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Organisation for Economic Co-operation and Development
Centre for Tax Policy and Administration
Tax Policy and Statistics Division

Sent via email: TFDE@oecd.org

Subject: Comments on Public Consultation Document – *Secretariat Proposal for a "Unified Approach" Under Pillar One*

Ladies and Gentlemen:

We appreciate the opportunity to submit these comments on behalf of EY on the public consultation document *Secretariat Proposal for a "Unified Approach" Under Pillar One* released by the OECD on 9 October 2019. In this submission, we first lay out some overall comments on the proposed "Unified Approach" and then provide comments in response to the specific questions raised in the consultation document.

Overall comments on the proposal for a "Unified Approach"

We believe it is important to begin with some big picture considerations regarding the Secretariat proposal for a "Unified Approach" and the importance of ensuring that any consensus under Pillar One on modifications to the international tax architecture fully reflects a common understanding and commitment by all countries.

Design development

We appreciate the OECD providing the opportunity for stakeholders to comment on this Secretariat proposal for a "Unified Approach" under Pillar One. However, the comments are necessarily high-level given that the outline of the proposal is itself quite high-level. As the proposal is further developed, we look forward to the OECD and the participating countries continuing this consultative approach. Consistent with a point we made in our comments on the initial consultation document in this project earlier this year, stakeholder input on the practical issues and economic and commercial implications of the proposed approach will become more important and more valuable as the approach is fleshed out further and more detail is provided.

Implementation process

It must be recognized that the new rules contemplated by the proposed "Unified Approach" would require that countries make significant changes in their domestic legislation and their treaty agreements. The new rules would also require new multilateral processes for addressing the division of taxing rights among countries. Therefore, reaching consensus on detailed rules cannot be viewed as the conclusion of this project, because substantial additional work will be necessary.

The work conducted through the Inclusive Framework must continue throughout the implementation period and beyond. Ongoing dialogue and some form of review process will be required to ensure that all countries make the particular changes in their domestic law and treaties that are required for consistent implementation of the new rules exactly as agreed. The dialogue and review process will also need to focus on consistency in application of the new rules as they become operative. In this regard, we believe that it will be essential to develop a workable mechanism for stakeholder input into the review process so that taxpayers can provide information on how the new rules are being applied in practice – and can do so without fear of reprisal and with the legitimate expectation that any practices that are not consistent with the consensus agreement will be addressed promptly.

Interaction with Digital Services Taxes and other unilateral measures

The twin objectives of the work on Pillar One are to develop revisions to existing profit allocation and nexus rules that represent a new coordinated global infrastructure for the division of taxing rights and to prevent the proliferation of uncoordinated unilateral measures that will lead to overlapping taxation. However, while the work in the Inclusive Framework continues, some countries have already implemented, or are in the process of implementing, Digital Services Taxes and other unilateral measures that target the same concerns as Pillar One. The work on Pillar One will not achieve its intended objectives unless all of these measures are withdrawn and no new unilateral measures are put in place. Therefore, any consensus on Pillar One must include a commitment by all countries not to pursue unilateral measures and to promptly withdraw any unilateral measures they have already implemented.

Such commitments must extend to any Digital Services Taxes and other unilateral measures that would apply to business activity that is specifically carved out of the scope of the new rules developed under Pillar One. The agreement that application of the new rules to such activity is not appropriate must be recognized as necessarily reflecting agreement that application of unilateral measures to such activity also is not appropriate.

In order to ensure that these commitments to forbearance or withdrawal with respect to Digital Services Taxes and other unilateral measures are satisfied, the work of the OECD and the participating countries on Pillar One must include identification of all unilateral measures that are inconsistent with Pillar One as well as ongoing monitoring of activity with respect to any such measures.

Dispute prevention and resolution

The public consultation document rightfully recognizes that mandatory and effective dispute prevention and resolution mechanisms are essential to ensure that the new rules developed under Pillar One work as intended and double taxation is prevented.

The best way to prevent disputes is to ensure that the rules are clear and easy to comply with and administer by taxpayers and tax administrations. Therefore, clarity and precision with respect to the definitions of the businesses in scope, the standards in the new nexus rule, the formulas and mechanics in the new profit allocation rules, the operation of industry-specific parameters, and the connection of these new rules with existing transfer pricing rules are essential.

