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FROM J.K.H. van Dam, J.M. Vázquez, S. Buriak, S. van der Kroon, J.W.M. Kunen and
R. van Tongeren
DATE January 25th, 2023
RE Public Consultation Document - Amount B of Pillar One

Dear Sirs and Madams,

We thank you for the opportunity to submit comments on the Public Consultation Document on Amount B of Pillar One released on 8 December 2022 (hereinafter referred as the “**Consultation Document**”).

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 in relation to enhancing tax certainty and reducing resource-intensive disputes between taxpayers and tax administrations. In the second part of our comments, we answer some of your specific questions on scope, the Amount B pricing methodology, documentation, and tax certainty, as laid down in the Consultation Document.

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.

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1 GENERAL COMMENTS

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

(i) General remarks

1. We believe that the Consultation Document offers useful additional guidance in discussions between taxpayers and tax administrations regarding baseline marketing and distribution activities (“**BMDA**”). In addition, the view of implementing Amount B as a safe harbour would simplify the process for determining the markup level for the BMDA in accordance with the arm’s length principle. Therefore, we do believe that Amount B contributes (to some extent) to reducing recourse-intensive disputes.
2. However, we also believe that the OECD has not fully accomplished its goal to reduce resource-intensive disputes between taxpayers and tax administrations.

(ii) The most resource-intensive transfer pricing disputes are regarding the stage of accurately delineating the controlled transaction, i.e., scoping criteria.

3. The scoping criteria trigger the need to agree with tax authorities on the “accurate delineation of the controlled transaction” which, in practice, leads to the most impactful transfer pricing disputes. Hence, we expect many resource-intensive disputes to remain. For example, we experience many wholesale distributors to determine the creditworthiness of their customers. This also occurs in third-party relations, as a service. We often notice, tax authorities too easily conclude that if the wholesale distributor renders such service to the principal, “when accurately delineating the buy-sell arrangement between the tested party and associated enterprise” the credit risk should be allocated to the wholesale distributor. Based on the criterion that the distributor must not perform any risk control functions that lead to the assumption of economically significant risks by the distributor, this wholesale distributor will be out of scope for Amount B. We believe that this criterion will in practice lead to many (unwanted) discussions and would suggest amending the criteria in this respect.

(iii) Differences in market sizes: General comment

4. In today’s globalized economy, operations of distributors frequently are not linked to the geographical market of only one country, but instead the market of several countries operate as a homogeneous or highly interconnected market area. The scoping requirement that the distributor must distribute primarily in its market of residence can deprive the distributors from smaller markets and scale up companies from the benefits of Amount B simplification measures. For example, a distributor in Switzerland can also cover Germany as a targeted market but fall out of the scope of Amount B merely because of objective differences in the sizes of the markets of two countries. We believe that this undesired effect would interfere with business decisions and would suggest amending this in the final scoping criteria of Amount B.

(iv) *No consideration in the Amount B proposal for the level of competitiveness of a market, in which BMDA are performed.*

5. In the process of interpreting what the final scoping criteria will be for taxpayers intended to be in scope for Amount B purposes, 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 consider the level of competitiveness on a market as a crucial factor for the economic analysis of companies which perform BMDA. We suggest including this in the final scoping criteria of Amount B.

(v) *Potential exemptions to applying the TNMM as a default method under the Amount B proposal*

6. The OECD IF is considering two exemptions that may impact the policy choice of applying the TNMM.

- 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. Amount B is developed for pricing BMDA, which have a routine character and do not uniquely contribute to the business of a multinational group. Therefore, in light of these characteristics, local comparables should be available. If there are no third parties to perform similar functions, the functions could be seen as unique and more valuable since an independent party, which would be a provider of such unique functions, would also have stronger bargaining power to agree on a higher return. We suggest amending this exemption as it would now adversely impact taxpayers active in competitive markets.
- The *second* exemption under consideration would apply if a method other than the TNMM is the most appropriate method in particular cases. We support the position that the Amount B pricing methodology, based on the TNMM with an appropriate PLI, 'should be used to price all in-scope transactions without the necessity of considering alternative transfer pricing methods, on the basis that Amount B represents a permissible administrative simplification to the most appropriate method principle". The scope rules are designed in a way that only BMDA are covered, for which a cost-based TNMM would be an appropriate transfer pricing method. The requirement to evaluate whether the CUP would be the most appropriate method for in-scope transactions would eliminate the simplification element of Amount B reducing the benefits of the additional compliance requirements for Amount B purposes.

