

# Why is value chain analysis critical in a BEPS environment?

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# 1. Why is VCA required in today's scenario?

As per the BEPS publications in 2015, the OECD is of the view that some of the transfer pricing approaches developed over the years do no longer provide a holistic view of allocation of margins/ profit across an MNE Group, i.e. the allocation of profit is often not aligned with the 'people functions' responsible for such profit creation.

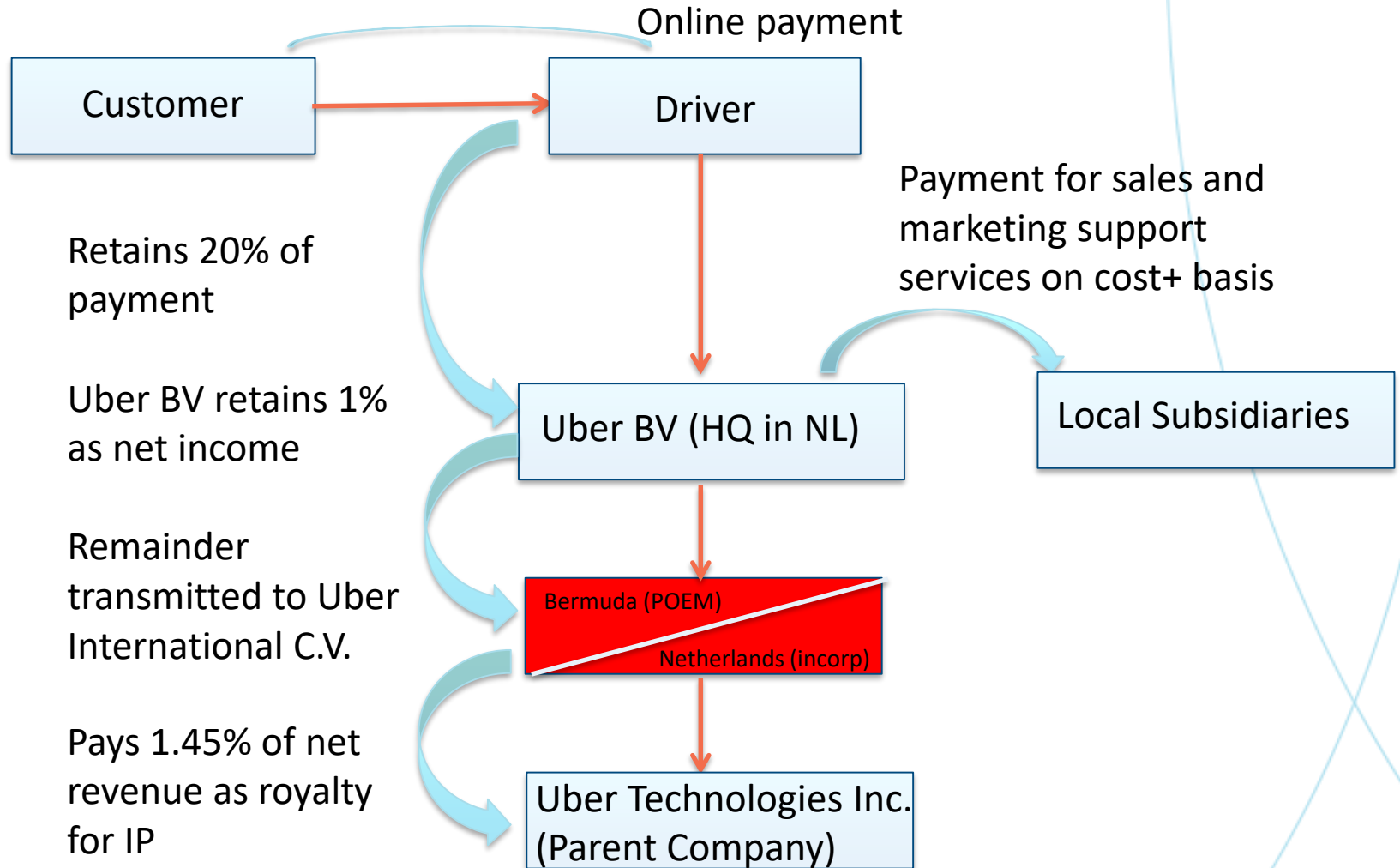
The following are now questionable in light of VCA analysis under BEPS:

- One-sided benchmarks (≠ holistic analysis)
- IP-structures which do not absorb any costs
- Commissionaire structures drawing disproportionate limited and fixed return
- Geographically fragmented IP structures

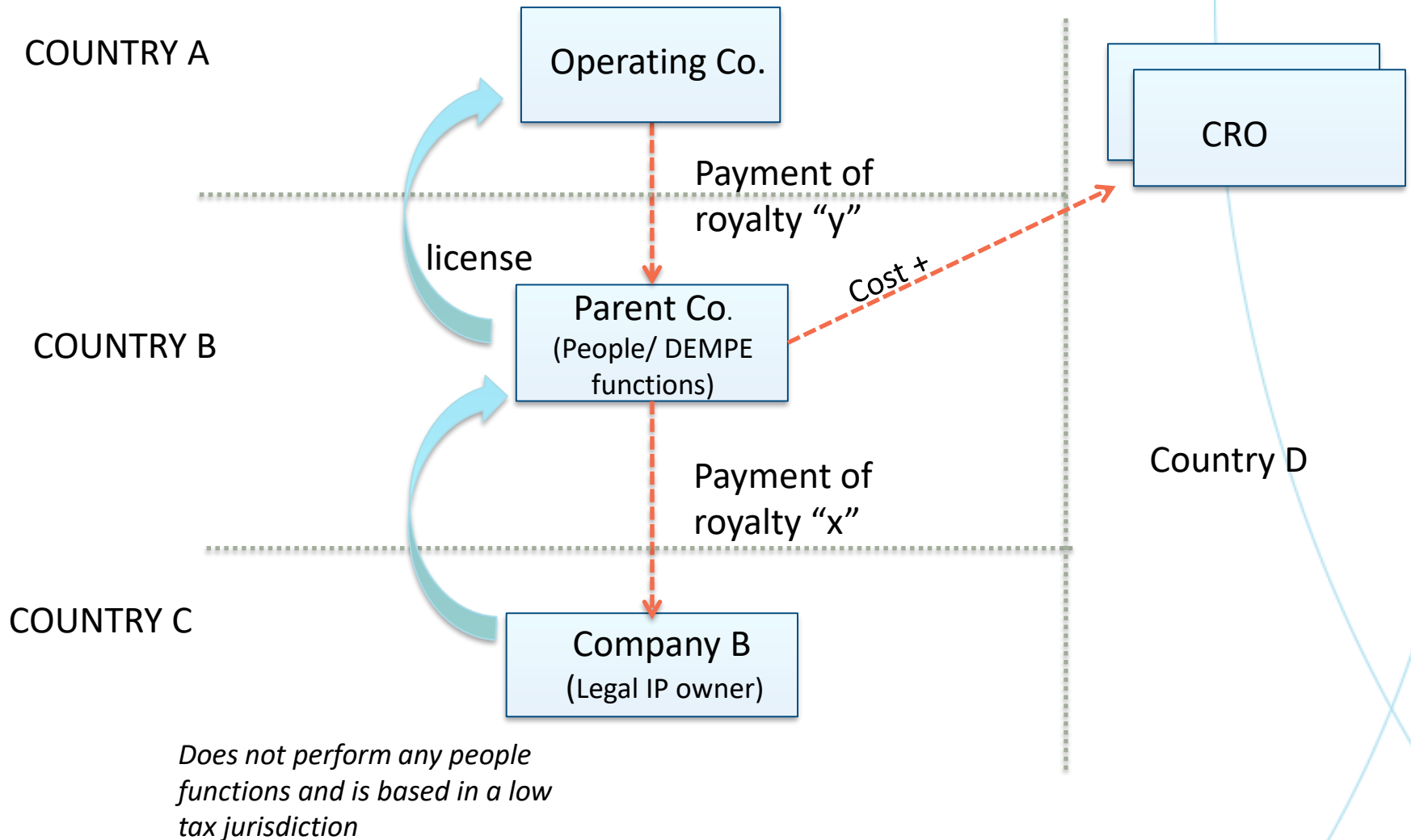
## 2.1 Questionable in the light of VCA outcomes under BEPS: One-sided benchmarks

