

Pillar Two

The impact on international M&A
and corporate group structuring



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Agenda



Introduction

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Pillar Two Principles and Data Sources

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Common Intra Group transactions

03

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04

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01

Pillar Two Principles and Data Sources



Core principles

In general, Pillar Two transactions treatment follows the accounting treatment on an entity by entity basis unless there is a specific provision to the contrary.

Transfer / impairment / write-off of assets and liabilities follows accounting treatment and included within the GloBE income and loss calculations with associated current and deferred tax.

Common example exceptions:



Excluded equity gains and losses



Intragroup transfers



GloBE reorganisations



Transactions not at arm's length



Companies in distress



Key is to:

- 01** Identify the data source for the aspect being reviewed (transitional CbCR safe harbour versus GloBE ETR)
- 02** Understand the accounting per that data source (including current and deferred tax); and
- 03** Consider whether there is a need to adjust that data source for either income or tax under applicable rules

Data source and core potential adjustments

	Transitional CbCR Safe Harbour	Detailed GloBE ETR Test
Data Source	<p>Qualified Financial Statements (QFS)</p> <p>(a) the accounts used to prepare the consolidated financial statement of the ultimate parent, or</p> <p>(b) financial statements of members of the group prepared in accordance with acceptable accounting standards or an authorised accounting standard.</p>	<p>Consolidated Financial Statements (generally)</p> <p>(a) the accounts used to prepare the consolidated financial statement of the ultimate parent (pre-consolidation adj)</p> <p>(b) under QDMTT, <i>may</i> be financial statements prepared under a local accounting standard, subject to certain conditions being satisfied</p>
Purchase Price Accounting (PPA)	<p>Need to reflect in CbCR and tests if reflected in the QFS source for a member, but no requirement for them to be reflected there.</p> <p>If reflected, then need to satisfy Consistent Reporting Condition, and consider need for Goodwill Impairment Adjustment.</p>	<p>The underlying profits and taxes of a member should generally be adjusted so that they do not reflect relevant share acquisition adjustments.</p>
Amounts recorded in OCI	<p>Not included in the data utilised</p>	<p>Generally excluded, other than (i) revaluation method gain or loss for PPE which is not recycled to the P&L, (ii) certain covered tax recorded in OCI or (iii) certain hedging by election</p>
Tax Data	<p>Per the QFS source, but remove:</p> <p>(a) Taxes which are not covered taxes or which are Pillar Two taxes</p> <p>(b) Uncertain tax positions reflected in the tax charge</p>	<p>Per the consolidated financial statements for the member, but adjust for:</p> <p>(a) Taxes which are not covered taxes or which are Pillar Two taxes</p> <p>(b) Uncertain tax positions reflected in the tax charge</p> <p>(c) Deferred Tax Adjustment Amount</p> <p>(d) Tax on items excluded from the GloBE calculation (or adjusted within the GloBE Calculation)</p> <p>(e) Allocations to other members, including certain withholding tax</p> <p>(f) Certain tax credits</p> <p>(g) Amounts not expected to be paid within 3 years</p> <p>(h) CFC taxes (differs under QDMTT)</p>

Adjusting Items - Simplified Overview for Tax Data

	Transitional CbCR Safe Harbor Tests	Detailed GloBE ETR Test
Tax Adjustments		
A. Current Tax		
Uncertain Tax Positions		Adjust to exclude
Non-Covered Taxes		Adjust to exclude
B. Deferred Tax		
Deferred tax non-recognition	Not adjusted for	Adjust to recognise
Recast of deferred tax expense	Not adjusted for	Adjust if recognised at >15%
Transitional Rules	Not adjusted for	Adjust per GloBE Requirements
Long term deferred tax liabilities	Not adjusted for	Adjust per GloBE Requirements
C. Foreign Taxes		
CFC Taxes Paid	Not adjusted for	Allocate to CFC (mechanical rules)
Head Office Tax on Permanent Establishments	Not adjusted for	Allocate to Permanent Establishment
Dividend Withholding Tax	Not adjusted for (recipient entity includes)	Generally, allocate to payor entity
D. Tax on GloBE Excluded Items		
Excluded Dividends	Not adjusted for beyond CbCR requirements	Exclude tax
Excluded Equity Gains / Losses	Not adjusted for	Exclude tax
GloBE Reorganisation	Not adjusted for	Adjust per GloBE Requirements
E. Amounts recorded in OCI	Not adjusted for	Adjust per GloBE Requirements

