AICPA & CIMA
Together as the Association of International Certified Professional Accountants

December 11, 2023

The Honorable Lily Batchelder
Assistant Secretary for Tax Policy
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

RE: Comments on Draft Organisation for Economic Co-operation and Development) OECD/G20 Inclusive Framework Pillar One Multilateral Convention Text

Dear Ms. Batchelder:

In response to the October 11, 2023 Department of the Treasury announcement requesting public input on the draft Organisation for Economic Co-operation and Development (OECD)/G20 Inclusive Framework Multilateral Convention to Implement Amount A of Pillar One (Pillar One MLC) and accompanying documents, the Association of International Certified Professional Accountants (the "Association"), which includes the American Institute of CPAs (AICPA) and Chartered International Management Accountants (CIMA), is providing the enclosed comments that were developed by our AICPA OECD Task Force. The comments focus on Amount B of OECD Pillar One.

The implementation of Amount B promises to streamline and simplify a fundamental transfer pricing issue, providing substantial benefits to taxpayers and governments. However, in light of substantial unresolved issues regarding the scope of transactions and a lack of transparency regarding the pricing matrix, the December 31, 2023, target date for resolution seems unlikely to be reached.

These comments are in addition to our prior comments on OECD documents.[1] The below comments discuss the following Pillar One MLC issues:

- Pillar One, Amount B;
- Scope of Transactions;
- Most Appropriate Method;
- Pricing Matrix;
- Dispute Resolution; and
- Remaining Issues.

[1] See prior AICPA comments, "Public Consultation Document – Global Anti-Base Erosion Proposal ("GloBE") – Pillar Two," December 2, 2019; "Public Consultation Document – Secretariat Proposal for a "Unified Approach" under Pillar One," November 11, 2019; "Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy – Comments on Income Allocation between Jurisdictions (Pillar One)," October 4, 2019; and "Comments on the OECD Public Consultation Addressing the Tax Challenges of the Digitalisation of the Economy," May 28, 2019.

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Pillar One, Amount B

On October 14, 2020, the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting ("IF") released "Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint" (the "Blueprint"). According to the Blueprint, Amount B is intended to simplify the process for pricing all baseline marketing and distribution activities, likely the most frequent fact pattern encountered by multinational enterprises (MNEs) in a manner consistent with the arm's length principle (ALP). Amount B is intended to enhance tax certainty and reduce resource-intensive disputes between taxpayers and tax administrations. Amount B should particularly address the needs of low-capacity jurisdictions (LCJs) that suffer from a dearth of local market comparables.

On October 8, 2021, the IF agreed a two-pillar solution to address the tax challenges arising from the digitalization of the economy. Working Party No. 6 and the Forum on Tax Administration (FTA) Mutual Agreement Procedures (MAP) Forum were mandated to undertake the technical work to design Amount B. The IF mandate dictated that Amount B simplifies and streamlines the pricing of in-country baseline marketing and distribution activities, while ensuring outputs consistent with the arm's length principle for all in-scope transactions. With the benefit of the public consultation in December 2022, the work on Amount B developed further.

On July 17, 2023, the IF issued "Public Consultative Document: Pillar One, Amount B," which reiterated the goals of Amount B and summarized the scoping criteria, application of the most appropriate method, the pricing matrix, and processes for dealing with potential disputes. Further, the OECD indicated its intention for the IF to approve and publish a final Amount B report by the end of 2023 so that Amount B can be incorporated into the OECD Transfer Pricing Guidelines (TPG) in 2024.

Scope of Transactions

The primary focus of Amount B is on the wholesale distribution of goods, including commissionaires and sales agents; de minimis retail sales are allowed. These distribution arrangements need to be "baseline" in order to fall within the scope of Amount B. The consultation document describes common features of baseline distribution, such as the absence of unique and valuable intangibles or certain economically significant risks. However, the precise definition of "baseline" distribution is open to further debate to achieve consensus on an appropriate balance between quantitative and qualitative metrics.

The two alternatives to scope that are presented: "Alternative A," which does not require a separate qualitative scoping criterion to identify and exclude non-baseline contributions, and "Alternative B," which requires a separate qualitative scoping criterion to identify and exclude non-baseline contributions. Although two alternatives are currently identified, either alternative could be modified, aspects of the two alternatives might be combined, or another alternative may ultimately be chosen as the means to determine scope for Amount B.

Some taxing jurisdictions take the Alternative A position that a separate scoping criterion will not improve the reliability of Amount B and will undermine the tax certainty objectives of Amount B. In their view, baseline distribution can be reliably priced under the Amount B pricing approach without the need for a separate qualitative scoping criterion. The simplified and streamlined pricing approach recognizes that operating margins for baseline distributors can vary based on certain factors, and appropriately adjusts returns for differences in operating assets, operating expenses, industry, and country. Further, a quantitative scoping criterion can ensure that a tested party's ratio of operating expenses to sales is broadly within the central tendencies of the global dataset, so that the global dataset may be a reliable basis on which to price the tested party. This group of jurisdictions is of the view that further requirements that aim to exclude from scope distributors making "non-baseline" or "above-baseline" contributions are not needed to achieve arm's length pricing. This group of jurisdictions considers that any potential reduced reliability of Amount B pricing for these cases would fall within a trade-off between reliability and administrability inherent in the arm's length principle.

