



Sales Tax Scenarios and Their Implications for Polish Trade Industry

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Presentation to

by

POHiD
POLSKA ORGANIZACJA HANDLU I DYSTRYBUCJI

OC&C
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Sales tax will have major implications on Polish trade industry, therefore its structure should be based on substantial and reliable analysis

Executive Summary

- **International chains have more positive impact on Polish state budget and economy than Polish chains**
 - They pay more CIT, not only in nominal terms, but also as a % of their sales
 - Benefits connected with economies of scale and lower purchase prices are transferred to clients in the form of lower shelf prices. As a result, international players do not enjoy higher gross margins than Polish ones
 - What is more, operations of international chains in Poland are connected with certain benefits, which cannot be provided by national chains, e.g. extension of export possibilities for Polish suppliers
- **Concept of progressive tax rate is neither fair...**
 - It is a form of unjustified discrimination of international players
 - It will affect economic situation of entities with lowest profitability on the market – hypermarkets (the highest tax would be imposed on the market segment with lowest margins)
- **...nor favourable for Polish households, especially the price sensitive ones**
 - Hypermarkets offer one of the lowest prices, which makes some products available for less affluent clients. After imposition of the tax hypermarkets will be forced to demand higher prices or limit the least expensive assortment
- **The fairest and still effective solution (from the perspective of the state budget) would be flat rate of sales tax**
 - The flat sales tax rate will ensure stable income to state budget due to fewer possibilities of tax avoiding practices (e.g. ownership transformations among the largest players)
 - Flat rate does not discriminate anyone, does not worsen the economic situation of less wealthy households and is not a form of an unjustified public aid
 - At the same time, this solution will provide the state budget with expected level of incomes
- **In order to mitigate the effects of the new tax, it should be imposed on as wide group of companies as possible**
 - Trade, in particular grocery trade, is one of the least profitable sectors of the economy,. Even a low tax rate will have a substantial impact on business entities on the market
 - Including other economic sectors as well as wholesale companies in the sales tax, will allow to distribute tax burden on more enterprises

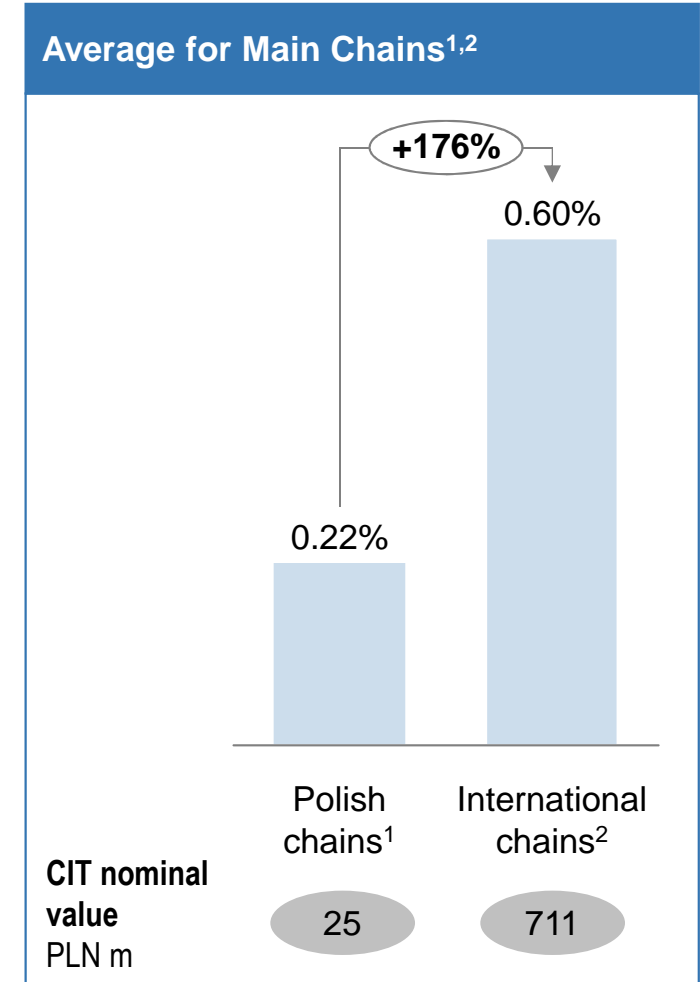
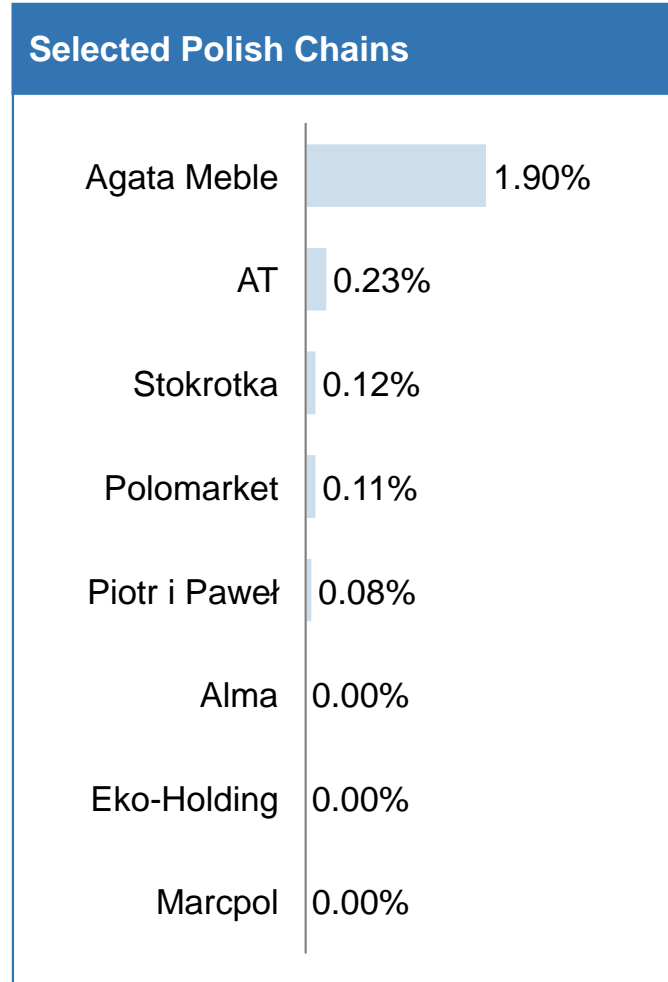
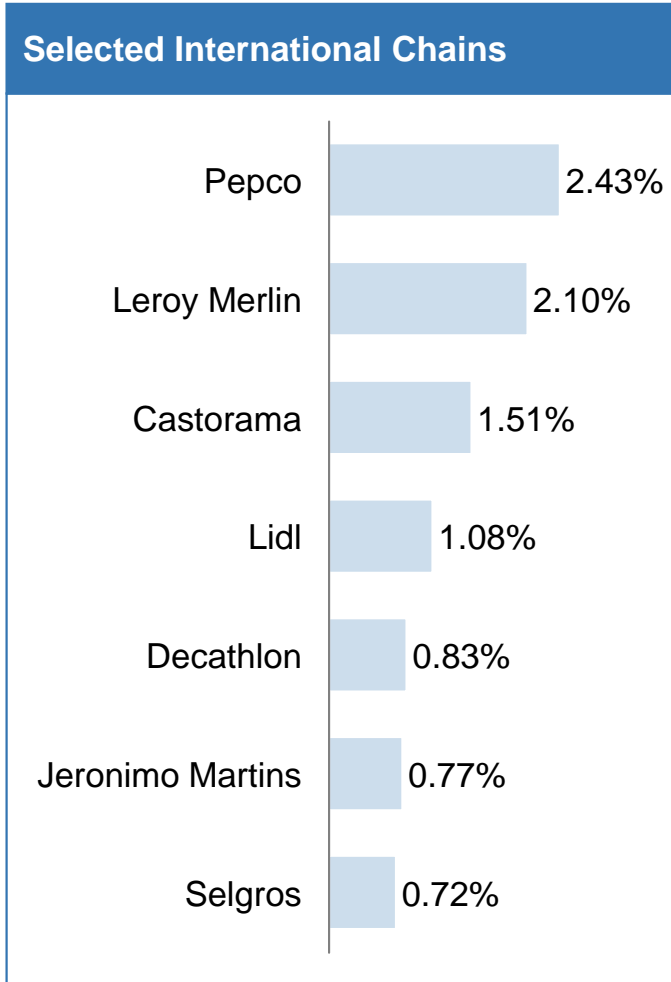
Sales Tax Scenarios and Their Implications for Polish Trade Industry

Agenda

- **Benefits for Poland Connected with International Retail Chains Operations**
 - Evaluation of Progressive Sales Tax Rate
 - Alternative Proposal of Sales Tax Structure
 - Assumptions and Calculations

