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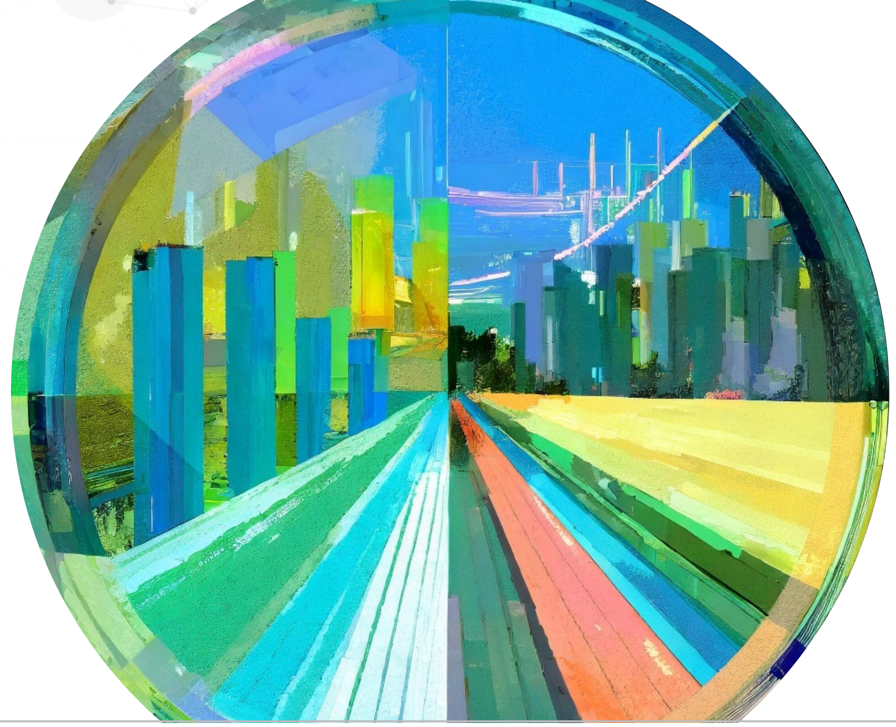


Impact of Pillar Two on M&A transactions

The introduction of Pillar Two, a global minimum tax initiative, has significant implications for M&A transactions. Pillar Two aims to ensure that multinational enterprises (MNEs) pay a minimum level of tax on the income arising in each jurisdiction where they operate. This initiative impacts various aspects of M&A transactions, including diligence, structuring, and modeling.

Diligence and structuring considerations

Conducting thorough diligence is crucial to understanding the Pillar Two implications of an M&A transaction.

The diligence process should be framed to address the following key points:

Nature of the transaction:
The type of transaction (e.g., full acquisition, carve-out, minority investment) can determine the scope of diligence required. In a carve-out, for instance, the buyer must consider the potential for top-up taxes arising from the seller group's retained entities in the same jurisdiction.

Pillar Two status:
The buyer should assess both their own Pillar Two status and that of the seller. This includes understanding whether the seller's ultimate parent entity is within the scope of Pillar Two and whether the relevant jurisdictions have implemented the income inclusion rule (IIR), qualified domestic minimum top-up tax (QDMTT), or undertaxed payments rule (UTPR). In addition to whether the jurisdictions have enacted Pillar Two, consideration should be given to whether the buyer and target are in the temporary safe harbor.

Interaction with US rules
The US/G7 Shared Understanding on the US 'Side-by-Side' Treatment with Pillar Two Rules needs to be taken into account, but it appears that US parented groups may still have obligations under QDMTTs and other Pillar Two provisions, pending enactment of relevant legislation; and US subgroups of non-US headed groups may also remain within scope of Pillar Two.

Status of data necessary for diligence:
The seller may not be in the scope of Pillar Two and/or qualify for temporary safe harbor. As such, detailed Pillar Two calculations may not be available. Additionally, the first GloBE information return likely has not been filed. This could require additional scope to properly diligence Pillar Two.

Jurisdictional implementation:
The buyer should review the Pillar Two implementation status in all jurisdictions where the target operates. This includes understanding which taxes have been implemented and when, to accurately assess the Pillar Two landscape of the target.

Structuring:
The forced consolidation or jurisdictional blending of tax rates can impact the effective tax rate of the combined entity impacting the computation of temporary safe harbors and the Pillar Two top-up tax computation for both the buyer and seller. Buyers need to consider the impact of specific exemptions under Pillar Two, such as those for capital gains, dividends, reorganizations, and debt forgiveness.

Modeling challenges

Modeling the impact of Pillar Two in M&A transactions may be challenging due to the lack of detailed jurisdictional financial data and the evolving nature of the rules. Accurate modeling requires granular financial information, ideally at the entity level, which is often not available during the deal phase. Buyers must work closely with their tax advisors to gather as much detailed information as possible and make informed assumptions for modeling purposes.

Key considerations include:

Data availability:
Financial models should include jurisdictional breakouts to assess the Pillar Two implications more accurately.

Safe harbors:
Many companies rely on safe harbors based on country-by-country (CbC) reports. The availability and accuracy of these reports can help make the modeling process more efficient.

