The **BEPS** Monitoring Group

COMMENTS ON THE OECD PUBLIC CONSULTATION DOCUMENT PILLAR 1 - AMOUNT B

This submission has been prepared by the BEPS Monitoring Group (BMG). The BMG is a network of experts on various aspects of international tax, set up by a number of civil society organizations which research and campaign for tax justice including the Global Alliance for Tax Justice, Red de Justicia Fiscal de America Latina y el Caribe, Tax Justice Network, Christian Aid, Action Aid, and Oxfam. This report has not been approved in advance by these organizations, which do not necessarily accept every detail or specific point made here, but they support the work of the BMG and endorse its general perspectives. It has been drafted by Sol Picciotto, Jeffery Kadet and Juliana Midori Kuteken.

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Summary

We strongly support the need for simplicity and certainty in allocating the rights to tax MNE profits, but this can only be achieved through formulaic methods. Complexity results from attempting to attribute profits by examining affiliates of MNEs in isolation and through one-sided transfer pricing methods. This is beyond any tax administration's capacity in practice, because it requires a time-consuming examination of the facts and circumstances of each individual entity to determine the functions it performs, followed by an illusory search for independent firms performing comparable functions. It is also mistaken in principle, because it disregards the reality that an MNE's affiliates are integral parts of a unitary corporate group, all contributing to its global profits. Hence, one-sided methods result in a systemic under-allocation of profits for functions deemed to be 'routine', while the 'residual' super-profits can be attributed to low-taxed affiliates.

The current proposal attempts simplification by focusing on a specific type of function, 'baseline' marketing and distribution, to establish benchmark profit level indicators through data-mining techniques to identify comparable entities. It proposes a relatively narrow functional scope, wholesale distribution, but would use standard industrial classifications that cover distribution in a very wide potential range of industries, as diverse as commodities, construction, food, electrical products, household goods and intangible products. The benchmarks would also encompass all global markets, although data on comparables is often unavailable particularly for small economies, and the economics of distribution greatly depend on geography and local market characteristics. Term-search filters would screen out firms performing other functions, but scrutiny of individual accounts would also be needed to eliminate material differences in accounting treatment. Published studies have focused more narrowly on distribution in specific industry sectors, but even these result in a range of possible profit levels too wide to act as an effective check, and the discussion draft does not resolve the difficulty of specifying the appropriate point or spread on the range.

In our view, the approach now suggested would be both ineffective and inappropriate. An MNE's profits from sales result from a range of activities such as product development, inventory and cost/quality controls, logistics, advertising, sales, marketing and customer support, which can only fictitiously be attributed to different entities. In practice wholesale distributors will have valuable information and data on local markets and customers. Limiting Amount B to supposedly 'baseline' stripped-risk functions will result in a systemic under-allocation of profit to sales jurisdictions.

Simplification should be done in line with the general approach in Pillar 1, of a formulaic allocation from the total global profits of the MNE. The original Amount B concept that came from MNEs in the consumer products sector proposed explicitly formulaic methods, and this would be a fairer and more effective approach. We suggest that the present proposal should be revised to present a formulaic method based on group-wide profitability.

A. General Comments

1. The importance of simplification

There is clearly an urgent need for simplification of the methods used for allocation of the profits of multinational enterprises (MNEs), following the G20 mandate for the BEPS project that tax should be aligned with where an MNE's activities occur and value is created. The current rules, as elaborated in the OECD Transfer Pricing Guidelines (TPGs), have been shown to be totally unsuitable, as they are both excessively complex and extremely subjective, allowing extensive scope for the highly paid MNE tax advisers to devise tax avoidance strategies that tax administrations simply do not have the resources to unravel and understand.