International chains pay much more CIT as a % of their sales than Polish ones

CIT Share in Sales in the Last Financial Year

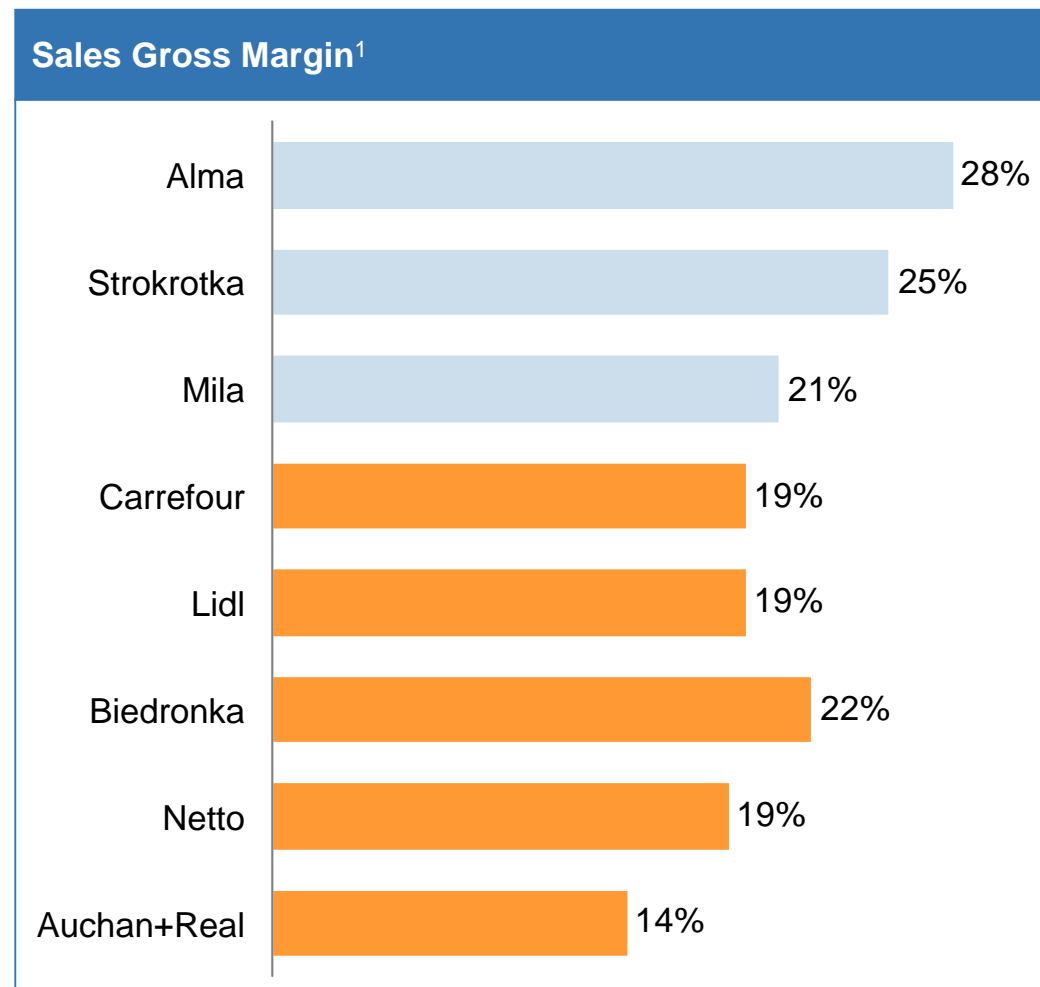
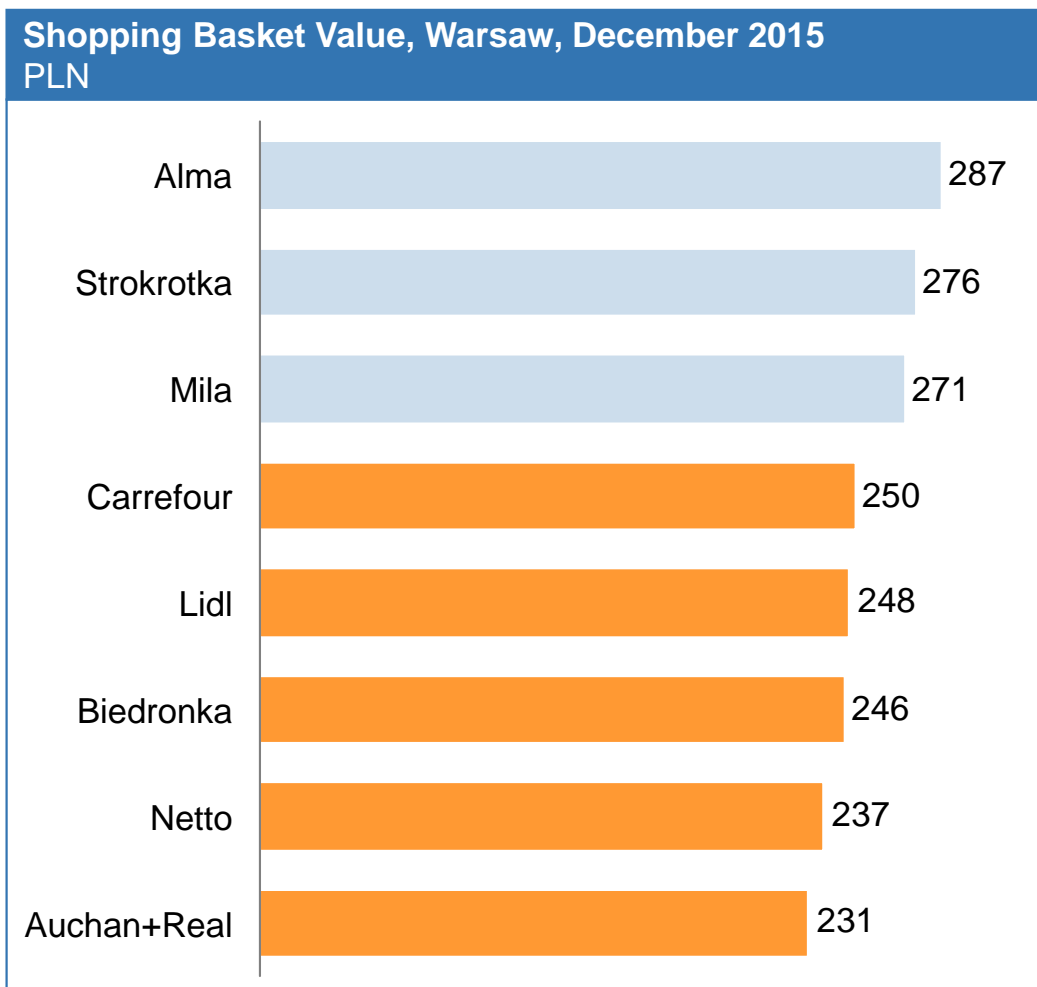


1. Agata Meble, AT, Stokrotka, Polomarket, Piotr i Paweł, Alma, Eko-Holding, Marcpol
2. Jeronimo Martins, Metro, Tesco, Lidl, Kaufland, Auchan, Carrefour, Castorama, Żabka, Leroy Merlin, Selgros, H&M, Pepco, Decathlon, Inditex, LVMH, Legardere, Leclerc

Source: InfoCredit; financial statements; OC&C analysis

International chains share benefits connected with economies of scale and lower purchase prices with their clients in the form of lower shelf prices – as a result they enjoy even lower gross margins than Polish chains

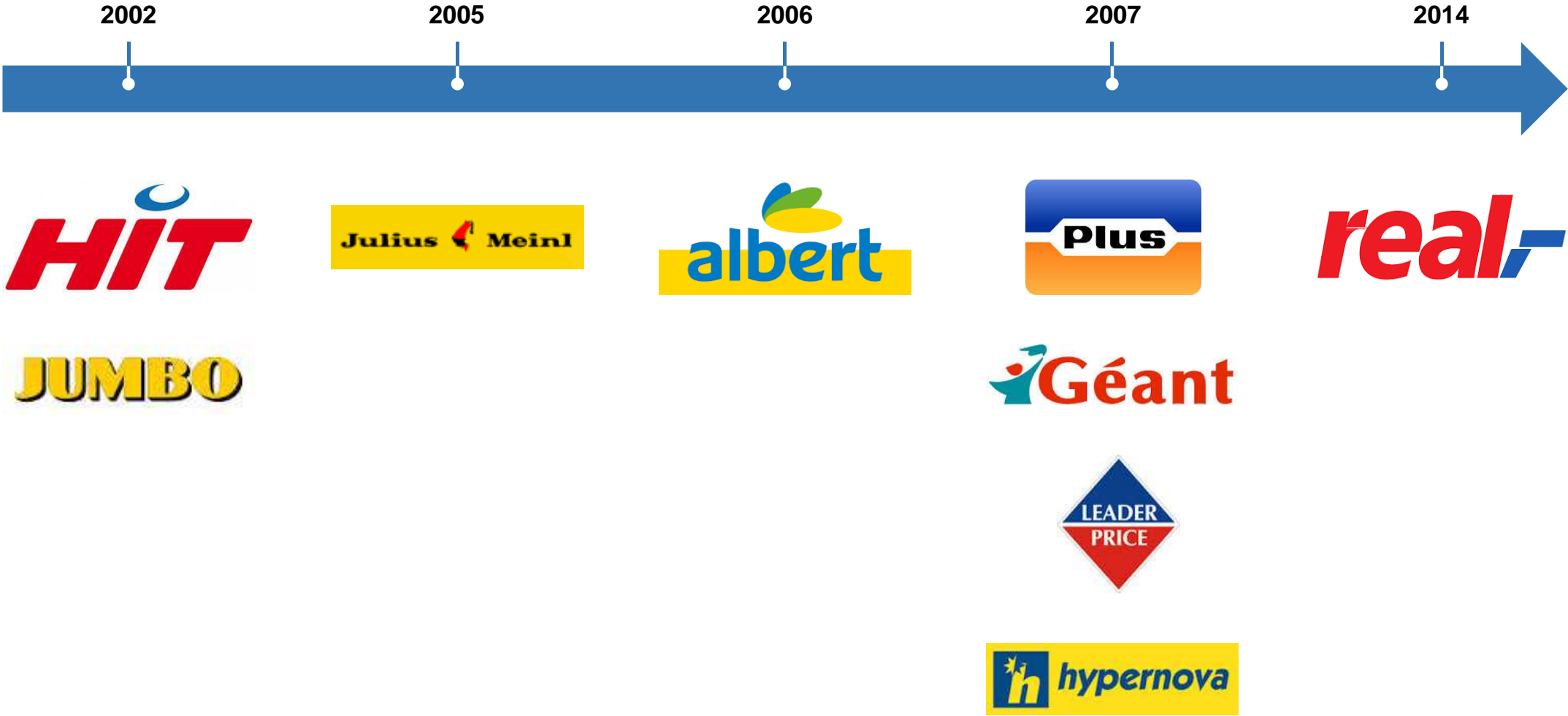
Prices and Profitability of Retail Chains



