

By e-mail

OECD Secretary
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FROM J.K.H. van Dam, J.W.M. Kunen, D.A. Both, and R. van Tongeren
DATE 31 August 2023
RE Public Consultation Document, 17 July 2023 – Amount B of Pillar One

Dear Sirs and Madams,

We are delighted to see that many of our comments regarding the previous Public Consultation Document on Amount B of Pillar One (released on 8 December 2022) (hereinafter referred as the “**Previous Consultation Document**”) have been taken into account. With regard to the new Public Consultation Document on Amount B of Pillar One (released on 17 July 2023) (hereinafter referred as the “**Consultation Document**”), we would again like to express our gratitude for the opportunity to submit comments. In our comments we strive for an application of Amount B that fits within the at arm's length principle and for it to be a genuine simplification for both taxpayers and tax authorities, resulting in a reduced administrative burden, uncertainty and disputes while trying to avoid artificial situations.

Our comments to the Consultation Document are divided into two parts. In the first part, we aim to provide general comments on Amount B rules, with a focus on enhancing tax certainty and emphasising what we consider to be “baseline” criteria. In the second part of our comments, we address the aspects where explicit input is requested.

The comments submitted herein are on behalf of Loyens & Loeff N.V. and should not be construed as representing the opinions of any of its clients.

1 General Comments

We have analysed the Consultation Document and we would like to place the following general comments:

(i) Safe harbour

We believe that the Consultation Document offers useful additional guidance in discussions between taxpayers and tax administrations regarding baseline marketing and distribution activities (“**BMDA**”). However, from the Consultation Document it does not become clear whether Amount B is going to function as a safe harbour or if it prescribes the interpretation of how the arm’s length principle applies to BMDA.

We would like to explicitly emphasise our preference for implementing Amount B as safe harbour. Furthermore, we believe that this safe harbour framework will only be effective if it binds competent authorities to avoid any transfer pricing mismatches.

(ii) Competitiveness

As we have not explicitly come across criteria which focus on the competitiveness of a market (i.e., could the related party be “easily” replaced by another (unrelated) party), we suggest including such a scoping criteria of Amount B.

In general, we are of the view that a minimum level of competition in the market is necessary to accurately define marketing and distribution activities as “baseline”. Highly competitiveness markets result in converging lower margins that can be reasonably well predetermined by industry and/or business. Contrary, businesses with only a limited level of competition generally earn higher returns, not allowing the envisaged Amount B (safe harbour) framework to be in place.

Therefore, we believe that considering the competitiveness of the market constitutes a key element when applying the at arm’s length principle for pricing marketing and distribution activities.

(iii) Development stage of individual business

In addition to the aforementioned, we believe that the criterion of a minimum amount of competition in a market to be considered “baseline” should not apply to individual businesses that are heavily developing. Even in highly competitive markets where well-established parties perform baseline activities, new entrants, such as start-ups, attempt to penetrate the market. In our view such new entrants are not comparable to the well-established parties with respect to their margins.

We therefore suggest withholding individual businesses that are in stage of development from the application of Amount B, even if these individual businesses operate in a highly competitive market.

2 SPECIFIC ASPECTS FOR PUBLIC COMMENTATORS

2.1 Introduction

Our comments regarding the specific aspects for public commentators follow the order as laid down in the Consultation Document. This results in comments regarding the specific aspects for public commentators in the following order: presented alternatives in paragraph 2.2, pricing framework in paragraph 2.3, framework to the wholesale distribution of digital goods in paragraph 2.4, country uplifts within geographic markets in paragraph 2.5, and criteria to apply Amount B utilising a local database in certain jurisdictions in paragraph 2.6.

2.2 Presented alternatives

“Alternative A” does not require a separate qualitative scoping criterion to identify and exclude non-baseline contributions, whereas “Alternative B” does require a separate qualitative scoping criterion to identify and exclude non-baseline contributions.

Qualifying transactions will be out of scope under Alternative B if the tested party makes specific non-baseline contributions to the transaction. Non-baseline contributions should be specifically identified based on the accurate delineation of the transaction and considering the facts and circumstances of the qualifying transaction.

As already mentioned in our submission regarding the Previous Consultation Document, we experience the most resource-intensive transfer pricing disputes to be in the stage of the accurate delineation of the controlled transaction. Implementation of Alternative B will therefore – according to our expectation – still lead to many (unwanted) resource-intensive disputes.

Hence, we encourage to implement “Alternative A”, which does not require a separate qualitative scoping criterion to identify and exclude non-baseline contributions. Implementing “Alternative A” would increase both the tax certainty and predictability for taxpayers, which are in line with the goals of Amount B. This is closely related to our desire to have Amount B functioning as a safe harbour.

2.3 Pricing framework

The financial information derived from the global dataset, that originates from the application of benchmark search criteria, screening and qualitative review, has in part formed the basis for the approximation of arm’s length results which has been translated into a pricing matrix.

The approximated arm's length outcomes are meticulously represented within matrix segments categorized according to Operating Asset to Sales Intensity (**OAS**), Operating Expense to Sales Intensity (**OES**), and industry affiliations. We note from Figure 4.1 that an observable trend emerges whereby an elevated OAS correlates with a heightened arm's length return.

