Written Testimony of Gary D. Sprague, Baker & McKenzie LLP
Before the House Committee on Ways & Means, Subcommittee on Tax
"Ensuring the Biden Administration Puts Americans First"
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Chairman Kelly, Ranking Member Thompson, and Members of the Subcommittee:

I am pleased to offer testimony today on the topic of the OECD's Pillar 1 project. I am a partner with Baker & McKenzie LLP, based in Palo Alto, California. I have practiced international tax law for over 40 years. I am an adjunct Professor of international tax at the UC College of the Law, San Francisco. My testimony will address Amount B as described in the OECD report issued February 19, 2024 (the "Amount B Report"). I provide these comments on my own behalf.

Current State of Transfer Pricing Disputes Relating to Distribution Activity

Across the world, countries generally have adopted the arm's length principle to test the prices charged between related parties engaging in cross-border transactions, as reflected in the OECD's Transfer Pricing Guidelines ("TPG") and the U.S. Treasury section 482 regulations. As relevant to Amount B, the transactions in question are the prices to be paid by a distribution entity established in a market state to acquire goods or services from a related, nonresident supplier to be resold to customers in the market state. The price paid then determines the taxable profits to be recognized by that entity for its distribution functions.

The OECD reports that the number of Mutual Agreement Procedure ("MAP") cases opened for transfer pricing matters has spiked since 2016.[1] With respect to U.S. MNCs, that increase reflects an increase in the number of non-US transfer pricing disputes worldwide. Similarly, the IRS publishes statistics on its completed Advanced Pricing Agreements ("APA").[2] IRS figures show an increase in the number of cases related to distributors from approximately 39% in 2018[3] to around 53% in 2022 - the latest year of reported executed APAs.[4] Of all tested parties[5] in closed APA cases, in 2018 non-U.S. distributors constituted 7%,[6] while they constituted 19% in 2022.[7] This demonstrates that U.S. taxpayers have been required to devote considerably more resources to resolving foreign distribution cases in recent years.

APA statistics reflect voluntary requests by taxpayers to resolve in advance their transfer pricing positions. Accordingly, the APA statistics also demonstrate that U.S. taxpayers increasingly value predictability and stability in the pricing of their distribution relationships. Anecdotally, the increased

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[1] OECD Mutual Agreement Procedure Statistics 2022 – Inventory Trends, https://www.oecd.org/tax/dispute/mutual-agreement-procedure-statistics-2022-inventory-trends.htm#tpcases (last visited March 4, 2024) (*see* "Inventory Trends for Transfer Pricing Cases"). A MAP case is an intergovernmental consultation triggered under a tax treaty when one tax administration makes an adjustment to a reported transfer price. *See also*, Internal Revenue Service, *Overview of the MAP Process*, Overview of the MAP Process | Internal Revenue Service (irs.gov).

[2] In an APA, the IRS agrees with a counterparty tax administration to the price to be charged in a transaction between a U.S. taxpayer and a foreign affiliate.

[3] "Announcement and Report Concerning Advance Pricing Agreements" (https://www.irs.gov/pub/irs-apa/announcement_2019-03_apa_report.pdf) , APMA Program, March 22, 2019, page 9.

[4] "Announcement and Report Concerning Advance Pricing Agreements" (https://www.irs.gov/pub/irs-drop/a-23-10.pdf) , APMA Program, March 27, 2023, page 9.

[5] In this context, the "tested party" is the entity engaging in local distribution activity.

[6] "Announcement and Report Concerning Advance Pricing Agreements" (https://www.irs.gov/pub/irs-apa/announcement_2019-03_apa_report.pdf) , APMA Program, March 22, 2019, page 9.

[7] "Announcement and Report Concerning Advance Pricing Agreements" (https://www.irs.gov/pub/irs-drop/a-23-10.pdf) , APMA Program, March 27, 2023, page 9.