Polish chains International chains

In previous years many international chains have decided to exit Poland as they were not able to achieve profitability on the competitive Polish market

Withdrawal of International Retail Chains from Poland



What is more, international chains provide many qualitative advantages to Polish economy that can not be generated by Polish entities

7 Contributions of International Chains for Polish Economy

- International chains quickly modernized Polish trade by implementing new technologies in logistics, transport and IT
- International chains share their expertise with Polish people in the form of franchise programs and by doing so support their entrepreneurial spirit
- International chains enable Polish suppliers to export their products by selling them to stores based in other countries
- International chains support the improvement of standards and quality of products among Polish suppliers
- International chains have invested PLN c.200bn in Poland (a few times more than Polish ones), having regularly returned their profits to the market
- International chains develop Polish labour market by conducting managerial programs and providing employment to graduates, women and 50+ elderly people (c.450k jobs)
- International chains popularize Polish food – it constitutes 83% of total grocery sales

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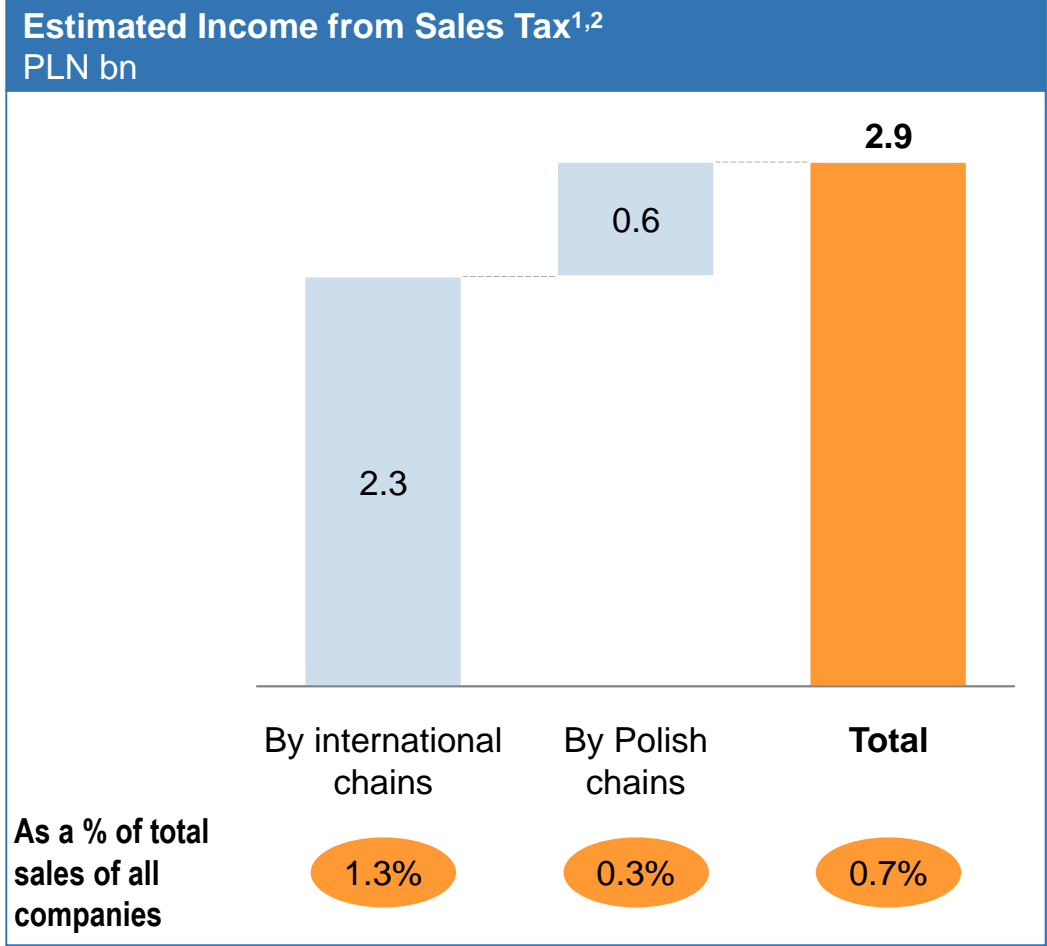
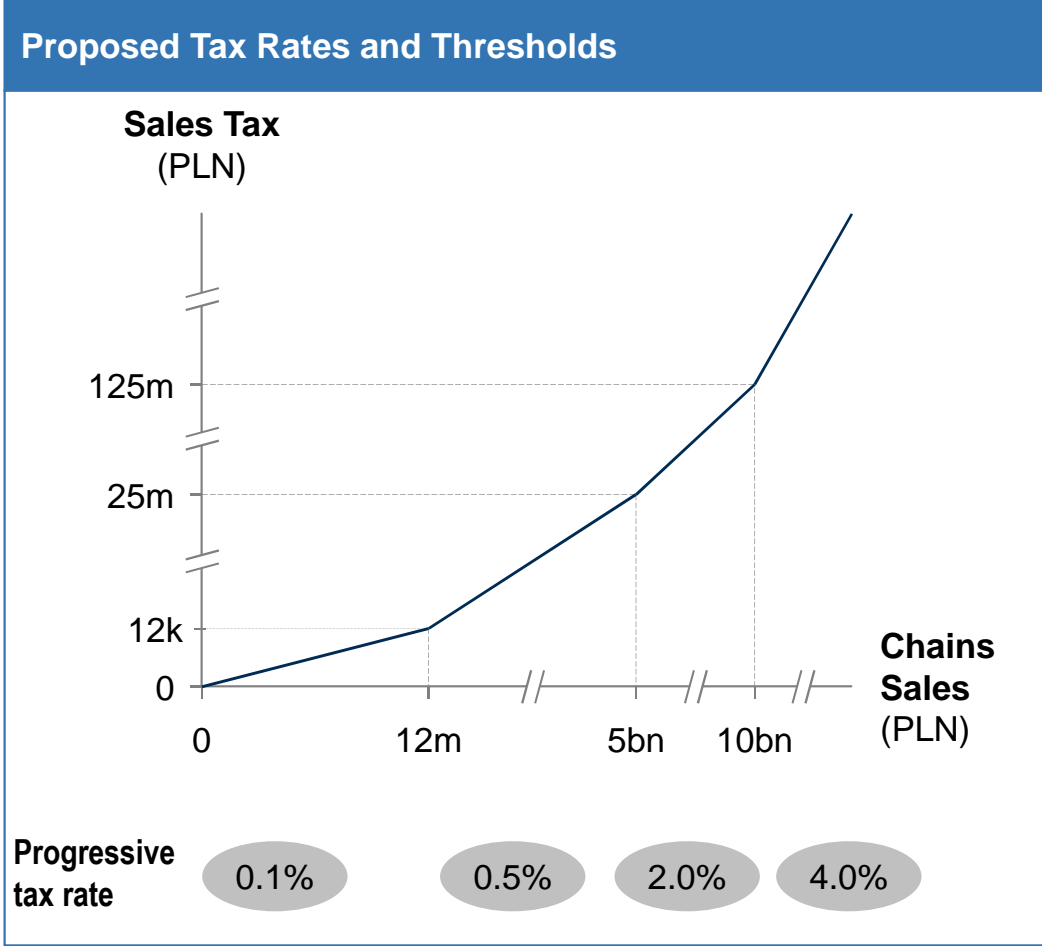
Agenda

- Benefits for Poland Connected with International Retail Chains Operations
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Progressive tax rate will affect mainly international chains that already pay more CIT as a % of their sales

Sales Tax Proposal for Retail Market Prepared by FPH

Estimation



1. Market value of PLN390bn has been assumed. In the following categories were included: grocery, electronics, home appliances, cosmetics, apparel, DIY, furniture and home equipment, entertainment. Retail sales via stalls and markets were not included. Service companies were not included; services provided by trade companies might have been included. Vehicles and fuel for motor vehicles in fuel stations were not included

2. Complete absorption of the tax by retailers has been assumed (no impact on prices, revenues and costs); most recent historical financial data has been used

