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Sent via email: TFDE@oecd.org

12 November 2019

Subject: Comments on Public Consultation Document "Secretariat Proposal for a 'Unified Approach' under Pillar One"

BDO is one of the largest full-service audit, tax and advisory organisations in the world. We have over 80,000 people across 1,591 offices in 162 countries. Our global organisation focuses on supporting entrepreneurially spirited, ambitious businesses.

We appreciate the opportunity to submit our comments on the public consultation document titled "Secretariat Proposal for a 'Unified Approach' under Pillar One" that was released by the OECD on 9 October 2019 and provide our input into the OECD's ongoing work in respect of this important tax policy matter.

We welcome the initiative taken by the OECD to reconsider whether the current international tax framework remains effective for a modern highly digitised economy. As businesses seek newer, improved, more efficient ways of doing business, the existing international tax architecture has not kept pace with the rapidly evolving business landscape. A review of the international tax framework presents significant scope for both improvement and simplification, driving a fairer tax system that better reflects modern business reality and is also simpler to administer for global businesses of all sizes.

We consider the OECD's goal to achieve simplicity, stability and certainty through these proposals is the right way forward. To achieve simplicity it will be necessary to find a pragmatic balance between administrability and accuracy, which may pull in different directions given the complexity and variety of modern businesses. To achieve stability, care will be needed to design rules that can cope not only with the businesses of today, but also the businesses of tomorrow, which will require careful consideration of boundary issues arising from scope definitions. To achieve certainty, the incorporation of robust dispute prevention and resolution measures will be critical.

The interaction of any new rules with existing and emerging rules will also require careful consideration. We have seen a proliferation of unilateral measures to address the perceived challenges associated with the digitalisation of the economy (such as the French and the UK's Digital Services Taxes with many other countries set to follow suit). If anything, the pace of countries moving forward with such measures has increased as the OECD's own work has progressed, suggesting an increasing number of countries are now no longer willing to wait for a global solution, despite an ambitious timeline by the OECD. The introduction of such revenue based taxes is economically distortive and gives rise to double taxation and significant administration not only at the taxpayer level but also for tax authorities.

In our view, the OECD should seek a commitment from countries that these measures should not be introduced (and where introduced these should be abolished) pending ongoing work under the Unified Approach and monitored by a formal OECD peer review process.

The OECD has set a challenging timescale to seek consensus agreement between the Inclusive Framework members. The timeline for agreeing the outlines of a unified approach by January 2020 is ambitious. Given the potential complexity embedded in the proposals, we urge the OECD not to rush this exercise and to take time to consult deeply with businesses and stakeholders. All interested parties should be given a chance to consider the impact of these rules on their business operations and contribute to the development of the proposals. Given what is a very challenging timeframe, we believe it may be helpful if time is spent first on resolving the issues surrounding Amount A (given this is a new taxing right) and to defer work on Amounts B and C to the extent possible (for which principles, although not perfect, already exist) until the approach on Amount A is agreed. Once there is ‘in-principle’ agreement on the mechanics of how Amount A would operate in practice, the interaction with Amounts B and C can be further clarified.

It is our view that further consultation (once feedback on the broader design and implementation aspects of the proposals has been obtained through the current consultation) would be highly beneficial and should be supported by some form of modelling /impact assessment exercise to see how these proposals are likely to affect digital and non-digital businesses. Businesses would need to be guided through the application of the rules by use of worked examples for them to fully understand how the rules are meant to work in practice, and should be allowed to input at that detailed level rather as well as at the current conceptual stage.

Set out below are our specific comments in response to questions for public comments on the policy, technical and administration issues arising from the proposals. We hope this response will be of assistance in highlighting those areas which need to be considered as part of a further detailed consultation process.

We have developed this response on behalf of a BDO global working party. We believe it is essential that we provide the OECD with our thinking on its consultation in this area as any reform on international tax affects our diverse client base and stakeholders. We would also welcome an opportunity to attend meetings and webcasts with the OECD, in order to ensure that an environment is developed that will help international businesses thrive and effectively manage their tax profile while allowing tax authorities to collect the tax revenues required to fuel their respective economies.