(vi) *Tax certainty*

7. It is unclear from the proposal, whether it is the tax administration or the taxpayer that will bear the burden of proof that the TNMM or the CUP is the most appropriate method for purposes of Amount B. If the taxpayer opts for Amount B and meets the scope criteria, the appropriateness of the TNMM has to be presumed.

8. Without mandatory binding arbitration potential disputes may not be resolved through a mutual agreement procedure (MAP). We believe that it would be preferred to link mandatory binding arbitration to Amount B in order to ensure that disputes are resolved in a timely manner. This

would also be in line with the aims of Amount B to improve tax certainty and reduce disputes for taxpayers in respect of BDMA.

SPECIFIC QUESTIONS FOR PUBLIC COMMENTORS

1.1 Introduction

9. Our comments to your questions follow the order of the questions as laid down in the Consultation Document. This results in the following order: scope in paragraph 2.2, pricing methodology in paragraph 2.3, documentation in paragraph 2.4, and tax certainty in paragraph 2.5.

1.2 Scope

1.2.1 Question 1

3.5.1. (i) Do you consider that any of the individual scoping criteria would be unlikely to be observed when reviewing the economically relevant characteristics of otherwise comparable independent enterprises on the basis that sufficiently detailed information is not available? (ii) Moreover, do you consider that such differences in observation could materially affect the ability to use those comparables in establishing arm's length prices?

a. Criterion "Primary Jurisdiction Test"

Para 18(b): "The distributor must distribute primarily in its market of residence, where the annual net sales generated by the distributor from customers located in other jurisdictions do not exceed [X]% of its annual net sales."

b. Comments to criterion "Primary Jurisdiction Test"

10. A geographical limitation to the scope of BDMA as a requirement for a distributor to benefit from the Amount B simplification measures can adversely affect the competition between the distributors in related geographical markets, stimulate the relocation of the place of residence from smaller markets and contradict the freedom of establishment in the EU single market.
11. In today's globalized economy, operations of distributors frequently are not linked to the geographical market of only one country, but instead the market of several countries operate as a homogeneous or highly interconnected market area. Examples of such market areas include Spain and Portugal, Belgium, Netherlands and Luxembourg, Germany, Switzerland and Austria, etc. The countries that may form a homogenous market area are often different in size of their markets, e.g., Germany and Switzerland.
12. The scoping requirement that the distributor must distribute primarily in its market of residence can deprive the distributors from smaller markets and scale up companies from the benefits of Amount B simplification measures. For example, a distributor in Switzerland can also cover Germany as a targeted market but fall out of the scope of Amount B merely because of objective differences in the sizes of the markets of the two countries. We believe that this undesired effect would interfere with business decisions and would suggest amending this in the final scoping criteria of Amount B.
13. In addition, this requirement may be considered as contradictory to the freedom of establishment and freedom to provide services in the EU, since the local distributor may not be able to apply

Amount B (i.e., receive a different tax treatment, incl. more burdensome compliance), depending on whether BDMA are only performed domestically or also cross-border.

14. We would initially assume that a potential reasoning for including this geographical limitation in the scoping rules was due to the objectives of Amount A, namely, to calculate the profit attributable the market jurisdiction where an MNE has a physical presence to determine the Amount A to which the market jurisdiction would be entitled. Yet, if we look at Amount B as a separate simplification measure from Amount A, the rationale behind this geographical limitation is not clear and we then suggest to amending this.

c. Criterion “Single Activity Test”

Para 18(c): “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.”

d. Comments to criterion “Single Activity Test”

15. If the BMDA are conducted by a local distributor along with other non-core routine activities that, in general, do not change the functional profile of the distributor as a limited-risk distributor and are formalised in separate transactions, we are of the view that Amount B should still apply to the BMDA only. The additional functionality should be then assessed under the standard transfer pricing assessment. This can extend the scope of Amount B and the benefit, if higher simplicity applies to more entities. In our view, this requirement should be omitted provided that the distributor can provide separate accounts for operating expenses for different functions, i.e., BMDA and additional routine functions.