Deferred tax assets (DTAs):
Assessing the recognition of DTAs under Pillar Two rules is complex. Certain DTAs may not qualify as good DTAs for Pillar Two purposes, potentially leading to top-up taxes.

Legal* documentation and transaction documents

The introduction of Pillar Two necessitates new provisions in legal documents to address the associated tax implications. However, market practice is still evolving, and there are no standard provisions yet. The evolving nature of Pillar Two requires close collaboration between accounting firms and legal counsel to ensure that transaction documents adequately address the associated tax risks and implications. As the implementation of Pillar Two progresses, it is expected that more standardized provisions will emerge, providing greater clarity and consistency in M&A transactions.

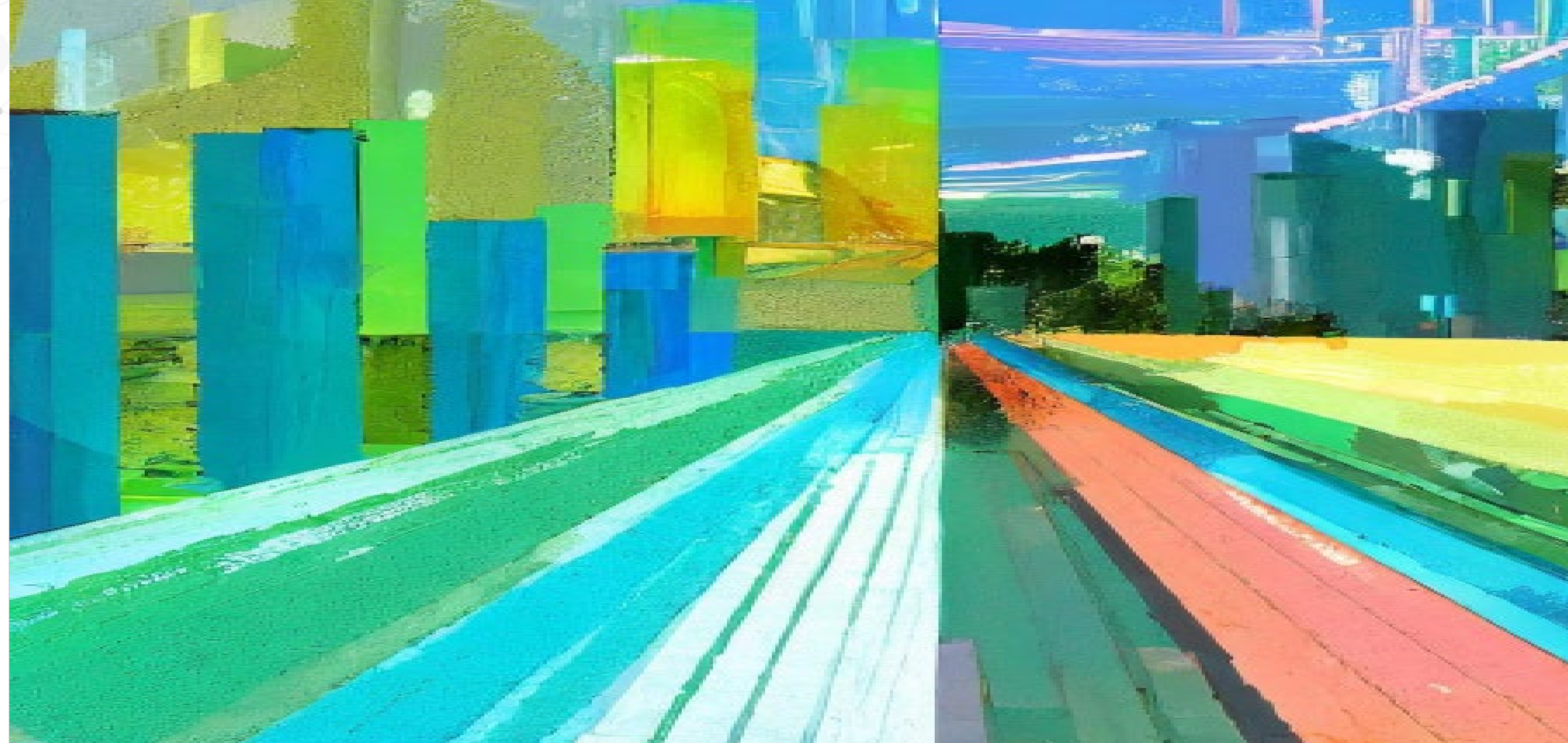
Key areas to consider include:

Definitions:
Legal documents should include clear definitions of Pillar Two taxes to ensure all parties understand the scope of potential liabilities.

Accrual computations:
In transactions with purchase price adjustment mechanics, the computation of accruals for Pillar Two taxes should be addressed to align with the economic arrangements of the deal.

Indemnity clauses:
In scenarios where diligence is limited, such as carve-outs, indemnity clauses may be necessary to protect the buyer from potential Pillar Two liabilities arising from the seller's retained entities. Given Pillar Two causes a forced tax consolidation, there is an increased prevalence of situations in which the seller's retained entities activities could impact the Pillar Two liabilities in acquired entities.

Shareholder agreements:
For minority investments, shareholder agreements should include provisions to address potential Pillar Two charges that may be allocated to the target entity or group.



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