If you have any questions or would like any further detail, please do not hesitate to get in touch with us. We look forward to work with you and in supporting you as you continue your work in this area.

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Executive summary

- We are supportive of the OECD striving for a consensus view on an important matter that should not be left to devolve into unilateral actions or to cause countries to disregard the Unified Approach thus creating risk of greater double taxation.
- We encourage the OECD to continue to drive for an approach which is unified around simplicity, stability and certainty in implementation.
- In designing the new taxing right, the OECD will face a challenging balance between fairness and operability: inevitably compromises will need to be made between accuracy and administrability – we suggest the design be weighted towards ensuring fairness and administrability.
- Careful consideration should be given to the design of the regime to ensure that it targets businesses appropriately. Key topics in this regard include:
    - Defining a rationale behind scope inclusions and exclusions to ensure the new regime is sustainable and able to cope with continually evolving business models.
    - Reflecting on the purpose and role of thresholds within the application of the rules – we encourage the OECD to aim to design rules that are administrable for taxpayers of all sizes and that use modern technology to improve administrability wherever possible. If this can be achieved, the need for thresholds, and therefore the need to manage some of the distortive impacts that thresholds could create, could fall away.
    - If a threshold for application of Amount A is pursued, businesses that fall below the threshold should be provided with the option of electing into the regime to ensure they are not unfairly disadvantaged relative to their larger competitors.
    - Centralised administration should be pursued wherever possible – the concept of a 'one-stop-shop' has significant support within the business community and this should be considered further.
- The calculation of Amount A using simplifying conventions should build in 'headroom' around typical routine margins to mitigate the risk of double taxation of amounts B and C without complex adjustment mechanisms.
- While segmentation for the determination of Amount A may be inevitable, clarity and simplicity will be paramount.
- Being clear on the definition of the territory 'source' of Amount A is as important as being clear on territory of 'destination' of Amount A otherwise double taxation may arise.
- In light of an ambitious timeline, we ask whether Amount A (as the key policy imperative) can and should be defined first with subsequent action to address

Amounts B and C – given that Amounts B and C are a refinement to the existing taxation and relieving systems (which do function, albeit imperfectly).

- Amount B would need careful management and may be better be expressed as ‘safe harbour’ ranges rather than fixed percentages.

A “unified approach” – the Secretariat’s proposal

We are in agreement with the OECD’s objectives for the rules under the unified approach to achieve simplicity, stability and increased certainty. The proposals should seek to minimise administrative burden on taxpayers and tax administrations such that the cost of compliance with the new proposals is proportionate with the additional taxes that the rules seek to deliver in the market jurisdictions. The new framework should enable businesses to pay taxes in those economies in which they participate without stifling their ability to drive growth across their international markets.

Our response to the questions for public comments are as follows:

1. Scope

a. General comments

We consider that the question of scope needs to first be addressed with a clear understanding of the policy rationale behind the proposals. This is not currently clearly stated within the consultation document. Without an understanding of the principles for inclusion of a business within the proposals, it is challenging to determine an appropriate basis for exclusion of a business, whether on size or sector grounds. Such challenges are likely to be exacerbated as business models continue to evolve without a clear policy rationale on which decisions can be based. We would welcome a clearer statement from the OECD on the overarching policy rationale to increase progress towards a consensus view of an appropriate scope and ensure the longevity of the solution.

b. Size threshold

We consider it is first necessary to assess why a size threshold may be appropriate. It would appear that the intent in setting a size threshold is to retain the current system for smaller businesses where the application of a new approach could represent an onerous administrative burden. It may be better to approach the issue from another perspective. Namely, if the Unified Approach could be developed in a way that was not administratively burdensome, is a size threshold necessary? In our view, a size threshold should not be used as a policy rationale for not seeking to drive simplicity into the Unified Approach. Eliminating the size threshold may ensure that the Unified Approach is applied consistently especially to high growth/scaling businesses that currently may not meet the agreed threshold but are likely to in the future. We acknowledge the complexity of the issues being addressed, however, we do not consider that it should be automatically assumed that any solution to those challenges must be complex such that a size threshold is required to protect smaller businesses from an undue administrative burden. We consider the ambition should be to create rules which do not require a size threshold to work effectively.