Other jurisdictions take the Alternative B position that without a separate qualitative scoping criterion being applied to support the definition of what is baseline distribution, Amount B will not reliably produce outcomes aligned to the arm's length principle. These jurisdictions are of the view that the absence of an explicit requirement for qualitative considerations to identify "non-baseline" distributors creates risks of base erosion and profit shifting and may increase instances where tax administrations assert that distributors that make non-baseline contributions could meet the conditions to apply a two-sided transfer pricing method, potentially increasing disputes.

Furthermore, Amount B acknowledges that MNEs may engage in different activities within the same legal entity and permits the segmentation of financial accounts to apply Amount B specifically to the distribution functions. The scoping framework explicitly excludes the performance of services and distribution of commodities from scope.

Most Appropriate Method

Consistent with TPG concepts, the Transactional Net Margin Method (TNMM) is viewed as the most appropriate method for in-scope transactions, but tax authorities and taxpayers may advocate for the comparable uncontrolled price (CUP) method using internal comparables.

Pricing Matrix

In Amount B, in-scope transactions are priced by reference to a pricing matrix, except for situations where internal CUPs are available. The pricing matrix provides a grid of arm's length returns expressed as returns on sales (ROS). The applicable arm's length return will depend on the distributor's specific features, such as the level of operating assets, operating expense, or the industry.

The global dataset of companies involved in baseline marketing and distribution activities was created by the application of the benchmarking search criteria as well as additional screening and qualitative review to reflect the scoping criteria. The financial information derived from that global dataset forms part of the basis for the approximation of arm's length results that has been translated into a pricing matrix. The approximation of arm's length results has been presented as matrix segments according to operating asset to sales intensity (OAS), operating expense to sales intensity (OES) and industry. The pricing framework also includes features to address geographical differences and data availability gaps, and it incorporates a corroborative mechanism to address extreme outcomes in low and high functionality cases.

The pricing matrix has been criticized for a lack of information regarding the empirical and econometric models applied to the dataset. The entire section on pricing is subject to further consultation and is expected to be updated every five years.

Dispute Resolution

Some level of transfer pricing disputes is expected under Amount B. Any primary adjustment by a tax authority under Amount B will be subject to normal MAP. In MAP regarding the application of the simplified and streamlined approach, competent authorities should consider the objectives of a streamlined application of the arm's length principle to in-scope qualifying transactions. Any agreement reached under a mutual agreement (including advance pricing agreement cases) prior to the adoption of the simplified and streamlined approach should prevail in relation to the covered qualifying transactions. In some cases, the taxpayer may have entered into advance pricing agreements (APAs) covering qualifying transactions prior to the adoption of the simplified and streamlined approach. In the absence of a breach of the critical assumptions or an agreement of the parties to cancel or renew the APA, the terms and conditions of such APAs would continue to be valid throughout the duration of the APA.

Remaining Issues

Further work will need to be undertaken on the following aspects of Amount B to achieve consensus on the scope and pricing framework:

1. Achieve an appropriate balance between a quantitative and qualitative approach in identifying baseline distribution activities.
2. Confirm the appropriateness of:
   A. The pricing matrix;
   B. Application of the framework to the wholesale distribution of digital goods;
   C. Country uplifts within geographic markets; and
   D. How to apply Amount B utilizing a local database in certain jurisdictions.

Conclusion

The implementation of Amount B promises to streamline and simplify a fundamental transfer pricing issue, providing substantial benefits to taxpayers and governments. However, in light of substantial unresolved issues regarding the scope of transactions and a lack of transparency regarding the pricing matrix, the December 31, 2023, target date for resolution seems unlikely to be reached. Further, some concern exists that the OECD will reach agreement on Amount B, but some taxing jurisdictions will not apply it or will apply it inconsistently. Regardless whether the December 31st target date is satisfied, the streamlining and simplification goals of amount B are worthy of the efforts and compromise needed to achieve a global consensus.

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The AICPA is the world's largest member association representation the accounting profession, with more than 421,000 members in the United States and worldwide, and a history of serving the public interest since 1887. Our members advise clients on federal, state and international tax matters and prepare income and other tax returns for millions of Americans. Our members provide services to individuals, not-for-profit organizations, small and medium-sized businesses, as well as America's largest businesses.

The CIMA is the world's leading and largest professional body of management accountants. CIMA works closely with employers and sponsors leading-edge research, constantly updating its professional qualification and professional experience requirements to ensure it remains the employer's choice when recruiting financially trained business leaders.

We appreciate your consideration of our recommendations and welcome the opportunity to further discuss our comments. If you have any questions, please contact Michelle Mullen, Vice President of International Advocacy at +44 787 603 0547, or Michelle.Mullen@aicpa-cima.com; or Melanie Lauridsen, AICPA Vice President of Tax Policy & Advocacy at +1 202 434 9235, or Melanie.Lauridsen@aicpa-cima.com.

Sincerely,

Melanie E. Lauridsen

Michelle Mullen
Vice President – International Advocacy

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Vice President - Taxation

cc: The Honorable Daniel I. Werfel, Commissioner, Internal Revenue Service
Ms. Lindsay Kitzinger, Office of the International Tax Counsel, Department of the Treasury
Mr. Jim Wang, Deputy International Tax Counsel (Acting), Office of the International Tax Counsel, Department of the Treasury
Ms. Elena Virgadamo, Office of the International Tax Counsel (Treaty Affairs), Department of the Treasury