Adjusting Items - Simplified Overview for Profits Data

	Transitional CbCR Safe Harbor Tests	Detailed GloBE ETR Test
Profits adjustments		
A. Dividends		
Excluded Dividends	Per CbCR Requirements	Adjust per GloBE Requirements
B. Gains and Loss		
Excluded Equity Gains and Losses	Not adjusted for	Adjust per GloBE Requirements
C. Other - Transactional		
Intercompany Financing Arrangements	Not adjusted for	Adjust per GloBE Requirements
GloBE Reorganisations	Not adjusted for	Adjust per GloBE Requirements
Debt Waivers	Not adjusted for	Not adjusted for (unless distressed)
Transfer pricing / Non-Arm's Length Transactions	Not adjusted for	Adjust per GloBE Requirements
Hybrid / transparent entities	Per CbCR Requirements	Adjust per GloBE Requirements
Amounts recorded in OCI	Not adjusted for	Adjust per GloBE Requirements
D. Other - Entity Characteristics		
Asymmetric foreign currency gain / loss	Not adjusted for	Potential adjustment
Share Based Compensation	Not adjusted for	Not adjusted for (possible election)
Tax Consolidation	Not adjusted for	Not adjusted for (possible election)
Hybrid / transparent entities	Per CbCR Requirements	Adjust per GloBE Requirements

02

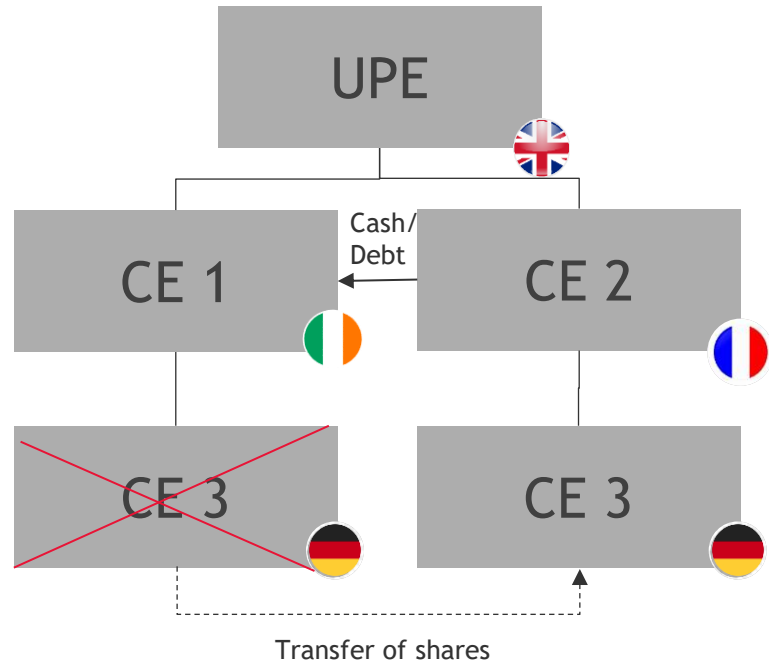
Common Intra-group transactions



Example 1

Cross border intra-group transfer of ownership interest (shares) of more than 10%

CE1 transfers its shareholding in CE3 to CE2 for cash / debt consideration.



Facts

- ▶ Book Value (BV) of CE3 in CE1 balance sheet = £100
- ▶ Cash / debt consideration at market value (MV) = £500
- ▶ Accounting gain for CE1 = £400

The transfer of shares is not subject to tax under local tax rules due to availability of a participation exemption.

CE 1	GloBE Income/loss	CbCR PBT	Covered taxes	ETR
TCSH impact	N/A	£400	Nil	Reduces ETR
GloBE Impact	Nil	N/A	Nil*	No impact

