How to perform a Value Chain Analysis for tax & transfer pricing?

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Agenda

VALUE CHAIN ANALYSIS

WEBINAR SERIES

TPA Global

Value Chain Analysis: Definition

- The **entire performance process of a company**, from R&D to delivery to end consumers.
- There is no **100 % objective method** to conduct a value chain analysis.
- Each VCA should start with **identifying the value chain within the industry.**
- Mapping the "value creation" requires identifying and separating **the value-creating activities of an MNE**.
- Value chain linkages should **contain evidence in the relevant context**. E.g., prices, cost premiums, margins, etc., are considered reasonable.

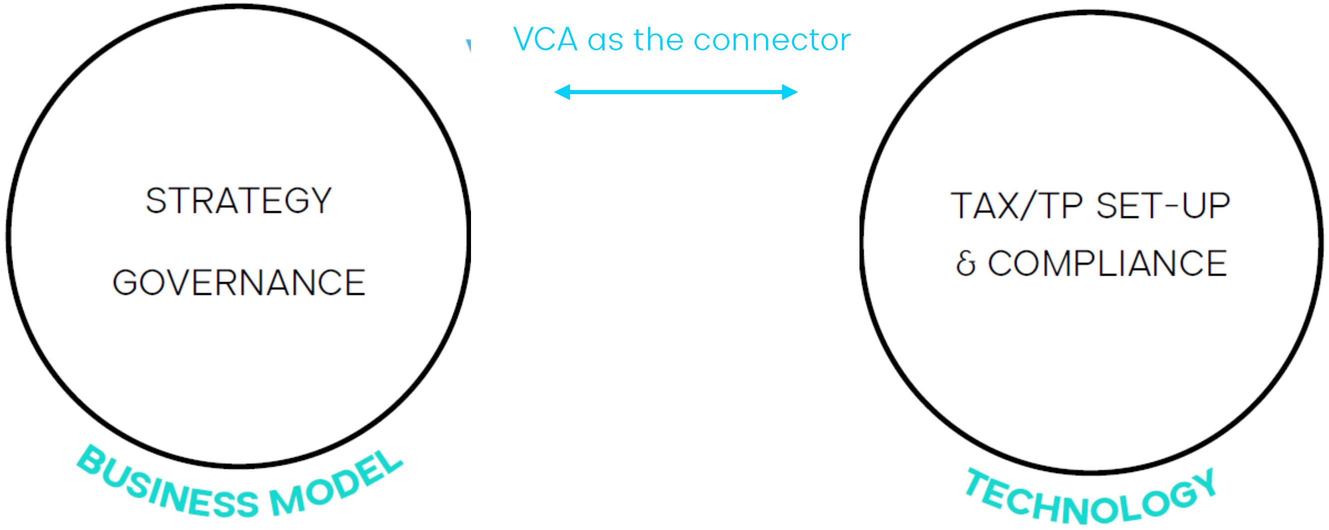
VCA 1.0 – The qualitative version of your value chain analysis

VCA 2.0 – The quantitative version of your value chain analysis (data from MNE)

VCA 3.0 – The quantitative version of your value chain analysis (data from the industry)

Where to use VCA?

- Design of Tax/TP system
- Implementation of Tax/TP system
- Documentation of Tax/TP system
- Defense/controversy management of Tax/TP system
- Establish link between strategy/business model versus Tax/TP – see below



OECD reference materials

Illustration of the scoring model

each point below should be scored with

1 – the quantification meets the criterion or

0 – the quantification does not meet the criterion

Quantification

1. The quantification should be based on **objective** data.
2. The quantification should be based on **comparable** data.
3. The quantification should rely on all the **economically significant** functions, assets, and risks contributed by the parties to the value driver.
4. There should be a **strong and relatively consistent correlation** between the variable and the creation of value represented by the relevant profits.

