Annex B. Approaches to implementing the Amount A formula

855.   A three-step process will be required to calculate the quantum of Amount A taxable in each eligible market jurisdiction. This process could be implemented by either using absolute amounts of profit (the "profit-based approach") or, alternatively, profit ratios (the "profit margin-based approach"). Both approaches would apply the above-described steps without changes or variations, and hence would provide the same quantum of Amount A taxable in each market jurisdiction. This identical outcome is illustrated below in algebraic form, as well as through examples in Box B.1. and B.2. But the administration of each approach may present some variations, and these differences would inform the choice of the most appropriate approach to calculate and allocate Amount A.[1]

Profit-based approach

856.   Consistent with the three steps described above, the profit-based approach can be described in algebraic form as follows.[2]

- **Step 1:** Isolate the residual profit (if any) by excluding the profit of the group or, where relevant, the segment that does not exceed an agreed level of profitability, e.g. a percentage of PBT to revenue ("z"). Assuming that the Amount A tax base for the relevant group or segment is "P", revenues of the group or segment are "R", and the profit margin of the group or segment is "P/R", this means that Amount A applies only if "P/R" is greater than z%, and that a positive residual profit "W" can be calculated as:[3]

$$W = P - (R \times z)$$

- **Step 2:** Separate "W" between the portion of residual profits attributable to Amount A (the allocable tax base, "A") and other factors ("X"). Where W = A + X. If the agreed portion of residual profit attributable to Amount A is, for example, a percentage ("y"), then "A" can be calculated as:

$$A = y \times W$$

- **Step 3**: Distribute the allocable tax base "A" among the market jurisdictions that meet the new nexus threshold. This would be done through an allocation key based on revenue (i.e. ratio of local revenue to total revenue). Assuming that in a particular market jurisdiction the group or, where relevant, the segment local revenue is "S", then the allocation key is "S/R". Therefore, the quantum of Amount A profit allocated to that particular market, expressed as "M", can be calculated as:

$$M = \frac{S}{R} \times A$$

857.   After bringing the three components together, the Amount A formula under a profit-based approach becomes:

$$M = S/R \times y \times [P - (R \times z)]$$

Box B.1. Example – profit-margin based approach

For the purpose of this example, it is assumed that the Amount A formula includes a 10% profitability threshold (step 1) and 20% reallocation percentage (step 2).

Facts

Group A is a large MNE group providing exclusively in-scope ADS via an online platform. It is assumed that Group A is treated as one segment for Amount A purposes and that it has the following simplified income statement:

	in million EUR
Revenue (**R**)	25,000
Profit before tax (**P**)	6,500
PBT margin (**P/R**)	26%

It is assumed further that the revenues are sourced exclusively from three market jurisdictions.

in million EUR	Local revenue (**S**)	
Market 1	2,000	local subsidiary
Market 2	18,000	remote activity
Market 3	5,000	remote activity
Total	**25,000**	

Due to the strategic location and attractiveness of Market 1, Group A established a local subsidiary in that jurisdiction performing baseline marketing and distribution activities for the whole world. In contrast, Group A has no taxable/physical presence in Market 2 and Market 3, where services are supplied remotely by the subsidiary located in Market 1. For Amount A purposes, however, it is assumed that a new nexus will be created in Markets 2 and 3 (i.e. nexus revenue threshold exceeded).

Applying Amount A formula

Step 1: Profitability Threshold

Determine Group A's residual profit (W) by subtracting 10% from the PBT margin (P/R).

$W = P - (R*10\%)$

$W = 6,500 - (25,000 * 10\%)$

W = 4,000

Step 2: Reallocation percentage

Determine Group A's allocable tax base (A) by multiplying residual profit (W) by 20%.

$A = 20\% * W$

$A = 20\% * 4,000$

A = 800

Step 3: Allocation key

Allocation key based on the ratio of locally sourced revenue (S) to total revenue (R). This last step provides for the quantum of Amount A taxable in each eligible market jurisdiction (M), as described in the below table.

in million EUR	Local revenue (S)	Allocation key (S/R)	Amount A (M)
Market 1	2,000	8%	A * S/R = **64**
Market 2	18,000	72%	A * S/R = **576**
Market 3	5,000	20%	A * S/R = **160**
Total	**25,000**	**100%**	**800**

Profit-margin approach

858.   Consistent with the three-steps described above, the profit-margin approach can be described in algebraic form as follows.[4]

- **Step 1:** Isolate the residual profit margin (if any) of the group or, where relevant, the segment by deducting the deemed routine profit margin – e.g. a percentage of PBT to revenue ("z") – from the total profit margin. Assuming that the Amount A tax base for the relevant group or segment is "P", revenues of the group or segment are "R", and the profit margin of the group or segment is "P/R", this means that Amount A applies only if "P/R" is greater than z, and that a positive residual profit margin "w" can be calculated as:

$$w = P/R - z$$

- **Step 2:** Separate "w" between the portion of residual profitability attributable to Amount A (the allocable tax base, "a") and other factors, such as trade intangibles, capital and risk ("X"). If the agreed portion of residual profitability attributable to Amount A is, for example, a percentage ("y"), then "a" can be calculated as:

$$a = y \times w$$

- **Step 3**: Allocate the relevant portion of residual profitability attributable to Amount A to the market jurisdictions that meet the new nexus threshold. This would be done through an allocation key based on local revenue. Assuming that in a particular market jurisdiction the group or, where relevant, the segment local revenue is "S", then the quantum of Amount A profit allocated to that particular market, expressed as "M", can be calculated as:

$$M = S \times a$$

859.   After bringing the three components together, the Amount A formula under a profit-margin approach becomes:

$$M = S \times [y \times (P/R - z)]$$

Box B.2. Example – profit-margin based approach

For the purpose of this example, it is assumed that the Amount A formula includes a 10% profitability threshold (step 1) and 20% reallocation percentage (step 2).

Facts

The same as in the other example (see Box 6.4).

Applying Amount A formula

Step 1: Profitability Threshold

Determine Group A's residual profit margin (w) by deducting 10% from the total PBT margin (P/R).

w = P/R – 10%

w = 26% – 10%

w = 16%

Step 2: Reallocation percentage

Determine Group A's portion of residual profitability attributable to Amount A by multiplying the residual profit margin (W) by 20%.

a = 20% * W

a = 20% * 16%

a = 3,2%

Step 3: Allocation key

Allocation key based on locally sourced revenue (S). This last step provides for the quantum of Amount A taxable in each eligible market jurisdiction (M), as described in the below table.

in million EUR	Local revenue (S)	Residual profit margin attributable to Amount A (a)	Amount A (M)
Market 1	2,000	3,2%	S x a = **64**
Market 2	18,000	3,2%	S x a = **576**
Market 3	5,000	3,2%	S x a = **160**
Total	**25,000**	**n.a.**	**800**

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