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demand for APAs related to foreign distribution is a response to the increased level of foreign-initiated controversies over the pricing of local distribution functions in recent years. The OECD press release on the Amount B Report noted that "[s]everal low-capacity countries report that between 30–70% of their transfer pricing disputes relate to baseline marketing and distribution activities."[8]

Transfer pricing disputes impose significant costs on taxpayers. In essentially all cases, a transfer pricing dispute involves a question of how an enterprise's tax base should be allocated between the two jurisdictions involved in the dispute. Transfer pricing issues are by their nature factually intensive, and outside of the distribution context, potentially can give rise to a wide range of results. Taxpayers must bear significant costs of compliance through preparing contemporaneous transfer pricing documentation, as well as the costs of responding to audits and managing actual disputes. Tax administrations bear the costs of auditing transfer pricing arrangements and managing the controversies. Ultimately, taxpayers bear the cost of unrelieved double taxation if the two tax administrations involved do not agree on the ultimate allocation of tax base. The uncertainty created by the possibility of future transfer pricing disputes imposes its own costs on business in the form of lack of predictability of the group's tax expense. Double taxation could disincentivize business investment and economic growth.

The transactions potentially subject to pricing under Amount B by definition relate to distributors which do not exploit material intangible assets in their business, and do not perform material other value-added activity beyond distribution. Accordingly, in principle, the range of possible profit results under normal applications of the arm's length principle for entities with that functional profile should be relatively narrow.

The essential promise of Amount B was to produce a simplified and streamlined approach which will increase certainty for taxpayers and tax administrations, and reduce the costs of controversies over what should be regarded as relatively straightforward transactions which could produce only a limited range of pricing results. This would increase certainty and limit compliance costs associated with simple distribution relationships, to be commensurate with the relatively small amount of income in dispute.

The Stated Purpose of Pillar 1 Is to Restabilize the International Tax Framework

The stated purpose of the OECD / Inclusive Framework Pillar 1 project is to restore stability to the international tax framework. That framework has been put under considerable stress in recent years as jurisdictions have enacted different types of unilateral tax measures in an effort to reallocate to market states the tax base historically residing in residence jurisdictions. Digital services taxes ("DSTs") are the most well known of these unilateral measures, but other types of taxes, such as rules that deem a nonresident to have nexus in the market state, also have started to appear.

Less well publicized are the instabilities created by aggressive transfer pricing positions taken by the tax administrations of various countries, including some of the United States' largest trading partners. Despite the relative consistency in the legal framework applying the arm's length principle, U.S. MNCs have experienced increasing numbers of disputes with market state tax administrations related to the pricing of the inbound distribution of goods and services.

[8] OECD, "Tax Challenges Arising From Digitalisation: Release of Amount B Report to Simplify Transfer Pricing Rules and Conforming Changes to the Commentary of the OECD Model Tax Convention, https://www.oecd.org/tax/transfer-pricing/release-of-report-on-amount-b-relating-to-the-simplification-of-transfer-pricing-rules-and-conforming-changes-to-the-commentary-of-the-oecd-model-tax-convention.htm (Feb. 19, 2024).

Aggressive Transfer Pricing Assertions Have Contributed to Tax Framework Instability

The effect of an aggressive allocation of profit to a local distributor is to reallocate tax base from the residence state to the market state. If the residence state grants a foreign tax credit or other tax relief, the tax cost of the aggressive allocation is borne by the residence state. If the taxpayer is unable to obtain a foreign tax credit or other double tax relief, the result is unrelieved double taxation.

Many of these disputes have arisen recently with respect to local entities which are engaged in the routine functions of distributing goods and services. In principle, the transfer pricing analysis of a routine distributor should be relatively straightforward, as such an entity does not exploit material high value intangibles and does not assume unusual commercial risks.[9] U.S. MNCs nevertheless have experienced in recent years a significant increase in transfer pricing disputes relating to those transactions. Those disputes require significant resources from both taxpayers and tax administrations, despite the fact that they are relatively routine transactions.