We have consistently pointed out that these problems can only be resolved by treating MNE corporate groups in accordance with the economic reality that they operate as unitary entities, and applying simple formulaic methods to allocate their global profits in line with their real presence and activities in each country. Hence, we have welcomed the enormous progress made in the work on Pillars 1 and 2 in the BEPS project, which entail a significant shift towards a unitary approach, and have provided detailed standards for the adoption of formulary apportionment.[1]

Pillar One marks a historic paradigm shift in international taxation, rightly described as 'revolutionary' by the OECD Secretary-General. For the first time it will apply a formulaic method to allow countries to tax MNEs on a portion of their global profits, allocated according to sales, regardless of physical presence. Regrettably, however, this will apply to only a small part of the profits of only around one hundred of the largest and most profitable MNEs. The existing unsuitable methods would continue to apply to the remainder of the profits of these MNEs, as well as to all those MNEs out of scope of Pillar One. The basic rules for Amount A itself are relatively simple and easy to administer, but they have been made unnecessarily complex by applying them only to 'residual' profit,[2] and attempting to

[1] See Sol Picciotto and Jeffery Kadet. 2022. 'The Transition to Unitary Taxation', *Tax Notes International*, 108: 453-61, available at SSRN: https://ssrn.com/abstract=4281528

[2] It should be recalled that the African Tax Administration Forum proposed the more straightforward approach of apportioning the whole of the profits: see 'ATAF Sends Revised Pillar One Proposals to the Inclusive Framework' 12 May 2021, available at https://www.ataftax.org/ataf-sends-revised-pillar-one-proposals-to-the-inclusive-framework .

combine these formulaic rules with the continued application of the current rules on ‘transfer pricing’.[3] Hence, there remains an urgent need for a wider adoption of simplified methods.

Although these proposals for Amount B have been driven by a particular concern about the capacity problems of low-income countries, in truth this is a problem for all tax administrations. Even the relatively well-resourced OECD members cannot match the capacity of the large numbers of tax advisers employed by MNEs, a high proportion of whom are concerned with income allocation. A recent article has noted that the Linked-In platform ‘counts 300,000 users worldwide who have “transfer pricing specialist” on their profiles.’[4] If we assume their average compensation is $100,000 (which is likely quite conservative), this suggests a compensation cost of $30 billion. It also seems likely that the vast bulk of these Linked-In members are partners or employees of law firms, accounting and business advisory firms, or other MNE advisors.

This $30 billion indicates the enormous cost of administering the current transfer pricing rules, and this figure is likely grossly understated. Not only tax authorities but MNEs themselves would greatly benefit from simplification, and there are indications that some are realising this. Indeed, the proposals for Amount B originated from MNEs in the household and consumer products sector, notably from Johnson & Johnson and Procter & Gamble. Such firms have sales and other activities in a very large number of countries, and are highly exposed to the problems of uncertainty due to the subjectivity of the current rules.

2. Relationship to Amount A

Although these proposals for what is described as Amount B form part of Pillar One, both their design and implementation are independent of Amount A. Amount A aims to allocate 25% of the ‘residual’ profits of the in-scope MNEs, defined as that part of their profits exceeding a 10% return on revenue worldwide. Hence, the proposals for Amount A include a ‘marketing and distribution safe harbour’ (MDSH) adjustment, aiming to eliminate double counting by restricting the profits attributed to the market jurisdiction other than Amount A to ‘routine’ profits. However, the MDSH has been formulated by a different process from that adopted for these proposals for Amount B. Although the discussion draft outlines several possible methods for implementation of Amount B, none of these involve its inclusion in the multilateral convention which would be needed to implement Amount A. The document suggests that ‘ideally’ implementation would be through adding guidance about Amount B to the TPGs. Clearly, it is being formulated so that it can be considered compatible with existing tax treaties, so could be implemented much more easily that Amount A.

Hence, these proposals should be evaluated on the basis that they would be implemented regardless of whether Amount A comes into force. This is important, because in our view it is inappropriate for the methods used for allocation of MNE income to be restricted only to ‘routine’ profits. A major limitation of the current rules for ‘transfer pricing’ is that they fail to take into account the competitive advantages of MNEs which tend to generate super-profits, generally in excess of the normal return for purely national firms, especially those operating in smaller markets. MNEs greatly benefit from their access to global markets which gives them economies of scale and scope, and their super-profits derive from the synergy of the firm as a whole and its ability to combine **all** the functions carried out by its affiliates. Hence, it is inappropriate, ineffective and mistaken to attempt to distinguish between

[3] See our comments on the Progress Report on Amount A, available at https://www.bepsmonitoringgroup.org/news/2022/8/24/amount-a-of-pillar-one .