Source: financial statements; Rzeczpospolita; Portal Spożywczy; OC&C analysis

The highest tax rates would be paid almost exclusively by international chains

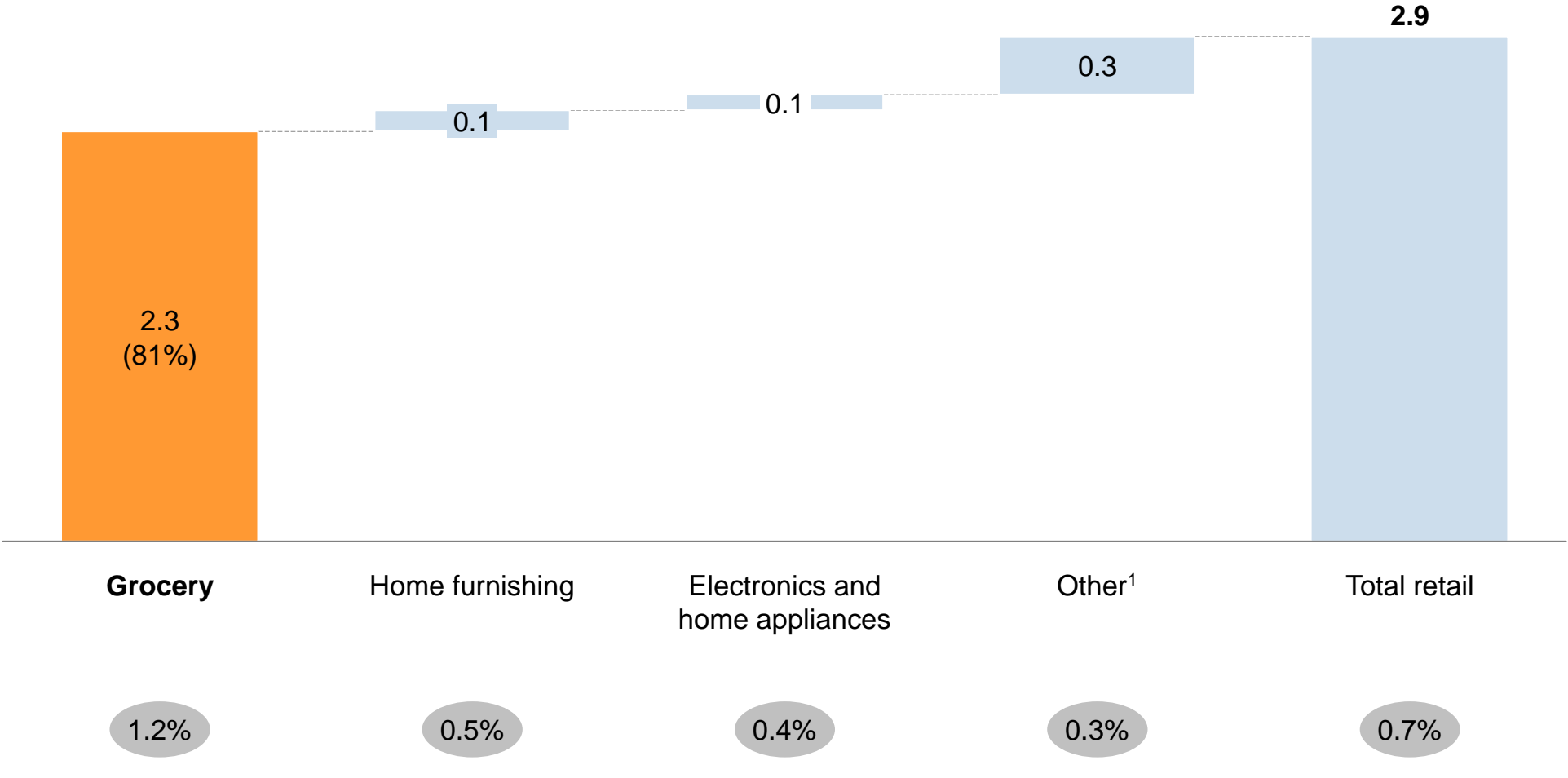
Retail Chains by Highest Tax Rate That Would be Applied to Some of Their Sales¹

	0.1%	0.5%	2.0%	4.0%			
International Chains	-	<ul style="list-style-type: none"> ■ Aldi ■ Netto ■ Leclerc ■ Aldik ■ Elea (Simply) ■ Intermarche ■ C&A ■ Cubus ■ Decathlon ■ GoSport ■ Intersport 	<ul style="list-style-type: none"> ■ Marks&Spencer ■ New Yorker ■ Peek&Cloppenburg ■ Pepco ■ Van Graaf ■ TK Maxx ■ Hugo Boss ■ H&M ■ Zara ■ Saturn ■ Superpharm 	<ul style="list-style-type: none"> ■ Sephora ■ Baltona ■ Hebe ■ Ikea ■ Jysk ■ Leroy Merlin ■ OBI ■ Bricomarche ■ Praktiker ■ Komfort ■ Toys R Us 	<ul style="list-style-type: none"> ■ Carrefour ■ Żabka ■ Rossmann ■ Kaufland ■ Castorama 	<ul style="list-style-type: none"> ■ Biedronka ■ Lidl ■ Tesco ■ Auchan+Real 	
Polish Chains	-	<ul style="list-style-type: none"> ■ Eko ■ Frac ■ Dino ■ Kefirek ■ MarcPol ■ Piotr i Paweł ■ Polo Market ■ Mila ■ Strokrotka ■ Topaz ■ Alma ■ Bresse Pol 	<ul style="list-style-type: none"> ■ Pelcowizna ■ Sedal ■ Sano ■ Chata Polska ■ Spar ■ Aelia ■ Społem Białystok ■ Mokpol ■ PGS ■ Api Market ■ Arhelan ■ Market-Jan 	<ul style="list-style-type: none"> ■ Livio i inne ■ Nasz Sklep ■ Społem ■ LPP (Reserved) ■ Carry ■ CCC ■ Kler ■ TSM Salony Meblowe ■ Meble Vox ■ TopSecret (GK Redan) ■ Diverse ■ Neonet 	<ul style="list-style-type: none"> ■ Agata Meble ■ Home & You ■ Empik ■ Matras ■ PSB ■ Majster ■ Meble Plast ■ Meblik ■ Media Expert ■ HAVO ■ Rtv Euro Agd ■ DDD 	<ul style="list-style-type: none"> ■ Lewiatan 	

More than 80% of potential state budget income would be paid by grocery retailers

Taxes to Be Paid by Retail Industry by Sector
PLN m

Estimation

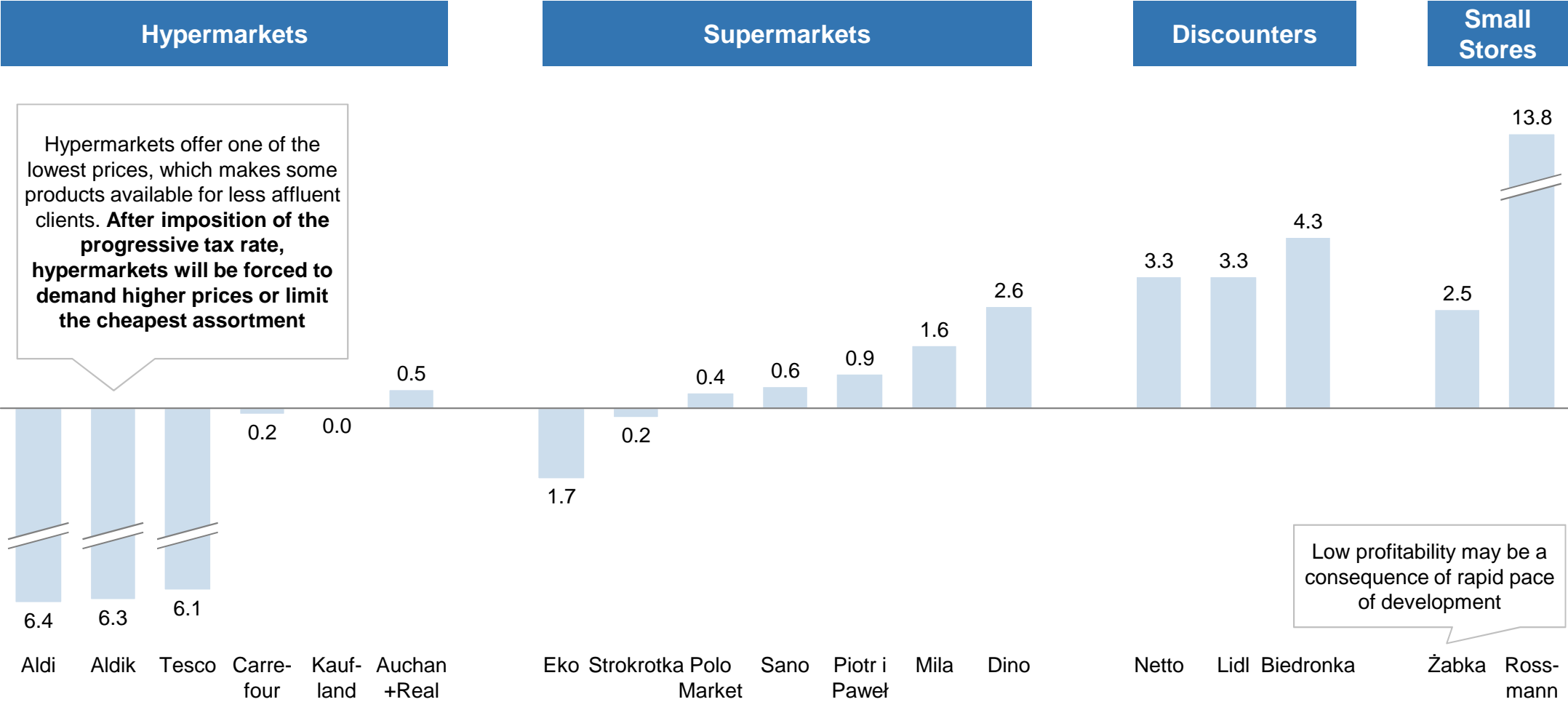


As a % of total sales of all companies

1. The number does not include vehicles and fuel
Source: financial statements; Rzeczpospolita; Portal Spożywczy; OC&C analysis