First of all we respectfully request further elaboration from the Inclusive Framework (**IF**) regarding the methodologies employed for calculating both OAS and OES. The existing Consultation Document,

regrettably, lacks explicit calculation directives for these intensity measures. In light of the non-standardized definitions of OAS and OES, we believe such instructions are imperative.

Additionally, we would agree with the position that a higher OAS results in a higher arm's length return. However, we do observe that, for companies with an OAS exceeding 15%, the pricing matrix retains a consistent return value regardless of the associated OES. The matrix implies that OES only influences the arm's length return in cases where OAS is under 15%.

We would like the IF to elaborate on the mechanism behind this outcome, as we are under the impression that the OES could also affect the arm's length return in cases where the AOS exceeds 15%. Specifically, we wish for a comprehensive account of the construction rationale behind the 15% threshold.

Furthermore, we understand that three different industry groups are distinguished. We would like to ask the IF whether the distribution of categories of goods over the three industries is susceptible to change. We suggest it could be very well possible that a category of goods could have high level of returns at first, but due to increased (decreased) competitiveness in that category, experience decreasing (increasing) returns. We would therefore argue that, similar to updating the arm's length return percentages, the categories of goods per industry group should be updated annually.

The pricing matrix depicted in Figure 4.1 highlights the applicability of a margin ranging between +/- 0.5% on the arm's length return in relation to sales for each designated cell, characterized by the combination of AOS, EOS, and industry. We seek clarification on the uniformity of this margin, whether it has been intentionally standardized across all cells.

This has led us to contemplate the underlying reasoning behind the choice of a 0.5 percentage point margin for all cells. Choosing a percentage points margin in combination with the range of arm's length returns in Figure 4.1 could lead to a relatively large margin to an arm's length return of 1.5% compared to an arm's length return of 5.5%. We would therefore suggest that a specific range is given per cell. In that regard we would suggest matching the IQR of the underlying Benchmark per cell.

2.4 Framework to the wholesale distribution of digital goods

We empathize with the IF's uncertainty regarding the implementation of Amount B to digital goods. However, we believe that digital goods should not be treated differently as long as provisions on competition (as noted under general comment (ii)) and the development stage of individual businesses (as noted under general comment (iii)) are included for the application of Amount B.

The at arm's length remuneration of marketing and distribution activities mainly depends on the level of competition and the development stage of individual businesses, regardless of the type of good (digital or non-digital). This stipulates the importance of our general comments mentioned in (ii) and (iii). Therefore, we believe that the envisaged framework – after including our general comments – is also appropriate for applying to the wholesale distribution of digital goods.

2.5 Country uplifts within geographic markets

Based on econometric analysis of the IF, 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.

On this basis, a modified pricing matrix has been established based on the observed material differences in profitability between qualifying jurisdictions and the global dataset.

(i) Modified pricing matrix for qualifying jurisdictions

An observed difference has been considered material where more than half of the companies in a jurisdiction have a return which does not fall within the interquartile range of returns of all the companies in the corresponding asset, expense and industry group.

From the Consultation Document it follows that where the majority of companies fall above the IQR in some cells but below in others, the results are netted off. Furthermore, the Consultation Document reveals that differences represented by a single company in a cell have not been taken into account in this process.

Although we believe that the main features of this approach are appropriate and do make sense, we would appreciate additional clarification on the details (e.g., regarding netting) to gain better understanding before drawing further conclusions.

(ii) Data availability mechanism for qualifying jurisdictions

The data availability mechanism is intended to account for cases where there is no or insufficient data in the global dataset for a particular tested party jurisdiction but there exists evidence of country risk in that jurisdiction that may influence arm's length returns attributable to baseline marketing and distribution activities.

From the Consultation Document it is not clear what can be understood by "insufficient data". We suggest implementing clear guidelines with regard to this definition to avoid discussion and potential disputes regarding the application of Amount B.

2.6 Criteria to apply Amount B utilising a local database in certain jurisdictions

A local dataset is used to address any potentially material data availability gaps that may exist in the global dataset owing to lack of country coverage of the underlying commercial database used to generate the global dataset.

We respectfully urge the IF to provide explicit guidance on identifying the occurrence of significant data availability gaps, triggering the utilization of a local database. Clarity in determining such material gaps is pivotal to the effective implementation of this framework and to try to avoid potential disputes.

An additional contemplation pertains to the potential capacity of tax administrations in jurisdictions experiencing data gaps to construct a localized dataset and the accompanying pricing matrix. It is imperative to assess the viability of such actions within these jurisdictions.

Furthermore, one could argue that local tax administrations may have an inherent incentive to manipulate datasets in a manner that results in an elevated arm's length return on sales. For example, by publishing anonymised "secret comparables" (i.e., self-compiled comparables based on data from local corporate income tax returns) which have been manipulated. We would like to ask the IF to clarify their strategies for safeguarding against such dataset manipulations.

Lastly, we draw attention to the potential ramifications of introducing local datasets and pricing matrices. While these measures aim to address data gaps, they might accidentally create problems by causing disputes between local tax offices and the IF. These discussions might centre around the verification of datasets and pricing matrices, potentially undermining tax certainty for taxpayers. This would be counter to the very essence of Amount B. We would therefore suggest introducing a tie-breaker dispute resolution mechanism to settle such disputes.

Yours sincerely,
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