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WORKING PAPER

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MEETING DOCUMENT

From: To:	Presidency Working Party on Tax Questions (Digital Taxation)
Subject:	Presentation by the Presidency

Delegations will find attached a document in view of the Working Party on Tax Questions (Direct Taxation - Digital) on 11 October 2019.

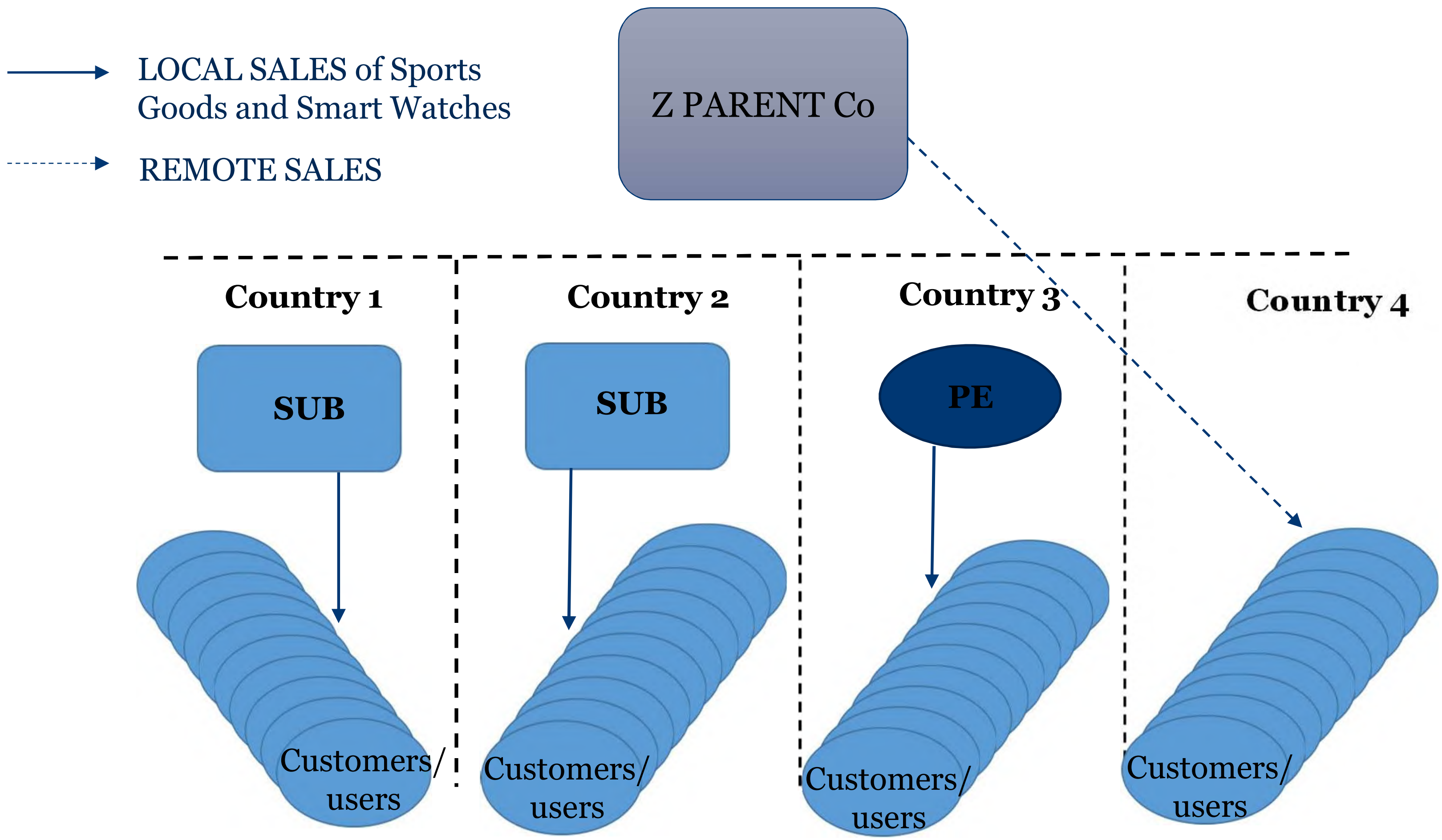
Example on amount A in Pillar I as discussed in WK10921/2019

