



August 31, 2023

Organisation for Economic Co-operation and Development
Centre for Tax Policy and Administration
Tax Treaties, Transfer Pricing and Financial Transactions Division
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Re: Comment Letter on the Public Consultation Document: Pillar One - Amount B

The National Foreign Trade Council (the “NFTC”) is pleased to provide written comments on the Public Consultation Document on Pillar One - Amount B published July 17, 2023 (the “Consultation Document”).

The NFTC, organized in 1914, is an association of U.S. business enterprises engaged in all aspects of international trade and investment. Our membership covers the full spectrum of industrial, commercial, financial, and service activities. Our members value the work of the OECD and the Inclusive Framework in establishing and maintaining international tax and transfer pricing norms that provide certainty to enterprises conducting cross-border operations. A list of the companies comprising the NFTC Board of Directors is attached as an Appendix.

General Comments

The NFTC reiterates our support for the objectives of Amount B, namely simplifying and streamlining the pricing of marketing and distribution activities in market jurisdictions. We appreciate the work conducted on the scope and design since the last consultation in 2022 and laud the more practical rules set forth.

We continue to encourage the Inclusive Framework to consider as broad a scope for Amount B as possible, without subjective screening criteria or undue compliance burdens, so that tax administrations and taxpayers may benefit from the simplified and streamlined approach. Amount B has the ability to be a useful tool to provide certainty, simplicity, and transparency while minimizing disputes. The utility is dependent on the proper scope relying on objective data. Where a taxpayer subject to Pillar One is conducting any marketing or distribution activities in a market jurisdiction, Amount B should apply to determine the arm’s length return to those activities. The various exclusions and thresholds unduly limit the scope of Amount B. In particular, we strongly recommend that the scope of Amount B be extended to include the distribution of digital goods and services (including digital services). As between Alternative A and Alternative B presented in the Consultation Document, we recommend the framework of Alternative A, which does not require a separate qualitative or subjective scoping criterion. Furthermore, we suggest that the OECD allow for Amount B to act as an elective safe harbor.

Regarding the guidance on pricing, in general, we recommend that the Inclusive Framework disclose the data and assumptions underlying the pricing matrix so that taxpayers can better understand as well as

replicate how the matrix outputs would apply in particular cases, as some members have observed the matrix starting point is at the high end of the range typically seen for routine distribution activities. In addition, in general, we do not support jurisdiction-specific adjustments because the underlying data already reflects globally blended results and because such adjustments undermine the general objectives of Amount B.

Finally, with regard to tax certainty, the implementation of Amount B could be achieved through the current OECD Transfer Pricing Guidelines; however, we recommend further consideration of dispute prevention and resolution as the existing mechanisms under bilateral tax treaties can be ineffective and time consuming. Therefore, we suggest the OECD consider using an MLI to implement Amount B as an effective, broadly applicable mechanism available in all jurisdictions that ensure uniform adoption and aid in avoiding disputes.

Specific Comments

Scoping (Section 2.2)

NFTC strongly recommends including within scope the distribution of digital goods and services, including digital services. The distinction in the consultation draft between tangible and digital goods and services signals, incorrectly, to tax authorities that the distribution of digital products do not constitute base-line distribution activities and, therefore, require higher returns. Inherently, this will result in further disputes and uncertainty, contrary to the OECD's stated goals. The failure to address digitization in the Amount B guidelines demonstrates that the OECD has veered off course from its initial objectives.

As between Alternative A and Alternative B presented in the Consultation Document, NFTC recommends using Alternative A. This alternative is better suited for the stated goals of Amount B to provide simplification, certainty and stability. Alternative A "recognises that operating margins for baseline distributors can vary based on certain factors, and appropriately adjusts returns for differences in operating assets, operating expenses, [and] industry," and is a better representation of a simplified and streamlined pricing approach.

