



A better perspective on your business

KPMG's Value Chain Analysis

Applications for tax



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A framework to analyse your tax model in a post – BEPS world



Map

Outlining the value chain



Evaluate

Relative value assessment



Apply

Overlaying Value Chain Analysis to tax applications

Executive summary

The demand for companies to be transparent about how they operate internationally and where they pay tax is ever increasing. As a consequence, businesses need to improve the way they explain their operating models and tax approach to stakeholders. More than ever before, this means being able to understand and readily explain the commercial facts of their business and align with profit and tax outcomes.

The changes brought in by the OECD's Base Erosion and Profit Shifting (BEPS) Action Plan have the potential to radically change tax outcomes for many taxpayers. The realignment of taxing rights with economic substance is at the heart of the initiative. The OECD defines this as the need for aligning transfer pricing outcomes with value creation.

Value Chain Analysis (VCA) is a vital tool for evaluating and communicating how a multinational enterprise (MNE) works.

// Through harnessing the power of VCA, taxpayers can more easily assess the relative importance of different value drivers in a global business – which has many useful tax applications in the new post-BEPS world. //

KPMG has developed a scalable and flexible methodology for analysing a business value chain. This approach has been implemented with many organisations across different industry sectors. We have refined and updated our methodology to reflect the latest OECD guidance resulting from BEPS. Our targeted deliverables have been tailored to assist taxpayers to manage their response to BEPS across the different applications, from ensuring a tax model is BEPS compliant or assisting with the new OECD Master File through to the design of a new transfer pricing model that underpins the wider business.

Introducing Value Chain Analysis

A Value Chain Analysis (VCA) considers an end to end view of a company's activities, enabling a better perspective on the way a business works and how each component contributes value.

There is an ever greater demand for tax transparency among governments and the public. The OECD's (BEPS) Action Plan is a direct result of this. Two key pillars of the BEPS Action Plan are: ensuring that substance and value creation are consistent with the location of taxable profits (Action 8 and 10); and requiring transparency in an Multinational Enterprise's (MNE) profitability, tax outcomes and global business value chain (through country by country reporting and the Master File, as per Action 13). By 'substance', the OECD increasingly means 'people'. Other value drivers and features, for example intangible assets and the terms of contracts, are important – only if they are properly aligned with key people.

This means that companies need a coherent and holistic picture of their business, which articulates how and where value is created, as well as help identify and explain profit and tax outcomes.

A VCA can be an important tool in demonstrating to both internal and external stakeholders that the location of a company's taxable profits is consistent with the location of key substance.

// In a tax context, a VCA considers the relative value of business activities, assets and risks to one another and how they correspond to a group's success or failure – aligning tax with the commercial view of a business //

As acknowledged by the OECD, global value chains are also very diverse across industries and enterprises. A VCA situates the relative value of these functions, assets and risks in the context of a company's industry competitors.

A VCA therefore involves the examination of:

1. All facts and circumstances surrounding how group companies interact with one another in their economic and commercial context.
2. How that interaction contributes to the rest of the value chain.
3. What the interactions involve in terms of the role that each party performs, the assets it employs, and the risks it assumes and manages.

