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To: Organization for Economic Cooperation and Development
Centre for Tax Policy and Administration
Tax Treaties, Transfer Pricing and Financial Transaction Division

Via e-mail: TFDE@oecd.org

From: Foglia & Partners

Re: Comments on "Progress Report on Amount A of Pillar One"

Date: 19 August 2022

Ladies and Gentlemen,

We appreciate the opportunity to submit these comments on behalf of Foglia & Partners on the public consultation document "Progress Report on Amount A of Pillar One" ("**Consultation Document**") released by the Organisation for Economic Cooperation and Development ("**OECD**") on 11 July 2022 and to contribute to the ongoing global discussion of these important tax policy matters.

We recognise that the OECD Secretariat has made extended efforts in elaborating the valuable inputs provided by the stakeholders in the context of the previous public consultations and in developing the draft technical rules of Amount A. At this stage, we believe that the contribution of the stakeholders to the works on Pillar One should focus on perfecting the technical rules regarding the building blocks of Amount A, on which consensus has been reached at OECD level. Therefore, our comments deal directly with the analysis of the very specific provisions, giving both inputs and comments – as requested by the OECD Secretariat – in relation to the proposed rules of the Consultation Document.

In order to facilitate the reading of our comments, please have in mind that the words with capital letter, if not specifically defined in the present document, should have the same meaning they have in the Consultation Document.

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Comments on the Consultation Document

1. Title 1: Scope

When determining the scope of the new measures, the Consultation Document opts for the identification of the in-scope Groups, based on the fulfilment of merely quantitative tests, without taking into account the specific business the interested Group carries out.

More specifically, Article 1 provides that, for a Group to be considered as a Covered Group, the following tests must be both satisfied:

(i) the revenues of the Group for the specific period under review are greater than EUR 20 billion ("**Revenue Test**"); and

(ii) the profitability of the Group is greater than 10 per cent in the specific period or, subject to specific rules, in the immediately preceding four periods ("**Profitability Test**").

We agree with the approach adopted in the Consultation Document. Providing for merely quantitative tests avoid creating – in the short or long term – misalignments, distortions and discrimination among groups operating in different industries and sectors. Each business has its own peculiarities and future developments, in each industry and sector, associated with the capabilities of penetrating new markets with digital tools are unpredictable. Therefore, a definition of the scope that refers to specific industries or sectors would have been restrictive, since it could have created misalignments and discrimination among groups operating in different industries and sectors in the short or long term.

1.1. Schedule A(1): Disclosed Segment of the Group as a Covered Segment

Schedule A contains provisions regarding the scope of Amount A aimed at supplementing those provided by Article 1 of the Consultation Document.

According to Schedule A(1):

> "*Where a Group meets the conditions in Article 1(2) for a Period but was not a Covered Group in any prior Period, the Group is not a Covered Group for the Period and instead a Disclosed Segment of the Group is a Covered Segment for the Period where the conditions in subparagraphs (a) to (d) are met:*
>
> *a. the Disclosed Segment meets the segment revenue test and the segment profitability test for the Period;*
>
> *b. the Disclosed Segment was a Covered Segment under Article 1(6) in two or more Periods immediately preceding the Period where the Group meets the conditions in Article 1(2);*
>
> *c. the Period falls within the five consecutive Periods that begin with the Period that immediately follows the two or more Periods referenced in subparagraph (b); and*
>
> *d. the Adjusted Segment Profit Before Tax of the Disclosed Segment that would be calculated under Section 5(1) of Schedule D for each Period that follows the two or more Periods referenced in subparagraph (b) is higher than the Adjusted Profit Before Tax of the Group calculated under Article 5 in each respective Period*".

In relation to the provision above, we have the following comments.

INPUT

We tend to disagree with the view that, if a Group has never been a Covered Group, but meets both the Revenue Test and the Profitability Test, it is not considered as a Covered Group, provided that certain conditions related to one of its Disclosed Segments – regarding basically its higher profitability compared to that of the Group as a whole – are met.