[4] Bill Parks, ‘It’s Past Time for Formulary Apportionment’, *Tax Notes International* 108: 1411-1415, at p. 1411.

‘routine’ and ‘residual’ profits, and to attribute only routine profits to a specific affiliate carrying out a particular function.

This can be seen in the difficulties which have become evident in the design of Amount B, due to its focus on the problematic concept of ‘baseline’ marketing and distribution activities. It is this very concept that has enabled MNE tax advisers to devise structures such as ‘limited risk’ distributors and commissionaires, along with other aggressive transfer pricing techniques, to minimise taxes payable in sales jurisdictions. The imbalance in capacity and information asymmetries make it hard for tax administrations, especially those in low-income countries, to identify the likely high percentage of situations where local distributors (including sales agents and commissionaires), do in fact go beyond the ‘baseline’, and perform materially more important functions, hold more assets, assume more risks, or benefit from local marketing or other relevant intangibles.

It must be understood and appreciated that when MNEs choose to integrate marketing and distribution into their corporate group rather than contracting out these functions to independent firms, they do so precisely because this generates greater profitability overall, due to the much greater direct operational control this gives them. In many economic sectors, close relations with customers are the key to higher levels of sales and therefore profit, enabling firms to foster loyalty and collect data from customers. This has become increasingly important as digitalisation has greatly facilitated both the collection and exploitation of customer data. It generally involves unique and hard to value intangibles, such as goodwill, customer relationships and brand identification, which depend on local knowledge. These can only be maintained, and are enhanced, by integrating marketing and distribution with the upstream activities of design and production. Hence, an MNE’s local distributor will always make an important contribution to its success (or failure) in that market, and so share in the risks of the business. It is therefore inappropriate to allocate profits to a distribution affiliate of an MNE by comparing it to an independent local distributor, or to allocate it only a ‘routine’ level of profit.

Limiting Amount B to ‘baseline’ functions, with the distributor being the tested party, will result in a **systemic under-allocation of profit to sales jurisdictions**. In our view, simplification should be done in line with the general approach in Pillar 1, of a formulaic allocation from the total global profits of the MNE. In our previous comments on the Amount B proposals outlined in the blueprints of October 2020,[5] we pointed out the pitfalls of attempting to design it on the basis of the existing transactional net margin method (TNMM) in the TPGs. Unfortunately, despite the two year’s further work that has been done, there has been regression instead of progress; our warnings were unheeded but have proved justified.

3. The problem of scope

The difficulties of disentangling the various functions contributing to sales revenues bring into focus to the question of scope. The discussion draft sets out a relatively narrow scope, limited to wholesale distribution to unrelated parties primarily in the distributor’s local market (para. 14). Marketing is no longer mentioned here. Without doubt MNE tax advisers will argue that it should have a wider scope, facilitating the continued use of limited risk distributors to minimise taxation at source.

In considering the issue of scope, it should be borne in mind that distribution is inevitably closely linked to other functions, such as logistics, advertising, sales, marketing and customer support, which can only fictitiously be attributed to different entities within the corporate

[5] *Submission on the Pillar One and Pillar Two Blueprints*, 15 December 2020, available at https://www.bepsmonitoringgroup.org/news/2020/12/15/submission-on-the-pillar-one-and-pillar-two-blueprints

group. While wholesale distribution of goods requires a physical presence, these other related activities are increasingly being done to a great extent remotely, and hence can easily be attributed to offshore entities. Although they are an integral part of efficient distribution, the functions can be notionally separated, and attributed to different entities in a corporate group. Hence, the introduction of Amount B, even with its very limited scope, will further encourage tax advisers to devise complex structures based on fragmentation of these related functions. Consequently, the administration of Amount B would greatly depend on the ability of the tax administration to determine whether these closely related activities have been separated in reality, and not just on paper. This will only increase, not simplify, the tasks of the tax administrations, which all face severe capacity constraints.

