B constitutes the application of the arm's length principle to in-country baseline marketing and distribution activities on a simplified and streamlined basis, with a particular focus on the needs of low-capacity countries.

As a package of twin measures, the proposal to implement Amount B as part of an update to the OECD Transfer Pricing Guidelines (TPG) is unclear, rather than forming part of the Multilateral Convention (MLC) through which the new taxing right under Amount A will be implemented.

The Consultation Document notes that the members of the Inclusive Framework (IF) are considering whether Amount B should be mandatory in application or elective, with potential options ranging from designing Amount B as a safe harbour to strictly prescribing Amount B as the interpretation of how the arm's length principle should apply to baseline marketing and distribution activities.

In our view, it is imperative that the rules for Amount B would not be overly prescriptive to the extent that taxpayers would be forced to use a pricing method that would not make sense for their particular business. Instead, we believe the application of Amount B would operate most effectively as a safe harbour which taxpayers could elect to adopt, similar to the elective simplified approach which currently applies to low value-adding intra-group services.

Adopting such an approach to Amount B would increase certainty for taxpayers while providing simplification for low-capacity jurisdictions. It would also permit MNE groups to apply Amount B to a transaction but if there was a more appropriate pricing method they could apply that method instead.

[1] OECD Public Consultation Document, Pillar One-Amount B, 8 December 2022 – 25 January 2023
[2] OECD/G20 Inclusive Framework on BEPS, Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy, 8 October 2021.

We have summarised below the Institute's key comments and observations on the main design elements of Amount B proposed in the Consultation Document, further details of which are contained in the body of this submission:

- The policy mandate for Amount B is to provide simplification for MNE groups when pricing in-country baseline marketing and distribution activities. However, the extensive qualitative scoping assessment which taxpayers would be required to complete to confirm if their activities are in scope of Amount B, coupled with the onerous documentation requirements that have been proposed in the Consultation Document, would not provide simplification for taxpayers.

- In fact, Amount B as currently proposed, would shift the amount of work businesses are required to complete from an economic benchmarking analysis to undertaking a detailed qualitative analysis to assess whether their activities are in-scope of Amount B. On balance, our members consider that the administrative burden is likely to increase rather than decrease because of Amount B.

- While a key objective of Amount B is to improve tax certainty and reduce disputes involving in-scope baseline marketing and distribution transactions, the subjective nature of the qualitative scoping assessment proposed for Amount B is likely to result in the assessment being open to challenge by tax administrations. Consequently, our members are concerned that rather than reducing the number of transfer pricing disputes, Amount B would merely change the focus of those disputes.

- The number of exclusions from the scope of Amount B are extensive with the result that the scope of activities and industries to which Amount B applies is extremely narrow in our view.

- As very few businesses solely carry on pure distribution activities, it would be important that the permissible threshold for ancillary services which may be undertaken by a distributor is set at an appropriately high level for Amount B to have meaningful application.

- In our view, Amount B will not provide certainty for taxpayers if it is open to tax administrations to challenge the application of the Amount B pricing methodology by requiring the use of local market comparables. We consider the dataset of global comparables on which the Amount B pricing methodology would be based must be sufficiently substantial so as to remove the need for local market comparables.

- The proposed level of detail that taxpayers must include in their written contracts which document their qualifying transactions is wide-ranging. We understand that many MNE groups would not have the proposed level of detail in their existing intra-group contracts and therefore, it would appear administratively

excessive to compel taxpayers to rewrite their existing contracts to qualify for Amount B.

- To improve tax certainty for businesses under Amount B, it would be beneficial if a mechanism could be developed to allow a MNE to obtain advance assurance as to whether a transaction is in scope of Amount B, similar to the process which has been proposed in respect of Amount A.

- If guidance on the application of Amount B is included in the OECD TPG, it would be essential to specify a commencement date for the application of Amount B to in-scope transactions.