However, even if the new rules, and the implementing legislation and treaty provisions put in place by countries, are perfectly clear, differences of opinion on the relevant facts may cause disputes to arise. In the case of Amount A, these disputes could be multilateral in nature. In the case of the Amount A mechanism, the aim would not be achieved if domestic definitions are used to define and interpret terms that are not clear; therefore, the relevant definitions and interpretations also need to be developed in a multilateral fashion. In addition, as discussed in more detail below, we believe the only practical approach for addressing factual questions regarding the formulaic determination and allocation of Amount A will be to assign exclusive responsibility for reviewing the calculations to the tax authority of the home country of the group's parent company.

Moreover, because dispute prevention provides far more certainty and cost efficiency to businesses and tax administrations than dispute resolution after the fact, we welcome the consultation document's reference to mandatory dispute prevention mechanisms. Businesses should have access to an effective mechanism to get an advance determination not just on whether they are in or out of scope, but also on all of the determinations that would be required in applying the new rules. If agreement cannot be reached on such a determination or if a dispute arises regarding any aspect of the application of the new rules, access to mandatory and binding arbitration should be available. Given the substantial administrative burdens that are expected to be associated with the new rules being developed, businesses should not be subject to them without having certainty on whether they are in scope and on how to apply such rules.

Finally, making sure that businesses have effective access to the Mutual Agreement Procedure (MAP) process will be more important than ever. Therefore, the work under BEPS Action 14 on improving MAP should be prioritized.

Economic impact assessments and use of country-by-country report data

As the OECD and the participating countries work to prepare assessments of the economic impact of the proposals under consideration, we urge that thorough analysis be done not only with respect to the tax revenue implications but also with respect to the potential effects of the new rules on investment and economic growth. In addition, we urge that the assessments take into account all of the costs associated with the proposed changes, including the costs associated with increased compliance and tax administration burdens and the costs associated with transition.

We also want to stress the importance of stakeholder involvement in the work on economic impact assessments. Taxpayers will be in the best position to evaluate the accuracy of the data on which these assessments are based. In this regard, we would note that country-by-country reporting was not designed to produce data that would be useful for this purpose. Indeed, the way in which such reports are required to be prepared means that the information reported does not provide an accurate measurement of total group profits and profit margins. Because the country-by-country reporting rules require that intercompany eliminations be disregarded, the profits so calculated would not align with total group profits (e.g., where there are intercompany sales of inventory or capital assets). Similarly, because country-by-country reporting data incorporates intercompany sales in addition to third-party sales, any measures based on sales (such as PBT/Sales) would be systematically distorted. Thus, data based on country-by-country reports should not be used as the basis for economic assessments of the impact of the proposed "Unified Approach", nor should such data be used as a starting point for measuring Amount A in the application of the proposed new profit allocation rules.

Targeted rules focused on intended objectives

We encourage the OECD and the participating countries to keep the work under Pillar One as targeted as possible, with a focus on the objectives at which the project is aimed. The new rules being developed will necessarily add additional complexity for taxpayers and tax administrations because they will be layered on top of, and must be connected to, the existing transfer pricing rules based on the long-standing arm's length principle. Moreover, because the new formula-based rules depart from taxation exclusively based on value creation, they will have the effect of separating the right to tax from the economic burden of the public infrastructure supporting investments that create value. Keeping the project as targeted as possible will help minimize all of these detrimental effects.

Transparency and clear communication

While the digitalization of the economy is a factor that is relevant to this project, the new rules being developed will have implications that go well beyond digital business models. The new rules contemplated under the proposed "Unified Approach" extend to a broad range of cross-border activity because of the globalization of the economy. We continue to encourage the OECD to limit the use of digital references in describing this project. It is important that it be clear to policymakers and stakeholders that the project is not limited in the way the digital label might suggest.

Deliberative process

Finally, we urge the OECD and the participating countries to devote the time that will be needed to fill in the myriad details that must be specified in order to yield a set of rules that countries will be able to incorporate into their law, and apply in operation, consistently. Real consensus requires clear and specific rules spelled out in sufficient detail that there can be a fully informed meeting of the minds. Anything less than that would create instability and uncertainty in the global international tax architecture, to the detriment of taxpayers and tax administrations alike.

