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Tax Treaties, Transfer Pricing and Financial Transactions Division
OECD Centre for Tax Policy and Administration

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Consultation on Pillar One – Amount B

Dear Sir/Madam

The Irish Tax Institute welcomes the opportunity to contribute to the OECD Inclusive Framework's public consultation on Pillar One – Amount B. Amount B is intended to apply 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. We note that the proposals set out in the Consultation Document[1] do not represent the consensus views of the Inclusive Framework, the Committee on Fiscal Affairs or their subsidiary bodies.

We have outlined below the feedback we have received from our members, who are tax professionals that provide tax services and business expertise to Irish owned and multinational businesses.

Scoping Criteria

'Alternative A' or 'Alternative B'

For a qualifying transaction to be in-scope of Amount B, the transaction must exhibit economically relevant characteristics, meaning it can be reliably priced using a one-sided transfer pricing method. In addition, the tested party in the qualifying transaction must not incur annual operating expenses lower than 3% and greater than a defined percentage of its annual net sales.

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

Member of the Confédération Fiscale Européenne

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In addition to these requirements, the Consultation Document notes that the Inclusive Framework are considering whether separate qualitative scoping criterion should be required to identify distributors that make non-baseline contributions which cannot be reliably priced using the pricing methodology, as set out in Section 4 of the Consultation Document.

Consequently, two alternative approaches are presented in the Consultation Document, namely, 'Alternative A' and 'Alternative B'. Alternative B requires a separate qualitative scoping criterion to identify and exclude non-baseline contributions whereas Alternative A does not require a separate qualitative scoping criterion.

Establishing that a transaction can be reliably priced using a one-sided transfer pricing method would require an analysis of the functions, assets and risks assumed by the distributor. In our view, a further qualitative scoping assessment, as proposed under Alternative B, with the addition of new concepts such as 'non-baseline contributions', is unnecessary.

Indeed, our members have raised concerns about the examples outlined in the Consultation Document and the detailed functional analysis that would need to be undertaken to demonstrate that the contributions made by a distributor should not be considered non-baseline contributions. We consider the subjective nature of the assessment which would be required under Alternative B to likely add further complexity to Amount B and result in the assessment made on scope being open to challenge by tax administrations.

A key objective of Amount B is also to improve tax certainty and reduce disputes involving in-scope baseline marketing and distribution transactions. We firmly believe that if Amount B is to achieve this goal, then Alternative A must be adopted, as it would be easier to apply and administer thus providing the necessary certainty sought by both taxpayers and tax administrations.

In contrast, we consider if Alternative B is adopted, rather than reducing the number of transfer pricing disputes, the focus of those disputes would merely change from disputes over the appropriate level of return for an arrangement to disputes over whether an arrangement falls within scope of Amount B.

We welcome the confirmation in footnote 16 of the Consultation Document, which states:

> *"Where a distributor falls out of scope, this should not be taken as implying any arm's length price for the controlled transaction, regardless of the scoping criteria used."*

The above line is important because it should be clear that the pricing matrix set out in Figure 4.1 of the Consultation Document is not intended to establish a 'floor' for controlled distributor returns.

It should also be apparent that if a taxpayer elects not to apply Amount B, or if a tax administration determines that a transaction does not fall within the scope of Amount B, this does not imply that a distributor is carrying on more than baseline marketing and distribution activities or that the appropriate return exceeds that which would apply under the pricing matrix set out in Figure 4.1.

Digital Goods

The Consultation Document seeks views on the appropriateness of the application of the Amount B framework to the wholesale distribution of digital goods. As the economically relevant characteristics of digital goods are similar to those for tangible goods, the rationale for excluding digital goods from the application of the Amount B framework is unclear. In our view, it should be possible for all goods to be in scope of Amount B, although we acknowledge that an adjustment for inventory may be required in the case of the wholesale distribution of digital goods.

As highlighted in our response to the previous consultation on Amount B in January, given cross-border flows of software form a significant part of global inter-company flows, the proposal to exclude the distribution of intangible goods from the scope of Amount B is very concerning, in particular considering the Two-Pillar Solution emanated from BEPS Action 1 which was entirely focused on addressing the tax challenges of the digital economy.