## 3. Scope of Amount B

Section 3 of the Consultation Document outlines the proposed scope of Amount B, which is the intra-group transactions that would be subject to Amount B based on qualitative and quantitative criteria. It includes buy-sell arrangements where the tested party purchases goods from one or more associated enterprises resident in other jurisdictions for wholesale distribution to unrelated parties, primarily in its local market.

The scoping criteria set out in Paragraph 18 of the Consultation Document contain a mixture of qualitative assessments that relate to the controlled transaction, as well as a number of quantitative measurements.

As Amount B is intended to be a simplification measure, we consider that determining whether a transaction is in scope should be a straightforward exercise for a taxpayer to undertake, with any quantitative measurements to be included as part of the scoping assessment, being easily verifiable.

**Qualitative Scoping Assessment**

In our view, the detailed qualitative scoping assessment to be completed by taxpayers to confirm they are in scope, would not provide simplification for taxpayers. Instead, Amount B, as currently proposed, would shift the workload that companies are required to complete from an economic benchmarking analysis to a detailed qualitative analysis of whether activities qualify for Amount B. On balance, our members consider that the administrative burden for businesses is likely to increase rather than decrease. Consequently, we believe that Amount B, as outlined in the Consultation Document, does not offer the mandated simplification.

We understand that, currently, many transfer pricing disputes arise from disagreement over the functions being carried on in a local market and whether those functions are consistent with a routine return. We do not foresee that Amount B would reduce the number of such disputes. The subjective nature of the qualitative scoping assessment required to be completed by taxpayers to determine if a transaction is in scope of Amount B would mean that the assessment is likely to be open to challenge by tax administrations.

Consequently, there is a concern that rather than reducing the number of transfer pricing disputes, Amount B would merely result in a change in the focus of those disputes. Furthermore, where agreement cannot be reached on scope, a taxpayer would inevitably then be required to undertake a traditional transfer pricing benchmark analysis of the relevant transaction.

**Exclusions from Amount B**

The exclusions from the scope of Amount B outlined in Paragraph 18 of the Consultation Document are extensive making the scope of Amount B extremely narrow, with only the most straightforward buy/sell arrangements likely to qualify.

It is proposed that the distribution of intangible goods and services would not be in scope of Amount B. As cross-border flows of software form a significant part of global inter-company flows, the proposal to exclude the distribution of intangible goods and services from the scope of Amount B is remarkable, in particular considering the Two-Pillar Solution emanated from BEPS Action 1 which focused on addressing the tax challenges of the digital economy.

The scoping criteria set out in Paragraph 18 contains a list of factors which, if applicable, would mean that a transaction would not be in scope of Amount B. In our view, it may be preferable for the starting point to include consideration of a positive list of factors which if satisfied would mean that Amount B could apply, rather than exclusions.

Notably, Paragraph 30 of the Consultation Document outlines a number of functions that contribute to sales generation (such as buying goods for resale, identification of new customers and managing customers' relationships, support and after-sales services, implementing promotional advertising or marketing activities), as well as other ancillary administrative or supporting activities (for example, warehousing goods, processing orders and performing logistics, invoicing and collection).

Paragraph 18(c) provides that the distributor must not perform any economic activity for which it is, or should be, remunerated at arm's length other than its core distribution function. These disqualifying activities may include the following:

- manufacturing activities;
- research and development activities;
- procurement activities; and
- financing activities.

There is no minimum threshold which applies to the carrying on of the disqualifying activities and there would appear to be no ability to segment financial results. Consequently, it is likely that many distributors would be excluded from the scope of Amount B because they would often carry out what's considered a disqualifying activity, while undertaking their baseline activities.

Paragraph 18(c)(i) mandates that the distributor should not perform any regulatory activities that are valuable and material to the ability to conduct the distribution activity in the market. This requirement would appear to exclude pharmaceutical companies from Amount B as the local distributor would commonly be required to hold a regulatory licence to put a drug on the market in the jurisdiction.