		Year 1	Year 2	Year 3	Year 4
Matchmaker	Principal/ Profit Center	\$-100	\$300	\$-600	\$100
Logistic Center	Cost Center	\$40	\$40	\$40	\$40
Distributor	Revenue Center	\$70	\$75	\$80	\$85
	<b>Total Profit</b>	<b>\$10</b>	<b>\$415</b>	<b>\$-480</b>	<b>\$225</b>

## 2.2 Questionable in the light of VCA analysis under BEPS: Structures without “people functions”



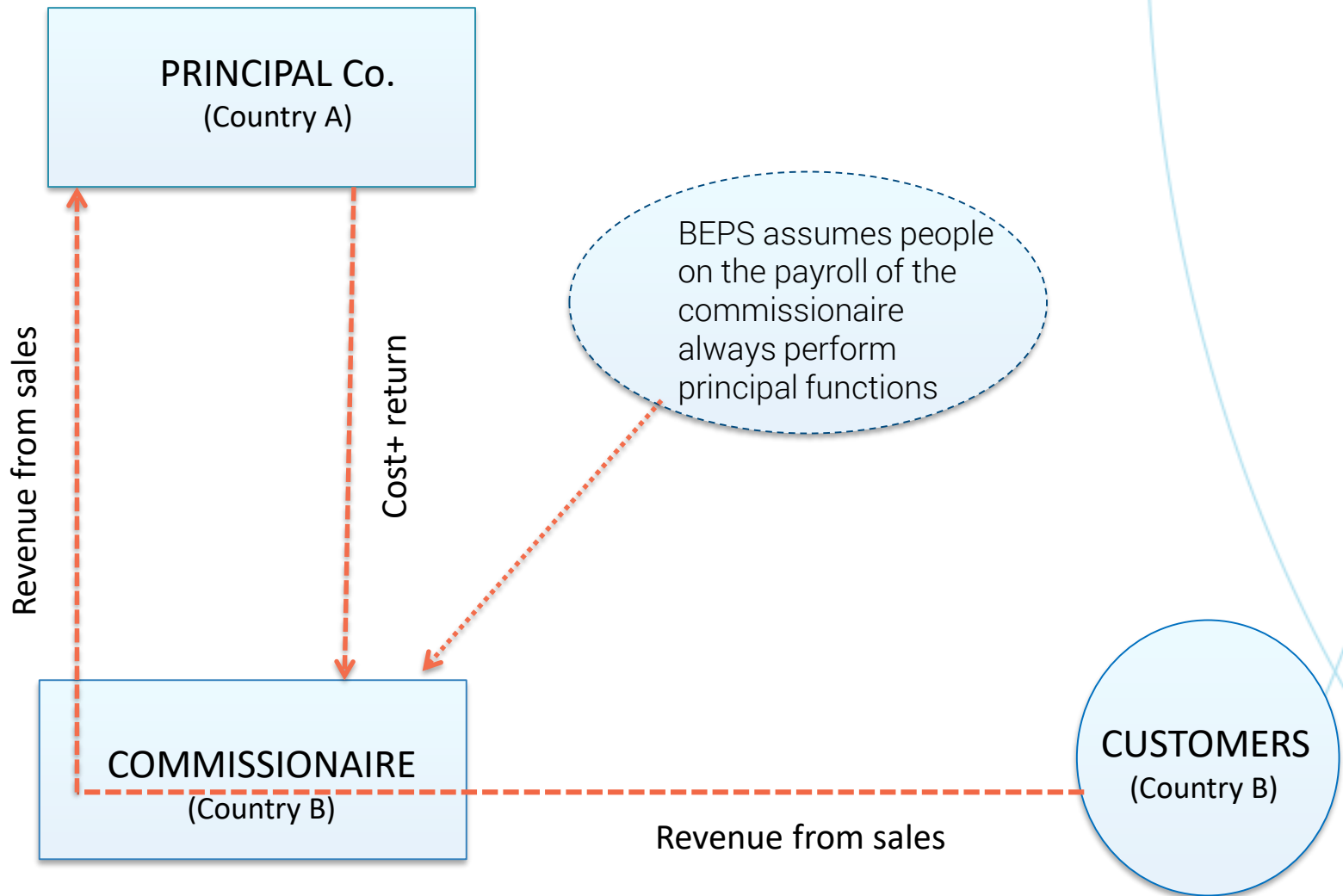
## 2.3 Questionable in the light of VCA analysis under BEPS: Entities owning IP without absorbing "IP related cost"