Allocation keys

1. Allocation keys should be based on **objective** data.
2. Allocation keys should be supplemented where possible **by external market data** that indicate how independent enterprises would have divided profits in similar circumstances.
3. Keys for the allocation of profits may be based on the **relative contributions** of the parties, as measured by their functions, assets used , and risks assumed.
4. Allocation keys should demonstrate a **strong correlation** between the allocation key and the value created.

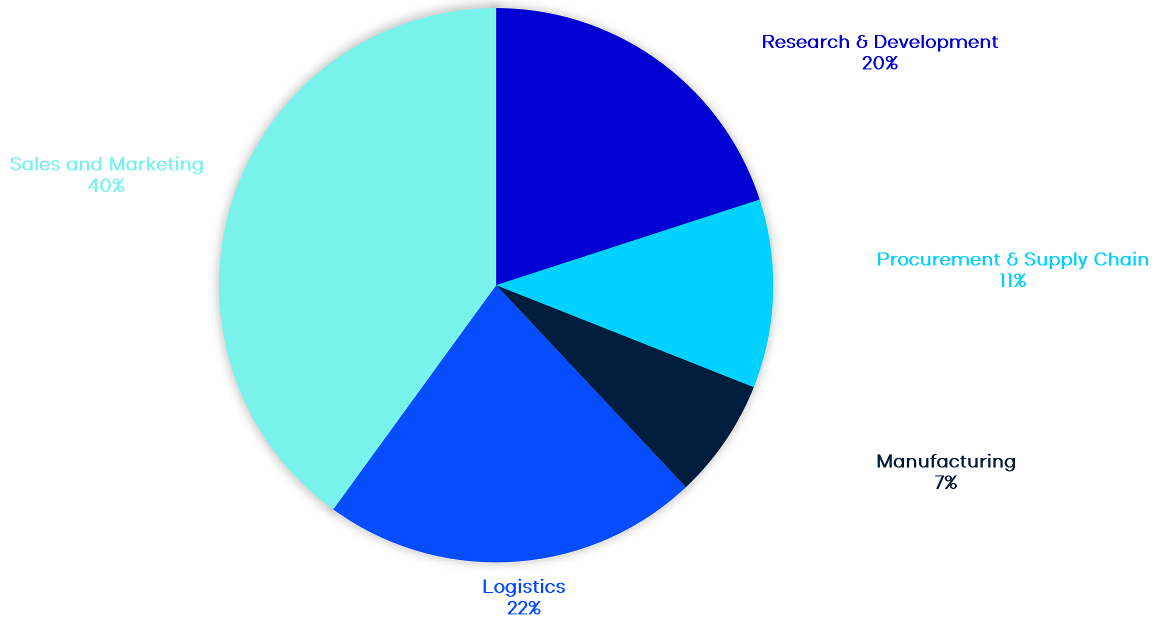
Source: OECD Guidelines 2017, OECD Guidelines 2022,
BEPS Report on Actions 8-10, published in October 2015

VCA in Local Jurisdictions x International

Countries
China
Germany
Israel
UK
South Africa

Institutions
OECD
UN
EU

Global Profits + VCA + Segmented P&L



P & L Table for Research & Development	
Turnover (Sales)	10,000,000
COGS	8,000,000
Gross Margin	2,000,000
SG & A	1,500,000
Operating Income (EBIT)	500,000
Operating Margin	5%

P & L Table for Manufacturing	
Turnover (Sales)	200,000,000
COGS	140,000,000
Gross Margin	60,000,000
SG & A	55,000,000
Operating Income (EBIT)	5,000,000
Operating Margin	2.5%

P & L Table for Distribution (Logistics and Sales & Marketing)	
Turnover (Sales)	600,000,000
COGS	300,000,000
Gross Margin	300,000,000
SG & A	210,000,000
Operating Income (EBIT)	90,000,000
Operating Margin	15%

Understanding Critical Success Factors across Industries

- CSF in the industry
- CSF in a company/MNE

CSF Definition and Relevance to VCA

Definition

Critical Success Factors (CSFs) are the **key areas, activities, or factors** that must be done well in order for a particular organization, project, or initiative **to be successful**. CSFs vary depending on the industry, the organization, and the specific goals and objectives being pursued.