Any size threshold which is set will ultimately be arbitrary. Wherever that dividing line is drawn, there is a risk of creating a two tier tax system and artificial distortions in the competitive position of businesses either side of the line.

Whether a business would be disadvantaged or advantaged by being within the scope of the new regime is likely to vary from business to business. As an example, let's consider a business is established in a high tax territory (which could include the US, France or Germany), where it retains its 'residual' profits and sells into lower tax territories without physical presence in those territories. Falling within the new regime may result in a reallocation of profits from the higher tax territory to the lower tax territories resulting in a lower global tax charge than the amounts paid under the current regime (provided mechanisms to manage double taxation operate effectively).

Given such potential distortions, it would be preferable to avoid the need for a threshold through careful design of the regime to ensure it is administrable for small and large businesses. To achieve this, we suggest an approach which seeks to identify the simplest possible approach to the determination of Amount A. This could be to use a formulaic calculation of the amounts of profit that are subject to reallocation drawing from consolidated financial information and subject to few adjustments). Then it would be necessary to identifying what challenges such a simple approach could give rise to (e.g. business line distortion). Those challenges should then in turn be addressed in the simplest possible way. In doing so, a balance will need to be found between 'accuracy' and 'administrability'. We would urge focus on 'administrability', even if such an approach could result in a degree of loss of 'accuracy'. A simple approach using objective criteria with minimal need for judgement to be applied is likely to also yield fewer disputes and, any disputes that do arise, would be easier to resolve.

If a size threshold is set, companies which are below the size threshold should be given the option to elect into the regime to ensure they are not at a disadvantage to their larger competitors.

The definition of MNE group should refer to those entities within the consolidated accounts wherever possible to enable the use of data presented in the consolidated accounts to drive any required calculations, which we expect will be a less administratively burdensome route for taxpayers to apply in practice.

c. *Definition of in scope businesses*

In deciding which businesses should be in scope, we suggest a focus on those sectors where there is most likely to be a material reallocation of profit under the proposed approach.

To achieve this, we suggest defining an approach to the calculation of Amount A that could, in principle, be applied across all sectors, and then applying that methodology to real case studies across industries to identify those industries where a material reallocation would arise. Excluding those sectors where there would not be a material reattribution of profit based on real case studies (for example, due to profit already being tied to physical establishment in a strong way or there being minimal profit beyond that related to routine functions) would seem to be a pragmatic approach to definition of scope, in the absence of a clear policy intent for exclusion of certain industries.

d. Other comments

The consultation document suggests, although it is not entirely clear, that the question of scope is relevant only for Amount A. As such it is inferred that Amounts B and C would be relevant for all businesses, irrespective of size and irrespective of sector. It would be helpful to clarify if that is the intent, or if the question of scope applies to the full package that constitutes the Unified Approach.

That said, our understanding is that the overarching intent of Amounts B and C is to reduce the number of disputes that arise for marketing and distribution functions, and to establish more effective dispute prevention and resolution mechanisms. Provided the operation of Amounts B and C for a business not otherwise within the scope of Amount A results in a technical, practical and administrative simplification of the current regime, then the extension of the philosophies underpinning Amounts B and C to all businesses (not just large, consumer-facing businesses) would seem to be an appropriate approach.

2. New Nexus

The consultation document requests input on the approach to defining appropriate country specific sales thresholds, and calibration to ensure that smaller economies can benefit.

We again would suggest the first question should be - what is the purpose of setting country specific sales thresholds? We understand that this relates to potential challenges with administration and seeking to ensure that an administrative burden should only be imposed where the tax allocation to a jurisdiction is significant enough to warrant the administrative effort. However, the administrative burden is a function of the design of the rules: effective design that mitigates the administrative effort could eliminate the potential complexities that could arise from setting country specific sales thresholds.

The consultation document refers to the concept of a new taxable nexus under Amount A, which suggests associated registration and filing obligations. However, such concepts are 20th century concepts and we would question whether a more effective approach could be found in the 21st century. This would be an approach which enabled the receipt of tax revenues in a jurisdiction, but minimised the burden on the taxpayer in achieving that, potentially through the modern digital means that are the subject of the debate underlying the consultation document.

