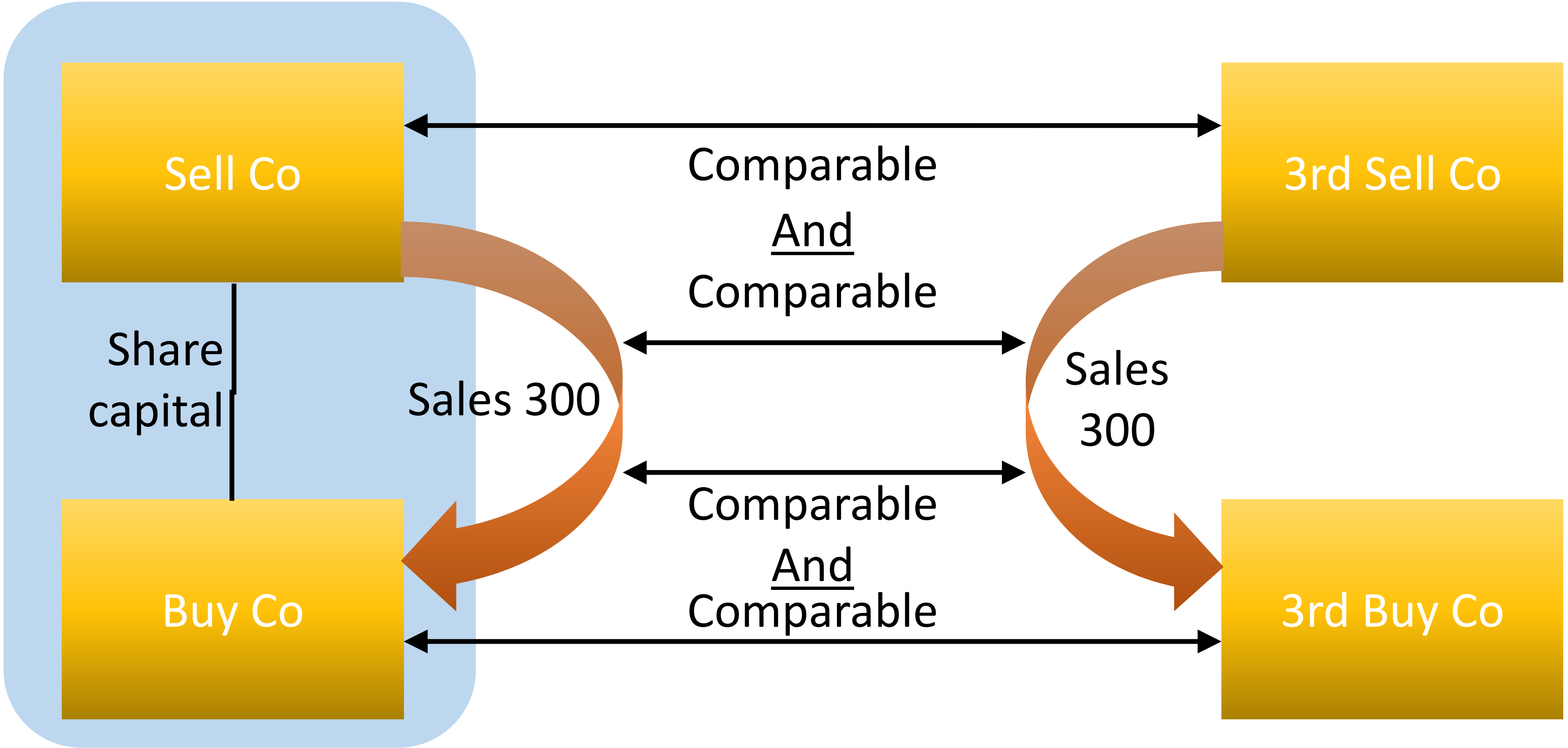
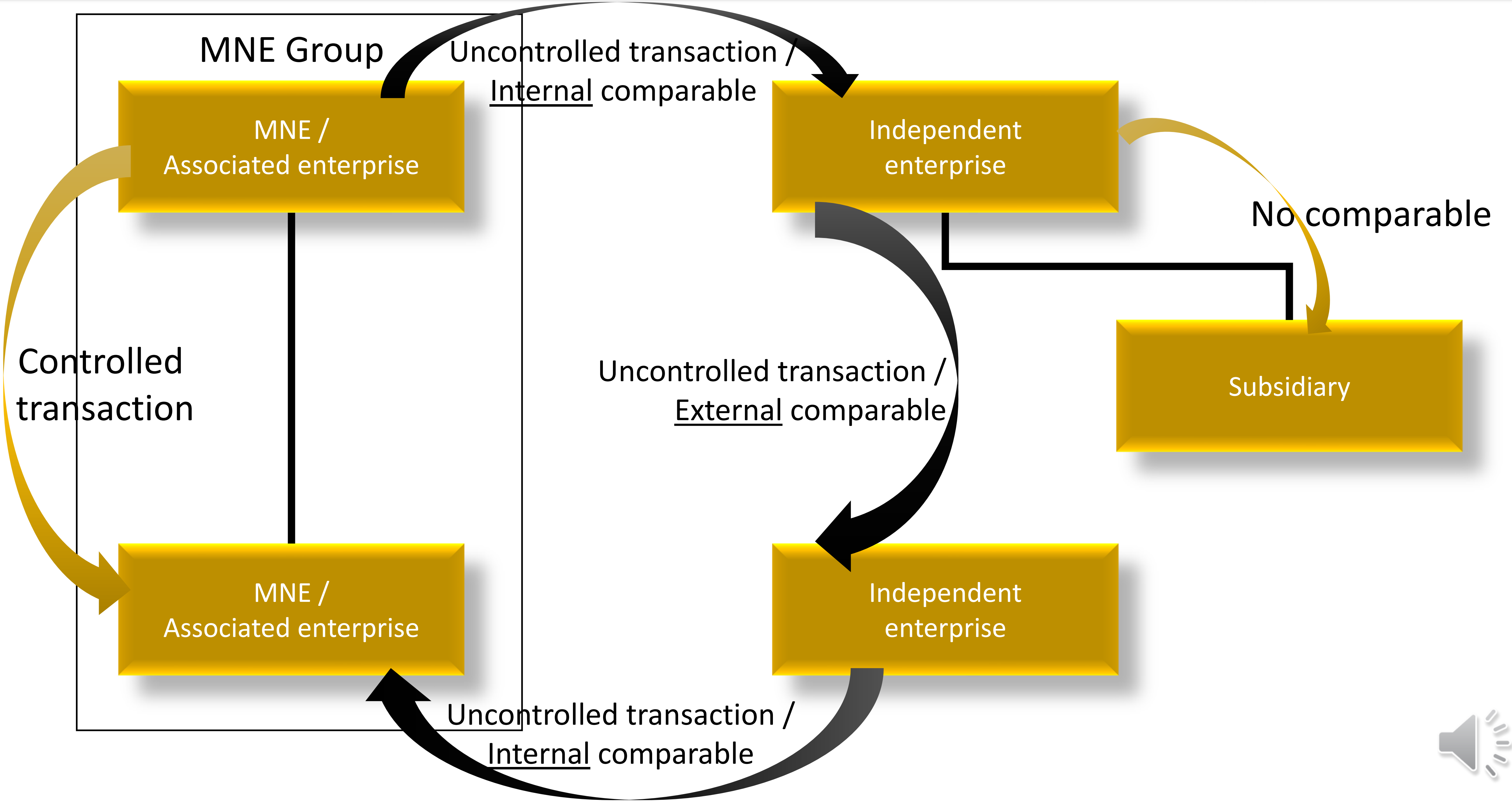
III.A.1 Unitary taxation/global formulary apportionment