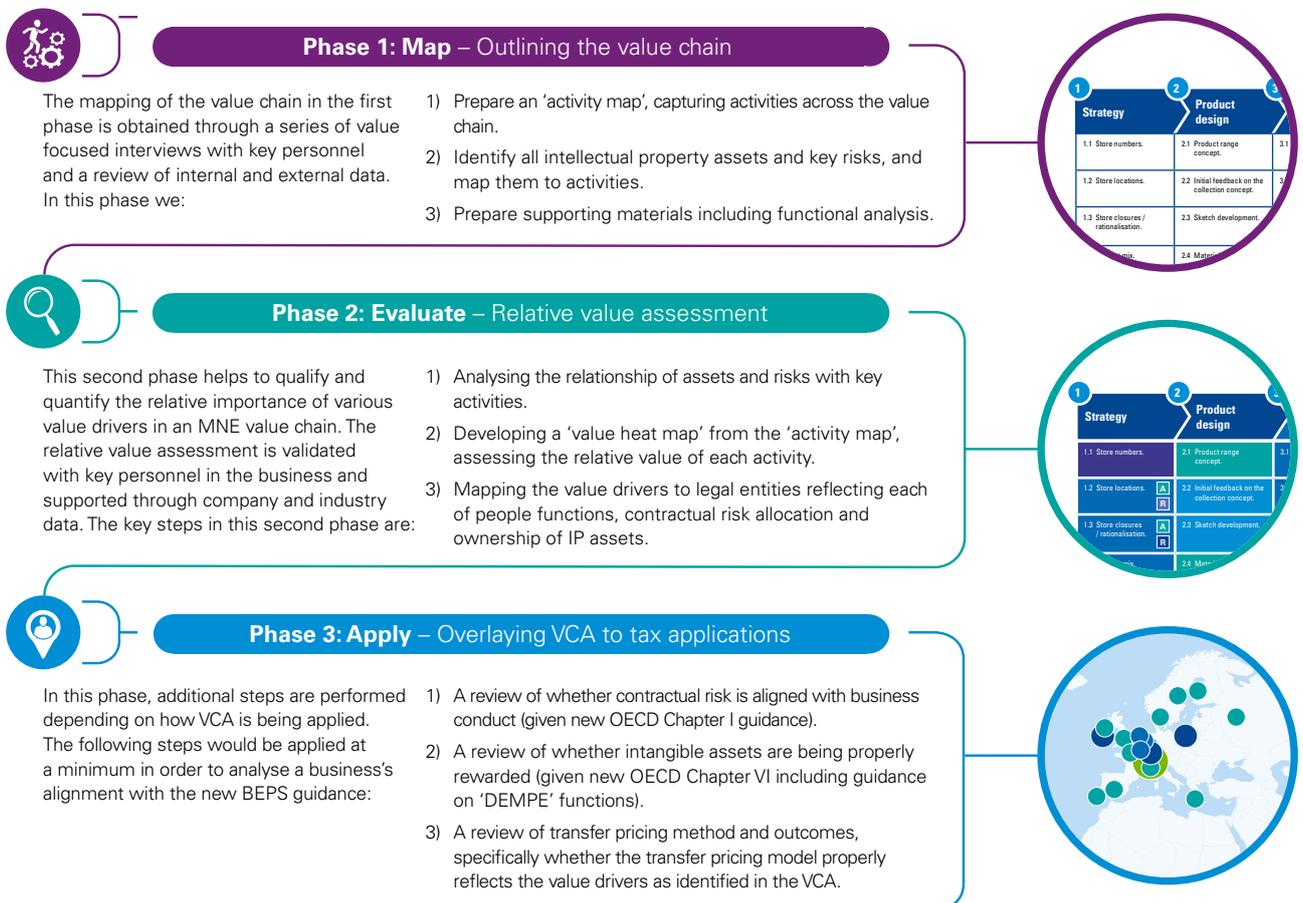
The KPMG Value Chain Analysis framework

KPMG's Value Chain Analysis

KPMG has developed a flexible approach to using VCA in a tax context. Our approach includes three phases with six core steps which can be scaled depending on its application as well as the size and needs of the business. The core methodology is tried and tested across many years and multiple industries. It has been refreshed and updated to help ensure the latest OECD BEPS guidance is fully reflected.

We have also designed a series of tools to capture our findings and present our analysis in the most useful manner for the multiple tax applications of VCA. In addition to a traditional functional analysis, we focus on pictorial/ graphical presentation to illustrate the value chain, bringing greater insight and clarity.

Our VCA approach combines management observations with objective industry and company data to evaluate key business processes, how value is created, commercial success factors and risks - both for the company and relative to competitors in its industry. Using the collected data, a 'value hypothesis' for the business can be formed and tested through value focused interviews with key business experts.