Paragraph 18(c)(ii) states that the distributor should not perform technical or specialised services that support the sale of the product or are essential to the customer relationship in the market, and notes that the distributor should not derive revenues from annual maintenance contracts. Even if the scope of Amount B were extended to include intangible goods, the impact of this condition would mean that the sale of software

would generally be excluded as it would be commonplace for software to be sold alongside a contract for services.

Paragraph 18(h) provides that certain specified ancillary activities are allowed to be undertaken within permissible thresholds. The level of the permissible thresholds is still under consideration and therefore, is not specified in the Consultation Document. As very few businesses solely carry on pure distribution activities, it would be important that the permissible threshold for the ancillary services which may be undertaken by the distributor is set at an appropriately high level if Amount B is to have meaningful application.

## 4. Amount B Pricing Methodology

It is proposed that the Amount B pricing methodology should be based on the Transactional Net Margin Method (TNMM). The Consultation Document notes that the Inclusive Framework is considering two exemptions that may impact this policy choice.

**Proposed Exemptions from Amount B Pricing Methodology**

The first exemption under consideration is whether the Amount B pricing methodology should not be applied when local market comparables are available to price the transaction. The second exemption under consideration would apply if a method other than the TNMM is the most appropriate method (MAM) to price a transaction.

(i) *Local Market Comparables*

The potential exemption where there are local market comparables is a key concern raised by our members. In our view, the dataset of global comparables on which the Amount B pricing methodology is based must be sufficiently large so as to remove the need for local market comparables.

While it may be appropriate to make an adjustment in exceptional circumstances (for instance where there is State intervention in the industry in the local market), we do not believe that the use of local market comparables should be an option that would be generally available to tax administrations. The policy intention of Amount B is to increase certainty but if it is open to a tax administration to generally apply a local market comparable, Amount B would not provide any certainty for taxpayers.

Should local market comparables be permitted, then transparency for taxpayers would be critical with the relevant data made available to taxpayers. This could potentially be achieved by the OECD publishing datasets on local market comparables.

(ii) *Most Appropriate Method*

It is proposed that the TNMM under the Amount B pricing methodology could be utilised on a 'rebuttable presumption' basis, meaning that either taxpayers or tax administrations could rebut the application of the Amount B pricing methodology on the grounds that another transfer pricing method (such as the comparable uncontrolled price or 'CUP' method) would be more appropriate to deliver an arm's length price.

In our view, it is imperative that the rules regarding Amount B are not so prescriptive that taxpayers would be forced to use a pricing method that would not make sense for their business. For example, for some industries, where there are high volume low margin sales, it may be more suitable to use a ratio based on cost (like the Berry Ratio). Also, in industries such as commodities, there may be a more appropriate method than the TNMM because of readily available published data which can easily be relied upon to determine pricing. In such circumstances, Amount B would not be a simplification as information on price is easily obtainable.

In our view, Amount B would work best as a safe harbour that taxpayers could elect to adopt, similar to the elective simplified approach which currently applies to low value-adding intra-group services. Taking such an approach would mean that groups could opt to apply Amount B, but if there was a more appropriate pricing method they could apply that pricing method instead.

**Annex A**

Annex A describes the benchmarking search criteria currently being considered by the Inclusive Framework for the purposes of Amount B. The firm level factors in the dataset include the region to which the country belongs and industry categories. It is unclear whether these categories will form part of the ultimate search criteria which would be used, however, the Consultation Document suggests that returns can vary considerably depending on these factors.

The regional categories which the Inclusive Framework are considering include Western, Eastern, Northern and Southern Europe. It is worth noting that studies have shown that in an EU context, European arm's length ranges do not statistically differ from country-specific arm's length ranges in most cases.[3]

The feedback we have received from our members is that in their experience returns across regions and industry tend to be relatively stable. However, members have queried the practicality of requiring geographical adjustments noting that differing reporting requirements across jurisdictions mean that there can be a lack of publicly available financial data.