Quantitative measures provide this certainty more efficiently than the open-ended and subjective approach detailed in Alternative B. Additionally, in Alternative B, technical or specialized support functions could de-scope an entity from Amount B. Comparables often include at least a portion of such support functions. If support functions are in excess of those provided by the comparables, other solutions, such as segmentation, would be preferable to excluding the taxpayer from scope. Creating new disputes over scoping defeats the purpose of avoiding disputes on methodologies and calculations.

Paragraph 8 provides that to be in scope, a tested party must not incur annual operating expenses lower than 3% or greater than either 30% or 50%. We recommend using the 50% upper boundary as reasonable for most scenarios. An exception may be appropriate for entities that are new entrants into a market. Such entities could have very routine functions (identical to other distributor entities) but have a higher costs to sales ratio for a limited time period. Separately, we agree with footnote 18, which reaffirms that taxpayers should exclude expenses and costs that do not represent value-adding distribution functions, such as passthrough costs when utilizing the quantitative criterion. However, further clarification is needed on the costs, which are considered to be passthrough costs.

Finally, NFTC suggests the OECD consider allowing taxpayers to opt out of Amount B or utilize Amount B as a safe harbor. This would put all taxpayers on a level playing field with taxpayers with Existing APAs, which apply notwithstanding Amount B, or taxpayers whose structures are not aligned with the Amount B scoping criteria. Taxpayers should be permitted to apply the arm's length principle, particularly given the novelty of the Amount B framework and the attendant uncertainty of its application.

Services (Section 2.3.4)

As noted above, NFTC implores the OECD to reconsider including services in Amount B. There is no data-driven justification to exclude services from Amount B. While the Consultation Document asserts that significant differences in the functions, assets and risks of distributors of services may exist, it provides no analysis or data supporting this assertion. Understanding the specific concerns with this assertion and allowing the business community to respond would be helpful. In our experience and data previously provided by the business community, similar functions are required in the distribution of services, resulting in similar ranges of arm's length returns.

The result of excluding services means that a large portion of companies subject to Amount A would not be in scope for Amount B. Either Amount B should include services and/or Amount A companies should be eligible for Amount B regardless of the general scoping criteria applied to other taxpayers. It may be difficult for some taxpayers to segregate the results of distributing digital services and digital goods from the results of distributing tangible goods. Invariably, the exclusion of services or digital goods from Amount B will be viewed as a signal by tax authorities that higher returns for the distribution of such items are required.

Non-distribution activities (Section 2.3.5)

NFTC supports the approach set forth in paragraph 42, which applies the 30% threshold using the total cost of all activities performed by the distributor as the denominator. Additional clarity is requested on computing the numerator. For example, where an entity distributes both in-scope and out-of-scope products (such as digital services), is an allocation of sales and marketing required? In cases where non-distribution economic activity is out of scope, such as manufacturing, R&D, procurement, or financing, more guidance is required to minimize disputes regarding what should be included (or excluded) from the numerator.

Pricing Matrix (Section 4.1)

Overall, we recommend that the Inclusive Framework disclose the data and assumptions underlying the pricing matrix and determination of industry group so that taxpayers can better understand and replicate how the matrix would apply in particular cases.

In addition, taxpayers involved in both distribution and non-distribution activities face challenges in accurately segregating operating assets between in-scope and out-of-scope transactions, for calculation of the operating asset to sales (OAS) ratio. Further, if companies have both in-scope or out-of-scope products based on these rules, they may not have any reliable data for allocated assets by product area. As mentioned elsewhere, we believe that the scope of Amount B should be expanded to include services, and this is another area where differences in rules by product will generate complexity, disputes, and a potential for lack of certainty. We strongly suggest the scope be broadened. In the absence of that action, we ask for guidance on options for allocating assets by product (for example, a reasonableness standard for using allocation keys). For these reasons, consideration should be given to using operating expense to sales intensity (OES) rather than OAS, either for taxpayers that distribute both in-scope and out-of-scope products or more generally. The use of OAS introduces inherent complexities and lack of consistency, and if retained, more detailed guidance would be needed for its use.

Furthermore, members have observed that pricing for distribution activities does not vary dramatically across geography or industry. NFTC requests additional data justifying the industry groupings contained in the pricing matrix.