Progressive tax would affect mainly hypermarkets, that have lowest profitability on the market

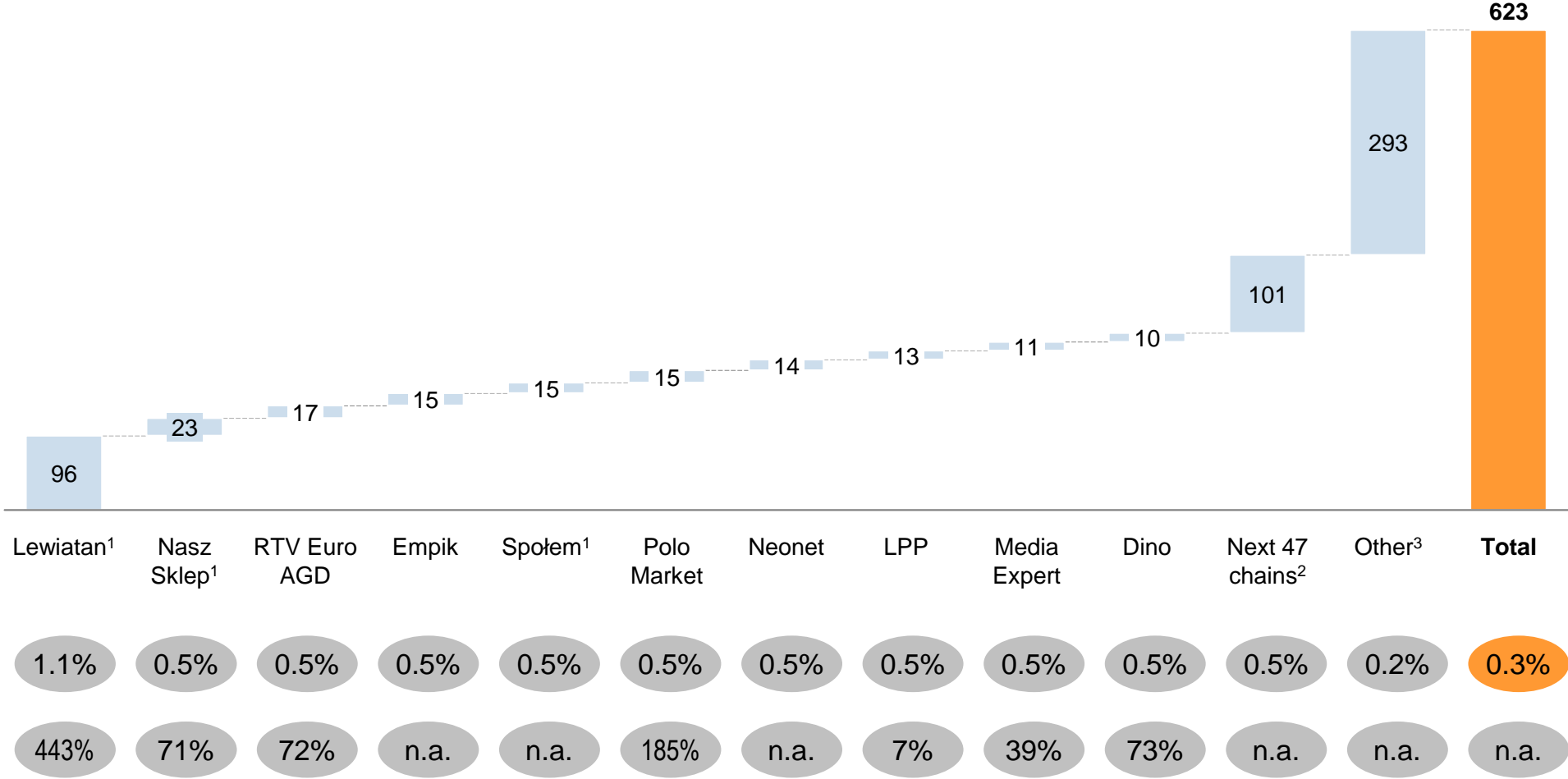
Operating Profit Margin (EBIT)
%



Polish players would pay PLN c.540m, ie c.0.3% of their revenues to the state budget

Value of Sales Tax Paid by Biggest Polish Players
 PLN m

Estimation



As % of revenues

As % of net profit

1. Based on total revenues of a group of stores
 2. Based on actual or estimated revenues of each of 47 chains
 3. Based on estimated total revenues of smaller chains; vehicles and gas were not included

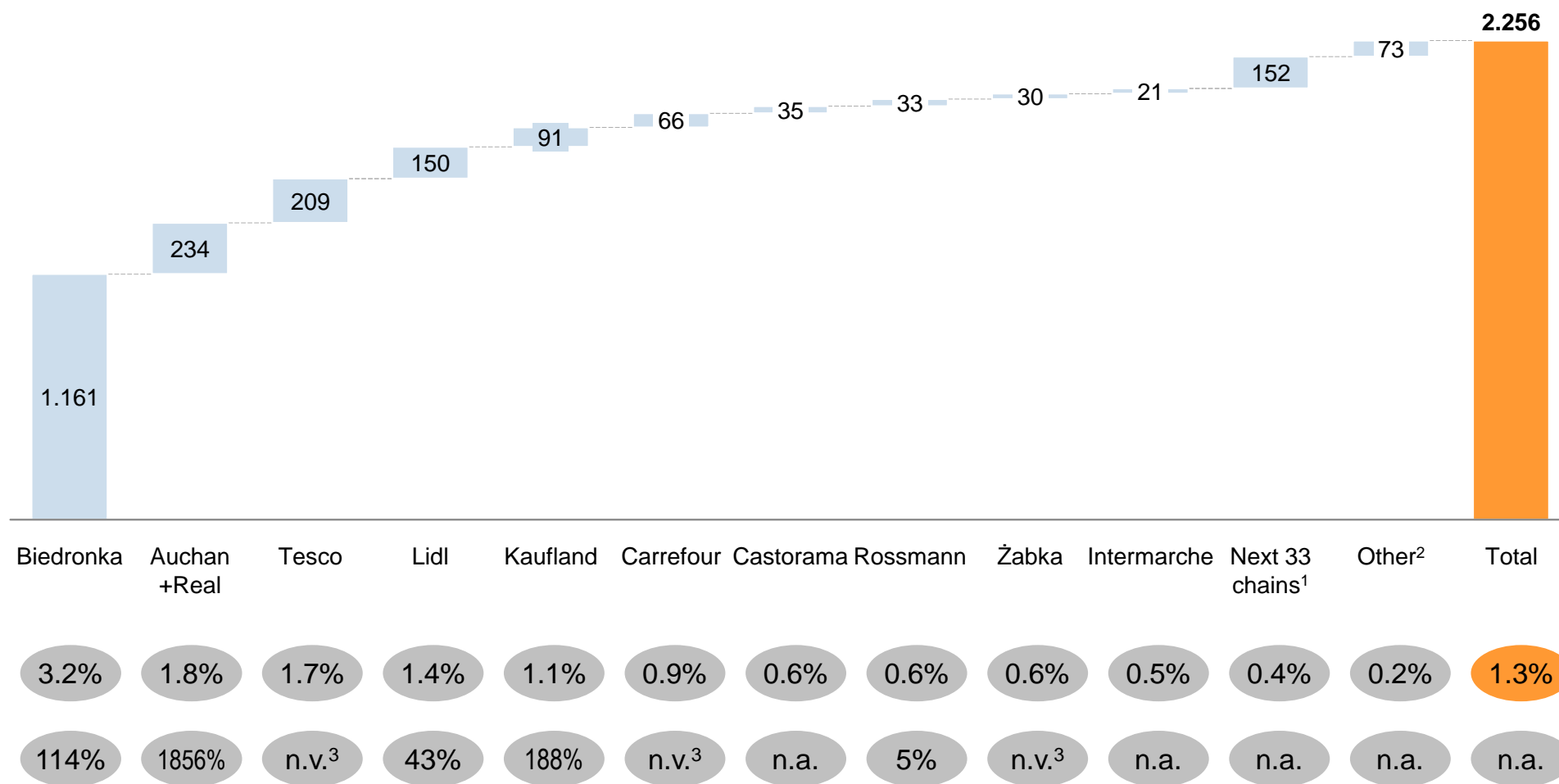
Source: financial statements; Rzeczpospolita; Portal Spożywczy; OC&C analysis

International players would pay PLN c.2.3bn, ie c.1.3% of their revenues to the state budget

Value of Sales Tax Paid by Biggest International Players

PLN m

Estimation



1. Based on actual or estimated revenues of each of 33 chains

2. Based on estimated total revenues of smaller chains; vehicles and gas were not included

3. Negative value

Source: financial statements; Rzeczpospolita; Portal Spożywczy; OC&C analysis

Progressive tax seems to be a solution that increases costs of international chains in Poland and does not ensure stable income to the state budget