The consequences to the U.S. tax base can be illustrated with a simple example. Assume a U.S. parent entity which designs, develops and produces a product in the United States, and which establishes distributors in several market jurisdictions to perform routine distribution functions, *i.e.* they do not exploit material intangibles. The U.S. entity has taken the entrepreneurial risk and incurred the related investment costs, and deserves under transfer pricing principles the returns to those entrepreneurial functions. The transfer price charged to the market state distributor should be set so that the distributor earns only a routine return for the distribution function. In the event that the local tax administration allocates additional income to the distributor, that income is taken from the U.S. tax base, and reduces the entrepreneurial return that is subject to U.S. tax. The increasing prevalence of these disputes has contributed to destabilizing the international tax environment.

Amount B Is an Integral Part of Pillar 1 to Restabilize the International Tax Framework

Amount B has been an integral part of the Pillar 1 project from the project's inception. Amounts A and B were designed to create greater stability for taxpayers and tax administrations in combination through complementary mechanisms. The two elements of Pillar 1 apply very different mechanisms; Amount A allocates a certain percentage of residual profits to market states on a formulaic basis, while Amount B seeks to enforce compliance with the arm's length standard for baseline distribution functions through a standard "simplified and streamlined approach" based on the arm's length principle. While different mechanisms, they share the common purpose of promoting stability and predictability.

The Amount B pricing mechanism will, in principle, apply to all in-scope taxpayers that engage in routine distribution activity. Amount A, in contrast, applies only to a small number of large global companies. The Amount B mechanism as it was originally conceived held the promise of creating a widespread benefit of reducing controversy and increasing certainty for taxpayers and tax administrations across a wide variety of industries and geographies, and for both large and small MNCs.

Amounts A and B are linked as complementary parts of the overall Pillar 1 project. The Amount A mechanism directly addresses the demand by some countries for a mechanical allocation of taxable profit based on sales into a market, while Amount B provides the complementary taxpayer-favorable element that

[9] The analysis should be relatively straightforward under both the transactional net margin method ("TNMM") (per OECD TPG) and the comparable profits method ("CPM") (U.S. section 482 regulations).

once the market state receives the unprecedented reallocation of tax base under Amount A, the market state should remain faithful to the arm's length principle as applied to related party distributors.

The Strength of the Amount B Concept Lies in a Principled Pricing Matrix

At the core of the Amount B Report is the concept that companies can be classified according to the criteria reflected in the pricing matrix, and that benchmark returns can be applied to each of the categories that are reasonable approximations of the arm's length return that would be earned by routine distributors exhibiting those economic characteristics.[10] The Amount B Report states that the pricing matrix has been based on a review of global comparables. U.S. MNCs certainly agree that the pricing matrix must be based on a review of actual comparable entities, and it appears that that has been the case here.

It is unfortunate that the OECD has not yet released details of the global comparables set used to set the returns in the pricing matrix. Absent insight into the actual comparables relied upon to populate the pricing matrix, it is not possible to provide specific comments on the reliability of those comparables to determine returns for routine distribution activity. U.S. MNCs have provided to the OECD comparables-based analyses that conclude that arm's length returns for routine distribution activity generally are consistent across the globe, without regard to industry sector, geography, or level of profit of the global consolidated group. The convergence of most industry sectors into a single Industry Grouping 2 in the Amount B Report suggests that the OECD broadly agrees with those observations made by U.S. MNCs.

Deficiencies of the Amount B Report Which Impair the Restabilization Goal

In its current state, the Amount B Report is not likely to achieve the expectation that a simplified and streamlined approach could be broadly adopted and lead to a material reduction in transfer pricing disputes. The three major issues are: (i) the narrow scope of industries covered by Amount B; (ii) the adoption of the simplified and streamlined approach is completely optional with jurisdictions; and (iii) the apparent intention that a further subjective (and optional) element will be introduced to the scoping criteria, which will erode the goals of simplicity and certainty. U.S. Treasury has noted these deficiencies.[11]

1. The Defined Scope Excludes Many of the US's Most Dynamic Industries

The Amount B Report limits the application of the simplified and streamlined transfer pricing approach to buy-sell marketing and distribution transactions where the distributor purchases goods from one or more associated enterprises for wholesale distribution to unrelated parties.[12] The distribution of non-tangible goods, services and commodities are expressly excluded. The principal deficiencies in this scope definition are (i) the exclusion of non-tangible goods and services, and (ii) the exclusion of activities which are not wholesale distribution.