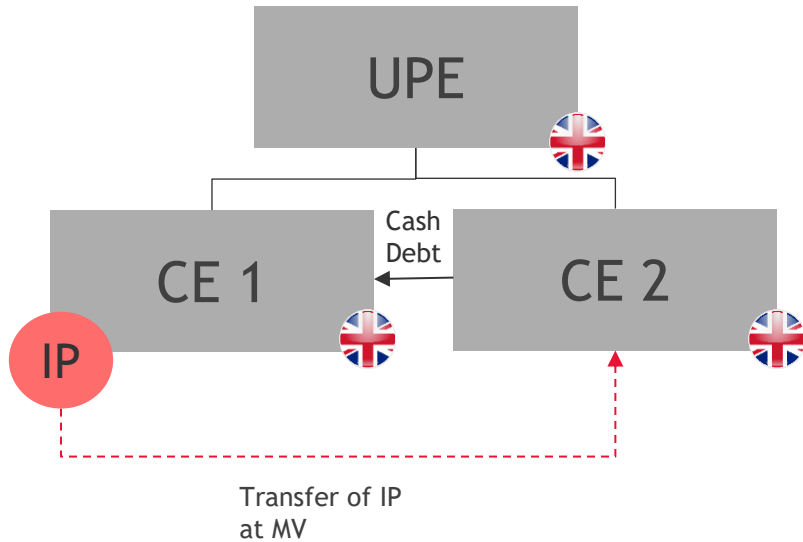
*If transaction is taxable under local tax rules, then exclude any current or deferred tax from covered taxes

** Asset values in CE3 remain at historic carrying values

Example 2

Intra-group transfer of asset / liability - intra-territory

CE1 transfers its IP to CE2 for cash / debt consideration at MV.



Facts

Book Value (BV) of IP in CE1 balance sheet = £100

MV of IP = £500

Accounting gain for CE1 = £400

Local tax - nil (transaction treated as tax neutral)

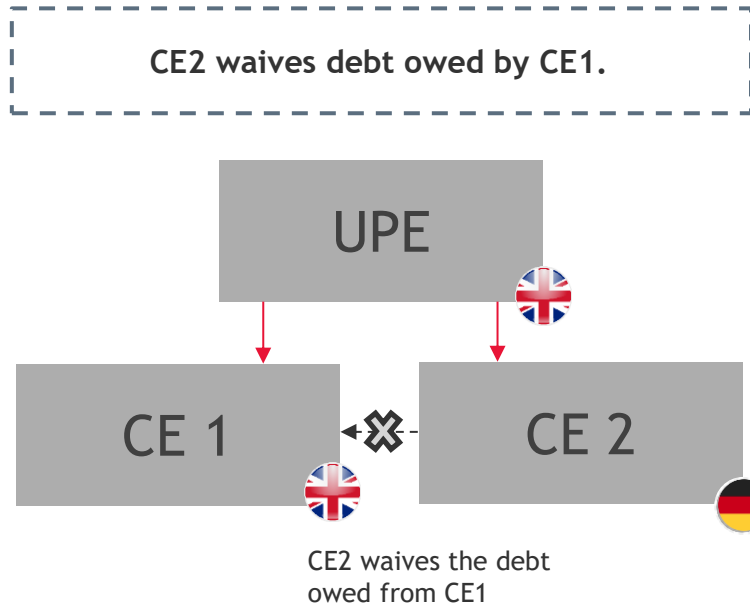
Cash /Debt consideration = Not GloBE Reorganisation ❌

CE 1	GloBE Income/loss	CbCR PBT	Covered taxes	ETR
TCSH impact	N/A	£400	Nil	Reduces ETR
GloBE Impact	£400	N/A	Nil*	Reduces ETR

*Assumes no DT implications of transfer. If transaction is taxable under local tax rules, then include any current or deferred tax from covered taxes

Example 3

Debt Waiver



Facts

CE2 waives an intercompany receivable of £500 from CE1 which is a loan relationship under UK local tax rules.

CE1 P&L - income of £500

CE2 P&L - expense of £500

CE 1 - nil local tax (write-off of debt arising from loan relationships is tax neutral)

CE 1	GloBE Income/loss	CbCR PBT	Covered taxes	ETR
TCSH impact	N/A	£500	Nil	Reduces ETR
GloBE Impact	£500*	N/A	Nil	Reduces ETR

* If relevant insolvency and other conditions do not apply

03

Mergers and acquisitions



Transactions considerations

Effect of acquisition on Purchaser

Merger Rules

- ▶ A consolidated group will be in scope of the rules in acquisition year if the revenue of the acquired entity/group if aggregated with the revenue of the buyer in any two of four prior periods exceeds the thresholds
- ▶ The merger rules apply where either:
 - all or substantially all of the members of two or more consolidated groups form a single consolidated group; or
 - an Entity that is not a member of any Group is brought under common control with another Entity or Group such that they constitute Group Entities of a combined Group