The scoping criteria in the discussion draft (para. 18) are already extensive, covering three pages. They are mainly qualitative and hence highly subjective. Although some quantitative criteria have been proposed, these refer to sales volumes and expenditures. The criteria for determining whether the distributor performs the key functions of assumption of risk or contribution to the generation of intangibles remain qualitative and therefore subjective. These are by their nature hard or impossible to specify or define in terms of location. For example, the criterion for contribution to the generation of intangible assets is defined in terms of ownership of the assets. In practice, the distribution function both depends on and generates valuable information on local markets, data on customers and customer loyalty and goodwill, but ownership of these assets can easily be attributed to other affiliates offshore. Indeed, the distributor might even be charged a licence fee for use of these assets.

The discussion draft states that the criteria in paragraph 18 are 'not exhaustive', but only 'describe the general features that must be considered in determining whether a distributor performs baseline distribution'; this question must be answered by an analysis of the actual facts and circumstances (para. 23). To this end, the discussion draft provides a further four pages of commentary intended to guide this functional analysis (section 3.3), as well as extensive additional material relating to possible exemptions and exclusions.

It seems hard to understand how this can be described as a simplified method, particularly for tax administrations with low capacity. The task of the tax administration will only be simplified if it just accepts the taxpayer's delineation of the transaction. Any challenge to this would necessarily entail close examination of the nature of the business, about which it will obviously have far less information than does the MNE itself. Thus, far from simplifying the rules on allocation of profits, Amount B will introduce new complexities, merely adding a new transfer pricing method and creating additional issues of uncertainty and debate around its scope.

4. The resource-intensive and futile search for comparables

One-sided transfer pricing methods, such as the TNMM, depend on the identification of independent firms that can be suitable comparable entities. For the reasons we have already outlined, in our view this search is futile, because if an independent distributor could perform the needed functions effectively, the MNE would choose to sub-contract the function. This is the underlying reason for the difficulties of the search for suitable comparable entities. This fundamental point is too often obscured by practitioners grappling with the technical complexities of the methodologies needed to identify suitable comparators.

The design of a methodology for identifying comparables entails a trade-off between administrability and accuracy (or 'reliability', as expressed in the discussion draft). Ease of administration should mean a wide scope of coverage, with relatively few different benchmarks. This was the approach essentially taken by Brazil as early as 1996, soon after

the adoption of the TPGs. This entailed the specification in legislation of fixed margins for essentially all types of business, based on the cost-plus and retail-minus methods in the TPGs, obviating the need for the resource-intensive analysis of the facts and circumstances of each taxpayer and search for specific appropriate comparables. Ending the need for detailed examination and subjective judgments by specialist staff had enormous advantages in greatly reduced compliance costs, particularly for the tax administration, increasing predictability, and ensuring a negligible number of disputes on transfer pricing. The very broad-brush method for attributing profits no doubt resulted in potential tax revenue losses, but these have been minimised by Brazil's wide regime for controlled foreign corporations, and source taxation of royalties and fees for services.

However, the OECD took a very different path, emphasising the need for a functional analysis of each affiliate, adopting the 'best method' rule rather than a hierarchy of methods, and further refining the one-sided methods, particularly the TNMM. In 1995 the chapter on administration in the TPGs included a section on 'safe harbours', but it concluded that they raised 'fundamental problems' and were 'generally not compatible with the enforcement of transfer prices consistent with the arm's length standard'.[6] As experience with the TPGs grew, a number of countries nevertheless found it necessary to introduce simplified regimes, and these were surveyed in a project by the OECD in 2010-12 on administration of transfer pricing.[7] This resulted only in revisions to the section on safe harbours which continued to take a cautious approach, stating that they must be 'carefully targeted and prescribed', and run the risk of erosion of the tax base.[8]

The inconsistency between the methods used by Brazil and OECD members finally led to a joint project initiated in 2018, producing a report on alignment.[9] This has now resulted in provisional legislation in Brazil, which would, if approved within 120 days by the legislature, largely adopt the OECD TPGs and the 'best method' rule, abandoning fixed margins.[10] In our view, Brazil's system has had significant advantages in terms of greatly reduced compliance costs, though no doubt the methods used could be improved. It would be regrettable for Brazil to abandon this approach without replacing it with something better. It seems particularly inadvisable to adopt the TPGs now, when they have been subject to such extended re-examination due to their evident defects and complexity.