The excluded sectors represent some of the most innovative and dynamic sectors in the U.S. economy. U.S. software, digital goods, digital services and other service providers typically endeavor to expand their international sales from an early stage of their development. Those sectors continue to grow at rates that

[10] Amount B Report, section 5.1.
[11] Stephanie Soong, *Amount B Certainty Is a Red Line for U.S., Bello Says*, TAX NOTES, Jan. 12, 2024 ("The third condition is securing an effective amount B, according to Bello. 'We think of amount B as a living, breathing tax certainty provision, if we get it right,' he said. 'Our red line with respect to amount B is that amount B needs to be robust. It needs to actually clearly apply to real taxpayers that have real transactions, and it needs to provide meaningful tax certainty.'")
[12] Sales agencies and commissionaires involved in those transactions are included.

exceed that of the U.S. economy as a whole.[13] They also achieve a greater percentage of their sales outside the United States compared to more traditional tangible goods makers.[14] Excluding those industries thus precludes some of the most innovative and dynamic enterprises in the U.S. economy from the benefits of the simplified and streamlined method.

Enterprises operating in those sectors report that they have been subject to a disproportionate amount of aggressive transfer pricing adjustments with respect to their non-U.S. distribution activity. Excluding those sectors removes Amount B protections from enterprises which have been experiencing the sort of aggressive transfer pricing assertions that inspired the idea of Amount B in the first place.

Enterprises in those sectors have been complying with all U.S. and foreign country transfer pricing documentation requirements for their local distribution activity. Those enterprises report that they have been able to find global, regional or country specific comparables appropriate to apply the CPM / TNMM to their distribution activity. Accordingly, there does not appear to be a technical reason to exclude non-tangible goods and services from the coverage of Amount B.

The Amount B Report does not explicitly explain why software, digital goods and services distribution have been excluded. The Amount B Report does state that the simplified and streamlined approach applies to qualifying transactions "involving the distribution of tangible goods for which there is broad consistency in the overall supply chain and functional analysis."[15] That text implies a view that a similar consistency does not exist for transactions involving the distribution of non-tangible goods or services.

The structure of Amount B does not require consistency across all distribution entities. It applies only to those distribution entities which perform a set of core distribution functions, which can be reliably priced using a one-sided method, and which incur annual operating expenses within a stated band relative to the entity's tested revenues. This definition causes the simplified and streamlined method to apply only to those entities for which it is appropriate. If some distributors of non-tangible goods and services do not fit with those parameters, that is no reason to exclude those that do. Furthermore, the pricing matrix itself exhibits a wide range of possible results, from 1.5% to 5.5% return on sales (before the application of market risk adjustments). That is a notably wide range of results for baseline distribution activity. There is no reason to believe that distributors of non-tangible goods and services will not find their appropriate place in that pricing matrix, along with functionally similar distribution entities in other industry sectors.

The fact that resellers of services do not acquire and dispose of title to goods is not a reason to exclude non-tangible goods or services. First, a routine distributor's principal functions are to market the goods or services, locate potential customers, engage in sales solicitation, conclude the transaction, and support the customer with ongoing needs. Those functions are identical for distributors of tangible goods, non-tangible goods, or services.