WPTQ 11 October 2019

Example calculation of amount A

- Group Z is a large MNE that designs, markets and manufactures branded consumer products – Sports goods, Smart Watches and a Health app designed for the Smart Watches.
- Group Z operates in five different regions and reports revenue on a regional basis. It makes sales (physically and non - physically) in a total of 70 countries: 35 countries through a subsidiary; 20 countries through a permanent establishment and 15 countries remotely (directly to consumers).
- Group Z is in the scope of amount A
  - Group Z meets the group size threshold, has highly digitalized and consumer-facing business

Group Z operational structure



Facts and assumptions

- Although Group Z operates in 70 countries, in the example more detailed analysis focuses on operations in 4 countries
- The Sports Goods, Smart Watches and Health app are sold in 3 local units
  - in 2 countries through a Z subsidiary, in 1 country through a Z PE
- Z Parent co.
  - Remote sales to Country 4
  - the remote sales are recorded in Z parent Co's books
- The nexus sales threshold is assumed to be 75 M €

Example calculation of ”above normal profit” in amount A

- Group Z’s sales revenue is 10 billion €, operating income is 1,2 billion € and operating margin (operating income/sales) is 12 %.
- The assumed ”normal” profit (OM) is 10 %.
- Group Z’s ”above normal” profit is 2 % (12 % - 10 %) = 200 M €
- Amount A is assumed to be 20 % of the above normal profit
- Group Z’s amount A is (200 x 20%) 40 M €.

Group Z Consolidated accounts	
Sales	**10 B €**
OP	**1,2 B €**
OM	**12 %**

Amount A calculation	
”Normal" profit	**10 %**
"Above normal" profit 2 %	**200 M €**
of which allocated 20 %	
Amount A	**40 M €**

Reallocating Amount A between market jurisdictions

- The amount A is reallocated in a local sales/group consolidated sales ratio to the countries (below calculation of countries 1-4)

- Country 3 does not exceed the nexus threshold of 75 M €

Group Z distribution of Amount A				
	SUB	SUB	PE	REMOTE PRESENCE
	Country 1	**Country 2**	**Country 3**	**Country 4**
Sales (M€)	**400**	**400**	**50 --> NO NEXUS**	**150**
Group Z's sales = 10 B €				
% of Group Z's sales	400/10000 = 4 %	400/10000 = 4 %	50/10000 = 0,5 %	150/10000 = 1,5 %
Amount A = 40 M €				
Reallocated amount	4 % x 40 M € = **1,6 M €**	4 % x 40 M € = **1,6 M €**	0,5 % x 40 M € = **0,2 M €**	1,5 % x 40 M € = **0,6 M €**

Questions and some open issues

- In the example, the nexus criterion is not fulfilled in Country 3. How should this affect the reallocation of amount A between the rest of the countries with nexus?
- What happens if the nexus threshold will be calibrated to take into account smaller economies? What kind of ratio would that be and how it could be implemented in the calculation?
- Let us assume that countries 1 and 2 have very different operating margins; despite the different profitability in countries 1 & 2, the excatly same amount A would be allocated to the countries.

	SUB	SUB
	Country 1	**Country 2**
Sales (M€)	400	400
Operating margin %	**15 %**	**5 %**
Operating margin €	**60**	**20**
Group Z's sales = 10 B €		
% of Group Z's sales	400/10000 = 4 %	400/10000 = 4 %
Amount A = 40 M €		
Reallocated amount	4 % x 40 M € = 1,6 M €	4 % x 40 M € = 1,6 M €

- Who would be the taxpayer and who would be entitled to eliminate double taxation in this case example (Z Parent Co, the entity with the highest accounting residual, someone else)?