While Brazil's approach applied simplified methods across the board, this discussion draft targets only a specific activity, wholesale distribution. Hence, it falls between two stools. It would not provide a comprehensive alternative to the complex transfer pricing rules, as did Brazil's rules; yet the wide range of industry sectors in scope would not produce reliable approximations. It resembles the sector-specific safe harbour regimes attempted in some countries, essentially to provide tax stability to foreign investors in sectors identified as economically important.[11]

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[6] OECD (1995), *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations,* paras. 4.121, and 4.125.

[7] OECD (2012) *Multi-Country Analysis of Existing Transfer Pricing Simplification Measures – 2012 Update;* see also J. Andrus, (2012). 'Improving the Transfer Pricing System: Simpler, Clearer, Faster', *Tax Notes International*, 68 79-83.

[8] OECD (2022) *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations,* para. 4.97.

[9] See https://www.oecd.org/tax/tax-global/oecd-and-brazil-work-together-to-align-brazil-s-transfer-pricing-rules-to-international-standard.htm

[10] Medida Provisória Nº 1.152, de 28 de Dezembro, available at https://www.in.gov.br/en/web/dou/-/medida-provisoria-n-1.152-de-28-de-dezembro-de-2022-454516132

[11] Notably Mexico (maquiladoras), India (contract R&D and auto components), and the Dominican Republic (all-inclusive hotel accommodation); they have had mixed results: see Sol Picciotto (2018), 'Problems of Transfer Pricing and Possibilities for Simplification.' ICTD Working Paper 86.

The approach now proposed for Amount B aims to build on benchmarking methodologies which have been developed by some transfer pricing practitioners. Benchmarking entails two steps: first the identification of appropriate comparable entities on which suitable data are available, and secondly analysing the data to produce a range of comparable profit ratios. We explained above why this approach is mistaken in principle, since independent firms cannot be considered truly comparable. The search for comparables is also fraught with difficulties in practice, and the methodology proposed does not produce results suitable for general use by tax administrations.

For the first step, the discussion draft states that work has been done to produce a dataset of 'businesses that undertake wholesale distribution as their majority business activity' (para. 52). The data source is Moody's BvD Orbis database, and the initial filter is of active companies in the standard industry classification codes NACE 45 and 46, with further filtering to reject companies based on the terms used in their business overview (Annex A, p. 48).

This may be compared to the methodology described in an ongoing series of studies published over the past two years by Andrew Hughes, an economist specialising in this area. These are even more targeted, covering a range including five distinct sub-sectors of wholesale distribution, and focusing on only one market (although a large one) - North America.[12] These studies do not select comparable companies by using standard industry classification codes, as proposed in this discussion draft, because they are excessively broad, covering distribution in a wide range of industries. Yet they also apply more fine-grained further screening than seems to have been used in the methodology outlined in the discussion draft. In addition to further quantitative and search-term screening, the Hughes studies involved reviews of all the individual companies, based on a variety of sources, including company websites. Importantly, the actual individual financial accounts were also examined to ensure comparability, and some companies were excluded due to differences in classification of material items, such as cost of goods sold, and operating expenses.[13] The benchmarking methodology outlined in Annex A does not seem to involve any screening for accounting differences, no doubt because it would be time-consuming due to the broad scope, but this would significantly degrade the quality of the data.

