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5x5 series: Insights and actions

Pillar Two: Transfer Pricing

Intercompany transfer pricing ("TP") is a relevant and critical technical area for companies to consider when preparing for Pillar Two compliance.

5 insights you should know

1. Pillar Two rules require that all related party dealings are **priced at arm's length** and **recorded at the same price** for GloBE purposes for all Constituent Entities involved.

2. Pillar Two compliance and the **"once out, always out"** Transitional Safe Harbor rules place unprecedented burden on CbCR preparation and intercompany TP processes. The ability to monitor, manage and analyze intercompany data is crucial to an MNE's Pillar Two readiness.

3. A key pre-requisite for preparing a **Qualified CbCR** under Pillar Two Transitional Safe Harbor is to ensure that the **Prepared CbCR complies with applicable CbCR Regulations**. MNE's will need robust support when relying on Transitional CbCR Safe Harbor.

4. **Material book-to-tax differences** (e.g., due to out-of-period TP adjustments) impact Covered Taxes calculations. For example, to the extent the TP adjustment **increases** the Covered Taxes an adjustment should be accounted for in the Fiscal Year in which adjustment is made, while if the TP adjustment **decreases** the Covered Taxes for a previous Fiscal Year, then the Effective Tax Rate and Top-up Tax for the previous Fiscal Year must be recalculated to incorporate such an adjustment.

5. Changes to TP, done in isolation without consideration to Pillar Two, can have an unexpected/detrimental impact on both GloBE income and Covered Tax calculations, and consequently level of Top-up Tax payable.

5 actions to take now

1. **Review compliance with Arm's Length Principle.** Review both domestic and cross border intercompany transactions and assess existing support for compliance with the Arm's Length Principle.

2. **Perform transitional safe harbor analysis and qualified CbCR assessment.** Conduct transitional safe harbor analyses and review the existing CbCR and preparation process from a Qualified CbCR point of view.

3. **Assess material book-to-tax differences.** Review historical material book-to-tax differences and assess the reasons for such differences. If TP is one of the main drivers for such differences, evaluate the current process and identify operational TP opportunities for mitigating out-of-period TP adjustments.

4. **Analyze the current intercompany transactions operational process.** Financial datasets, starting in 2024, must meet more granular needs of the new rules, including from an operational TP perspective; therefore, taxpayers should evaluate potential technology enabled solutions that could streamline and improve robustness of intercompany processes.

5. **Review intercompany legal agreements.** Review and assess potential changes to the existing intercompany legal agreements from a strategic TP perspective. Evaluate structural TP opportunities from a post Pillar Two lens.

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