Assume Group A acquires Group B on 31 Dec 2024	Merger Rules apply	Merger Rules don't apply
A. Facts 2020: Group A - EUR 350m; Group B - EUR 410m (combined 760m) 2021: Group A - EUR 320m; Group B - EUR 320m (combined 640m) 2022: Group A - EUR 400m; Group B - EUR 400m (combined 800m) 2023: Group A - EUR 300m; Group B - EUR 410m (combined 710m) 2024: Combined Group - EUR 775m 2025: Combined Group - EUR 760m		
B. Application		
2024	In scope (2020 and 2022)	Out of scope
2025	In scope (2022 and 2024)	Out of scope

Transactions considerations

Effect of demerger

Demerger Rules

- ▶ A demerger is any arrangement where the Group Entities of a single Group are separated into two or more Groups (each a demerged group) that are no longer consolidated by the same UPE
- ▶ A demerged group will meet the consolidated revenue threshold in the first year after demerger if threshold exceeded in that year and second to fourth year if the threshold test is met in at least two years following demerger.

Assume Group X demerges into Groups A and B on 31 Dec 2024	Group A	Group B
A. Facts <ul style="list-style-type: none">▶ 2024: Combined Group - EUR 1,500m (Group A EUR 600m, Group B EUR 900m)2025: Group A - EUR 750m; Group B - EUR 850m2026: Group A - EUR 760m; Group B - EUR 710m2027: Group A - EUR 700m; Group B - EUR 800m		
B. Application		
2025	In scope (first period > EUR 750m)	In scope (first period > EUR 750m)
2026	In scope (2025 and 2026)	Out of scope (no two periods post)
2027	In scope (2025 and 2026)	In scope (2027 and 2025)

Structuring matters

Pre acquisition structuring

- ▶ Asset and entity carve outs
- ▶ Debt waivers.

Transaction structuring

- ▶ Asset deal v Share deal.

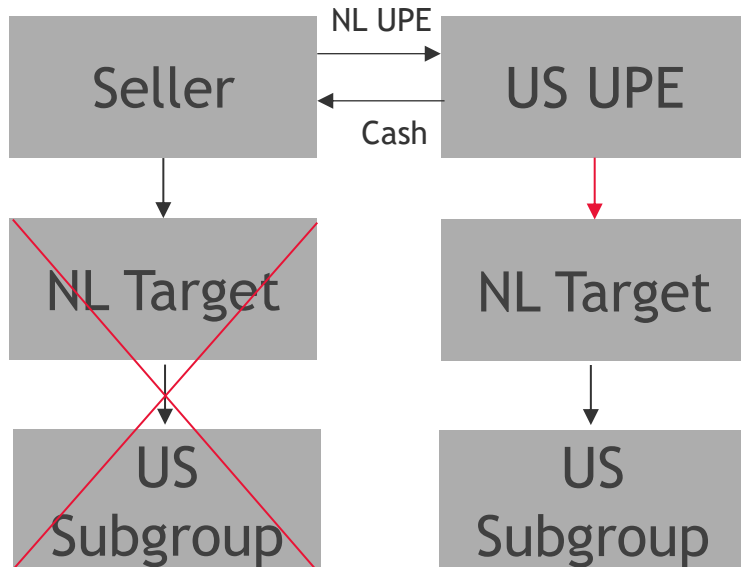
Post acquisition integration / optimisation

- ▶ Asset extraction
- ▶ Legal entity mergers / rationalisations
- ▶ Tax grouping.



Pre-acquisition structuring - Case Study Example

US UPE acquires and out of scope group that has operations in the US.



Pillar Two Considerations:

- ▶ The Netherlands has implemented an IIR. The potential Pillar Two profile for the acquirer differs depending upon the structuring approach:

Approach 1

- ▶ US UPE acquires NL Target and then seeks to extract the US Subgroup from under NL Target post-acquisition to bring into the consolidated US tax group
 - US subgroup is within scope of NL IIR for the period from acquisition to extraction
 - NL IIR is undertaken on a jurisdictional level, requiring testing of all US entities for that period (albeit any Top-Up Tax would be limited to that attributable to US Subgroup)
 - Could result in significant Pillar Two compliance and possible Top-Up Tax in respect of US operations that may not arise under Approach 2.