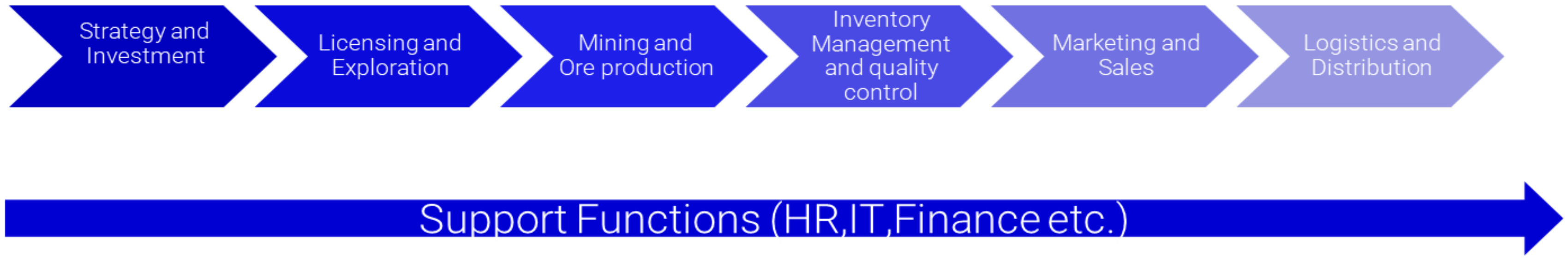
Identifying and focusing on these critical success factors assists organizations prioritize their efforts and resources to achieve their goals and objectives more effectively.