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[13] Tina Highfill and Christopher Surfield, *New and Revised Statistics of the U.S. Digital Economy, 2005-2021*, U.S. Department of Commerce, Bureau of Economic Analysis (Nov. 2022), *available at* https://www.bea.gov/system/files/2022-11/new-and-revised-statistics-of-the-us-digital-economy-2005-2021.pdf ("Growth in price-adjusted GDP (also referred to as "chained-dollar" or "real" GDP) was 9.8 percent in 2021, greatly outpacing growth in the overall economy, which increased 5.9 percent."). *See also* MarketLine Industry Profile: Global Software, April 2023.

[14] United Nations Conference on Trade and Development, *How Digital Multinationals are Transforming Global Trade and Investment* (May 16, 2022), *available at* https://unctad.org/news/how-digital-multinationals-are-transforming-global-trade-and-investment (Since 2016, Digital MNEs' "foreign asset footprint has decreased, while foreign sales have grown. The ratio between the latter and the former is up by 11%, with most of the rise taking place in 2021.")

[15] Amount B Report, para. 25.

Second, sales agents and commissionaires are expressly included in scope. Those business models involve commercial intermediaries which do not take title to tangible goods. If the pricing matrix is based on comparables appropriate to price sales agents and commissionaires, there is no reason to believe that those comparables can't also support pricing for distributors of digital goods and services.

The exclusion of software, digital goods and services also is perplexing since the cross-border supply of digital goods and services was one of the principal impetuses behind the Amount A design. Pillar 1 as a whole was designed to respond to the tax challenges of the digitalized economy. The principal "tax challenge" was how national tax law should address remote supplies of digital goods and services to customers without the supplier establishing the type of local sales presence that had been common in other sectors.

At the national level, several countries did not wait for the development of an Amount A proposal and instead imposed unilateral taxes on digital service providers, notably the DST. It is particularly unfortunate that the current Amount B scope expressly excludes those companies which were the impetus for the Amount A design and are the sole subjects of the DSTs.

Even if digital goods and services are not brought into the scope of Amount B, any Amount A taxpayer should be able to obtain the benefits of the simplified and streamlined approach. Actual Amount A taxpayers should benefit from the interdependency between the complementary Amounts A and B regimes to restabilize the international tax framework.

There is no reason that the scope of Amount B can't be widened to include digital goods and services in the future. If Amount B retains the current limited scope, the OECD should commit to a workstream and provide a timeline to identify the appropriate comparables for the distribution of digital goods and services so that those sectors can be brought into the simplified and streamlined approach. In the meantime, it should be made clear that the Amount B pricing matrix should not apply to out of scope transactions, and in particular should not be viewed as a "floor" for pricing the distribution of services and non-tangible goods.[16]

2. Optionality in the Amount B Report Seriously Impairs the Goals of Achieving Stability

The policy goals of Amount B are: (i) to reduce disputes over what should be less controversial intercompany transactions; (ii) to enforce the norms of the arm's length principle in an environment where some jurisdictions have endeavored to reach into nonresident residual profits through transfer pricing adjustments; and (iii) to provide workable tools for low capacity jurisdictions to apply transfer pricing rules for inbound distribution in their jurisdiction. Those goals are undercut by the permission granted in the Amount B Report that allows all jurisdictions, without limits, to opt in or out of the Amount B regime. That optionality will impair the hoped-for benefits of predictability and stability for U.S. MNCs.

These concerns have been manifested already. Immediately upon the release of the Amount B Report, New Zealand announced that it will not participate in the Amount B project, and will not regard any application of the Amount B pricing matrix as evidence of arm's length pricing. Australia followed soon thereafter with a statement that it favors the optionality permitted in the Amount B Report.

[16] The OECD should clarify that the simplified and streamlined approach applies to B2B transactions where the business customer acquires the goods for its own use or for incorporation into another product. The definition of "wholesale distribution" includes distribution to any type of customer except end consumers. That suggests that B2B transactions are within scope, although B2B sales for final use by the B2B customer normally are not referred to as "wholesale distribution".