Alternative approach (not depicted)

- ▶ US UPE acquires US Subgroup from NL Target before it acquires NL Target
 - NL IIR is not invoked - if UTPR safe harbour applied for the US (for example), there is no need to undertake a Pillar Two calculation for the US jurisdiction
 - Consequences of disposal for NL Target to be considered, and whether timing of sale of US Subgroup affects domestic tax outcomes in any territory.

Transaction structuring - Principles

In general

01

Share Deal:

- ▶ **Seller:** excludes gain or loss from the disposition of the ownership interest (Art. 3.2.1(c))
- ▶ **Target:** maintains the same carrying value in its assets that it had pre-acquisition (historic carrying value) and any purchase accounting consolidation adjustments are ignored (Art. 6.2.1(c)).

02

Asset Deal (not GloBE Reorganization):

- ▶ **Seller:** includes gain or loss from the disposition of assets and liabilities (Art. 6.3.1)
- ▶ **Acquirer:** must use the adjusted carrying value as determined under the financial accounting standard used to prepare the UPE's Consolidated Financial Statements, generally equal to the acquisition price. (Art. 6.3.1).



Transaction structuring - Variation to general principles

03

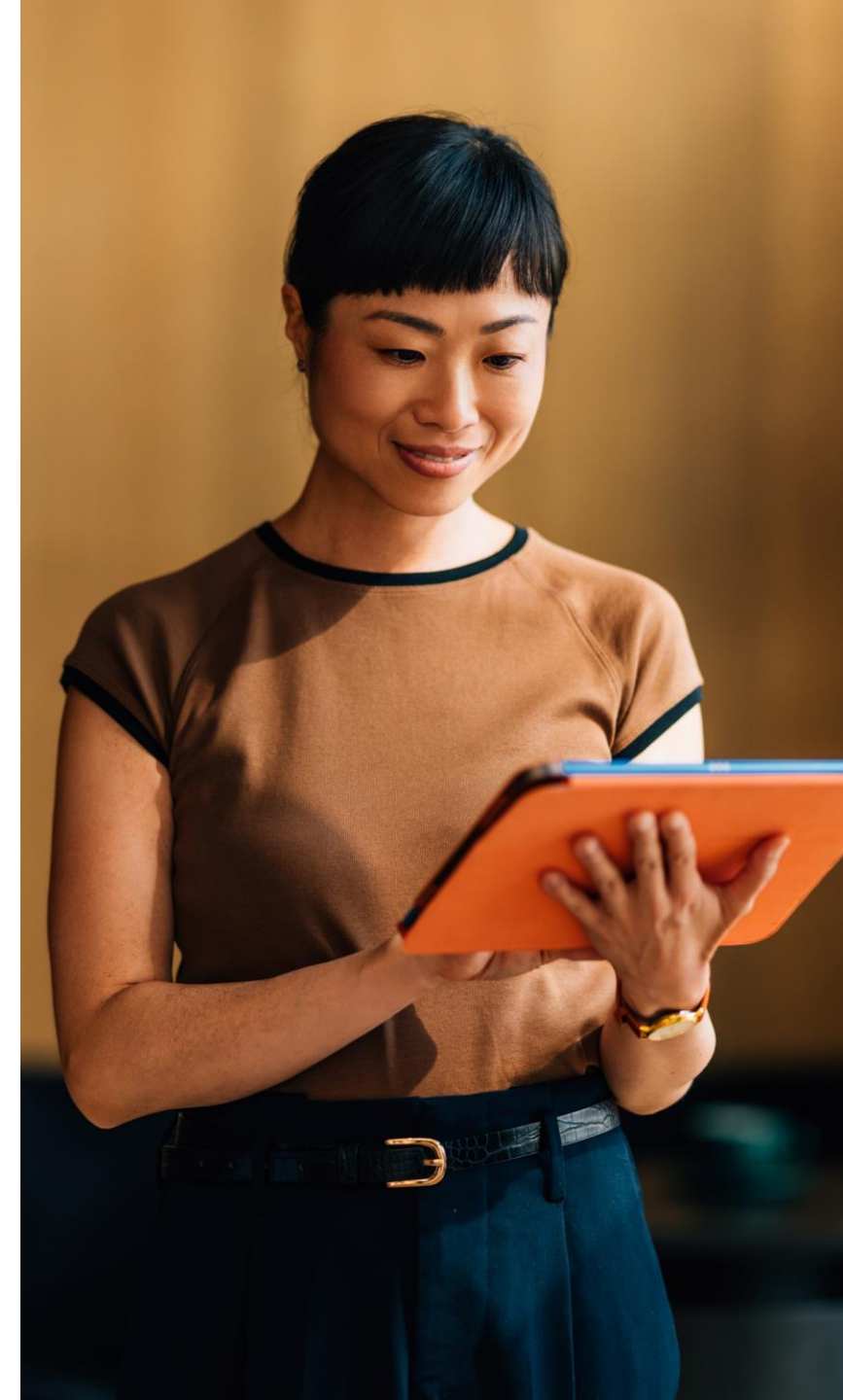
Share deal

Where target's jurisdiction treats as an asset acquisition and taxes the seller as if it sold assets based on the difference between fair value and tax basis, Art. 6.2.2 requires the following:

- ▶ **Seller:** excludes gain or loss from the disposition of the ownership interest under Art. 3.2.1(c).