For example, we consider that, with an effective ‘one-stop-shop’ regime, the need for country specific sales thresholds could potentially be disposed of entirely (or set at a consistently low level globally). Under this approach, an MNE group would file a single full return of the calculation of Amount A and the global allocation of that amount to a single territory (e.g. the headquarter territory). The MNE group may then file simplified statements to each territory that is to receive an allocation stating the quantum of Amount A, and the allocation due to that country. A single payment of taxes due under amount A could perhaps be made to the headquarter territory, and then this payment could be allocated, in accordance with the full return, to the appropriate territories.

Where the allocation of Amount A is formulaic there should be minimal risk of dispute (however, please note our comments below around ‘A Source’ territories). Information sharing between the territory where the full return is filed and the territories of allocation should be sufficient to manage those disputes. The territory where the full return is filed would have the sole responsibility for the audit of the calculation of Amount A itself, mitigating the burden that could arise from multiple tax authorities auditing the same data. If deemed necessary, a second territory could perhaps review the determination of Amount A to provide a check and balance - for instance, if the headquarter territory stood to lose out on tax revenue as a result of the reallocation of the Amount A profit to other territories.

The advantage of such an approach is that the administrative burden in each territory where Amount A is allocable is very low (as there is no registration, compliance or fiscal representation requirement but rather just a cash payment to reflect the tax due on allocated profit), eliminating the need for country specific sales thresholds. By avoiding a need for registration in each territory, collateral issues such as overlap with VAT registrations and associated compliance/filing obligations would be minimised. Moreover, all economies where sales are made/revenues are derived by the MNE could benefit, without a need to address questions such as what happens to parts of Amount A that would be allocable to a particular market but for a country specific sales threshold not being met, and how to most effectively calibrate country specific sales thresholds.

3. **Calculation of group profits for Amount A**

a. What would be an appropriate metric for group profit

We consider that a sensible starting point would be to use the profit before tax figure from the audited group (consolidated) accounts.

To provide simplicity and minimise the risk of disputes, we consider that minimal adjustments should be made to the figures in the audited consolidated accounts. The would perhaps only include adjustments for extraordinary items, such as impairments, fair value movements, foreign exchange movements, capital gains/losses on disposals, certain non-recurring items etc. Any metric used would need to be sensitive to differences in how businesses finances their operations.

b. What if any standardised adjustments would need to be made to adjust for different accounting standards

If the expectation is that material differences could arise in the reporting of profits through the use of different accounting standards, further consideration would need to be given to what, if any, standardised adjustments could be made to level the playing field in calculating profits.

Our view is that profits reported in audited accounts that have been prepared under internationally accepted accounting standards should be respected, unless the OECD thinks there is a strong case for more work in this area to get to a position where companies use some form of a “standardised template” through which the group profits can be arrived at and reported by in-scope businesses. This will clearly add to the administration required in complying with the new rules, and so would need to be balanced with consideration of the extent to which material differences could arise between different GAAPs.

c. *How can an approach to calculating group profits on the basis of operating segments based on business line best be designed? Should regional profitability also be considered?*

We acknowledge that some form of segmentation is likely to be required to obtain agreement between a wide range of stakeholders. However, segmentation has the potential to add significant complexity, particularly where data for segmentation is not readily available. A practical solution to this would be to use data that is already with the business.

Many businesses will already prepare segmental information to keep stakeholders appraised of business/operational performance, and have an obligation to present segmented data which shows a true and useful view of the business to its stakeholders. On this basis, it is our view that any segmentation prepared by the taxpayer (providing it is reflective of business line /country etc. performance) should be respected and it should not be disturbed by tax authorities.

For this to work smoothly, the segmentation approach could be agreed with the parent country tax jurisdiction. Such determination should be final and should not be subject to a challenge by the tax authorities in other jurisdictions for a specified period of years. In order to achieve this, the OECD, with its members will need to agree to a set of policies and procedures whereby tax authorities can engage in a practical and pragmatic manner without involving the taxpayer in the process. We recognise that any up-front investment in agreeing segmental allocation of profit is likely to impose a greater deal of administrative burden on taxpayers. However, once agreed, it is likely not to be disturbed unless/until there is significant business change.