The facade of consensus without a true shared understanding grounded in specific details could be more disruptive than no consensus at all. In such a situation, countries with incompatible views on what has been agreed could all go forward with different approaches, each with the mistaken belief that its own particular approach carries with it the imprimatur of global consensus. This is an outcome that must be avoided.

Unrealistic deadlines cannot be allowed to interfere with the continuation of a collaborative and deliberative process within the Inclusive Framework that achieves true consensus.

Comments in Response to Specific Questions Raised in Consultation Document

1. ***Scope***

   The OECD Secretariat proposal for a "Unified Approach" looks to "consumer-facing businesses" as a key parameter in delineating the scope of the new rules. The reason for this focus on consumer-facing businesses seems to be the view of participating countries that the interaction with consumers (or users) in a particular market may enhance the profitability of the products sold or the services provided by these businesses in the market (e.g., through the value of brands) and that under the current international tax system these profits are taxed not in the market jurisdiction but in other jurisdictions within the business's footprint such that a re-allocation of profit to the market jurisdiction is warranted. Keeping this in mind, it is important that scope is clearly delineated so that the reach of the new rules is appropriately targeted.

   The threshold matter of scope requires clear definitions that are supplemented with illustrative examples across a range of industry sectors. The concept of "consumer-facing business" could be used in delineating scope in either of two ways: indirectly, by starting with all businesses in scope and carving out non-consumer facing businesses, or directly, by defining what is a consumer-facing business. Because precision in the definition seems critically important to limiting profit re-allocation to situations where there is value added through the consumer relationship in the market, the direct definition approach seems more likely to lead to an appropriate result without overreach. Therefore, we believe that the next phase of work should involve a thoughtful effort to develop a positive definition of consumer-facing businesses. We believe that the opposite approach of a negative definition should not be considered because it would be difficult to define on a comprehensive basis all sectors and activities for which value is not materially enhanced by interaction with consumers in the market.

With scope based on a positive definition of consumer-facing businesses, the effect should be that businesses involved in business-to-business (B2B) transactions generally are out of scope. Any aspects of the scope definition that operate to bring a B2B business into scope should be very narrow and should target situations where there is a realistic potential for consumer-facing businesses to change their supply chains with the aim of circumventing the scope definition. Products that are sold on a B2B basis should not be brought into scope simply because the final product into which they are incorporated is sold to or used by consumers. Moreover, it should be recognized that there will be situations where there are practical limitations on a business's ability to retrieve information on sales to the ultimate consumers through third-party intermediaries.

In situations involving a business that is largely B2B but that also has some direct to consumer sales, we believe that it would be appropriate to apply a de minimis rule to treat such business as out of scope.

Even in situations where there is a consumer-facing business, the products sold or services provided may be of a nature that they are virtually indistinguishable from the products or services of competitors, making it unlikely that any material value is added through the way the business interacts with consumers in the market. This circumstance is part of the rationale underlying the reference to extractive industries and commodities being out of scope, together with the strong connection to the source jurisdiction that is present for the extractives and commodities industries. It may also be relevant to the ongoing consideration of an exclusion for regulated financial services businesses. A clear description of this circumstance should be included in the guidance so that it can be appropriately taken into account wherever it arises.

Moreover, there are common business models in which the profits related to the relevant consumer-facing intangibles are already allocated to the local market under the current international tax system. This is the case when these intangibles are owned and exploited in the local market. It also can be the case that the marketing activities performed outside the local market receive no or a limited return, which may effectively mean that the residual profits generated by the marketing activities are allocated to the local markets. If a business can prove that it uses this type of local marketing intangible model, the business (or the relevant segment) should be out of scope.

