You and the Taxman

What multinational enterprises must know about the transfer pricing implications of BEPS 2.0 Pillar Two

Plan ahead as the implementation of BEPS 2.0 Pillar Two can significantly affect existing transfer pricing strategies.

BEPS 2.0 Pillar Two is designed to curb unhealthy corporate tax rate competition among different jurisdictions. It establishes a framework that sets a minimum effective tax rate for large multinational enterprises (MNEs), regardless of where they operate or are headquartered.

With this, MNEs operating in Singapore, including those benefiting from tax incentives, could have an effective tax rate below the proposed global minimum tax rate of 15%, potentially triggering top-up payments.

The implementation of these rules can have significant implications on transfer pricing (TP) arrangements.

Article 3.2.3

The Global Anti-Base Erosion (GloBE) adjustments aim to eliminate double taxation or double non-taxation scenarios.

Article 3.2.3 of the Pillar Two Model Rules [1] states that adjustments must be made for transactions between Constituent Entities (CEs) located in different jurisdictions that are not recorded at the same value in both entities' financial accounts or are not consistent with the arm's length principle.

MNEs typically maintain TP policies based on the arm's length principle, and the transfer price is reflected in the financial accounts of the transaction counterparties. In practice, differences may arise on the finalisation of a CE's local tax return or when the tax return is audited by the local tax authority.

Where transfer prices differ due to unilateral measures or other reasons, the income base for computing the effective tax rate may need to be adjusted.

[1] "Tax Challenges Arising from the Digitalisation of the Economy –Commentary to the Global Anti-Base Erosion Model Rules (Pillar Two", *The OECD website*, https://www.oecd.org/tax/beps/tax-challenges-arising-from-the-digitalisation-of-the-economy-global-anti-base-erosion-model-rules-pillar-two-commentary.pdf, accessed 22 January 2024.

TP implications of Article 3.2.3

Article 3.2.3. will bring increased regulatory scrutiny on intercompany transactions, with the tax authorities seeking to verify whether transactions are priced in accordance with the arm's length principle. A jurisdiction may not readily accept an Article 3.2.3 adjustment arising from a unilateral TP adjustment made by an overseas jurisdiction, especially if it results in a reduction in top-up tax collection. Therefore, MNEs must ensure that their TP policies are appropriate, well documented and aligned between jurisdictions.

Article 3.2.3. may also encourage companies to enter bilateral and multilateral Advance Pricing Agreements (APAs) to reduce uncertainties. This ensures the transaction is recorded in the same amount and priced in accordance with the arm's length principle in all jurisdictions. There could be even closer ties between jurisdictions through Mutual Agreement Procedure (MAP) cases, which may not always be in the taxpayer's favour.

Key considerations regarding Article 3.2.3

Considerations for companies operating in Singapore include:

- Is the accounting treatment of asset transferred between the company's related parties (e.g., fair market value and book value) aligned with the arm's length principle?
- Has the Singapore entity taxed income from services provided to related parties on a deemed basis, without actually billing those services to the related parties receiving them?
- Was the Singapore entity subject to TP adjustments, for which corresponding adjustments were not applied?

Transitional country-by-country reporting (CbCR) safe harbour (TCSH) rules

During the transitional period covering fiscal years beginning on or before 31 December 2026 (but not including a fiscal year that ends after 30 June 2028), the top-up tax in a jurisdiction will be

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considered zero for a fiscal year where certain safe harbour requirements are met. The safe harbour computations for TCSH purposes are based on data extracted from the CbC Report and financial statements. Furthermore, where the TCSH rules reduces the top-up tax to zero in a jurisdiction, the CE responsible for filing the GloBE Information Return is not required to complete the detailed GloBE computations regarding the jurisdiction.

TCSH will significantly reduce the immediate compliance burden for MNEs. This enables more opportunities to develop in-house resources and the technology to collect the requisite data for the fully-fledged GloBE calculations after the transitional period.

If an MNE Group has not applied the TCSH rules with respect to a jurisdiction in a fiscal year in which it is subject to the GloBE Rules, the MNE Group cannot qualify for safe harbour for that jurisdiction in a subsequent year.

The TCSH rules also refer to a Qualified CbC Report, which introduces specific source information that is not reflected in the OECD's BEPS Action 13 guidance. CbC Reports that are fully compliant in the jurisdiction in which they are filed may not meet the definition of Qualified CbC Report for Pillar Two.

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TP implications of TCSH

The TCSH rules provide opportunities to significantly reduce the complexity of the GloBE calculations and the compliance burden in the transitional period. To benefit from this, MNEs must assess if their CbC Report is fully compliant and qualifies as a Qualified CbC Report.