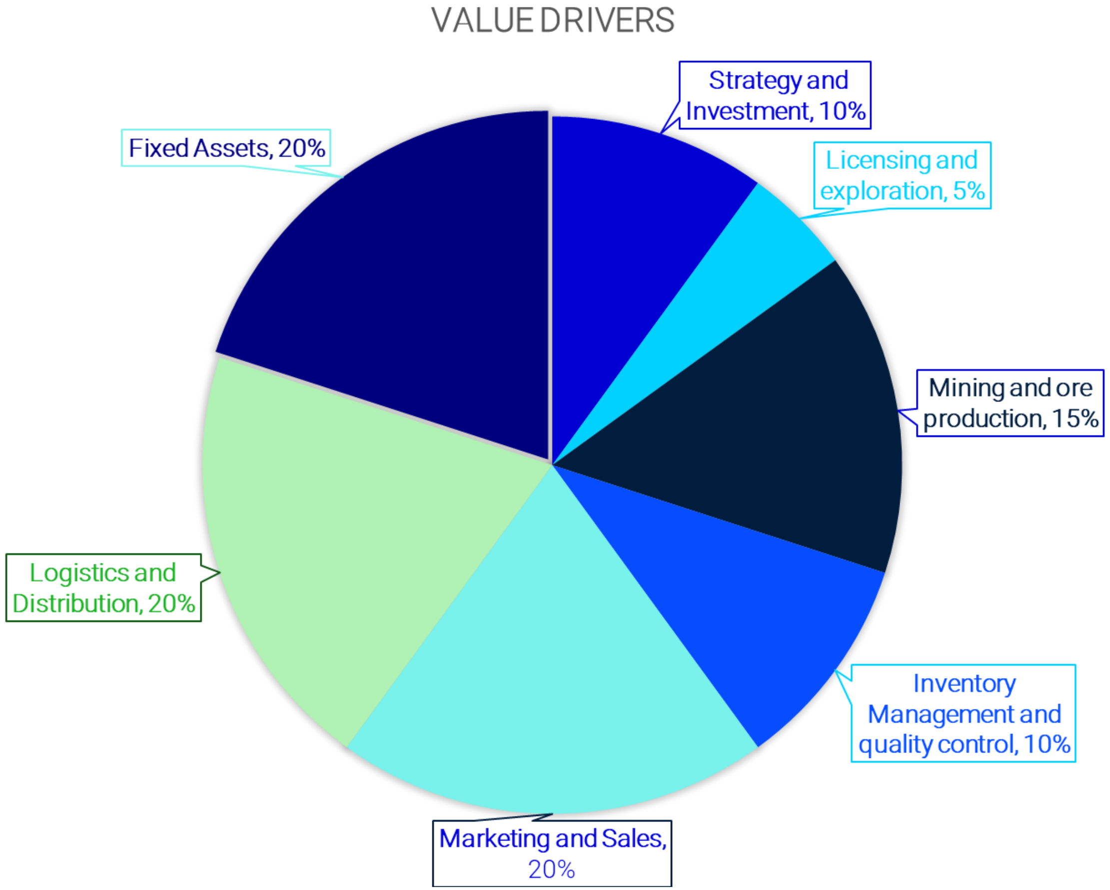
Relevance to VCA

Critical Success Factors (CSFs) are highly relevant to value chain analysis as they **help to identify the key areas of an organization's value chain that are critical to its success.** A value chain analysis is a strategic tool used to analyze an organization's activities and processes to determine how it creates value for its customers and stakeholders.

By identifying the CSFs within each activity or process in the value chain, an organization can focus its efforts and resources on the areas that are most critical to its success.

CSF's in The Mining Industry





CSF'S in The Chemical Industry

1. Research & Development — #1
2. Procurement & Supply Chain — #2
3. Manufacturing — #3
4. Logistics — #4
5. Sales & Marketing — #5

Functions	The company provides strategic management and direction of the R&D function withing the company's business.	The process for planning and forecasting raw materials needs is based on the sales forecast.	The manufacturing process is automated and has been standardized within the company.	Delivery of final products is organized by the manufacturing plant and is detailed in the terms of customer contracts..	A formal sales plan is drawn up each year by the commercial leadership of each business segment. The sales plan is developed initially by the commercial or sales directors from bottom-up input provided by the account managers.
Risks	Market and business risk R&D risk.	Compliance risk Supply risk Inventory risk Price risk Foreign exchange risk Product liability risks for upstream material	Inventory risk Foreign exchange risk Product liability risk Credit risk Warranty risk	Transportation risk	Market and business risk Product liability risk Credit risk
Assets	*Tangibles:* Land and buildings associated with its offices, the production plant and warehouses, machinery and production equipment, furniture and fixtures, office equipment, and transportation vehicles. *Intangibles*: All intangible property developed by the company is owned by company X funds all costs, and manages all key decisions and risks relating to R&D.				

Question: What has changed in the CSF's of the industry?

Fast- Fashion Apparel Value Chain

A value chain of the apparel industry summarized

- Design — #1
- Procurement — #2
- Manufacturing — #3
- Logistics — #4
- Marketing — #5
- Sales & Distribution — #6

• design standard (t-shirt) • design originals	• select suppliers/fabric/textiles • negotiate • purchase agent	• own versus third party production • manage production process • decide on inventory levels • agree on supply chain	• execute on flow of goods • select and contract warehouse/transport capacity	• run marketing campaign • set up omni-channel strategy	• bricks or clicks • customer journey • pricing strategy and executions • mark-down policy