Paragraph 20 of the consultation document discusses the appropriate scoping of the new rules under Pillar One, noting, among other things, that "Further discussion should also take place to consider whether other sectors (e.g., financial services) should also be carved out, taking into account the tax policy rationale as well as other practicalities." For the most part, regulated financial services groups must operate in the jurisdictions where their customers are located, primarily because global and local country financial services regulators require this. The business models required by this regulatory environment result in the profits of these businesses being taxed in the customer jurisdiction. Thus, regulated insurance groups, regulated banking and similar financial services groups, and regulated asset managers (and the investment funds themselves which are generally exempt from tax in most OECD countries) are examples of the kind of businesses that should be out of scope as their profits are already allocated to the local markets under the current international tax system.

Setting a revenue threshold below which a business will be out of scope is a way of targeting the new rules by carving out smaller businesses where the burdens of compliance and administration may well be disproportionate to the amount of profit that potentially could be re-allocated. For purposes of determining whether a business falls within scope or not, the revenue threshold that is specified should be applied on a segment basis rather than to a group as a whole. Segment-based application is necessary to ensure that the new rules apply in the same way to two similar businesses of the same size, regardless of whether either of the businesses is part of a larger group.

2. *New Nexus*

As in the case of the delineation of scope, it is very important for the new nexus rule to be targeted and precise. The new standard for nexus should be targeted at situations where extraordinary profits that are made outside a market country are generated by the business's interaction with the local consumers (and users) in the market country. Hence, local-to-local sales, which are sales of products where the associated intangibles (e.g., a brand) are exploited locally, should be excluded from the nexus definition. Sales through third-party intermediaries also should not be taken into account to create nexus in any countries where the third party sells (other than its home country), except in situations that involve a restructuring through the intermediary with the aim of avoiding the new nexus standard.

It is important that the new nexus rule applies only for purposes of the new rules on allocation of profits under Amount A and not for any other purpose. Limiting the application of the new nexus standard in this way avoids the potential for any collateral effects in any other areas. Therefore, we welcome the explicit statement in the consultation document that the new nexus rule will be a stand-alone provision that is separate from the permanent establishment provision in article 5 of the OECD Model Tax Convention.

If the new nexus standard is based primarily on a revenue threshold, as is suggested in the consultation document, we believe that a fixed threshold should be used, rather than a threshold based on a percentage of the particular group's sales revenue for example. A fixed threshold approach would be more consistent with the interests of maintaining a level playing field. We also believe that the threshold should be applied based on average revenue over a multi-year period that ends with the year before the year at issue – the use of an average will have a smoothing effect that will provide greater stability and the use of an average for a closed period will reduce uncertainty. In addition, the threshold should be applied on a business segment basis, rather than to a group as a whole, in order to provide a level playing field. In this regard, any finding of nexus under the new rule should apply only to the particular segment and not to the group more broadly. Finally, in using a revenue threshold, careful consideration should be given to the treatment of new business models where revenue is generated by a business in one jurisdiction because of consumer activity in other jurisdictions.

On the question of whether the threshold for nexus should be calibrated so that smaller economies can benefit, it should be kept in mind that this threshold will have two effects. On the one hand, setting a lower threshold for smaller countries may be viewed as beneficial to these countries because more businesses would be found to have nexus, with the potential for new tax obligations in the particular country. On the other hand, a threshold that is too low could cause businesses to weigh the cost of the new obligations associated with nexus against the benefits of involvement in the country, which could lead to business decisions to terminate that involvement. The result for developing countries could be reduced access to goods and services that are important to the local population.

Finally, in order to limit additional administrative costs to the maximum extent possible, rules will be needed to specify the compliance obligations that will be associated with a finding of nexus under the new rules.

3. *Calculation of group profits for Amount A*

The most appropriate profit metric from a group's consolidated financial statements to use as the starting point for the computation of Amount A is "profit before tax" (PBT). The use of any profit level presented in financial statements as a subtotal above PBT, such as "operating income", would be challenging and inequitable for two reasons. First, the different accounting standards used in the preparation of financial statements do not have common definitions for the various headings and subtotals that are conventionally used in the presentation of financial statements. Therefore, there is diversity in practice as to what is included in the particular line items, headings and subtotals that are presented. Second, any subtotal above PBT would necessarily exclude expenses that should be properly taken into account for Amount A, such as interest expense. It is most appropriate to start with PBT as the Amount A profit measure and then require that adjustments be made to remove any specifically enumerated items of income or expense that are considered irrelevant to the computation of Amount A (e.g., income and loss reported under the equity method of accounting for non-consolidated subsidiaries). In this regard, clear guidance will be needed regarding the adjustments, if any, that are to be made to PBT to yield Amount A.