Disadvantages of Progressive Tax

- The progressive tax suggested by Polish retail chains will imply that international chains bear most of its burden (which will be a discriminative action and might question the reliability of Poland as a country of prospective investments)
- The progressive tax will infer that highest burden is born by formats that have highest revenues and lowest margins (which will eventually have an impact on their economics and employment)
- The progressive tax, as a one that differentiates the market, might turn out to be ineffective in the long run; a reasonable enterprise will look for alternatives that minimize its ailment in the form of a tax
- The progressive tax will not be a sustainable solution that could allow for accurate forecasting of its income to the state budget
- Progressive taxes exist already in Poland and Europe, but they are applied to profits (not revenues); a tax system should not lead to a situation when taxpayers return most of their profits to the state
- Sales tax should take into account the profitability of a particular market segment, otherwise the tax might interrupt and limit economic activity

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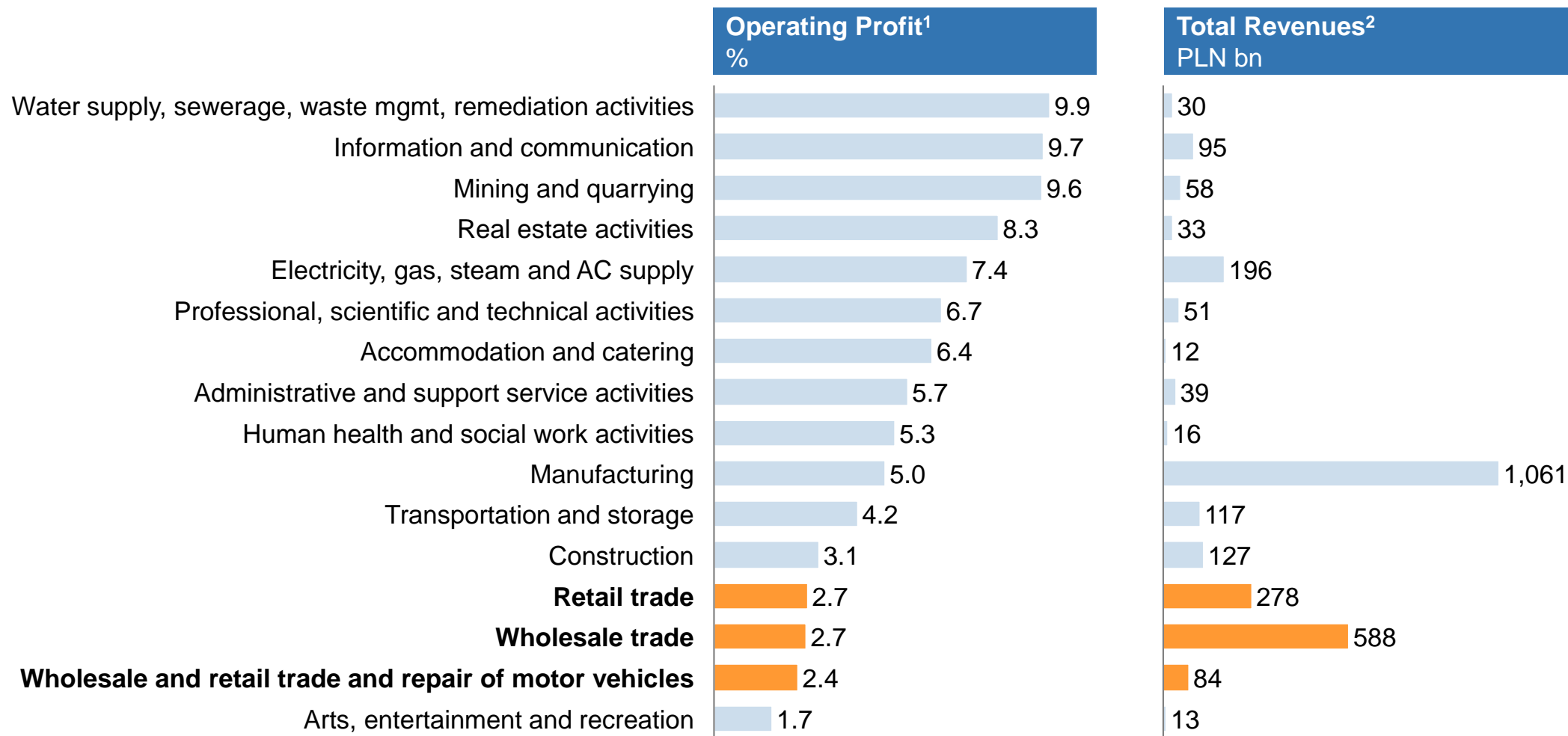
Flat sales tax will be the most fair and effective solution from the standpoint of the state budget

Advantages of the Proposed Solution

- Sales tax would ensure income to the state budget by elimination possibilities to tax avoidance (such as ownership transformations of the big players) and would be a generally good method of taxing the entire economy
- A flat tax does not discriminate anyone in an unfair way and does not worsen the economic situation of the least affluent households
- This solution can ensure expected income to the state budget (which in the long run might not be applicable for the progressive tax)
- Such solution i.e. flat sales tax already exists in some sectors and seems to be an effective way of tax collection
- One issue remains to be considered i.e. how to deal with the link between sales and income tax (whether to exempt sales taxpayers from income tax, include income tax payments in sales tax or vice versa)

Trade sector is one of the least profitable in the entire economy, therefore the sales tax should be imposed on the widest possible group of enterprises

Sector Financial Data, 2013, Enterprises Above 10 Employees



1. EBIT

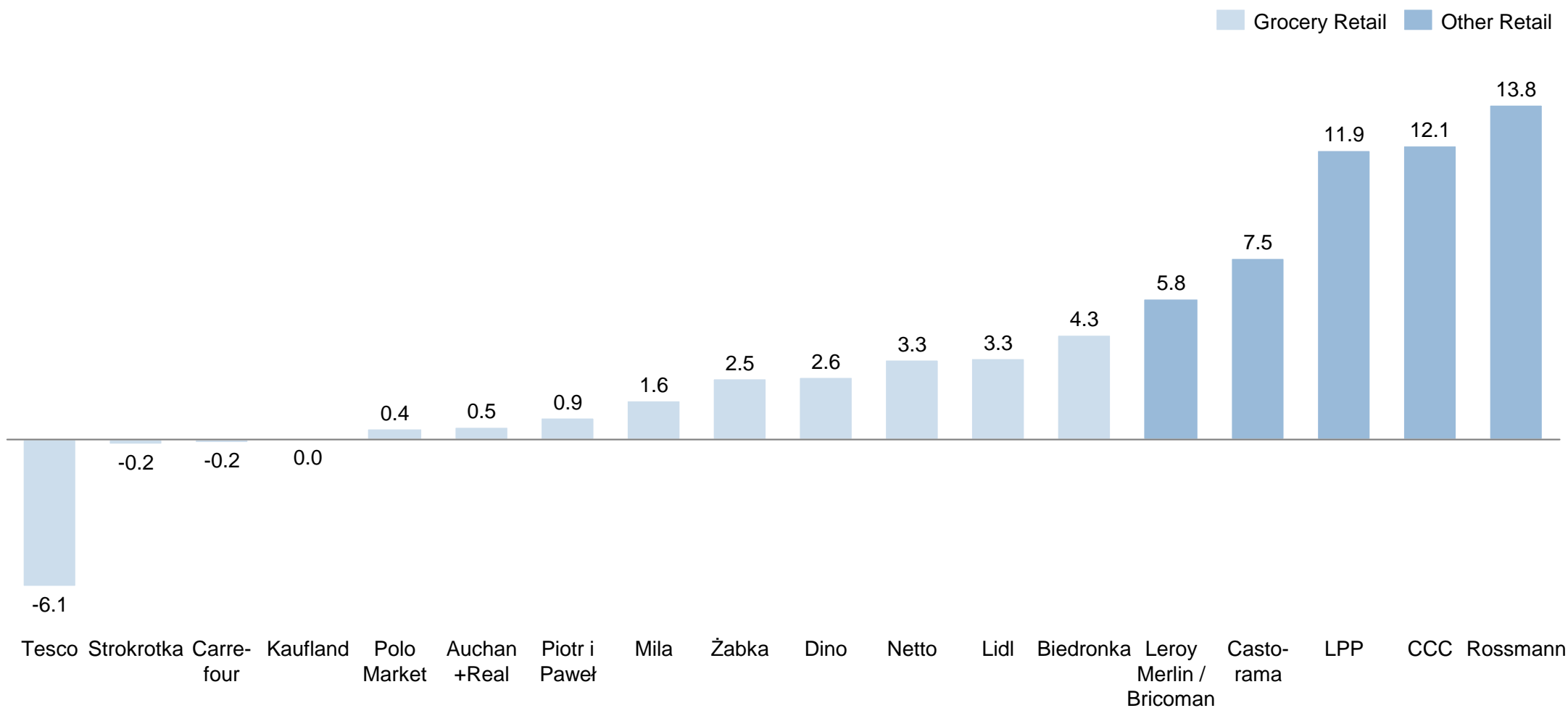
2. Revenues from operating activity

Source: GUS; OC&C analysis

In particular, the tax should not be limited to grocery retail, that is one of the least profitable retail trade sectors

Operating Profit Margin (EBIT)