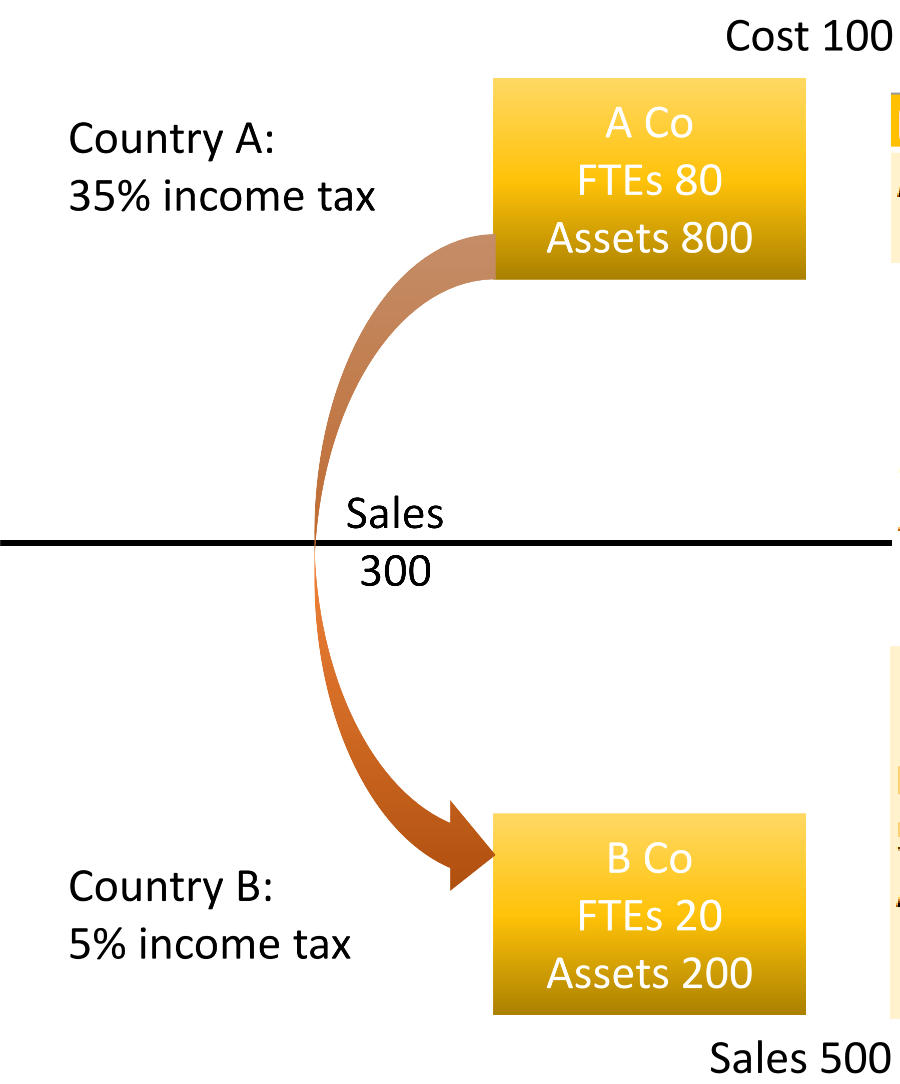
- TPG 1.6: Because of the ALP's separate entity approach, the comparability analysis with third parties is at the heart of the ALP.