Issues addressed through Value Chain Analysis



Assess your transfer pricing model's alignment with the OECD BEPS principles

A VCA can help assess the risk of a transfer pricing model for multinational groups and test whether the location of key value drivers and business substance is appropriately connected with the location of taxable profits.

In the UK, a VCA can support and corroborate the analysis undertaken to determine whether companies have an exposure under the Diverted Profits Tax legislation or the more recently introduced Profit Diversion Compliance Facility.



Support your Master File and Country by Country Reporting

A VCA can help you explain the drivers of business profit and principal contributions of value creation for your group, as required under the new OECD Master File.

It will also help explain your Country by Country Reports and the location of taxable profits.



Deepen your understanding of how your business functions

A well-executed VCA can help you align your operating model to reality, and enable you to articulate this simply and objectively. As businesses evolve, change and restructure, a VCA can ensure that the tax outcomes continue to align with the new operating model. It can then be used to develop the most appropriate transfer pricing approach to apply.



Develop a more sustainable model

A VCA can identify a fundamental change in the way a company operates, or may simply reinforce the validity of its existing model.

In several recent projects, we could identify previously under-valued functions by asking the difficult questions to the right people and mapping the whole value chain, supporting a more sustainable model.



Prepare for discussions with tax authorities and stakeholders

A VCA can help you clearly and transparently demonstrate to tax authorities and other stakeholders how a legal entity's share of the total business profit correlates with their role in the value chain.

Case studies

A VCA has multiple applications and potential benefits

Here are some examples of cases where KPMG helped its clients overcome different challenges by applying VCA:

Case 1

Master File and reporting

A company was concerned about the margins being reported in its markets by comparison to the business model adopted by its competitors.

Result

The company was able to explain why and how its business operated differently to its competitors. This meant the risk of challenge from tax authorities could be mitigated, with the VCA also being used as part of the group's Master File.

Case 2

Operating model

One of our clients had a large amount of unutilised tax losses and was concerned about ensuring the ongoing BEPS compliance of their transfer pricing model.

Result

It was established that the head office drove most strategic and operational decisions in the business, yet was compensated as a cost centre, which was neither BEPS-compliant nor tax-efficient. KPMG used VCA to advise on and implement a new, compliant transfer pricing model for the business, enabling them to access tax losses.

Case 3

BEPS risk review

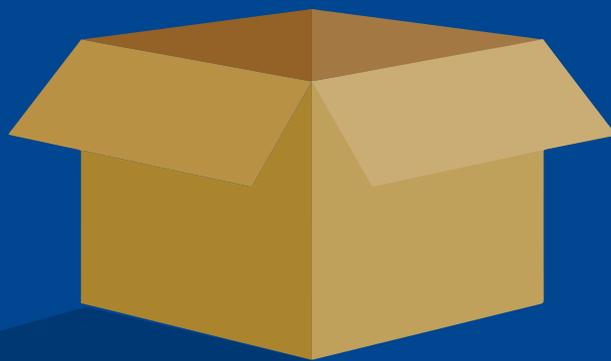
A company was leaving a valuable intangibles return in a high tax location with no meaningful substance or value drivers.

Result

VCA enabled the company to bring its tax model up to date with the latest OECD thinking, whilst managing tax risks and improving the tax outcome.

KPMG's Value Chain Analysis is a clear and established methodology for analysing a business value chain. It can help in:

1. getting valuable insights in relation to the value drivers of the business
2. clearly articulating value creation within the business
3. engaging in discussions with tax authorities



Contacts

If you would like to discuss further and find out how we can help, you can speak to a member of the KPMG team:

Tim Sarson

Partner

T: +44 (0)20 7694 4831

E: tim.sarson@kpmg.co.uk

Richard Murray

Partner

T: +44 (0)20 7694 8132

E: richard.s.murray@kpmg.co.uk

Erica Perry

Director

T: +44 (0)20 7694 4891

E: erica.perry@kpmg.co.uk

www.kpmg.com/uk/tax

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