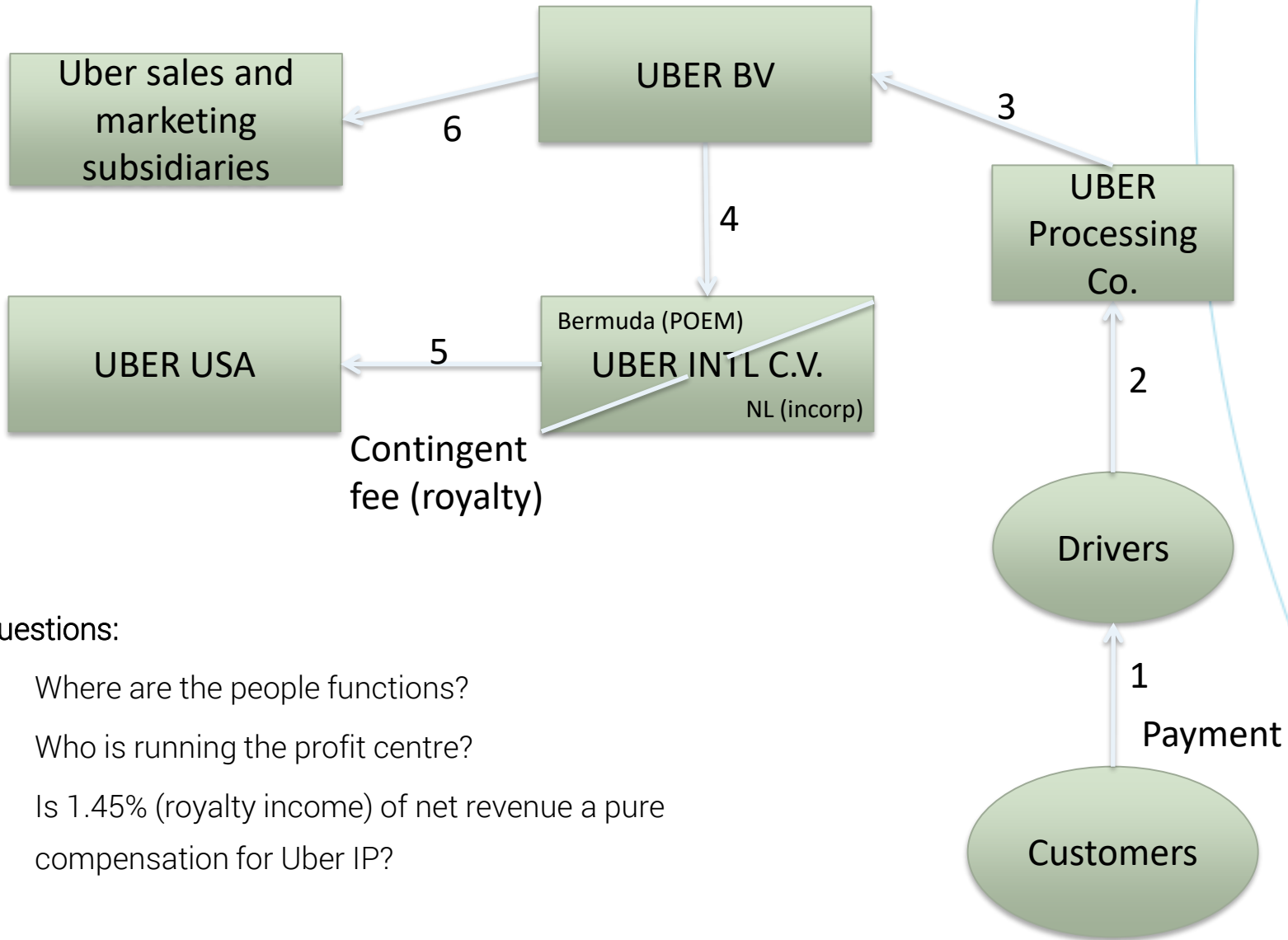
## 2.4 Questionable in light of VCA under BEPS:

### Commissionaires structures with “significant people functions”

(Cases where Profits are allocated to the Principal Co. instead of Commissionaire)