Similar to our recommendation regarding the applicable revenue threshold for applying the new nexus rule, we believe that use of a multi-year average approach should be considered in determining Amount A as well. Under such an approach, Amount A would be the average of the group's annual PBT (with any required adjustments) for the specified period that ends with the year before the year at issue. The use of an average would have a smoothing effect that would provide greater stability, particularly in the case of cyclical businesses. The use of an average for a closed period would provide greater certainty.

In using financial statements as the source for Amount A, it will be necessary to conform the group that is included in the consolidated financial statements and the tax group to which the new profit allocation rules are being applied. The various accounting standards generally used in the preparation of consolidated financial statements include different models and definitions for determining control of an entity for purposes of the entity's inclusion in a group's consolidated financial statements. Requiring that an entity that is not otherwise included in the consolidated financial statements pursuant to the relevant accounting standards be added to the group for the exclusive purpose of computing Amount A would be so complex and administratively burdensome as to be unreasonable. For this reason, Amount A should be measured based only on entities that are included in a group's consolidated financial statements.

There are numerous different accounting standards used in the computation of consolidated financial statements, including US GAAP, IFRS and various local country GAAP standards. There are numerous differences among all of these standards. In addition, accounting policy elections that are available within a specific standard can result in different accounting treatment of a particular item between similarly situated groups that prepare their consolidated financial statements under the same general accounting standard. It is also important to note that differences may arise as the result of differences in interpretation of the application of general accounting principles across industries or within an industry. However, the trend in recent years has been increasing conformity between US GAAP and IFRS. In addition, there is significant similarity in the general principles and conceptual framework used in the different accounting standards. Therefore, the majority of differences affect the timing of recognition of an item of income or expense rather than the item's absolute recognition or not. Given the burden that would be associated with identifying any required adjustments and the complexity that would be involved in recomputing and tracking such adjustments over time, we believe that there should be no requirement to make adjustments to the accounting standard used in preparing the financial statements for purposes of determining Amount A. In this regard, the guidance regarding Amount A should provide that adjustments may be made, at the discretion of the taxpayer, to address specified differences in accounting standards that have a material effect.

For purposes of determining Amount A, we believe that it also is not appropriate to require adjustments to financial statement income to reflect common tax policies, such as limitations on the deductibility of interest expense for example, in an attempt to align financial statement income with taxable income on a global basis. Amount A is used as nothing more than a proxy for residual profit and is based on financial statement income for simplicity and transparency. Requiring adjustments to financial statement income to reflect tax differences would add substantial complexity with no true increase in the precision of the formulaic approach used for Amount A.

The ability of taxpayers to segment consolidated financial statement income on a business line and/or regional basis is critical to the appropriate measurement and allocation of Amount A. Within a consolidated group, different segments may have very different profit margin profiles and very different geographic footprints. Measuring and allocating Amount A separately for these different segments is essential to prevent significant distortions and inequities. The segmentation that is allowed for this purpose should not be limited to the segmentation, if any, that may be reported in the published financial statements. The segment information in financial statements is quite limited and, in those cases where segment information is reported, the segments that are used can vary significantly from year to year. For purposes of Amount A, taxpayers should be allowed to use any reasonable segmentation, supported by an overall reconciliation of the aggregate reported segment income to consolidated financial statement income. Guidance on Amount A could specify a consistency requirement so that taxpayers are required use the same segments from year to year, absent a significant business change. Moreover, in the interests of avoiding excessive administrative burden, taxpayers that choose to use segments for purposes on Amount A should not be required to make adjustments to recognize any profit or loss eliminated in the consolidated financial statements for intercompany transactions between those segments. Finally, given the data that will need to be developed and presented in order to apply the new rules on a segment basis, the adoption of segmentation for this purpose should be in the taxpayer's sole discretion.