[3] Brussels, 24 February 2004, Taxud/C1/LDH/WB - EU Joint Transfer Pricing Forum, Contribution by Dr. Heinz-Klaus KROPPEN, Is Europe One Market? A Transfer Pricing Economic Analysis of Pan-European Comparables Sets, Deloitte White Paper. DOC: JTPF/007/BACK/2004/EN

The Consultation Document foresees that a benefit of Amount B would be that the underlying benchmarking data can be readily updated to reflect the latest available data. It is not specified whether it is intended that the OECD would be responsible for these updates. It would be important to have transparency regarding updates to ensure that taxpayers could have confidence that the pricing is reflective of current market trends.

## 5. Documentation Requirements

The level of information sought in the documentation requirements set out in Paragraph 87 of the Consultation Document is wide-ranging and is more than what is required under current transfer pricing rules. Such extensive documentation requirements would appear to be overly onerous given Amount B is intended to be a simplification measure. As an alternative, consideration could be given to require the relevant information to be made available on request.

**Contractual Terms**

Paragraph 18(a) provides that taxpayers must document their qualifying transactions in a written contract that reflects the division of responsibilities, obligations and rights and the assumption of the economically significant risks associated with the distribution activities and should not contain terms that are inconsistent with the other scoping criteria. Paragraph 87(k) identifies ten elements which should be included in the written contract of an in-scope controlled transaction.

The contractual terms of a controlled transaction are normally the starting point for accurately delineating the transaction between the associated enterprises. It is evident from Paragraph 1.36 of the OECD TPG that the contractual terms of a transaction is just one of the economically relevant characteristics or comparability factors that need to be identified in the commercial or financial relations between associated enterprises in order to accurately delineate a transaction.

From a common law perspective, a contract may be a valid contract notwithstanding that it does not contain the elements outlined in Paragraph 18(a) and Paragraph 87(k). We understand that many MNE groups would not have the proposed required level of detail in their existing intra-group contracts and therefore, it would appear to be administratively excessive to compel taxpayers to rewrite their existing contracts to qualify for Amount B.

In our view, it may be more appropriate for the elements described in Paragraph 18(a) and Paragraph 87(k) to be framed as best practice or a level of detail which parties should aim towards rather than a minimum requirement.

## 6. Tax Certainty

The intended purpose of Amount B is to improve more certainty and reduce disputes involving in-scope baseline marketing and distribution transactions. However, the

subjective nature of the qualitative scoping assessment required to be completed by taxpayers to determine if their activities qualify for Amount B means that the assessment is likely to be open to challenge by tax administrations, thus reducing tax certainty for taxpayers.

Our members have highlighted measures such as the applicable federal rate (AFR) in the US which applies to inter-group loans, and the elective simplified approach to define service fees levied between related parties for the provision of low-value-adding intragroup services in the OECD TPG, which have assisted in increasing certainty for taxpayers. Our members do not consider that Amount B, as outlined in the Consultation Document, would have a similar impact for taxpayers.

To improve the certainty provided by Amount B, it would be beneficial to develop a mechanism which would allow a MNE to obtain advance assurance as to whether a transaction would be in scope of Amount B, similar to the process that has been proposed in respect of Amount A. In this regard, we note the reference in Question 6.3.2 of the Consultation Document to an elective early certainty program such as a streamlined Advance Pricing Agreement type process. We believe such a process could provide taxpayers with the confidence they would need regarding the application of the Amount B pricing methodology.

Annex 1 to Chapter 4 of the Transfer Pricing Guidelines contains sample Memoranda of Understanding (MOUs) for use by Competent Authorities in negotiating bilateral safe harbours for certain common categories of transfer pricing cases. Consideration could be given to the use of such MOUs on a multilateral basis. However, the legal status of such MOUs would need to be clarified for MNE groups to have the tax certainty they would need regarding the application of Amount B.

Should guidance on the application of Amount B be included in the OECD TPG, it would be essential to specify a commencement date for the application of Amount B to in-scope transactions. This would improve certainty for taxpayers regarding the potential application of Amount B to pre-existing transactions.