The Pricing Framework

Three possible industry groupings are provided under the global pricing matrix set out in Figure 4.1 of the Consultation Document. Members have highlighted to us that where a tested party distributes goods in two different industry groupings, disputes would likely occur over the most appropriate industry grouping. In such circumstances, the application of Amount B to an arrangement would not provide certainty for the taxpayer. Therefore, we believe it is imperative that Amount B would operate as a safe harbour which taxpayers could elect to adopt.

Uplifts within certain geographic markets to account for country risk

The Consultation Document proposes the pricing methodology would recognise that a distributor operating in a 'high country risk' jurisdiction would be entitled to higher returns relative to a distributor operating in a 'low country risk' jurisdiction (all other things being equal). Where a tested party is exposed to a higher level of country risk relative to the global dataset, it is intended that an adjustment would be made to the return under the global pricing matrix. The appropriate adjustment would be determined by reference to the sovereign credit rating category of the jurisdiction.

We understand from our members that an adjustment would not generally be made based on the sovereign credit rating category of a jurisdiction. As the level of sovereign credit risk depends on various factors, it is doubtful that using sovereign credit ratings would be a coherent approach to determine the appropriate level of return to which a distributor should be entitled. For example, the risk attached to selling goods in a specific jurisdiction may not be high even though the jurisdiction may have a low sovereign rating.

Furthermore, it would be expected that where there is an increased risk associated with a jurisdiction, such a risk is more likely to be borne by the entrepreneur company in the group rather than the limited risk distributor operating in the jurisdiction.

Utilising local databases in certain jurisdictions

The Consultation Document notes that geographic differences have been observed to influence the profitability of baseline marketing and distribution entities in a small number of jurisdictions for which relevant data is available. It is proposed that a modified approach and an adjustment mechanism would be established to account for these geographic differences.

The proposed modified approach includes the application of a modified pricing matrix which would be based on the observed differences in profitability between qualifying jurisdictions and the global dataset. A modified pricing matrix would undoubtedly add further complexity to the application of Amount B. In our view, the global dataset should be sufficiently robust to remove the need for a modified pricing matrix to take account of local market differences.

If members of the Inclusive Framework determine that a modified pricing matrix is appropriate, then there must be distinct economic evidence to demonstrate the existence of genuine local market differences that would support the use of a modified pricing matrix for a particular jurisdiction. It would also be important for any modified pricing matrix to be fully transparent and based on independent verifiable data. In our view, the same database and search parameters should apply as those applying for the global pricing matrix with only the region being narrowed to take account of local pricing differences.

Proposed Implementation Timeframe

The Inclusive Framework has confirmed it intends to approve a final report on Amount B and incorporate content into the OECD Transfer Pricing Guidelines by January 2024[2]. Given key operational aspects of Amount B remain under consideration, our members have expressed concern over the proposed short timeframe in which taxpayers will have to prepare for its implementation.

[2] Outcome Statement on the Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy, 11 July 2023.

Tax Certainty Mechanisms

We believe the application of Amount B would operate most effectively as a safe harbour which taxpayers could elect to adopt. Paragraph 96 of the Consultation Document proposes that the application of Amount B to a transaction may be considered by competent authorities in resolving mutual agreement procedures (MAPs) even in situations where neither the taxpayer nor the tax administration of the jurisdictions involved have asserted the application of Amount B. Our members have expressed serious concerns regarding this proposal as it would mean Amount B would not operate as a true safe harbour.

If it is not intended that Amount B would operate as a safe harbour, or indeed, if the Alternative B approach to scope is adopted, then it would be necessary for tax certainty mechanisms to be developed which would allow multinational groups to obtain advance assurance over whether a transaction is in scope of Amount B.

In the absence of such advance certainty mechanisms, it is our firm view that if Alternative B is adopted, assessments made on scope are likely to be open to challenge by tax administrations, due to the subjective nature of the qualitative scoping assessment required to be completed by taxpayers to determine whether their activities qualify for Amount B under the Alternative B approach. Such disputes are only going to lead to more uncertainty for taxpayers rather than reducing it.

Conclusion

The primary objective of Amount B is to simplify and streamline the application of the arm's length principle to in-country baseline marketing and distribution activities. If Amount B is to achieve its objective, we would urge the members of the Inclusive Framework to adopt the Alternative A approach to define scope. In addition, we would contend that it should be possible for the wholesale distribution of digital goods to come within the scope of Amount B.

Please contact Anne Gunnell of this office at agunnell@taxinstitute.ie if you require any further information in relation the above matters.

Yours sincerely

Colm Browne
Institute President