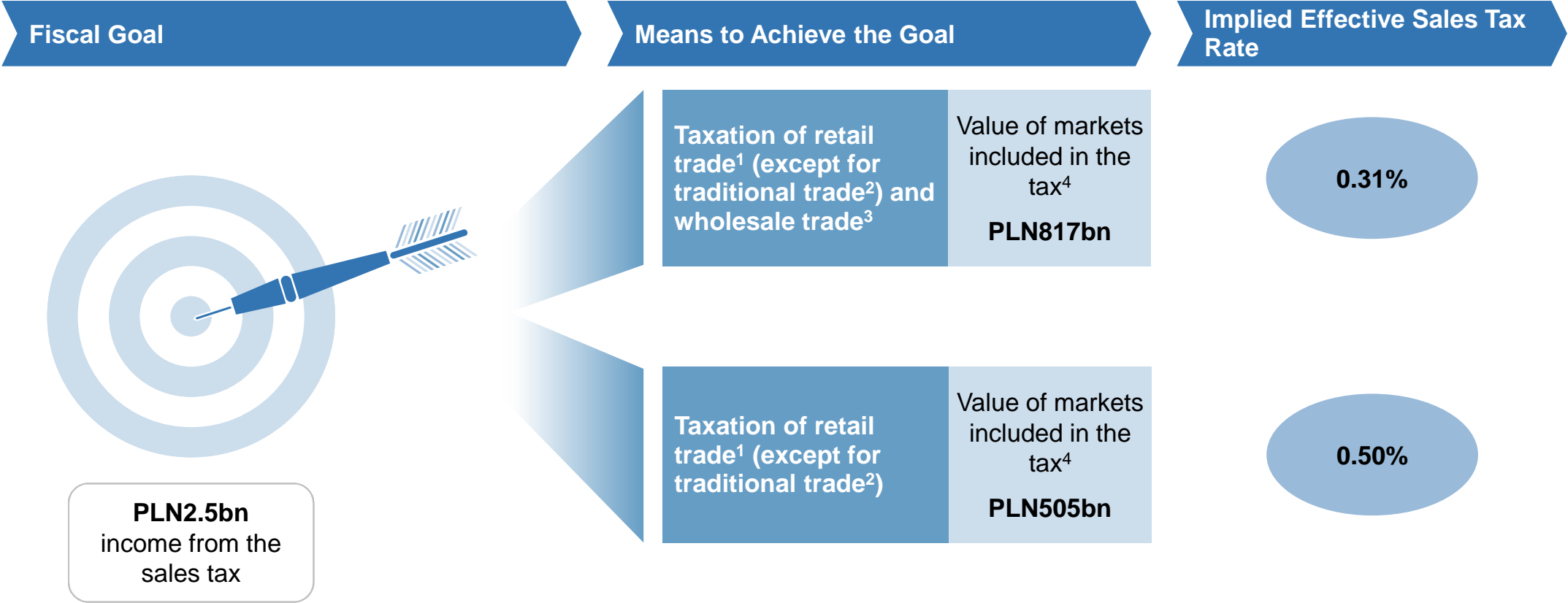
%



If the entire retail and wholesale trade, except from traditional trade, were included in the flat sales tax of 0.31%, income to the state budget would amount to PLN 2.5 bn

Flat Sales Tax Suggestions

Estimation

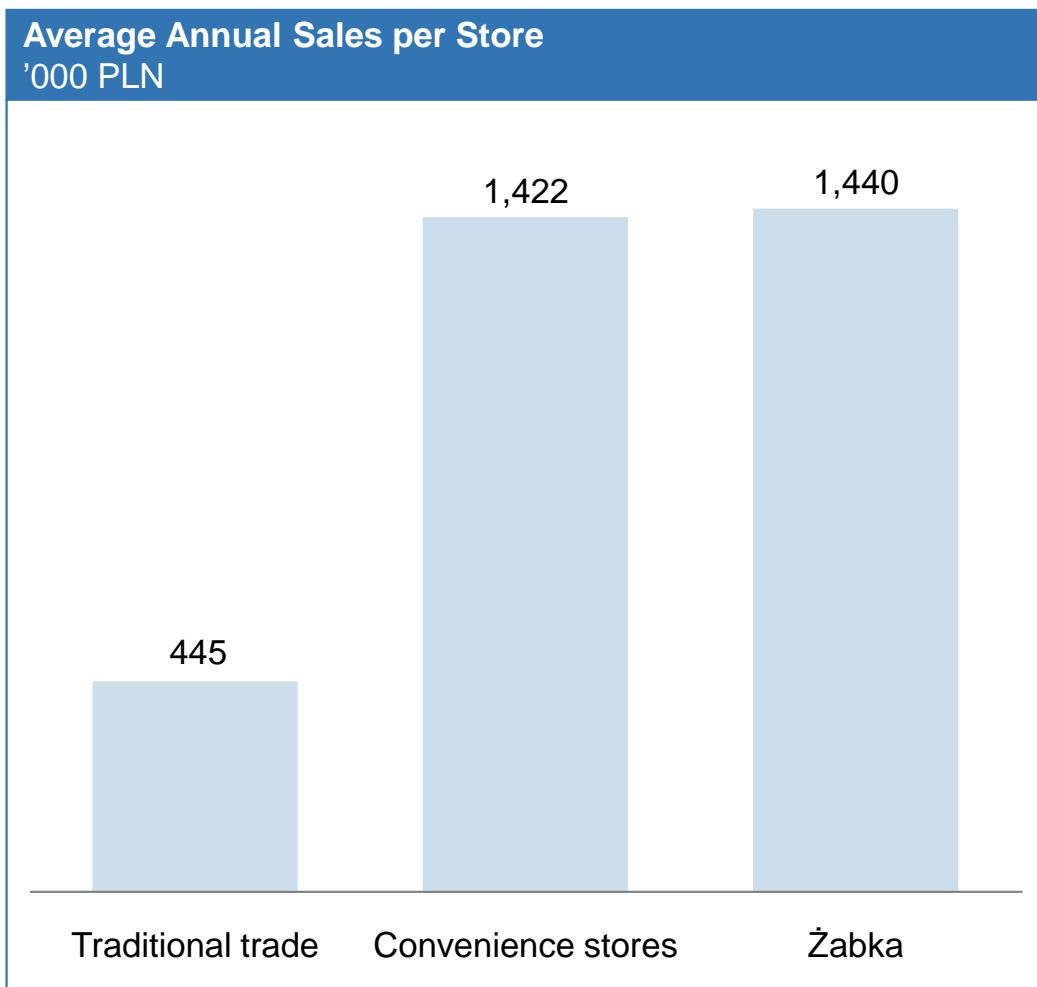


1. In the following categories were included: grocery, electronics, home appliances, cosmetics, apparel, DIY, furniture and home equipment, entertainment, retail sale of fuel for motor vehicles in fuel stations. Includes as well as retail and wholesale trade, maintenance and repair of motor vehicles (not possible to extract retail trade only). Taxing all stores was assumed – regardless of their area, revenues or channel (online vs offline). Retail sales via stalls and markets were not included. Service companies were not included; services provided by trade companies might have been included
2. Unorganized, unaffiliated, independent grocery stores with an area up to 300m²
3. The following categories have been included: grocery, beverages, tobacco products, household products, IT and communication equipment
4. In 2013

Source: GUS; Nielsen; financial statements; OC&C analysis

Excluding grocery traditional trade from the sales tax could be achieved by setting a threshold at PLN 500-600k of annual turnover and justifying it as a mean to limit costs of tax collection