There are a number of new quantitative ratios introduced in the consultation document. Additional guidance is requested on the precise calculation of these ratios, such as whether local GAAP financial results are necessary.

Geographic Differences (Section 4.2)

Section 4.2 introduces a variety of potential adjustments to account for geographic differences that potentially influence returns to distribution activities. In general, NFTC believes that these adjustments are not appropriate as they will unduly complicate the administration of Amount B, potentially including a process for monitoring and updating the list of qualifying jurisdictions entitled to special treatment. We request an opportunity to review the data supporting the modified pricing matrix in a future consultation once the data is made public. Differentiated results are not necessary, and the data does not show meaningful geographic differences. The brightline assertion that a “riskier” country should automatically result in a higher return to the tested party performing distribution activities seems contrary to arm’s length principles, particularly where such risks are generally borne by the principal or regional hub. Our examination of the comparable data does not support that there are meaningful geographic differences in profitability, and therefore, the use of adjustments or local comparables is not appropriate.

If the OECD proceeds with regional differences for certain jurisdictions, then comparables operating in those jurisdictions should also be removed from the general data set. Adjusting the return for a particular jurisdiction would skew the aggregate results from those results observed in the global benchmarking analysis. If the use of local comparables is absolutely necessary, we appreciate that a process for review and approval has been established, and that data would be subject to similar filters. Any resulting comparables should be added to the global set instead of creating another separate country matrix.

Corroborative mechanism (Section 4.3)

NFTC welcomes the use of corroborative methods - particularly the Berry ratio cap and collar previously recommended by the business community. However, in some circumstances, the Berry ratio may generate controversy over classification of costs between operating expenses and cost of goods sold. Thus, we recommend either providing some simplified guidelines for cost classification when applying the Berry ratio in this context or using a simplified corroborative mechanism based on the operating margin/profit, e.g., return on costs (or cost plus) would remedy these concerns.

Transitional Rules (Section 6)

NFTC welcomes the guidance that companies should determine the best structure for them - including whether or not to restructure entities to satisfy the requirements of Amount B. Allowing companies to adapt to new rules creates a more equitable playing field for all taxpayers. More specific definitions and rules are needed on “artificial restructuring” as ambiguous rules create more uncertainty and disputes.

Tax Certainty (Section 7)

The Consultation Document provides excessive subjectivity to tax authorities with no dispute prevention and resolution mechanism tailored to Amount B. The current dispute prevention and resolution mechanisms rely on the mutual agreement procedures (MAP) of existing bilateral income tax treaties. As the work on Pillar One continues, consideration should be given to replacing these existing measures with more effective mechanisms that apply even in the absence of bilateral tax treaty relationships.

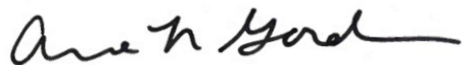
We appreciate the recognition that Existing APAs would prevail unless changes to business were made. On the other hand, we are concerned that Pillar One may result in a dearth of future APAs, leaving taxpayers with less certainty than before.

Further, while the Consultation Document recognizes that some countries may resolve economic double taxation through unilateral corresponding adjustments, most would only be able to do so under MAP procedures. MAP is not always available (either because of a lack of an in-force treaty or decisions of one of the MAP jurisdictions). Thus, developing one cohesive MLI that includes dispute prevention and resolution mechanisms for Amount B is preferable. Otherwise, we risk double taxation absent the development of a more binding, coordinated agreement.

Conclusion

The NFTC appreciates the opportunity to comment on the proposals outlined in the Consultation Document. Prior to the finalization of the Amount A MLI, we request a consultation on all of Pillar One to ensure a cohesive and practical approach to the architecture of the Pillar. Consultation with the business community is essential to achieving the goals of Pillar One, and we look forward to continued dialogue on this matter.

Sincerely,

A handwritten signature in black ink, appearing to read "Anne H. Gordon". The signature is fluid and cursive, with a long horizontal stroke at the end.

Anne Gordon
Vice President, International Tax Policy

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