U.S. MNCs generally believe that the simplified and streamlined approach should be mandatory for tax administrations. The Amount B regime will be included in the OECD's TPG. New Zealand and Australia are both OECD members. Their early declarations may give other tax administrations cover to also back away from a commitment to apply the simplified and streamlined approach. Double taxation is inevitable if one jurisdiction does not regard an adjustment by the counterparty jurisdiction as legitimate, as correlative relief then becomes unavailable.

Ideally, OECD/IF members will continue to negotiate the simplified and streamlined approach towards the goal of becoming mandatory at least for all OECD members, and other jurisdictions which choose to follow the OECD TPG for their transfer pricing guidance. Failing that, the IRS might consider negotiating Competent Authority Agreements with the major U.S. trading partners to achieve mandatory treatment on a bilateral (or multilateral) basis. U.S. leadership on that point will be useful to counteract the negative drag on the initiative created by tax administrations publicly embracing optionality or opting out altogether.

3. The Possibility of an Additional Optional Subjective Scoping Criterion Will Further Degrade Certainty and Simplicity

The Introduction to the Amount B report notes that the IF is continuing to work on an additional optional qualitative scoping criterion that jurisdictions may choose to apply as an additional step to identify distributors which perform non-baseline activities, and thus would be excluded from the simplified and streamlined approach.[17]

U.S. MNCs believe that any further subjective scoping criterion will lead to further uncertainty. The Amount B Report sets out three principal layers of criteria necessary to define transactions in scope and to determine a price: (i) the objective scoping criteria set forth in section 3.2 of the Amount B Report; (ii) the pricing matrix itself based on a careful review of the comparables and differentiated by industry groupings and levels of operating asset and operating expense intensity relative to sales; and (iii) an operating expense based cap and collar to the pricing matrix results. This triple definition to determine a price is directly supported by transfer pricing theory and is based on comparable transactions. The objectivity of the various screens enhances predictability and certainty. Introducing an optional qualitative (i.e. subjective rather than objective) criterion will seriously degrade certainty and predictability for any transaction with entities operating in a jurisdiction that elects to impose that qualitative criterion. U.S. MNCs suspect that the principal consequence of imposing that additional qualitative criterion will be to exclude many of the United States' most innovative and dynamic sectors from the application of Amount B.

If the IRS does pursue Competent Authority Agreements with major trading partners, the IRS should insist that no additional qualitative criteria be considered.

The Importance of Amount B Is Enhanced due to the Missed Opportunity to Harmonize Amount A and Amount B through the MDSH

The purpose of the marketing and distribution safe harbor ("MDSH") in the Amount A structure is to preclude a jurisdiction from double dipping into the residual profits of nonresident group entities. Notionally, any jurisdiction which is a party to the Multilateral Convention implementing Amount A would be entitled to tax its full share of the nonresident group's residual profits as attributed to that jurisdiction based on sales sourced to that state. If that market state has already taxed some part of the group's residual profits through other mechanisms, however, there is no basis to allocate the full notional Amount A to that

[17] Amount B Report, p. 6. *See also* Amount B Report, footnote 4, for India's endorsement of that feature.

jurisdiction. If the jurisdiction received the full notional Amount A allocation, it will be double dipping into the group's residual profits.

A jurisdiction which includes in its tax base the normal profits earned by a distributor performing only baseline marketing and distribution activity would not be regarded as taxing a portion of the nonresident group's nonroutine returns. If the group's activities in that jurisdiction result in taxable profits in excess of that, however, those profits may be part of the nonroutine return, and to that extent should reduce the Amount A allocable to that state. The MDSH is the Amount A mechanism intended to achieve that adjustment.

Regrettably, the mechanism described in the MLC draft will not achieve that goal.[18] This heavily negotiated element resulted in a MDSH cap that will only partially ameliorate double dipping. A more appropriate mechanism for the MDSH would have been to set the MDSH as a hard cap, *i.e.* that the Amount A allocation would be reduced by the amount of profits already taxed in that jurisdiction beyond the cap. This is a structural feature of Amount A, not Amount B, so it should be a focus of U.S. Treasury if that element becomes open for renegotiation. In the meantime, that MDSH deficiency reinforces the need for an Amount B with wide scope to at least counter double dipping through aggressive transfer pricing assertions with respect to in-country distribution activity.