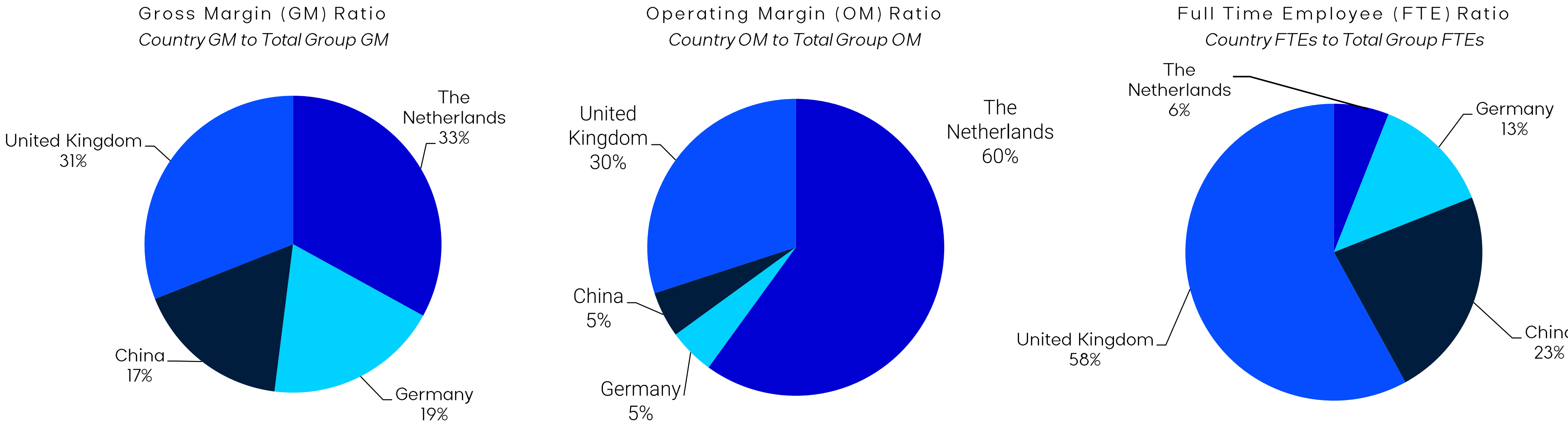
Question: what has changed in the CSFs of this industry?

VCA Visualization Techniques

Technique 1

How to analyze and align the business model

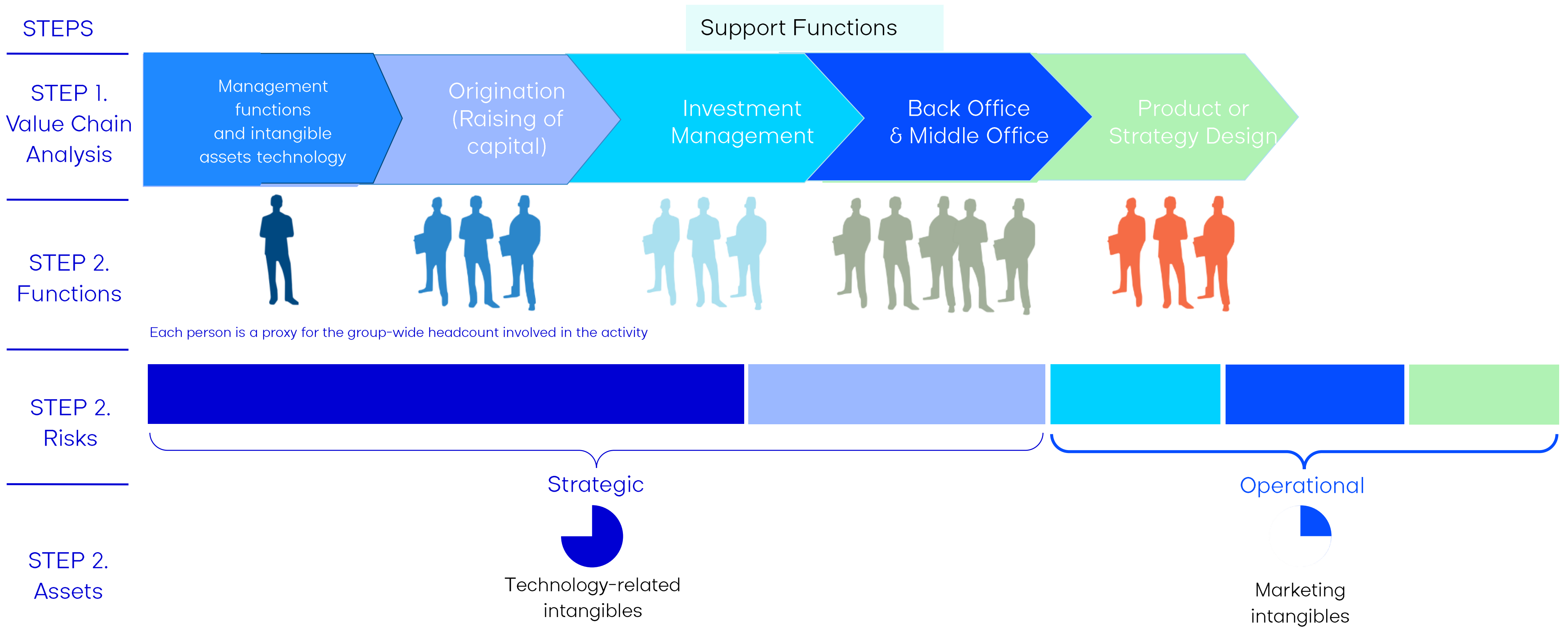
Alignment Between Gross Margin, Operating Margin, and FTEs
Illustrative