The methodology of the Hughes studies resulted in datasets that were much smaller, but much more likely to include only truly comparable companies. Yet even so they produced only a wide range of profit level indicators that could be considered arm's length comparables. In the view of Michael Durst, a practitioner with extensive experience in both government and the private sector, 'The interquartile ranges computed in virtually all of Hughes's studies are far too wide to be useful in tax administration'.[14]

This seems even more likely with the dataset resulting from the methodology outlined in the discussion draft. In contrast with the highly specific targeting and fine-grained filtering

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[12] Those concerning distribution are: Hughes (2021) 'North American IT and Electrical Components Distribution, *Tax Notes Today International*, 8 August; Hughes (2022), 'North American Food Distribution', *Tax Notes International*, 105: 795-9; Hughes (2022), 'North American IT Distribution', *Tax Notes International*, 106: 763-66; Hughes (2022), 'North American Healthcare Distribution', *Tax Notes International*, 106: 1407-10, and Hughes (2022), 'North American Construction Distribution', *Tax Notes International*, 107: 675-8.

[13] 'Transfer Pricing Benchmark: 2022 North American Food Distribution', *Tax Notes International*, 105, at p.798.

[14] Michael C. Durst (2022), 'It's Time to Reform Transfer Pricing Benchmarking', *Tax Notes International*, 106: 1271-8, at p. 1533-4.

adopted in the Hughes studies, the methodology proposed in the discussion draft aims at creating a comprehensive pool of data, including all global markets for which data are available. The draft outlines the specialised econometric techniques that would then be used to test and analyse the data, and to produce profit level indicators. It does not provide any indication of the results that have been obtained by using this dataset. These results must be published before the approach can be adequately evaluated. The proof of the pudding is in the eating.

However sophisticated these econometric techniques may be, they cannot remedy the defects of an inappropriate dataset. Some of the inadequacies in the data will be systemic: notably, as is well known, the Orbis database has relatively little data from low-income countries, yet these are the ones for which this method is mainly intended. This problem is only briefly mentioned in the discussion draft (para. 56(b) p. 31), suggesting only that 'underlying assumptions will need to be outlined about the applicability of findings' to jurisdictions for which the dataset does not include data. Given the importance of this problem, we find it hard to understand how it can be brushed under the carpet in this way.

The long experience of many tax administrations and practitioners of using the TNMM consistently shows that it generates a wide range of results. A key question is always how to choose the appropriate point in the range. On this, the discussion draft states only that consideration is being given to using 'a specific arm's length result or some very narrow range of results (e.g., smaller than the interquartile range)' (paragraph 73). While this is certainly desirable, it is hard to see how it could be anything but arbitrary.

The possibility of using this type of benchmarking approach to simplify transfer pricing has also been suggested by the European Commission, in relation to its Business in Europe - Framework for Income Taxation (BEFIT) proposals, an outline of which has recently been published for public consultation. However, that consultation states that '[t]he aim would not be to replace the arm's length principle … [it] would only provide guidance on tax authorities' risk approach to businesses' transactions'.

The futility in practice of attempting to simplify one-sided transfer pricing methods that depend on an illusory search for comparables only adds to the inappropriateness of building on the TNMM which, as explained in section A2 above, would result in a systemic under-allocation of profit to sales jurisdictions.

5. Formulaic methods based on group-wide profitability

A much sounder approach to simplification should be based on the actual profitability of each MNE concerned. Several methodologies based on this have been proposed. Indeed, the Amount B concept itself originated from proposals from Johnson & Johnson and Procter & Gamble, both of which explicitly proposed a formulaic approach. Briefly put, the Johnson & Johnson proposal was that a local distributor should earn a minimum operating margin, computed as a percentage of the MNE's global consolidated operating margin, measured by the ratio of the local distributor's spending on sales, general and administration costs to local revenues. The Procter & Gamble proposal was to apply a specified percentage of the MNE's global profit margin to local sales revenues, with a higher percentage for higher global profit rates, based on earnings before tax rather than operating margin, which would forestall profit shifting via excessive interest payments.[15]

[15] Johnson & Johnson (2019) Comments on Pillar One Proposal, 11 November 2019, (comments provided by Katherine Amos and Louise Weingrod); Procter & Gamble (2019) Comments on Pillar One Proposal, 11 November, (comments provided by Timothy M. McDonald), both available at

Although these proposals seem much more promising than the one now proposed, we have not been provided with any explanation of why they were not followed up. We suggest that a methodology could be developed based particularly on the approach suggested by Procter & Gamble, based on the global operating margin of either the specific MNE, or specific industry sectors. This could be used for advance pricing agreements agreed bilaterally or multilaterally, either for specific MNEs or for industry sectors.