- ▶ **Target:** treated as disposing of its assets and liabilities and includes gain or loss from disposition under principles of Art. 6.3.1 (included in the Seller Group's ETR for the target jurisdiction).
- ▶ **Acquirer:** treated as acquiring assets and liabilities and uses the adjusted carrying value under the UPE's financial accounting standard, generally equal to the acquisition price under Art. 6.3.1.

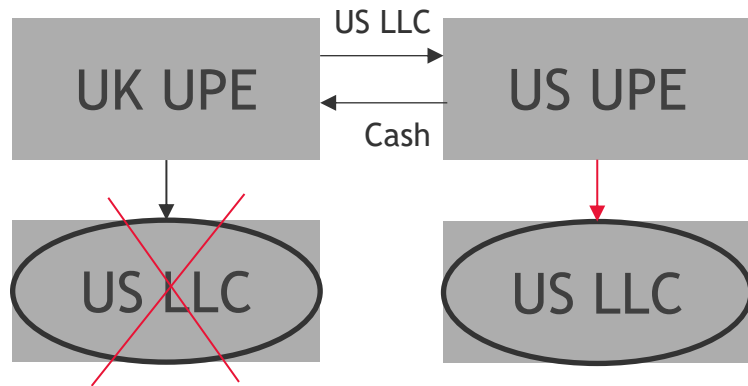
Two conditions for Art. 6.2.2 to apply:

1. The jurisdiction of the target Constituent Entity treats the transaction as, or similar to, an acquisition or a disposal of the underlying assets and liabilities for tax purposes.
2. The jurisdiction of the target Constituent Entity imposes a covered tax '**on the seller**' based on the difference between:
 - a) The tax basis of the underlying assets and amount of the underlying liabilities and
 - b) The consideration received in exchange for the controlling interest, or the difference between that tax basis and fair value of the assets and liabilities.



Transaction structuring - Example

UK UPE transfers US LLC to US UPE for cash / debt consideration.



US Tax Considerations (abridged):

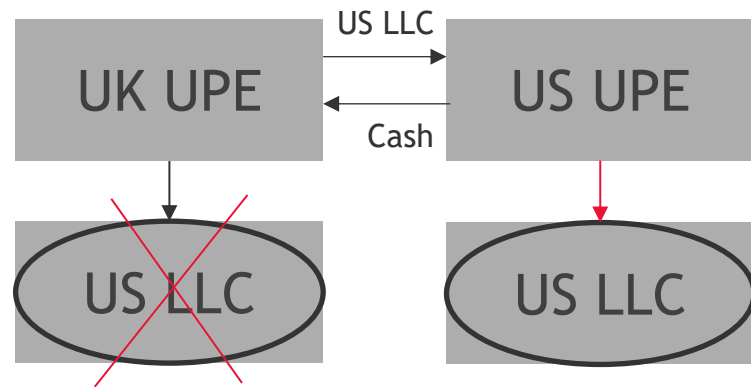
- ▶ A US LLC that does not make an election to be treated as a corporation for US federal income tax purposes defaults to being treated as disregarded from a US federal income tax perspective.
- ▶ Accordingly, for US federal income tax purposes:
 - UK UPE Seller is treated as selling the assets and liabilities of US Target LLC, and
 - US UPE Buyer is treated as purchasing assets & liabilities of US LLC Target.