Misalignment is visible as the country and total group ratio for gross margin, operating margin, and FTEs. The higher the delta, the greater the need to explain to the Tax authorities.

Technique 2

Visual representation of Analytical Framework
Value Creation, Functional Analysis and Roles and Responsibilities



STEP 3. Entities

Define the roles of the entities in the joint value creation and responsibilities regarding the different value drivers and related risks.

Technique 2

Quantitative Approach to divide the residual profit

Starting Point	Key People Functions	Legal Entities
Determine EBIT%	Allocation of EBIT%	Allocation of People Functions and EBIT%

Residual:	Other:	Cost Plus:	Cost Plus or Percentage of Operating Margin:
IP Owner Match making	Finance Activities (cash pool)	Contract manufacturing Contract R&D	Local sales or marketing offices

Support Services (admin, legal, HR etc.)

Residual

Investment Center	Profit Center
✓Capital market/customer driven activities ✓Mostly performed for stakeholders/MNE as a whole ✓Core Activity e.g., IP Owners	✓Capital market/customer driven activities ✓Mostly performed for external customers ✓Mostly core e.g., Distribution Centers
DEMPE Functions + Filter	Match-Making

Source: TPA Global. - [a] Development Enhancement Maintenance Protection Exploitation Functions.

Technique 3

Canvas Approach BMO Strategy

The Business Model Canvas

Key Partners

Key Activities

Key Resources

Value Propositions

Customer Relationships

Channels

Customer Segments

Cost Structure

Revenue Streams

Key Takeaways

- A balancing act between transactional TP vs VCA
- OECD/EU/Country specific references to VCA provide a solid anchor
- How reliable is your VCA? - apply the criteria from OECD
- With 6 years of VCA experience (design, implementation, documentation & controversy) and trends (CBCR & Pillar II) VCA is here to stay
- Data-driven business model (e.g. platform economy) will be dependent on a quantitative VCA to get an "at arm's length compensation" to each of the "MNE actors in the value chain"
- VCA - only dynamic link between your strategy/business model and your tax/TP set up.

Following webinars

The upcoming webinars in the series will focus on:

•Quantitative VCA based on MNE-specific data sets (VCA 2.0)

•Quantitative VCA based on Industrywide data sets (VCA 3.0)

Thank you.

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Who we are

TPA Global is an independent professional service and solutions partner that serves its clients globally through a network of Members and Alliance Partners in over 60 countries.

We deliver scalable services and solutions in the areas of:

- International Tax, Transfer Pricing and Valuation;
- Tax Technology; and
- Tax Litigation and Mediation.

With a diverse global network of over 5,000 professionals, TPA Global deals with global and complex challenges corporates face at the crossroads between Finance, Tax and IT.

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Years experience

60+

Countries in global network

5,000+

Partnered professionals globally

Amsterdam, Netherlands