Segmentation could come with its own challenges and limitations. Businesses may need to distinguish and report domestic and international product sales separately (which may not be something that the business currently reports). This is further exacerbated if products are sold directly to both consumers and businesses, as potentially only the sales to consumers will need to be included in determining Amount A in accordance with proposals as currently drafted. Tracking what is in and what is out, is likely to give rise to significant complexity. However, permitting businesses to find appropriate ways to manage this is likely to ease the burden without introducing material scope for abuse or manipulation.

4. Determination of Amount A

Amount A is the deemed residual profit to be calculated by taking total group profit, and excluding from it a percentage for deemed routine profit and then allocating a portion of the deemed residual profit (or loss) to market jurisdictions.

We agree that pricing intercompany transactions under the arm’s length principle is becoming increasingly complex. However, we believe that the existing TP rules that consider the functions, assets and risks in determining the remuneration between group companies should continue to form the basis of calculating the routine profits, albeit with minor modifications to allow for more simplicity and less complexity. This is because whilst there are challenges with the arm’s length principle, it does work effectively for the determination of the return to routine functions.

We agree that the interaction of any proposed Amount A calculation with Amounts B and C would need to be explored further to ensure that the same profits are not double counted because existing transfer pricing principles account for an element of non-routine profits already being allocated to market jurisdictions.

Further, any formulaic approach towards allocating routine profits is likely to disrupt the well-established profit allocation mechanisms that are closely connected with value creating activities as propagated by the OECD’s BEPS project and now widely used in the allocation of profits across groups.

Once determined, there will need to be a mechanism to ensure that any Amount A allocations that are reallocated to market jurisdictions are dealt with at the same time (i.e. in the same tax year) and taken into account for tax purposes in only one country – ie preventing double taxation because the same profit is taxed not taxed in two countries in different tax years.

Tax authorities may need to establish procedures whereby a notification mechanism exists (perhaps something similar to the current CbCR notifications) that informs the tax authorities of any allocated profits that result from Amount A allocations.

There are likely to be challenges in separating the routine profit in arriving at the non-routine profit, for example:

- Matching of R&D costs and income: typically R&D costs are incurred years before sales and profits from the R&D activity are recorded. This is likely to give an impression that all income accruing from historical R&D is subject to redistribution, as costs would have been accounted for previously in an earlier period to when the sales have arisen. This could give rise to a significant mismatch in costs and associated revenues which would distort the group’s tax profile in a manner that would not seem to be aligned to the policy objective. It would be reasonable, in situations such as this, to allow for either a cost recapture mechanism under which profits are only reallocated once investment expenditure has been recouped, or a profit deferral mechanism under which super profits are spread across a number of future years to reduce the incidence of tax in any one given year.
- Interaction with indirect taxes: reduced margins are a factor of higher operating and sales costs, some of which relate to high indirect taxes which have a direct impact in increasing the selling price of a product. Jurisdictions that impose high indirect taxes could potentially be entitled to a higher proportion of Amount A allocations due to higher sales in that jurisdiction, whilst concurrently benefiting from substantial indirect tax revenues. The interaction of any adjustments under these proposals with indirect tax measures in particular will require careful consideration.

5. Elimination of double taxation in relation to Amount A

Determining where residual profit is allocated from will be essential in avoiding double taxation.

a. Identifying relevant taxpayers(s) entitled to relief

Residual profits under Amount A are likely not to be restricted to one entity or one country in a multinational group. Business operating models are evolving quickly and it has become increasingly challenging to determine where value (and associated intangible property) is created.