We believe that, once both the Revenue Test and the Profitability Test are satisfied, the interested Group should be considered as a Covered Group (as a whole) since the first year in which the tests have been satisfied. This solution would grant greater certainty and would be also the easiest one from a compliance and administrative perspective for both the Groups and the Tax Administrations.

COMMENT

We do not understand how the conditions set by the letters (b) and (c) should be applied.

If we consider N as the period in which, for the first time, Group Y meets both the Revenue Test and the Profitability Test, in order for Group Y not to be a Covered Group and instead its Segment X to be a Covered Segment:

- the condition set out in letter (b) requires that Segment X was a Covered Segment in two or more periods immediately preceding N. It means that such a condition should be existent at least in N-1 and N-2;

- the condition set out in letter (c) provides that N must fall within the five consecutive periods that begin with the period that immediately follows the two or more periods referenced in letter (b). Therefore, since the period that immediately follows the two or more periods referenced in letter (b) is N itself, N will always fall within the prescribed five-year term.

On the basis of the example above, it seems that the condition provided by letter (c) is not necessary, because, when the condition under letter (b) is fulfilled, the condition provided by letter (c) is always also met. As a consequence, it should be clarified if:

(i) the condition under letter (c) is simply superfluous, because the Period would necessarily fall within the five-year period following the two or more periods that immediately precede the Period; or

(ii) the condition of letter (b) needs to be modified, eliminating the word "immediately". As a result, by way of example, considering that the relevant Period is N and that the Disclosed Segment was a Covered Segment in N-3, N-4 and N-5 (letter (b)), Period N falls within the five consecutive periods that begin with the period that immediately follows the two or more periods provided by letter (b) (*i.e.,* period N-2 – N+2).

We believe that the solution under (i) is to be preferred and is more in line with the whole provision. If the solution under (ii) is adopted and letter (b) modified, the operation of the condition contained in letter (d), which refers to letter (b), would result significantly affected and would require an amendment.

1.2. Schedule A(3): Anti-fragmentation rule

According to Schedule A(3):

> "*Where, following an Internal Fragmentation, the UPE of a Group is owned directly or indirectly by an Excluded Entity, an Investment Fund that is not a UPE or a Real Estate Investment Vehicle that is not a UPE, with a Controlling Interest and the Group has Revenues of EUR 20 billion or less in a Period, the revenue test in Article 1(2)(a), (3)(a) or (4)(a), whichever is relevant, is deemed to be met in that Period for the Group if (the anti-fragmentation rule):*

a. *the Group meets the profitability test in Article 1(2)(b), (3)(b) or (4)(b) in the Period;*
b. *the sum of the Revenues of the Group and the other Groups, resulting from the same Internal Fragmentation and each with a UPE owned directly or indirectly by the same Excluded Entity, Investment Fund that is not a UPE or Real Estate Investment Vehicle that is not a UPE with a Controlling Interest, for the Period ending in the same calendar year is greater than EUR 20 billion; and*
c. *it is reasonable to conclude, having regard to all relevant facts and circumstances, that failing the revenue test in Article 1(2)(a), (3)(a) or (4)(a) was one of the principal purposes of the Internal Fragmentation referred to in subparagraph (b)*".

The provision contains an anti-fragmentation rule applicable in case of Internal Fragmentation of a Group aimed at preventing that the Group avoids – as a result of the Internal Fragmentation – the fulfilment of the Revenue Test and, as a consequence, falling into the scope of the Amount A provisions.

INPUT

Among the conditions for the application of the anti-fragmentation rule above, Schedule A(3)(c) requires that failing the Revenue Test was one of the principal purposes of the Internal Fragmentation.

With specific regard to the such a condition, we believe that the meaning of "*principal purposes*" should be interpreted in light of the clarifications rendered by the Commentaries on the OECD Model Tax Convention on Income and on Capital in relation to the *principal purpose test* provided by Article 29(9) of the OECD Model Tax Convention on Income and on Capital, given that the wording of the provision and its anti-abuse intent are perfectly matching.