B. Specific Comments

1. Scope

Breadth of Scope

As we have explained in Section A, in our view true simplification is only possible by adopting formulaic methods based on the actual profitability of each MNE group. This would permit a broad scope for simplification, obviating the need for complex scoping conditions as well as elaborate techniques for identifying possible comparables.

However, given the proposed approach based on the TNMM, in our view the scope should be very narrowly defined. Even the scope presently proposed of wholesale distribution is quite wide, as it includes sectors as diverse as food products, construction equipment and electrical and IT equipment. This will inevitably result in such a wide range of potential profit level indicators that the methodology should only be used, if at all, for risk assessment.

Any widening of the scope, for example to include retail distributors (question 3.5.3 on p. 26), would significantly change the economic characteristics and inevitably further widen the range of comparables. The same applies to distribution hubs, i.e. distributors that distribute tangible goods to markets outside their country of residence (question 3.5.5, p. 27).

Assumption of Risk and Contribution to the Generation of Intangibles

The discussion draft suggests that distributors can undertake risk control and/or DEMPE functions that contribute to the generation of intangible assets, without necessarily involving the assumption of risks in this regard (p. 10, footnote 6, and question 3.5.9, p. 27). (We may have misunderstood this, due to the convoluted syntax of the drafting). It is not clear from the discussion draft in which situations would the distributors undertake risk control functions at arm's length, but would not assume such risks. In our view, it is impossible and inappropriate to try to identify which affiliates within an MNE group bear risk. MNE groups present themselves to outside investors, suppliers and customers as unitary entities, and the risks are those of the group as a whole. Any contribution to the generation of intangible assets is potentially valuable, and all the activities making such contributions share in both the upside and the downside.

Sales agency and commissionaire arrangements.

There is no reason to distinguish between distributors as such and sales agency or commissionaire arrangements. The actual function is the same irrespective of the legal form of the contractual relationship. There may well be 'variance in functional intensity'

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https://www.dropbox.com/s/3pb98p1o3qnz3me/oecd-public-comments-secretariat-proposal-unified-approach-november-2019.zip?dl=0&file_subpath=%2FPublished+15+November+2019 . See Michael C. Durst (2020), 'A Simplified Method for Taxing Multinationals for Developing Countries: Building on the "Amount B" Proposal to Repair the Transactional Net Margin Method', ICTD Working Paper 108, pp. 11-12.

depending on the business model and other factors, but it is hard to see why this results from the legal form.

That said, to a large extent sales agency arrangements and especially commissionaire arrangements have been executed specifically to eliminate or otherwise minimize market country taxation while still conducting through group members most or all distribution functions within a market country. For example, a foreign supplier may lease local warehouse facilities so that these functions are technically provided by the foreign supplier rather than a local sales agent or commissionaire. These types of concerns have been addressed to some extent by BEPS Action 7, resulting in changes to the model convention and commentaries implemented through the Multilateral Instrument, which aimed at legal structures intended to avoid permanent establishment status. It is important to coordinate the results of Action 7 with the Amount B provisions now under discussion.

Given this use of such arrangements along with the facts that (i) Amount B will cover only distributors at the lower end of the spectrum with respect to functions performed, assets owned, and risks assumed and (ii) the actual distribution and related functions performed within the jurisdiction by group members will not significantly differ irrespective of the legal form of contractual relationship (i.e. distributor, sales agent, or commissionaire), we believe that both sales agency and commissionaire arrangements should be covered by Amount B. From the perspectives of increasing simplicity and imposing taxation based on functions performed, assets owned, and risks assumed within the borders of each market country and not based on artificial taxpayer-created documentation that is primarily tax motivated as to form, we further suggest that consideration be given to not have any difference in the Amount B pricing between distributors on one hand and sales agents and commissionaires on the other.