I.A - Key concepts

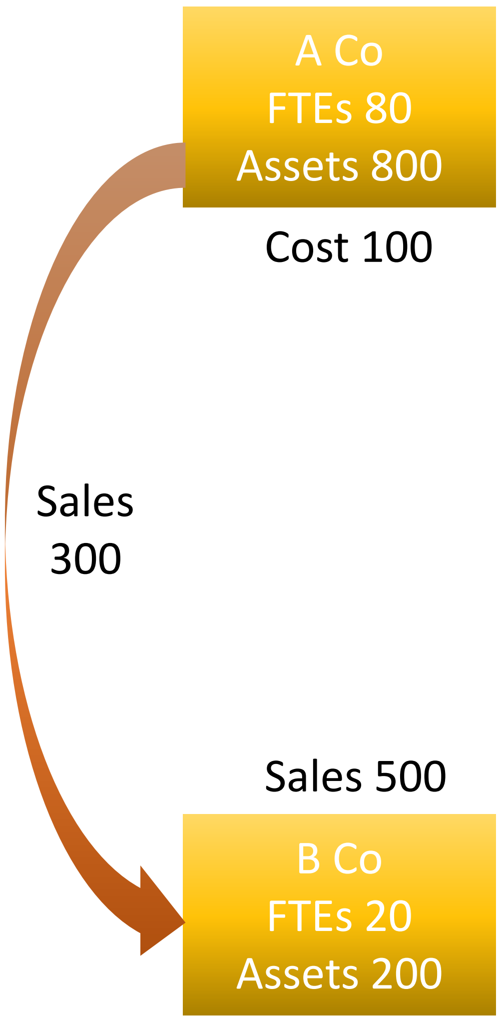


II.C – Global formulary apportionment



Profit allocation method	Profit A Co	Profit B Co
Arm's length principle	300 - 100 = 200	500 - 300 = 200
Formulary apportionment 33% Sales, 33% FTE, 33% Assets	500 - 100 = 400 (400x0/500))x33% ...+(400x80/100)x33% ...+(400x800/1000)x33% (0+107+107=) 214	500 - 100 = 400 (400x100%)x33% ...+(400x20%)x33% ...+(400x20%)x33% (133+28+28=) 186
Formulary apportionment 50% Sales, 25% FTE, 25% Assets	500 - 100 = 400 (400x0/500)x50% ...+(400x80/100)x25% ...+(400x800/1000)x25% (0+80+80=) 160	500 - 100 = 400 (400x100%)x50% ...+(400x20%)x25% ...+(400x20%)x25% (200+20+20=) 240

II.A The arm's length principle: formulary apportionment vs profit split



Profit allocation method	Profit A Co	Profit B Co
Formulary apportionment Sales 33%, FTEs 33%, Assets 33%	500-100 = 400 (0+107+107=) 214	500-100 = 400 (133+28+28=) 186
ALP residual profit split Routine functions (cost +; resale -)	E.g. Like contract manufacturing Cost plus 5%. Cost = 40, plus = 2	E.g. Like routine sales Resale price - 4%. 500 x 4% = 20
ALP residual profit split Value adding functions	Unique production know how + large capital investments, justifying 65% of residual profit (400-2-20=378)*65% = 246	Large loyal customer base + strong branding performance, justifying 35% of residual profit (400-2-20=378)*35% = 132
ALP Total profit	2 + 246 = 248	20 + 132 = 152

<u>Formulary apportionment vs the ALP profit split method</u>

In the ALP PS compensation for 1) routine functions and 2) value adding functions are unique to every case. They are determined per case by the facts and circumstances, not a predetermined formula.