Amount B Provides Important Benefits to Low-Capacity Jurisdictions

One of the principal policy goals of the Amount B project is to provide simplified tools to allow low-capacity jurisdictions to enforce arm's length pricing rules for inbound distribution structures. The Amount B Report has succeeded in that goal. The report incudes a political commitment by IF members to respect the outcome reached under the simplified and streamlined method when applied by a low-capacity jurisdiction.

The Amount B Report includes some more questionable additional allocations for jurisdictions classified as "qualifying jurisdictions", which may differ from those classified as "low-capacity jurisdictions". Those qualifying jurisdictions can benefit from a higher operating expense cap in the operating expense cross-check formula,[19] and can enjoy an overall uplift to the pricing matrix results based on the jurisdiction's sovereign risk category.[20]

It is not clear whether those generous uplifts are based on rigorous data analysis or are more in the line of a political agreement to benefit the "qualified jurisdictions". As a matter of transfer pricing theory, there is no reason to increase the return on sales for sovereign risk when that risk is not borne by the distribution entity itself. In any event, those special considerations, if ultimately allowed, should be limited to the smaller developing countries, and not made available to larger economies.

Recommendations for a Way Forward

The Amount B proposal held out the promise of a significant reduction in uncertainty and administrative cost for both taxpayers and tax administrations. The range of possible results under the one-sided methods of CPM / TNMM for baseline distribution activity should be fairly small. The Amount B concept holds out the prospect of reducing disputes over where within that limited range of results a transaction should be placed. For U.S. multinationals, the Amount B project also held out the prospect of limiting unreasonable

[18] October 11, 2023 Draft Multilateral Convention to Implement Amount A of Pillar One, Article 5(2).
[19] Amount B Report, section 5.2
[20] Amount B Report, section 5.3.

transfer pricing adjustments by foreign tax administrations by ensuring that in-scope baseline distribution activity would be priced according to a rigorous application of the arm's length principle.

As currently conceived, however, the project does not meet the original expectations due to scope limitations, optionality, and the lack of connection to Amount A. These deficiencies do not result from taxpayer objections to the concept of Amount B; they result from the failure of OECD / IF participants to agree on an approach to price relatively simple transactions based on the arm's principle.

There is no need for negotiations over the terms of Amount B to cease. Even if Amount B is introduced into the TPG in its current form to be effective in 2025, the United States should request further discussions to address these deficiencies. As an element of the TPG, the terms of the simplified and streamlined approach can be modified through the consensus processes at the OECD. The United States should encourage the OECD to publish a roadmap and timeline for expected further work on the Amount B project, including goals for scope expansion to cover digital goods, services, and retail sales, and mandatory application by tax administrations.

In the meantime, the IRS should prepare to negotiate Competent Authority Agreements with major trading partners to implement the Amount B concepts on a bilateral or multilateral basis, with the goal to remedy at least bilaterally the deficiencies described above. Those agreements should expand the scope of transactions covered to include digital goods and services, and should be mandatorily applicable to the respective tax administrations. The IRS could propose a limited number of years for the initial agreements in order to get the program in place and test it for efficiency.

These Competent Authority Agreements should build on the work already accomplished at the OECD. The objective scope definition, the pricing matrix segregated by relative operating expense and asset ratios, and the operating expense cap and collar are all useful mechanisms to define the in-scope transactions in an objective way and set the price based on the arm's length principle.

The IRS also could take that opportunity to revise the global data set to be more focused on comparables relevant to the particular bilateral or multilateral context. Given the evidence supplied by U.S. MNCs to the OECD as part of the Amount B project that baseline distribution returns do not vary much by jurisdiction or by sector, we expect that there would not be much, if any, variation in the ranges applicable to those enterprises brought within an expanded scope.

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I would be pleased to respond to any further questions from the Subcommittee as desired.

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