e. Criterion “Ratio [annual operating expenses / annual net sales]”

Para 18(i): “The ratio of annual operating expenses over annual net sales of the distributor is in the range of [X]% to [X].”

f. Comments to criterion “Ratio [annual operating expenses / annual net sales]”

16. Unpredictable events and the economic cycle in general, significantly affect the company's profitability. For example, the (unexpected) extreme rise of energy costs and high inflation in 2022 resulted in higher operating costs (salaries and purchased goods). Though companies may increase prices, most cannot or do not increase them enough to cover their higher operating costs. As a result, they often fail to maintain profitability in real terms. Such events therefore potentially impact whether the taxpayer falls inside or outside the range. We wonder whether the proposal intends to conclude Amount B is not appropriate if a taxpayer falls out of the range due to such circumstances. In addition, no consideration for economic cycle fluctuations and higher operating expenses are intended, one should avoid that, for example, high energy prices automatically lead to a higher profit of the BMDA.

17. In order to enhance tax certainty and predictability for taxpayers, we suggest considering complementing the range with additional alternative rules:

- Alternative (i): look at the five-year [or X-year] average ratio to determine whether a company is within scope.

- Alternative (ii): if this year's ratio deviates 20% [or X%] or more from the five-year [or X-year] average ratio, disregard this year's ratio.

1.2.2 Question 2.1

3.5.2. (i) Do you consider that any other financial indicators may be utilised to measure the performance of certain functions, ownership of certain assets, or assumption of certain risks relevant to the scoping criteria other than those already described above? (ii) Moreover, do you consider that any financial or non-financial quantitative metrics may be utilised in order to reliably and objectively determine if the scoping criteria are met, for example with reference to the limited assumption at arm's length of economically significant risks?

18. As stipulated in our general comments to the design of Amount B, in the process of interpreting what the ultimate scoping criteria will be for taxpayers intended to be in scope for Amount B purposes, 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 consider the level of competitiveness on a market as a crucial factor for the economic analysis of companies which perform BMDA.

1.2.3 Question 2.2

3.5.2. (i) Do you consider that any other financial indicators may be utilised to measure the performance of certain functions, ownership of certain assets, or assumption of certain risks relevant to the scoping criteria other than those already described above? (ii) Moreover, do you consider that any financial or non-financial quantitative metrics may be utilised in order to reliably and objectively determine if the scoping criteria are met, for example with reference to the limited assumption at arm's length of economically significant risks?

19. As we find a competitive market crucial for applying Amount B (see above). We looked for financial indicators reflecting a competitive market. Economic theory links a competitive market with low returns over costs or revenue. Potentially, low margins of the competitors would be a good indicator.

1.2.4 Question 3

3.5.9. Do you consider that a controlled distributor that contributes (i) to strategic marketing functions or (ii) to control of risk but does not, under the accurate delineation of the transaction, assume the associated risks, or (iii) contributes to the generation of marketing intangibles but does not, based on an accurate delineation of the transaction, assume the significant risks associated with those intangibles, should necessarily be out of scope for Amount B? Please outline the reasons why you consider or do not consider this to be the case. (iv) Moreover, do you consider that entities which do not assume economically significant risks related to development, enhancement, maintenance, protection or exploitation of marketing intangibles, but do make some contribution to risk control functions that may warrant compensation at arm's length per paragraph

1.105 of the OECD TPG, should be out of scope? If so, please outline the reasons why you consider this to be the case.

20. When a controlled distributor performs (i) strategic marketing functions or (ii) control of risk functions, many argue, it “necessarily” excludes the possibility of applying a costs-based methodology for pricing intra-group transactions and impacts the functional qualification of the taxpayer as a routine or non-routine entity. The steps of “accurate delineation of the transaction” as included in the OECD TPG, however, contain a detailed analysis that in certain situations accepts that strategic marketing or risk control functions can be rendered as a service (like it frequently happens in third-party transactions). Consequently, we don’t agree with “necessarily” out of scope for Amount B.

1.3 Amount B pricing methodology

1.3.1 Question 1

4.4.1. Do you have any comments on the proposed architecture of the Amount B pricing methodology for baseline marketing and distribution entities?