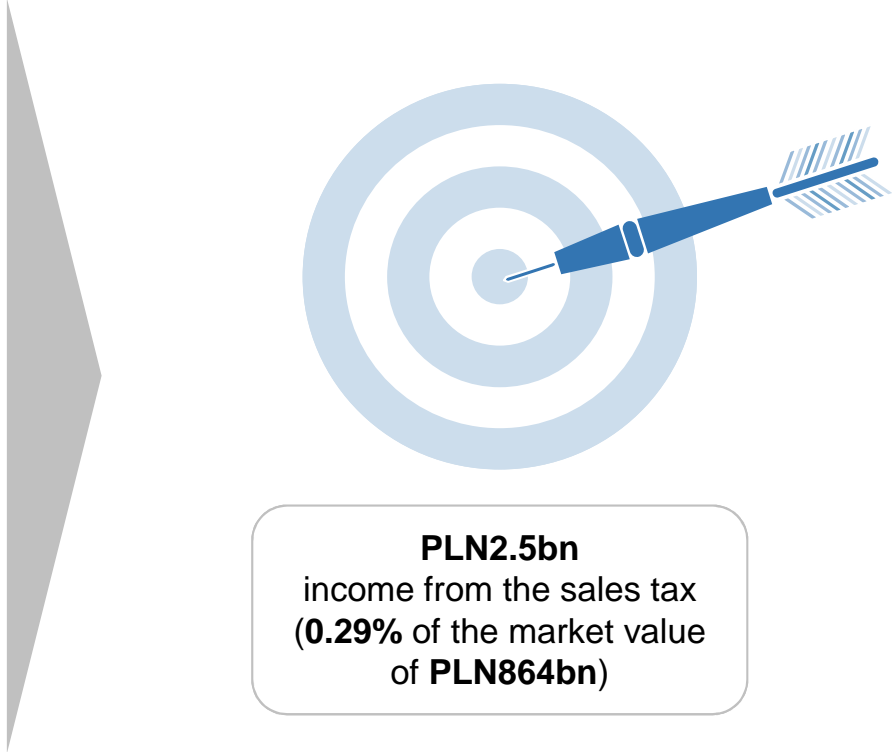
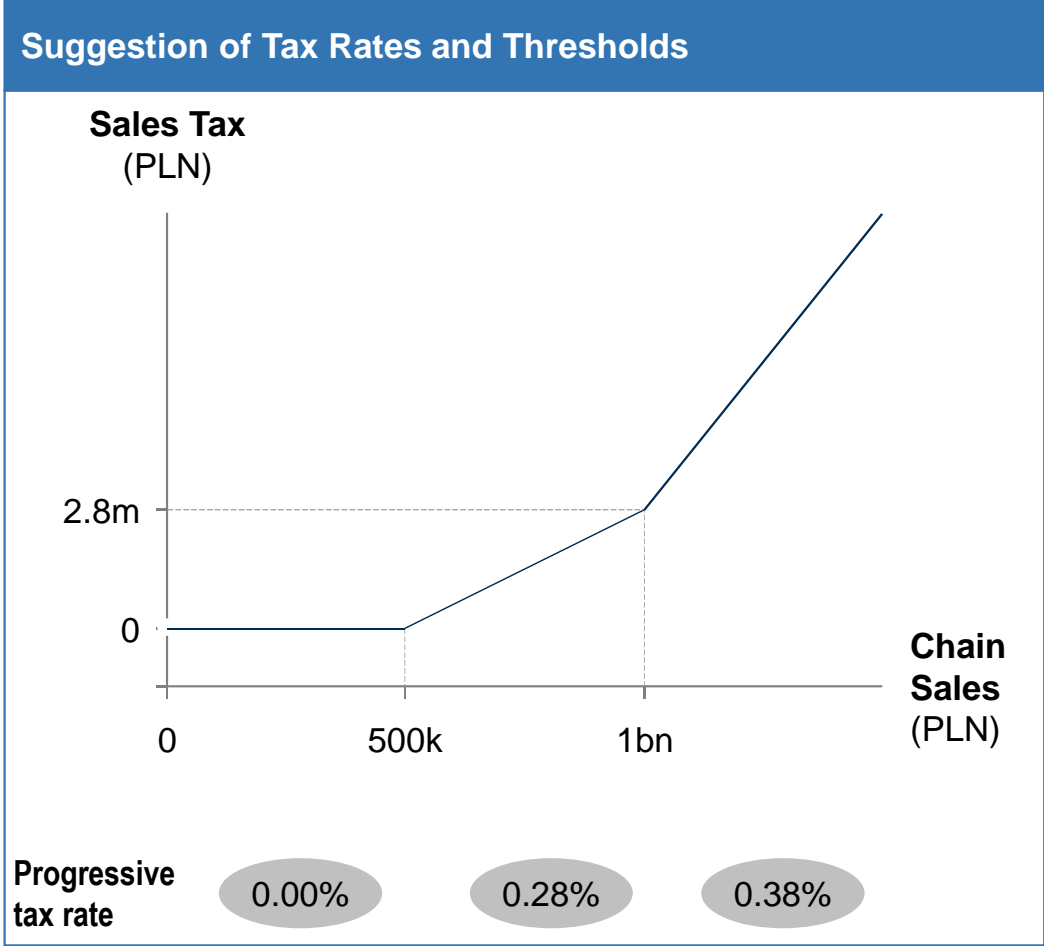
Way to Exclude Grocery Traditional Trade from the Sales Tax



- An average grocery traditional store achieves annual turnover of PLN c.450k
- In order not to tax this format, a lower threshold should be set – at PLN c. 500-600k, slightly above the average turnover to be on the safe side
- This ensures that **the tax will be imposed on convenience chains**, as their average annual sales per store amounts to PLN c.1.5m
- This solution, when a part of the market is excluded from the tax, could be legally justified (i.e. would not influence the competition and would not be an illicit state aid) as a mechanism to limit costs of tax collection (they could be higher than the tax itself)

The same fiscal effect could be achieved with a progressive sales tax of 0.00%, 0.28% and 0.38% rates that would encompass the entire retail and wholesale trade¹

Progressive Sales Tax Suggestion¹



1. Includes the entire retail trade, wholesale trade of grocery, beverages, tobacco products, household products, IT and communication equipment and motor vehicles, and maintenance and repair of motor vehicles

Source: GUS; Nielsen; financial statements; OC&C analysis

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Calculations presented in this document were based on a number of assumptions

Assumptions (1/3)

Assumptions for Estimations

- **Auchan, Real and franchise networks** (eg Lewiatan) are one entity – consequently their total revenues were taken into account when assuming an applicable tax rate
- Based on our best market knowledge, **revenues of „other” companies** were split in the following way:
 - 80% to PL players, 20% to international players
 - For each industry a different split by turnover segment has been assumed

<PLN12m / >PLN12m

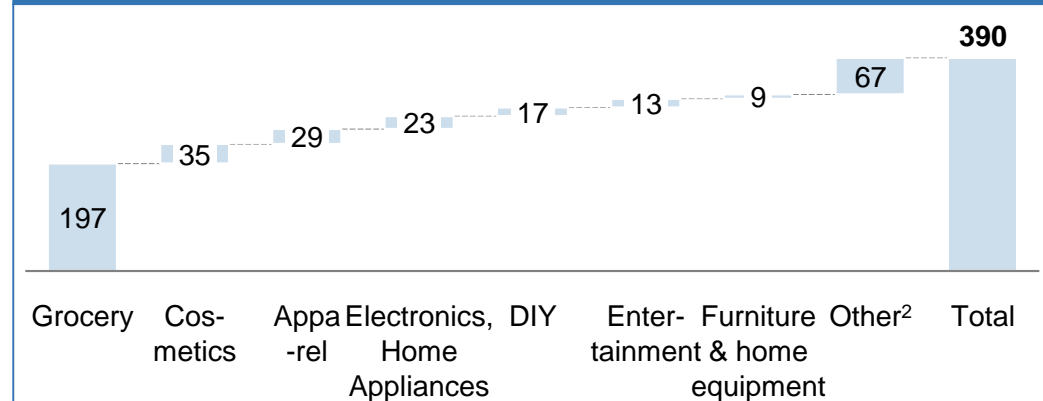
• Apparel	90% / 10%
• Grocery	80% / 20%
• Cosmetics	80% / 20%
• Entertainment	80% / 20%
• Other	80% / 20%
• Furniture & home equipment ¹	60% / 40%
• DIY ¹	40% / 60%
• Electronics, home appliances	50% / 50%

Assumed Reactions of Market Participants on the Sales Tax

- **Retailers**
 - Do not increase prices
 - Do not cut costs
- **Consumers**
 - Do not feel the tax
 - Do not change consumption levels
- **Eventual impact on the retailers’ financials**
 - Maintenance of current revenues
 - Complete absorption of the tax

Assumptions for Retail Market Value (Excl. Gas and Vehicles)

PLN bn



1. For the purpose of this documents, these two segments have been combined as home furnishing

2. Difference between the total retail market value (GUS) and the sum of value of particular categories (total PLN323bn according to PMR), does not include gas and vehicles

Source: GUS; PMR; OC&C analysis

Calculations presented in this document were based on a number of assumptions

Assumptions (2/3)

	Assumed Value	Source	Commentary
Retail Trade Market Value (Including Gas and Vehicles)	PLN552bn	GUS	<ul style="list-style-type: none"> ■ In the following categories were included: grocery, electronics, home appliances, cosmetics, apparel, DIY, furniture and home equipment, entertainment, retail sale of fuel for motor vehicles in fuel stations. Includes as well as retail and wholesale trade, maintenance and repair of motor vehicles (not possible to extract retail trade only) ■ Retail sales via stalls and markets were not included ■ Service companies were not included; services provided by trade companies might have been included ■ Retail and wholesale trade, maintenance and repair of motor vehicles was estimated to have been PLN162bn basing on GUS data from 2012 and applying growth rate between 2011-12 ■ Sales value of other categories (PLN390bn) was taken from GUS directly
Wholesale Trade Market Value	PLN312bn	GUS	<ul style="list-style-type: none"> ■ Value was estimated by basing on GUS data from 2012 and applying growth rate between 2011-12 ■ The following categories have been included: grocery, beverages, tobacco products, household products, IT and communication equipment
Trad. Trade Market Value	PLN47bn	Nielsen	<ul style="list-style-type: none"> ■ Value was estimated by basing on GUS data from 2012 and applying growth rate between 2011-12

Calculations presented in this document were based on a number of assumptions

Assumptions (3/3)

	Assumed Value	Source	Commentary
Average Annual Sales per Store in Traditional Trade	PLN445k	Nielsen	<ul style="list-style-type: none"> Market value divided by number of stores Both figures were estimated by basing on Nielsen data from 2012 and applying growth rate between 2011-12
Average Annual Sales per Store in Convenience Channel	PLN1,422k	Nielsen	<ul style="list-style-type: none"> Market value divided by number of stores Both figures were estimated by basing on Nielsen data from 2012 and applying growth rate between 2011-12
Segmentation of Companies by Revenue (estimation)	n.a.	GUS	<ul style="list-style-type: none"> For the part of the market for which financial statements were not used (market value of PLN139bn): <ul style="list-style-type: none"> The entire traditional trade (market value of PLN47bn) has annual revenues below PLN500k Other companies (market value of 92bn) have annual revenues between PLN500k and PLN1bn For retail and wholesale trade, maintenance and repair of motor vehicles 5% / 85% / 10% split of revenues among below PLN500k / between PLN500k and PLN1bn / above PLN1bn respectively was assumed For wholesale trade 80% / 20 % split of revenues between between PLN500k and PLN1bn / above PLN1bn respectively was assumed