The CbC Report will also be a focus for tax authorities due to its importance in determining whether top-up taxes arise. While MNEs have been producing their CbC reporting and documentation for several years now, they should review their processes for producing these reports to ensure alignment with the TCSH rules.

Key considerations regarding TCSH

Considerations relevant for companies operating in Singapore include:

- Is my CbC Report a Qualified CbC Report?
- Am I able to produce the CbC Report on a timely basis for forecasting purposes to determine whether the TCSH requirements are met?
- Has my CbC Report been prepared compliantly? Do I have documentation and processes in place to support its preparation and processes in relation to the data?
- What is the impact of the TCSH rules on my Pillar Two compliance? Which jurisdictions do not meet the conditions and as such, require fully fledged GloBE calculations in the initial years?

Subject to Tax Rule (STTR)

Like the GloBE Rules, the STTR is an integral part of Pillar Two. The STTR is a treaty-based rule that applies to intragroup payments from source jurisdictions (i.e., the jurisdiction in which the income arises) that are subject to tax rates below 9% in the payee's jurisdiction of residence. The STTR will be implemented through a multilateral instrument or bilateral renegotiation of the treaties.

The STTR allocates to the source country a limited and conditional taxing right to ensure a minimum level of taxation. The applicable tax rate is based on the statutory tax rate applicable in the jurisdiction where the related party deriving the income is a resident. Special rules apply if the person benefits from a preferential adjustment regarding the income.

The STTR applies to interest, royalties and a defined set of other payments made between connected companies, including all intra-group service payments. Other than interest and royalties, the STTR does not apply if the recipient's income was not remunerated more than the costs incurred in generating that income, plus an 8.5% mark-up threshold.

Taxes imposed under the STTR are levied after the end of the fiscal year in which they arise. This is known as an ex-post annualised charge. They will apply if the aggregate amount of payments exceeds the materiality threshold of €1 million (or €250,000 for jurisdictions with a GDP of less than €40 billion).

TP implications of STTR

MNEs need to analyse their structures and payments to determine whether, taking into account the preferential adjustment rules, the appliable tax rate on corresponding income for in-scope payments falls below 9%.

MNEs should identify and monitor in-scope payments throughout the fiscal year while also performing additional forecasting and reporting. In addition, they must understand how these payments interact with the other Pillar Two calculations, as well as their impact on TP adjustments.

Appropriate operational TP procedures must be in place for the purpose of closely monitoring intercompany transactions. These include the tracking of mark-up and materiality thresholds as part of STTR compliance.

Operating model and value chain

MNEs' operating models are already under scrutiny, especially those that are not aligned with substance and the actual conduct of the parties. Moreover, Pillar Two may introduce additional tax liabilities for MNEs with operations in jurisdictions with statutory tax rates below the minimum tax rate. This will increase the cost of doing business in certain countries.

It is time for MNEs to reassess their operating model and value chain in the context of Pillar Two. This could mean a re-evaluation of their principal structures and profit split arrangements, or a review of their entire value chain to consider whether the location of their operations continue to be fit for purpose and cost-effective in a post-BEPS 2.0 world.

In summary

Here are the key actions MNEs should take to prepare for BEPS 2.0 Pillar Two.

- Review intercompany transactions to ensure that TP policies are in accordance with the arm's length principle and the same pricing is reflected in the financial accounts of the transaction counterparties. MNEs may consider standardising TP policies across the Group.
- Consider entering bilateral and multilateral APAs to reduce uncertainty and avoid complex adjustments to the GloBE calculations.
- Review CbC Report to ensure it is fully compliant and qualifies as a Qualified CbC Report under the TCSH.
- Analyse intercompany arrangements to identify payments that fall within the scope of STTR and planning to minimise STTR and top-up payments.
- Review the MNE's operating model and value chain in the context of Pillar Two to ensure the location of its operations continues to be appropriate and cost-effective.

Plan ahead

In a post-BEPS 2.0 world, preventative measures are key. MNEs should proactively consider the tax implications and take a more integrated approach to TP, from planning to implementation, including compliance and the management of disputes. Under Pillar Two, there is an increased risk of controversy due to the potential for double taxation and the complexity of the new rules. MNEs will need to have robust processes in place for quicker and multi-sided dispute resolution, which requires standardised data and technology to support these processes.

The number of tax authority audits will continue to increase globally, and these will become more sophisticated and all-encompassing. TP adjustments arising from such audits will significantly add to the complexity of GloBE compliance. These may lead to double taxation in scenarios where GloBE calculations and top-up taxes have already been paid. Therefore, a robust, supportable and well-documented TP model will be more important than ever.

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