This phenomenon could lead to there being multiple entrepreneurial entities in a group that are entitled to “non-routine profits” based on their current functions and activities, their risk appetite and the assets they employ. This could, for example be where the group holds its intellectual property in more than one location. There must be clear rules to determine which entities will be subject to an Amount A re-allocation. Taxpayers could leverage from existing work done in determining where non-routine profits sit within the group. This could be a relatively simple exercise for larger groups that have a requirement of preparing a Master File but less so for medium-sized/smaller businesses that have not needed to prepare detailed transfer pricing documentation.

b. Building on existing mechanisms of double tax relief, such as tax base corrections, tax exemptions or tax credits

The scope for double taxation of Amount A would significantly reduce if there is agreement on what fixed proportion of the non-routine profits relate to marketing intangibles and what proportion relate to “other” intangibles, capital employed and risks. Given the allocation may be based off accounting profits, the simplest way to administer this would be for there to be a mechanism to agree a fixed percentage that should be allocated to marketing intangibles and a percentage that should be allocated to non-marketing intangibles. Further work will be required to determine what this fixed percentage should be. This fixed percentage should be kept under constant review by the OECD and should be based on principles that could allow for later adjustments to align with future business models and economic realities.

There will need to be acceptance and agreement between the Inclusive Framework countries that no tax will be levied on amounts (in the Amount A country) that are allocable/surrendered and that any tax due will only be payable by the entity that has received this allocation. Further clarification will be required to confirm whether the allocated sums are permitted to be offset by existing losses in the country receiving the Amount A allocation.

Timing of reallocation and resulting taxation is key. It is important to ensure that rules take into account the timing of when the amounts allocable are taxed and where they are taxed. Further work could be undertaken to explore a mechanism whereby the surrendered amounts are taxed in the market jurisdiction in the tax year in which they have been determined (and not arisen). For clarity, there should be a clear delineation between Amount A and Amounts B and C and taxes paid in respect of Amounts B and C should be considered separately to those payable under Amount A.

Businesses that have a decentralised, multiple-point value creating organisational set up could face the need to carry out multiple layers of allocation and re-allocation of profits in a complex multinational environment with interdependencies spread across the group. Any allocation methodology would need to factor into and eliminate the risk of double counting the profits. This will no doubt add significant complexity in the allocation of the non-routine profits so it will be critical that simplicity and universal applicability are the core components of any allocation methods devised.

As discussed above, one possible way of limiting double taxation that could arise when allocating/reallocating Amount A, would be to centralise the reporting obligations to the parent jurisdiction. Alternatively, an MNE should be given the opportunity to elect which will be the "reporting entity" for the group and have responsibility for ascertaining the Amount A profits spread across different jurisdictions and reporting the allocation of those profits to the tax authorities.

c. *Ensuring that existing mechanisms for eliminating double taxation continue to operate effectively and as intended*

In our view, the existing mechanisms for eliminating double taxation should not be disturbed in light of these proposals to the extent there is no overlap of income attribution (i.e. Amount A) over existing incomes on which tax is levied.

However, if an entrepreneur entity is receiving royalty income on which it suffers withholding tax, then there should be mechanisms in place to carve out that income in determining Amount A or there would need to be a mechanism in place whereby the market jurisdiction does not re-tax the same amount of income.

6. Our comments on Amount B and response to the questions raised

We note that Amount B appears to be intended to, in effect, tackle a subsidiary problem to the creation of a new taxing right that informs the approach set out for Amount A.

Before commenting on the specifics of the question we think it is worth examining the general statement of intent at para 16, namely:

"*…That in turn requires a change to the nexus and profit allocation rules not just for situations where there is no physical presence, but also for those where this is. Otherwise, taxpayers could simply side-step the new rules by using alternative forms of in-country presence (whether a local branch or related entity) making the new taxing right elective for taxpayers and creating an open invitation for tax planning*".

Our understanding is that Amount A, where triggered by a revenue, or other defined threshold, is not predicated on there being a traditional nexus (indeed that is the point). Where there is also a traditional nexus attracting an Amount B, the particular market may enjoy both A and B (or C). As such, it would not appear that definition and enablement of Amount B and C is required to enable the definition of Amount A. There would also appear to limited 'side-stepping' possible given the construction of Amount A.

In particular, we observe that Amount A is to be set by a simplifying convention and is not determined by (as it would be in a traditional residual profit split) being the excess profit (or loss) once all of the routine rewards have been established: i.e. there is no calculation link between A and B or C, with B and C therefore capable of continuing to use the arm's length principle and existing (potentially enhanced) international framework.

This is important for matters of design, and for the ability to phase the development where time is a constraint. We cover both aspects below.