More specifically, as clarified by the OECD Commentary on Article 29, Schedule A(3)(c) should be interpreted according to the following principles:

- in order to determine whether one of the principal purposes of an Internal Fragmentation is failing the Revenue Test, an objective analysis of the aims and objects of the Internal Fragmentation should be carried on;

- such an evaluation should consist in a factual analysis, carried out on a case-by-case basis;

- the Group must demonstrate that one of the principal purposes is not failing the Revenue Test through concrete evidences (*e.g.,* the mere declaration that the object

of the Internal Fragmentation is not failing the Revenue Test could not be sufficient);

- it is not necessary that failing the Revenue Test is the sole or dominant purposes of the Internal Fragmentation, instead it is sufficient that it is one of the principal purposes.

Furthermore, we believe that the Title 6 of the Consultation Documents should contain specific provisions regulating the administrative process and the related guarantees recognised in case of audit or control by the Tax Administration in relation to the principal purposes of an Internal Fragmentation under Schedule A(3)(c). In this respect, we suggest that Title 6 of the Consultation Documents will either:

(i) rely on the procedures and guarantees laid down in the domestic law of each jurisdiction in relation to audits based on anti-abuse provisions; or

(ii) establish own guidelines and/or *de minimis* rules regulating procedures and guarantees (*e.g.*, mandatory hearing phase prior to the issue of the final tax assessment; obligation on the Tax Administration to specifically illustrate the grounds for the tax assessment in relation to the abuse).

2. Title 3: Revenue sourcing rules

Article 4 lays down the main revenue sourcing rules, categorised per type of revenues, that identify the market countries that will benefit from the Amount A.

The provisions of Article 4 are supplemented by those of Schedule E, which set up rules identifying, in relation to each revenue sourcing rule, the relevant Indicators necessary to apply the prescribed revenue sourcing rule in the specific case.

We agree with the approach

2.1. Schedule E: Hierarchy of revenue sourcing rules

Most of the revenue sourcing rules contained in Schedule E provide for different Indicators to be used, as long as they can be considered as Reliable Indicators, to identify the exact source of the Revenues.[1]

[1] We refer, in particular, to the provisions of Schedule E, Section 3(A)(2); Section 3(B)(2); Section 5(A)(2); Section 6(A)(2); Section 6(A)(5); Section 6(B)(2); Section 6(B)(4); Section 6(C)(3); Section 6(C)(4); Section 6(C)(7); Section 6(C)(8); Section 6(E)(2); Section 6(F)(2); Section 6(F)(5); Section 7(A)(2); Section 7(A)(4);

By way of example, it is sufficient to refer to the structure of Section 3(A)(2) – that is similar to that of the other provisions listed in footnote No. 2 – regarding the sourcing rule of the Revenues derived from the sale of Finished Goods to a Final Customer, which states as follows:

> "*For the purposes of paragraph A(1), the place of the delivery of the Finished Goods to a Final Customer is determined using the following Indicators, provided they meet the definition of a Reliable Indicator in Section 12:*
> *a. the delivery address of the Final Customer;*
> *b. the place of the retail store selling to the Final Customer;*
> *c. Another Reliable Indicator as defined in Section 2(4); or*
> *d. an Alternative Reliable Indicator as defined in Section 2(5)*".

INPUT

We believe that the provision should better clarify whether the Indicators should be examined in the order provided by the relevant provision – meaning that the indicator under (b) could be considered only and after it has been excluded that the indicator under (a) is not available or proves not to be a Reliable Indicator – or could be used indifferently, without one having a hierarchical precedence over the others.

On the one hand, the hierarchical approach would imply greater certainty and uniformity in the application of the revenue sourcing rules, being based on objective and (generally) easily available elements for both the Covered Groups and the Tax Administrations.

On the other hand, allowing a Covered Group to "cherry pick" the Indicators would certainly result in a simplification for many Covered Groups, which can rely on the most easily available elements, but could also result – for the same reason – in a more burdensome choice for Tax Administrations, given that they could not have the same set of information of the Covered Groups in relation to the elements considered for those purposes and they would deal with different and – even divergent – practice that can make audits and controls more difficult.