Potential exemptions and exclusions

The issues raised in section 3.4.2 (Box 3.2) reveal the flaws in the proposed approach, which creates far too wide a gap between administrability and reliability. As we outlined in section A.4 above, even the focus on wholesale distribution would include a diverse range of industry product sectors, and diversity would be compounded by attempting to cover all geographic markets. This is presumably the motivation for suggesting on the one hand a narrowing of the scope, e.g. by product-based exclusions (commodities, non-tangible goods), and on the other hand allowing the use of local market comparables where they exist, or even reversion to the principle of using the most appropriate method.

Maximum administrability would certainly militate against any exclusions. However, this would mean that the benchmarking of ‘distribution’ would include a very wide range of product sectors, with big differences in their supply chain characteristics. The discussion draft highlights commodities (which also extend from hydrocarbons and minerals to agricultural products), and intangibles such as software, but big differences also exist between for example construction materials and household goods. However, as pointed out in section A.4 above, even benchmarking studies that focus on distribution in such specific product sectors produce a wide range of potentially comparable profit level indicators. Different geographic markets also diverge greatly, depending on factors such as population densities, quality of transport and communication infrastructure, and cultural factors.

It would therefore hardly be surprising that such a broad-brush approach to benchmarking might frequently produce results significantly different from those that might be observed in actual arm’s length transactions in a local market involving similar products, or by using a different transfer pricing method. Hence, it is entirely understandable to suggest that local

comparables should be permitted where available, or that the Amount B methodology should apply on a 'rebuttable presumption' basis.

Yet adopting these suggestions would clearly remove the advantages of simplicity and certainty at which the Amount B concept was aimed. In our view, this demonstrates the need for a different approach. A general simplification in our view can only be effective if based on a formulaic approach, as outlined in section A.5 above. If the proposed benchmarking approach based on the TNMM is adopted, its scope should be narrow to have any hope of being close to reliable. Preferably, it could be used as a basis to develop advance pricing agreements either for specific MNEs or industry sectors.

2. Pricing Methodology

As outlined in section A.4 above, we consider that the proposed methodology would not result in sufficiently reliable data. Published studies using these benchmarking techniques have:

> (i) focused on distribution in specific industry sectors, not the broad range of standard industry classifications proposed here;
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> (ii) covered only particular geographic markets for which good data are available; and
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> (iii) filtered using manual scrutiny, including of actual accounts, and not just term searches.

Even these published studies have resulted in broad ranges of hypothetically comparable profit level indicators that seem too wide for general use by tax administrations. The defects in the data to be analysed could not be remedied by the sophisticated econometric techniques suggested in the discussion draft.

It would certainly be desirable to be able to specify a 'specific arm's length result or some very narrow range of results (e.g., smaller than the interquartile range)', as suggested in section 4.3.2, para. 73. However, we consider that on the available evidence about benchmarking, and the extensive previous experience of use of the TNMM, the data would result in so wide a range that specification with more precision would be arbitrary.

3. Documentation requirements

We would point out that the use of transactional transfer pricing methods entails enormous documentation requirements, creating significant burdens for MNEs (especially the smaller ones), but also for tax administrations which need to evaluate the documentation for each entity. These are very intrusive, including extensive details of operations. By comparison, the documentation required for formulaic methods would be far more straightforward.

4. Tax certainty

Dispute prevention

The methodology under development may be found suitable by some tax administrations as a basis for APAs, including sectoral APAs, which can be administered in a streamlined manner.

We do not see any need for any superstructure or other international mechanism such as is contemplated for Amount A to deal with Amount B matters.

Dispute resolution

We see no reason for any change to countries' existing commitments to dispute resolution for the purposes of Amount B. In particular, the obligation under article 25 of tax treaties is for tax administrations to use their 'best endeavours' to resolve a disagreement, but not necessarily to reach an agreed outcome. Taxpayers of course always have available the option of resorting to domestic legal procedures. As is well known, there is widespread opposition among developing countries to the use of international arbitration, the arguments about which have been frequently rehearsed.