It is the acknowledged that further work is required to eliminated double counting and/or double taxation on A vs B or C and our view is this could be facilitated by building in 'headroom' to the specification of the routine margin over which the excess Amount A is calculated. The intention of including this headroom would be to mitigate the risk of conflict between A and B (or C) and allow the continued operation of bi-lateral resolution of appropriate profit attribution and double tax relief. The headroom would need to be carefully calibrated of course, as would the view of the routine margin level, but this would simpler and leave the arm's length principle to operate within the routine margin level for businesses where Amount A is in point.

In addition, this observation also leads us to the question whether the issues being addressed by B and C can be deferred to allow greater focus on Amount A in what is a very challenging time frame. We recognise this might extend a period of uncertainty for an entire package of reform, but it may allow for quicker agreement on Amount A.

Following our general comments, we understand that the intended effect of Amount B would be to simplify the basis of profit attribution to distribution functions and amount C to facilitate more effective dispute resolution on the already established arm's length principle application, and our comments below are in this light.

a) *The need for a clear definition of the activities that qualify for the fixed return.*

Our experience is that, where TNMM is used as the most appropriate TP method (as is commonly observed for distribution functions, more so than RPM), there are two main areas of a dispute over the reward for marketing and distribution:

1) The appropriate method (specifically, the PLI associating with the TNMM analysis)

2) The margin.

Area 1) tends to generate greater opportunity for mismatch in perspectives between tax authorities. The transfer pricing testing does not always align with the 'mechanical' price-setting, e.g. businesses may use a cost plus mechanic but test against a return on sales, but in many cases there is a commonality of mechanic and testing. In any event, the debate can often be around the question of whether the function being revised is deserving a return on costs, or is it a function deserving a return on sales. The resulting profit attribution can be significantly different.

Area 2) is often observed and will either be a dispute on the position in the range, or the introduction/de-selection of comparables on comparability points by a taxing jurisdiction which moves the range and therefore the supportability of a position.

In both cases, the nature of tested party activity is key to selecting the method but also to judge comparability. Therefore, a clearly defined baseline of activity to qualify for a return based on sales (or a return on costs) would be helpful particularly for area 1) i.e. a clear specification of the 'proximity' required to sales to require a return on sales based reward versus a return on cost. There is little in the way of guidance within current OECD Guidelines (paras 2.93 and 2.96 are most pertinent) and this could supplemented with specification and examples.

b. *A determination of the quantum of the return (e.g. a single fixed percentage; a fixed percentage that varied by industry and/or region or some other agreed method)*

Our experience has been that, assuming use of TNMM as is commonly the case, once the PLI has been established, comparability benchmarking is relatively effective given distribution business are readily identifiable for the most part using commercial databases and publically available information.

A single fixed (or industry varied) return would be a blunt instrument and, if tied to a detailed specification of baseline activity, likely to shift areas of contention to the nature of the business and, in this framework, move rapidly on to the question as to what amount C should be.

A more workable approach may be something along the lines of the ATO Practical Compliance Guideline PCG 2019/1 ('PCG') profit marker ranges applied to inbound distributors. This does not displace the arm's length principle, or benchmarking, but is helpful to build a view of typical return and, therefore, the potential requirement for additional scrutiny. This could be more easily coupled with the additional guidance around defined 'baseline' distribution activity (which would no longer be baseline per se).

7. Amount C - dispute prevention and resolution

We consider that APAs are effective, where taxpayers are able to invest in and are selected for such programmes, but these agreements are long in the making and can be difficult to arrive at. Unilateral APAs have become somewhat more limited in usefulness and availability and this leaves BAPAs or multi-lateral APAs which are subject to the issues above.

ICAP has not yet become part of the mainstream dispute prevention toolkit but we hope to see its successful adoption by taxpayers and fiscal authorities.

Of all the measures, universal assumption of binding MAP arbitration within double tax treaties would be the most potent measure for effective dispute resolution.

As mentioned above, we believe that Amount C is subsidiary to the key measure which is the introduction of a framework around Amount A. Therefore, we have kept our comments on this aspect brief. We support the approach of defining a comprehensive and effective framework around Amount A and leaving the existing framework around B and C to be defined and/or augmented at a later date.