### 3.Uber in VCA context

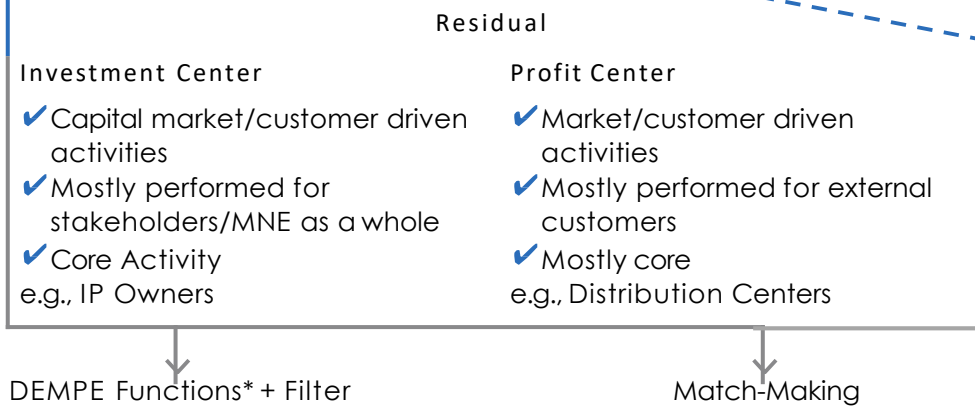
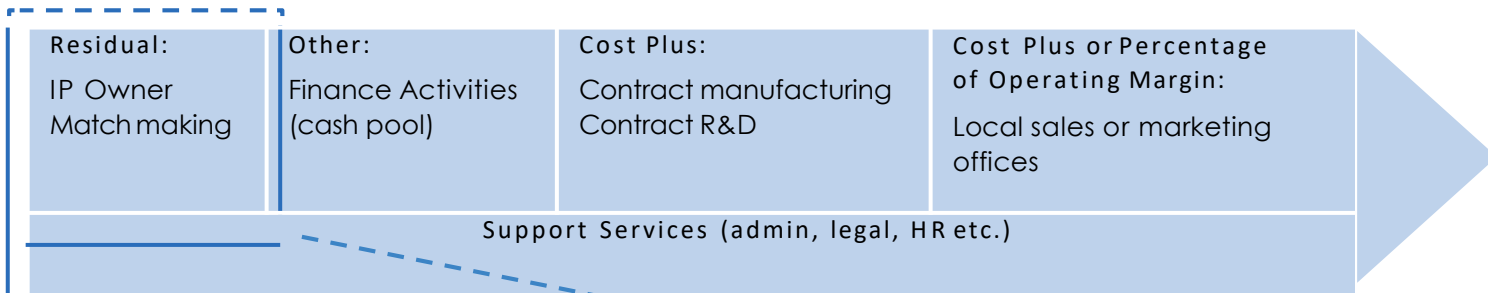
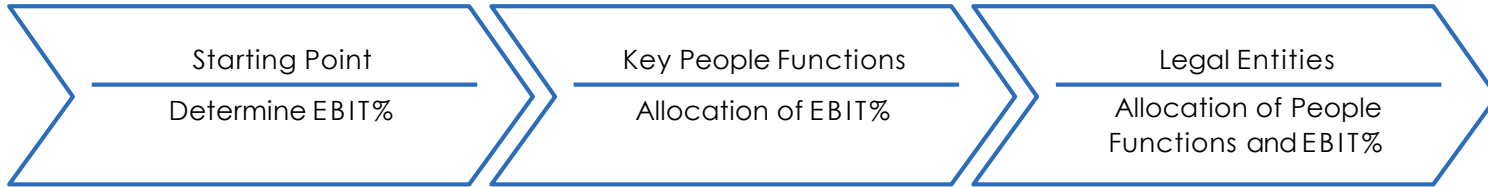


#### Questions:

1. Where are the people functions?
2. Who is running the profit centre?
3. Is 1.45% (royalty income) of net revenue a pure compensation for Uber IP?