It should be noted that the treatment of entities included in a group's consolidated financial statements that are less than wholly owned raises questions of equity and complexity in the computation and allocation of Amount A. In order to avoid anomalies, we believe it would be appropriate to allow a taxpayer to elect to treat a consolidated entity that is less than wholly owned as a separate segment for purposes of computing and allocating Amount A.

In the interest of simplicity and certainty, we believe that the new rules should specify that the determination of group profits for purposes of Amount A, including the use of segmentation, should be subject to audit only by the tax authority of the group parent's jurisdiction of residence. Allowing multiple jurisdictions to audit the computation of group profits for Amount A would create enormous administrative burdens as well as the potential for complex multilateral disputes.

4. Determination of Amount A

Multilateral agreement on the determination of Amount A is essential to the proposed "Unified Approach". Under the proposed approach, the determination of Amount A would involve a formulaic basis for determining "deemed routine profits", which would be subtracted from the profits of a group (or segment) for purposes of determining "deemed residual profits" of the group (or segment). In addition, under the proposed approach, a formulaic basis would be used to determine the portion of such deemed residual profits to be allocated to (and then among) the market jurisdictions. It is critically important that the parameters used in these formulas be universally accepted and applied consistently.

We believe that the parameters used for formulaic determination of deemed routine profit and of the portion of deemed residual profit to be allocated to market jurisdictions should be supported with a clear economic rationale. It will be important to lay out that rationale so that countries understand the parameters they are agreeing to. In addition, consideration should be given to laying out a procedure for periodic re-evaluation and potential adjustment of the parameters to ensure that they continue to be supported by current economic data, including industry-based data to support industry-specific parameters.

It also is important that deemed routine profit and deemed residual profit are concepts that are used only for purposes of determining Amount A and are not applied for any other purposes. In this regard, we welcome the statement in paragraph 56 of the consultation document that the determination of deemed routine profit is not intended to disturb any determinations of routine returns under the existing transfer pricing system.

In allocating a portion of deemed residual profits among the market jurisdictions, the allocation should be made without regard to whether or not there is a finding of nexus under the new rule with respect to any such jurisdiction. Under the proposed "Unified Approach", nexus is determined through the use of market jurisdiction revenue thresholds and then revenue is used as the key for allocating a portion of the deemed residual profit to the market jurisdictions. We recommend that it be made clear that the use of revenue as the allocation key should be relative to total revenue earned by the group (or segment). If the group (or segment) does not meet the revenue threshold for nexus in a particular jurisdiction, this should not result in a higher allocation of profits to the other market jurisdictions for which the revenue threshold is met. In other words, the revenue denominator should not change depending on whether the revenue threshold for nexus is met and profits that would otherwise be allocated to a market jurisdiction where there is no nexus are not to be reallocated to other market jurisdictions where there is nexus.

As noted in our comments on the initial consultation document, we believe that any new rules on nexus and profit allocation should apply equally in situations where the results to be allocated are losses instead of profits. The consultation document in paragraphs 29 and 51 confirms that the new rules should be effectively applicable to both profits and losses. We believe that if the actual consolidated profit of a group (or segment) is below the deemed routine profit amount, the negative deemed residual profit should be treated like a loss and the group (or segment) should be able to carry over such loss to reduce the deemed residual profit in prior or future years. To maintain the equal treatment of profits and losses, the utilization of carry forward losses should not be time limited. Moreover, the ability to use losses also should not be affected by changes in the legal structure of the group. Finally, we stress the importance of developing transition rules to ensure appropriate treatment of losses that are incurred in years prior to the adoption of the new rules and that relate to profits generated in years when the new rules are applicable.

In situations where the profit of a group (or segment) is below the deemed routine profit such that its deemed residual profit will be negative, consideration should be given to what, if any, compliance obligations are triggered by reason of this negative Amount A.

5. *Elimination of double taxation in relation to Amount A*

It is imperative that the new profit allocation approach contains clear and administrable rules to prevent double taxation. An important aspect within this framework relates to the identification of the entity or entities within a group that are subject to the new nexus rule, under which part of their profits are to be allocated to market jurisdictions through the Amount A mechanism.

