Tax Insights & Commentary
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# US MNEs Must Tackle Transfer Pricing as Pillar Two Progresses

- *Skadden attorneys examine transfer pricing and Pillar Two*
- *US MNEs should establish holistic policy to avoid scrutiny*

Top Treasury officials have again signaled the US should get on board with implementing Pillar Two rules, which seek to enforce a coordinated global minimum tax of 15% applicable to large multinational enterprise groups under a set of anti-base erosion rules.

Many jurisdictions—including the EU, UK, Australia, and Japan—have enacted the Pillar Two provisions. As such, Pillar Two is now a reality.

Regardless if the US takes a seat at the table, large US MNEs operating in Pillar Two jurisdictions should pay substantial attention to the interaction between Pillar Two rules and the traditional transfer pricing regime to ensure they take a holistic approach.

**Pillar Two Impact**

While the exact relationship between Pillar Two and the transfer pricing rules won't be fully clear until subsequent guidance is issued on the topic, there are a few points worth noting.

The introduction of Pillar Two doesn't eliminate the recent enhanced focus on transfer pricing enforcement to tackle perceived profit-shifting by various jurisdictions, including the US. Even among Pillar Two jurisdictions that will maintain a corporate tax rate at or above the 15% threshold, tax rates and preferential tax measures provided by each country will continue to differ.

As such, tax authorities around the globe will seek to safeguard their tax bases and will proactively ensure MNEs are paying their fair share of tax on any related-party profits or intragroup lending. Similarly, more transfer pricing audits are expected since tax authorities are frequently collaborating across borders due to advanced technology and global information exchange systems, such as country-by-country reporting and Pillar Two information return requirements.

The impact of Pillar Two on MNEs' financial operating models is significant. For example, certain transfer pricing adjustments to taxable income, such as year-end true-ups—a common practice by many MNEs to ensure an arm's-length price is charged for all controlled transactions—must be closely monitored, as these adjustments might result in additional compliance efforts.

Generally, these self-initiated adjustments are made after the closing of consolidated financial statements, which likely will result in a book-tax difference and can affect the Pillar Two calculations if an MNE falls within the scope of these rules.

Such an adjustment made in one jurisdiction could potentially lead to additional taxation under the Pillar Two rules in another, which could result in double taxation risks unrelated to traditional transfer pricing transactions. There is no clear guidance on how to treat such adjustments under the Pillar Two framework.

**Important Considerations**

MNEs should consider the following to avoid risk of transfer pricing scrutiny.

**Robust transfer pricing policy.** MNEs should allocate sufficient resources to ensure a holistic transfer pricing policy is in place that incorporates the relevant Pillar Two guidance and aligns with the current business climate. This effort should include substantial transfer pricing documentation that highlights the reasonableness of the selected method, functional analysis, and benchmarks for all intercompany transactions.

Such documents should highlight the company's intent to comply with relevant policies and should be dynamic to allow frequent updates to include any changes in material facts and legislation. MNEs should also regularly review and monitor internal transfer pricing control systems to ensure consistency, proper adherence, and alignment with economic activities.

**Operational and accounting readiness.** MNEs should focus on developing operational improvements and process optimization within accounting and finance teams to ensure proper transfer pricing results are in place to minimize any post-year true-up adjustments.

This is especially crucial for companies with various complex intercompany transactions, as appropriate accounting methods and standardized financial data management systems will be key for Pillar Two calculations—and for managing any potential tax audits or disputes.

**Risk assessment.** Methods to mitigate and prevent transfer pricing risks through traditional competent authority procedures should be part of the discussion. While taxpayers rightfully often look to advance pricing arrangements to prospectively resolve transfer pricing issues, the potential benefits of the International Compliance Assurance Program shouldn't be overlooked.

ICAP is a voluntary risk assessment program intended to facilitate engagements between MNEs and multiple tax authorities to assess each covered transaction—such as transfer pricing risks or permanent establishment risks—as low-risk or not low-risk.

Although ICAP doesn't provide the legal certainty that could be achieved through an APA, it does give assurance that a covered transaction classified as low-risk won't be audited in the future for the covered tax years, which can lessen the risk of MNEs having to modify the relevant Pillar Two calculations. ICAP can also improve consistency between various tax authorities in treatment of transactions and encourage an open dialogue, which can decrease future disputes.

While ICAP may present some risks for taxpayers when compared with other competent authority options, it usually covers several controlled transactions involving an average of five or more tax authorities in each assessment, require no application fee, and generally have a shorter completion time, making the program a viable option.

**Outlook**

Whether the US will implement Pillar Two rules is yet to be determined. Meanwhile, MNEs with operations in Pillar Two jurisdictions should focus on understanding the available guidance, assessing potential exposure, and implementing necessary systems to ensure compliance. But they shouldn't overlook traditional transfer pricing considerations.



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