Pillar Two Considerations:

- ▶ If the sale of US LLC Target meets the requirements of Art. 6.2.2:
 - UK UPE (Seller) is treated as selling its Ownership Interest, and gain/loss on sale is excluded from Seller's GloBE Income.
 - US LLC Target is treated as disposing of its assets and liabilities and includes gain/loss from deemed sale of assets that is included in UK UPE Seller Group's ETR in the US.
 - US UPE (Buyer) is treated as buying assets and liabilities and generally uses the acquisition price as the adjusted carrying value of the assets acquired.
- ▶ Consider the second condition of Art. 6.2.2, which requires the target jurisdiction (here, the US) to impose a covered tax on the seller.
- ▶ For this purpose, consider whether the 'seller' is:
 - The US Target, which is technically not subject to US tax, or
 - The UK UPE, which may be subject to US tax on the sale of assets used or held for use in a US trade or business or on gain or loss effectively connected with the conduct of a US trade or business.
- ▶ If the sale of US LLC Target does not meet Art. 6.2.2, then absent making an election under Art. 6.3.4 (discussed later), the sale may be treated as an ordinary stock sale under Art. 6.2.1(c) as discussed on prior slides.

Transaction structuring - Example

UK UPE transfers US LLC to US UPE for cash / debt consideration.



Pillar Two Considerations (continued):

Consequences:

- ▶ If Art. 6.2.2. does not apply, the sale of a US LLC may cause larger ETR differences between financial accounting and GloBE because:
 - Seller may have paid tax on the sale that is treated as excluded equity gain for GloBE purposes pursuant to which, such taxes are removed.
 - Potential for UK UPE Seller's GloBE ETR < UK Financial Reporting Standard ETR.
 - Buyer may be taking future depreciation and amortisation deductions for US tax purposes on a higher, stepped-up asset basis that is disallowed for GloBE purposes because GloBE requires the target in a stock acquisition to maintain the historic carrying value of its assets.
 - Potential for US Buyer's GloBE ETR < US GAAP ETR.

Alternative to analyse:

- ▶ Where a Group entity is required or permitted to adjust the tax basis of its assets or liabilities to fair value for local tax purposes and the transaction is not subject to Art. 6.2.2, the Group may elect under Art. 6.3.4 to cause such entity to:
 - Recognise gain or loss for GloBE purposes; and
 - Adjust the carrying value of the impacted assets or liabilities (other than ordinarily sold assets and transfer pricing adjustments) based on the difference between the book carrying value of the asset or liability prior to the triggering event and the fair value after the triggering event (may spread the net amount pro rata over 5 years).

Transaction structuring - Article 6.3.4 Election

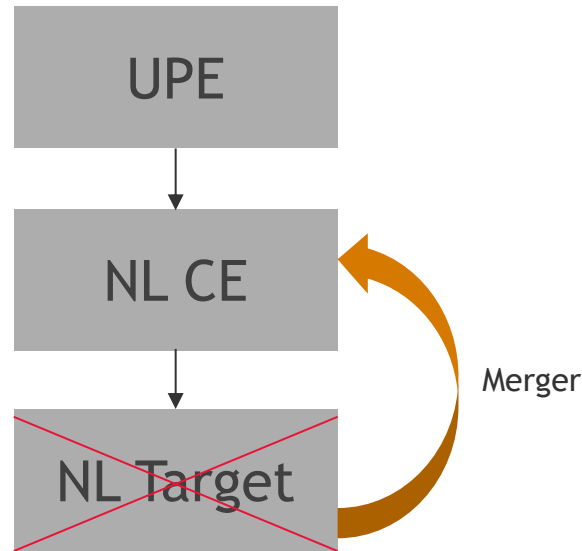
Examples of triggering events under Art. 6.3.4 that may require or permit an entity to adjust tax basis of some of its assets or liabilities:

- ▶ acquisition of an ownership interest that results in an adjustment to the tax basis of assets (e.g., section 338(h)(10) election);
- ▶ change of tax residence;
- ▶ cross-border reorganization resulting in an exit tax;
- ▶ leaving consolidated group (resulting in adjusted tax basis to some or all of an entity's assets).