Many businesses do not operate in a centralized manner with residual profits located in a single entity. There may be several entities in a group (or segment) that would be considered to have a share of the deemed residual profits to be reallocated based on the new nexus. Careful consideration should be given to (i) the various operating models that businesses apply, (ii) what the impact of Amount A is in these models, (iii) which entities are to be required to allocate part of their profits to the market jurisdictions, and (iv) how the prevention and elimination of double taxation can be realized in these situations. In situations where multiple entities with residual profits are identified, clear rules on how to divide the deemed residual profits allocated to market jurisdictions among such entities are necessary. Such rules must specify both the amount of deemed residual profit assigned to each entity and the portion of such profit that is to be allocated to each market jurisdiction.

Ensuring that these reallocated amounts are not subject to double taxation will require that countries incorporate new double tax relief mechanisms into their domestic law. The mechanism should be a 100% exemption in order to provide full relief, which should apply for purposes of Amount A without regard to the particular double tax relief that the country applies for other purposes. In addition, any expense allocation rules that operate to limit double tax relief should not apply for purposes of Amount A given that it is already a net profit amount. It also should be made clear that any branch profits tax would not apply to the deemed branch created by reason of Amount A. Moreover, given the multilateral nature of the proposed allocations, modifications to existing domestic law mechanisms may be needed to ensure that they operate effectively on a multilateral basis.

6. Amount B

In our view, guidance on Amount B should solely focus on the objective of achieving results that reduce potential disputes while being generally consistent with the arm's length principle. Amount B should not be developed as a further opportunity to increase taxing rights in market jurisdictions.

If the fixed return in Amount B is to be based on operating margins, we believe that it should be applied on an industry-by-industry basis. Accordingly, the baseline marketing and distribution activities also should be clearly defined on an industry-by-industry basis, recognizing that the level of functionality establishing a baseline level of marketing and distribution activity are not uniform across industries.

If a benchmarking exercise is to be used to set the level of the fixed return under Amount B, the process by which the benchmarking is undertaken should be transparent, and stakeholders should have the opportunity to provide input. This benchmarking should take into account local country as well as industry sector differences. Moreover, the benchmarking process should be revisited periodically so that the returns that are established and the levels of baseline activities that are set are up to date with current economic developments.

In order to achieve the objectives of administrability and approximate arm's length outcomes, the baseline activities should be narrowly focused and limited in nature, with the fixed return commensurately low. Amount C will always ensure appropriate returns when activities exceed the baseline amount, while on the other hand setting Amount B too high could systematically lead to both non-arm's length outcomes and an increase in disputes, contrary to the OECD's stated objectives.

If, instead, the Amount B baseline activities are more broadly defined with commensurately higher returns, there will be situations where the actual distribution and marketing activities are significantly less than the baseline amount, and there may be other circumstances that justify a lower return (such as multiple distribution entities contributing to the ultimate transaction). In those circumstances, Amount B should not apply and under Amount C only traditional transfer pricing rules should be applicable.

We also believe that consideration should be given to including a restriction on Amount B to ensure that it does not exceed a specified percentage of total profits of the group (or segment).

7. Amount C

We believe it is important that it be clear that the Amount C return is only applied where there are identified functions in a country in addition to the baseline activities determined under Amount B. That is, Amount C should not be allowed to be inappropriately used to "top up" local taxation where tax authorities take the view that the Amount A and/or Amount B returns are somehow insufficient. Therefore, it should be clear that Amount C applies only where there is functionality in the entity in addition the functionality covered by Amount B and that Amount C represents only the arm's length return on such extra functionality.

As noted in the consultation document, given the potential for complexity in implementation and interpretation of the new measures, and the connection of the new rules to amounts determined based on traditional transfer pricing under Amount C, it is important that there are binding and effective dispute resolution mechanisms. As discussed above, existing dispute resolution mechanisms are insufficient to address the challenges of the proposed "Unified Approach" and new, robust, and effective mechanisms that are fully multilateral must developed.

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We welcome the opportunity to discuss these comments in greater detail and to continue to participate in the dialogue as the OECD and the participating countries advance the work on this important project.

If there are questions regarding this submission, please contact me at +1 202 327 5824 or barbara.angus@ey.com.

Sincerely,

Barbara M. Angus
EY Global Tax Policy Leader