21. The OECD IF is considering two exemptions that may impact the policy choice of applying the TNMM.

- 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. Amount B is developed for pricing BMDA, which have a routine character and do not uniquely contribute to the business of a multinational group. Therefore, in light of these characteristics, local comparables should be available. If there are no third parties to perform similar functions, the functions could be seen as unique and more valuable since an independent party, which would be a provider of such unique functions, would also have stronger bargaining power to agree on a higher return. We suggest amending this exemption as it would now adversely impact taxpayers active in competitive markets.
- The second exemption under consideration would apply if a method other than the TNMM is the most appropriate method in particular cases. We support the position that the Amount B pricing methodology, based on the TNMM with an appropriate PLI, 'should be used to price all in-scope transactions without the necessity of considering alternative transfer pricing methods, on the basis that Amount B represents a permissible administrative simplification to the most appropriate method principle". The scope rules are designed in a way that only BMDA are covered, for which a cost-based TNMM would be an appropriate transfer pricing method. The requirement to evaluate whether the CUP would be the most appropriate method for in-scope transactions would eliminate the simplification element of Amount B reducing the benefits of the additional compliance requirements for Amount B purposes.

1.3.2 Question 2

4.4.2. Can you share your observations of arm's length results for independent baseline marketing and distribution entities and provide any available supporting analysis or market data evidencing such observations?

22. Based on the studies performed at Loyens & Loeff, we observe a negative correlation between the total turnover and margin of baseline distributors. However, this observation can – due to the limited timeframe – not be substantiated by market data.

1.4 Documentation

1.4.1 Question 1

5.3.1. Do you think the proposed documentation approach for the application of Amount B strikes the right balance between the additional burden for taxpayers and the need to ensure that tax administrations obtain the necessary information to evaluate the taxpayer's application of Amount B?

23. We support that the documentation aligns as much as possible with the OECD local file requirements to limit the administrative burden for taxpayers. Such limitation would also be in line with the goals of Amount B.

1.5 Tax certainty

1.5.1 Question 1

6.3.2. Do you think the current tax certainty framework described in this section is sufficient to prevent or address potential disputes arising in relation to the applicability and/or operation of Amount B?

24. It is unclear from the proposal, whether it is the tax administration or the taxpayer that will bear the burden of proof that the TNMM or the CUP is the most appropriate method for purposes of Amount B. If the taxpayer opts for Amount B and meets the scope criteria, the appropriateness of the TNMM has to be presumed.

25. Without mandatory binding arbitration potential disputes may not be resolved through a mutual agreement procedure (**MAP**). We believe that it would be preferred to link mandatory binding arbitration to Amount B in order to ensure that disputes are resolved in a timely manner. This would also be in line with the aims of Amount B to improve tax certainty and reduce disputes for taxpayers in respect of BDMA.

1.5.2 Question 2

6.3.2. Is there any other approach that could supplement this framework to enhance tax certainty and reduce the risk of double taxation and/or double non taxation arising from the application of Amount B, subject to a jurisdiction's availability of resources? For instance, should the work on Amount B include, for interested jurisdictions, the design of an elective early certainty program to provide a specific early (pre-audit) certainty (e.g. streamlined APA-type process) or an indication of the

compliance risk inherent to controlled transactions regarding the application of Amount B and its pricing methodology?

26. See comment above in respect of mandatory binding arbitration to be linked to the Amount B implementation for an additional approach that we would suggest supplementing the existing framework.
27. An advance pricing agreement (**APA**) is also mentioned as a dispute prevention mechanism in this section. However, as also mentioned, this would seem quite burdensome for BDMA, where simplification in respect of such functions is one of the aims of Amount B. In case an APA would be the mechanism to provide upfront certainty to taxpayers on Amount B, we would suggest that a simplified (preferably bilateral) APA mechanism would be introduced as part of Amount B. Such simplified APA process would again be in line with the aims of Amount B to provide a streamlined system for taxpayers to improve tax certainty and reduce disputes. For such (bilateral) APA the required Amount B documentation should be sufficient to substantiate such request to facilitate taxpayers and not impose unnecessary additional burdens.

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