Post Acquisition structuring - Example

MNE group acquires Target, and seeks to rationalise into existing structure.



NL Tax Considerations (abridged):

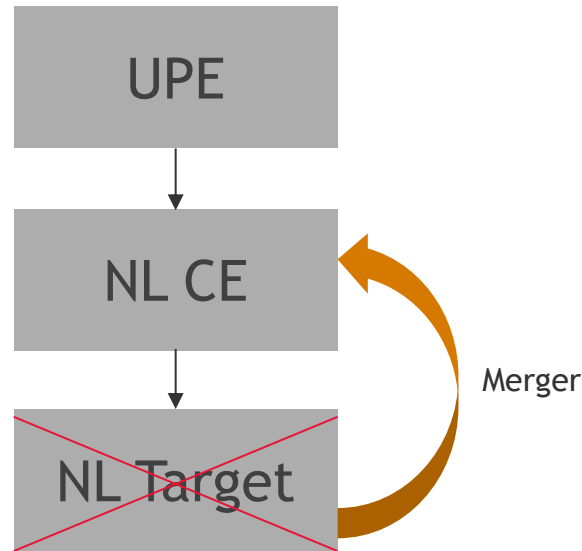
- ▶ Merger triggers taxable gain at company level
- ▶ Carry-over relief available (no CIT due).

Pillar Two Considerations - Transitional CbCR Safe Harbour:

- ▶ Transitional CbCR Safe Harbour QFS Impact
 - UPE may process Purchase Price Allocation (PPA) Adjustments, e.g. goodwill impairments in CFS or separate financial statements (push-down accounting) (in our example: in NL Target's books)
 - **Key Consideration:** OECD Guidance on PPA must be observed to ensure no risk to QFS.
- ▶ Transitional CbCR Safe Harbour Simplified ETR Impact
 - Simplified Covered Taxes: from CFS or from separate financial statements
 - NL CE Relief on separate financial statements in 2024 (and in 2025 as well)
 - No CIT due in NL due to merger. No adjustment
 - Profit Before Tax: from CbCR Report
 - Whether the (exempt) gain for tax purposes is reflected in Profit Before Tax depends on (i) applicable GAAP and (ii) CbCR interpretation of UPE State
 - As intercompany transaction, typically no accounting profit.
 - Key Consideration: Gain may be reflected in PBT, which reduces ETR (possibly too low).

Post Acquisition structuring - Example

MNE group acquires Target, and seeks to rationalise into existing structure.



Pillar Two Considerations - GloBE ETR:

- ▶ Art 6.3.1 - NL Target must include the gain in its GloBE income
 - How is the gain computed? At arm's length -/- carrying value (Article 3.2.3. OECD MR at arm's length req.)
- ▶ Article 6.3.1. OECD MR: NL CE determines its GloBE income using NL Target's carrying value of the acquired assets under UPE CFS GAAP
- ▶ If the merger is viewed as GloBE reorganisation (Article 6.3.2 OECD MR), Article 6.3.1. OECD MR does not apply and:
 - NL Target excludes any gain from its GloBE income calculation (see also Article 3.2.1).
 - NL CE continues with NL Target's carrying values.
- ▶ GloBE reorganisation is, in short: a reorganisation that benefits from carry-over relief for the assets transferred
- ▶ **Key consideration:** Even when the Transitional CbCR Safe Harbour is applied, Art 6.3 must be considered.

NL Tax Considerations (abridged):

- ▶ Merger triggers taxable gain at company level
- ▶ Carry-over relief available (no CIT due).

Post Acquisition Structuring - Summing Up

For any merger/entity rationalisation, the following must be examined:

- ▶ Historical PPA adjustments
- ▶ CIT treatment
- ▶ Accounting treatment of merger under separate entity GAAP and UPE CFS GAAP
- ▶ CbCR SH and GloBE rules.

This example was still benign, but:

- ▶ What if the merger were external?
- ▶ What if the merger were cross-border?
- ▶ What if tax carry-over relief is claimed, but it is not a GloBE reorganisation
- ▶ What if losses were taken over?
- ▶ What if accounting standards differ?
- ▶ What are the shareholder tax consequences?



Reflections on key points

01 Pillar Two Principles and Data Sources

02 Impact on Common Intra Group transactions

03 Impact on Mergers and Acquisitions



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