3. Title 4: Determination and allocation of taxable profit

According to Article 5, in determining the Adjusted Profit Before Tax of a Covered

Section 7(A)(6); Section 7(B)(2); Section 8(A)(2).

Group, Net Losses have to be deducted from the Financial Accounting Profit (or Loss), after making the provided adjustments.

Within the notion of Net Losses are encompassed both the Financial Accounting Losses of the Covered Group that have not been offset against Financial Accounting Profits of the Covered Group over the Eligible Prior Period(s), after making the provided adjustments, and any losses transferred in an Eligible Business Combination or Eligible Division. Specific rules are laid down in Schedule H for the determination of the losses transferred in such a latter case.

3.1. Schedule H, Section 1(1)(a): Transferred losses rules in case of Eligible Business Combination

Section 1(1)(a) provides that:

> "*For the purposes of Article 5(3)(b), and subject to paragraph 2 (business continuity conditions), a Covered Group may elect to deduct losses determined under subparagraph (a) (Eligible Business Combination) or (b) (Eligible Division):*
> *a. following an Eligible Business Combination, the total amount that would be the Net Losses of the Transferred Group or Entity at the time of the Eligible Business Combination, calculated under Article 5(3)(a) with respect to losses of the Transferred Group or Entity, but replacing "Covered Group" with "Transferred Group or Entity" and by reference only to prior Period(s) that would be Eligible Prior Period(s) of the Covered Group if any Unused Loss of the Transferred Group or Entity was an Unused Loss of the Covered Group, and with respect to losses transferred to the Transferred Group or Entity in another Eligible Business Combination or in an Eligible Division prior to this Eligible Business Combination, determined under Article 5(3)(b);* […]".

COMMENT

We believe that, due to the complexity of the wording, it would be necessary to clarify the following two aspects:

1) whether the condition "[…] *by reference only to prior Period(s) that would be Eligible Prior Period(s) of the Covered Group if any Unused Loss of the Transferred Group or Entity was an Unused Loss of the Covered Group* […]" operates:

   (i) only from a temporal perspective, identifying the periods of the Transferred Group whose losses can be transferred to the Covered Group by verifying that, for those periods, the Unused Loss of the Transferred Group or Entity was also an Unused Loss of the Covered Group;

(ii) also from a quantitative perspective, limiting the amount of the Net Losses of the Transferred Group or Entity to an amount equal to the difference between the Unused Loss of the Transferred Group or Entity and the (hypothetical) Unused Loss of the Covered Group, had the Unused Loss of the Transferred Group or Entity been an Unused Loss of the Covered Group;

2) whether the "[…] *losses transferred to the Transferred Group or Entity in another Eligible Business Combination or in an Eligible Division prior to this Eligible Business Combination* […]" should be taken into consideration only as long as they refer to Eligible periods determined according to the mechanism described in the previous point No. 1 or they should be entirely added to Net Losses, as determined according to the first part of Section 1(1)(a).

In respect to point No. 1), we believe that the condition operates only from a temporal perspective, identifying the Eligible Periods, given the plain wording of the provision that does not support any different redetermination of the amount of the Unused Loss of the Transferred Group or Entity.

In respect of point No. 2), we believe that losses transferred to the Transferred Group or Entity in another Eligible Business Combination or in an Eligible Division should be considered as additional losses that should be wholly taken into account along with those determined according to the mechanism described by the first part of Section 1(1)(a). In other words, in our view, Section 1(1)(a) should be read in the sense that, following an Eligible Business Combination, the relevant Net Losses are formed by the sum of:

- losses determined according to Article 5(3)(a), with reference to those periods where it is verified that the Unused Loss of the Transferred Group or Entity was also an Unused Loss of the Covered Group;

- losses transferred to the Transferred Group or Entity in another Eligible Business Combination or in an Eligible Division.

* * *

Hoping that you will find our comments useful, please do not hesitate to contact us if you require any clarification.

We welcome the opportunity to discuss these comments in greater detail and to continue to participate in the dialogue as the OECD and country policymakers advance the work

on this important project.

Yours sincerely,

Foglia & Partners