Pillar Two - Middle East insights

Pillar Two: Protecting shareholder value in M&A transactions

Key Pillar Two considerations

Pillar Two matters in an M&A transaction, even if your group is not in scope

Pillar Two may impact current and future transactions regardless of whether your MNE Group is in-scope of the rules. Therefore, it is important that Groups are aware of the potential implications and ready to take appropriate actions. **Groups that proactively manage Pillar Two implications and risks, not only protect shareholder value, but also increase their competitiveness in the market by ensuring a better Return-on-Investment ("RoI") than groups that fail to adequately take into account the effects of Pillar Two.**

In-scope MNE Groups need to factor Pillar Two into their acquisition structuring, financial modelling and bid price, as well as deal with historical Pillar Two risks and the effect of acquisitions or disposals on their jurisdictional Pillar Two calculations. **Out-of-scope groups** need to understand the potential consequences of M&A activity bring their group in scope of Pillar Two, and ensuring their investments are protected from Pillar Two consequences caused by their investment partners.

01 **It is important to understand the Pillar Two profile of the target group pre-acquisition to understand the impact on your MNE Group. Pre and post-deal structuring needs to be carefully considered to minimise immediate Pillar Two related cash-tax exposures.**

02 **Deal legal documents need to include clauses that protect your investments from unfair Top-up Tax allocation, especially if you are a minority investor. Ensuring Pillar Two is factored in is essential to mitigating risks and preserving investment value.**

03 **Modelling the effect of Pillar Two is fundamental to understanding the future tax profile of your investment, including assessing the value of tax attributes. Acquisitions and disposals can affect the entire Pillar Two profile of your MNE Group.**

04 **Groups can inherit Pillar Two liabilities of acquired entities, for pre-acquisition periods, including if the acquiring group is not subject to Pillar Two. Groups also need to consider transitional Pillar Two attributes in deal calculations.**

The Pillar Two rules require the revenues of acquired entities prior to the acquisition / merger to be combined with the acquiring group for revenue threshold testing. In addition, the acquisition activity may result in the loss of Pillar Two concessions, bringing a group immediately in scope of the rules. ***Consequently, groups need to carefully assess whether M&A activity inadvertently brings their group in-scope of Pillar Two.***

Key considerations and recommended steps

01 Pillar Two impact on RoI
It is important to assess current and future investments from a Pillar Two perspective as it will be an additional liability that may reduce the RoI. This must be carefully analysed and communicated to key stakeholders. Pillar Two is a jurisdictional calculation. As such, M&A tax financial modelling needs to incorporate the Pillar Two implications of a transaction into the broader jurisdictional calculation.

02 Collaboration between tax and legal
Sale & purchase agreements, shareholder agreements, joint venture agreements and M&A documents, may need revisions to address responsibilities for Pillar Two-related taxes. Investment teams and legal counsels need to come together to ensure Pillar Two exposures and risks are effectively managed. **Without such protections, Groups expose themselves to considerable risks that partner actions or changes in profile may bring an investment in scope of Pillar Two, reducing returns to shareholders.**

03 Prepare a checklist for transactions
Consider how M&A activity may affect the wider PillarTwo group. **Having a checklist in place will help you assess upcoming transactions and avoid unwanted future surprises (due to unnecessary additional tax liabilities).** Loss of concessions or being subject to certain previously made elections may give rise to unexpected Top-up Tax.

04 Get expert advice, everytime!
All M&A transactions should consider the potential Pillar Two implications, even if your group is not in scope of the Pillar Two Rules. It is imperative that you understand the relevant risks and get the right advice.

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