# 3.1 Technique 2: Basic Approach to divide the residual profit



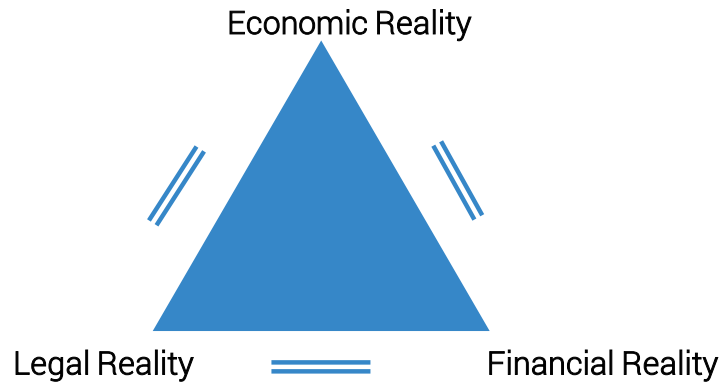
Source: TPA Global.

\* Development Enhancement Maintenance Protection Exploitation Functions.

Taking control of the future

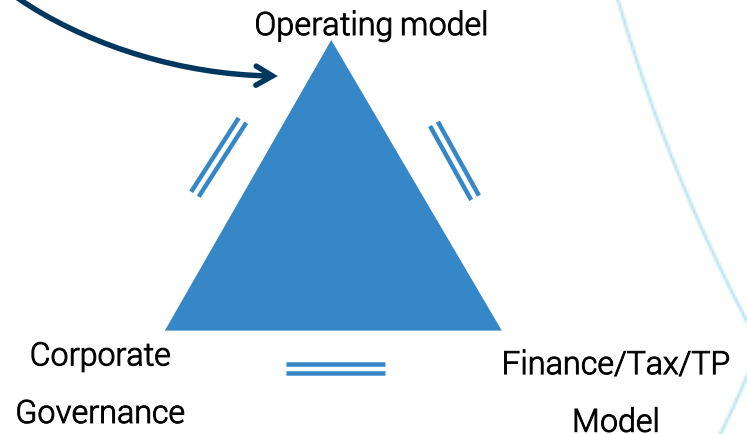
# 4. VCA: BEPS Generation of Functional Analysis

Pre BEPS Functional Analysis



Move from  
Pre to Post  
BEPS

Post BEPS Value Chain Analysis



Source: TPA Global

## 5. When to apply VCA?

- In the traditional transfer pricing in the pre BEPS era, a functional analysis assisted in the alignment of the legal, financial and economic realities.
- However, in the post BEPS era, a value chain analysis has replaced the functional analysis and is used to fully align the corporate governance framework, operating model and the tax/ TP structure of an MNE.
- Any discrepancies in such alignment can trigger not only an additional tax liability (along with a penalty and interest) but also potential criminal charges.

## 6. Regulatory background associated with VCA

- OECD References:
  - Final BEPS Report on Actions 8-10
  - Discussion Draft on Revised Guidance on Profit Splits published in July 2016
- Guidance from the Chinese Tax Authorities (<https://www.tpa-global.com/files/streamfile27398/download/2016-10-29-095843/161029-bna-tpr-china-vca-sh-yw.pdf>)
- Guidance from the German Tax Authorities

# 7. Applicability of VCA: Alignment of Master file, CbCR and Tax Return

## Master file

Contains a “blue print” of the MNE group:  
(i) the MNE group’s organizational structure;  
(ii) a description of the MNE business(es)  
(iii) the MNE; intangibles  
(iv) the MNEs intercompany financial transactions;  
(v) the MNEs financial and tax position.

## CbCR

Contains key elements of the financial statements by jurisdiction, providing local tax authorities visibility to revenue, income, tax paid and accrued, employment, capital, retained earnings, tangible assets and activities.

## Tax Return

Contains information regarding only the local entity disclosed for local corporate tax filing obligations, including its intercompany transactions with other entities in the group.

← THE MISMATCHES CAN NOW BE ALIGNED USING VCA →

## 8. Key reasons for VCA - Take aways

- BEPS = Full tax transparency;
- BEPS = a merger of residence of “taxable income” with the residence of “people functions” responsible for generating it;
- BEPS feeds “greed at the level of tax authorities;
- BEPS has already triggered some tax authorities to:
  - Open the hunting season for aggressive tax structuring(s). For example, the Australian Tax Office; and
  - Request a full value chain disclosure in TP local country files and CbC reporting. For example, the Chinese Tax Authorities.

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