Chapter 6.1: Mergers and Demergers

Learning Objective

After completing this chapter, you will be able to assess the impact of mergers and demergers on the €750 million revenue threshold, apply the retrospective combination rule for mergers, determine when demerged groups remain in scope, and handle partial-year treatment for entities entering or leaving an MNE Group.

1. The Revenue Threshold Challenge

The standard €750 million threshold test looks at **revenue in 2 of 4 preceding fiscal years**. But what happens when: - Two groups merge mid-year? - A group demerges into separate entities? - An acquisition occurs that brings new entities into scope?

The problem: Without special rules, groups could structure transactions to avoid or delay Pillar Two application.

The solution: Article 6.1 provides special rules that reconstruct history for mergers and test forward for demergers.

2. Merger Rules *(Article 6.1.1)*

2.1 The Retrospective Combination Rule

When two MNE Groups merge to form a single consolidated group, the **combined group's revenue is reconstructed as if it had always existed in its post-merger form**.

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│ MERGER: RETROSPECTIVE COMBINATION                                    │
```

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│                                                                │
│ For the purpose of the €750M threshold test:                   │
│                                                                │
│ → Add together the revenues of BOTH groups                     │
│ → For EACH of the four preceding fiscal years                  │
│ → As if the merger had occurred at the start of the first year │
│                                                                │
│ This prevents groups avoiding Pillar Two by merging            │
│ two sub-threshold groups into an in-scope group                │
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```

2.2 When the Combination Rule Applies

The rule applies when an MNE Group acquires **all or substantially all** of the members of another consolidated group.

Scenario	Combination Rule Applies?
Group A acquires 100% of Group B	**Yes** — combine historical revenues
Group A acquires 80% of Group B (full consolidation)	**Yes** — substantially all
Group A acquires a single entity from Group B	**No** — standard rules apply
Merger of equals forming new Group C	**Yes** — combine both groups

2.3 Example: Merger Brings Groups Into Scope

Pre-Merger:

Group	FY-4 Revenue	FY-3 Revenue	FY-2 Revenue	FY-1 Revenue	In Scope?
	€400M	€420M	€450M	€480M	

Group	FY-4 Revenue	FY-3 Revenue	FY-2 Revenue	FY-1 Revenue	In Scope?
Alpha Group					No (< €750M)
Beta Group	€380M	€350M	€400M	€420M	No (< €750M)

Merger occurs on 1 July FY 2025.

Post-Merger Reconstruction:

Combined	FY-4	FY-3	FY-2	FY-1	≥ €750M?
Alpha + Beta	€780M	€770M	€850M	€900M	**Yes**

Result: The combined group **immediately** falls within Pillar Two scope for FY 2025 because the reconstructed revenues exceed €750M in at least 2 of the 4 preceding years.

2.4 Critical Insight: No Grace Period

A common misconception is that merged groups have time before Pillar Two applies. **This is incorrect.**

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 IMPORTANT: The retrospective combination rule means a merger can trigge
IMMEDIATE Pillar Two application if the combined historical revenues
exceed €750M in 2 of 4 preceding years.

There is no transition period or phase-in for mergers.
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3. Demerger Rules *(Article 6.1.2)*

3.1 The Forward-Looking Test

When a group demerges, each resulting group is tested **forward** rather than retrospectively.

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│ DEMERGER: FORWARD-LOOKING TEST                                       │
│                                                                      │
│ A demerged group meets the revenue threshold if:                     │
│                                                                      │
│ YEAR 1 (first full FY after demerger):                               │
│   → Revenue ≥ €750M in that year                                     │
│                                                                      │
│ YEARS 2-4 (subsequent fiscal years):                                 │
│   → Revenue ≥ €750M in at least 2 of the years since demerger        │
│                                                                      │
│ This prevents automatic exit from Pillar Two via demerger            │
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```

3.2 Demerger Testing Mechanics

Scenario: MegaCorp (in scope) demerges into NewCo A and NewCo B on 30 June 2025.

Year 1 Test (FY 2026 — first full FY after demerger):

Entity	FY 2026 Revenue	In Scope?
NewCo A	€820M	**Yes** (single year test)
NewCo B	€600M	**No** (below threshold)

Subsequent Years Test (FY 2027-2028):

Entity	FY 2026	FY 2027	FY 2028	Years ≥ €750M	In Scope?
NewCo A	€820M	€790M	€850M	3 of 3	**Yes**
NewCo B	€600M	€680M	€760M	1 of 3	**No**

NewCo B exits scope because it does not have revenue ≥ €750M in at least 2 years post-demerger.

3.3 Anti-Avoidance Consideration

A group cannot avoid Pillar Two by demerging and then immediately re-merging. The combination rules would apply to reconstruct revenues.

4. Partial Year Treatment *(Article 6.2.1)*

4.1 Entities Joining Mid-Year

When an entity joins an MNE Group during a fiscal year, the GloBE rules apply **only to the portion of income and taxes consolidated in the UPE's financial statements**.

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 Entity joins on 1 July (mid-year):
→ Include 6 months of GloBE Income
→ Include 6 months of Adjusted Covered Taxes
→ Include 6 months of payroll costs for SBIE
→ Tangible assets: see special rule below
```

4.2 Tangible Assets for Partial Year

For SBIE purposes, tangible assets are **not prorated** like payroll. Instead:

- **Joining entity:** Use asset value at **joining date** (not year-end average)
- **Leaving entity:** Use asset value at **leaving date**

(Article 6.2.1(e))

4.3 Example: Mid-Year Acquisition

Stratos acquires TechStart Ltd on 1 July 2025.

Item	Full Year	Consolidated (6 months)
TechStart GloBE Income	€12,000,000	€6,000,000
TechStart Covered Taxes	€1,440,000	€720,000
TechStart Payroll	€3,600,000	€1,800,000
TechStart Tangible Assets	€8,000,000	**€8,000,000** (at joining date)

For Stratos's FY 2025 GloBE calculations: - Add €6,000,000 to Irish jurisdictional GloBE Income - Add €720,000 to Irish Adjusted Covered Taxes - Add €1,800,000 to Irish payroll for SBIE - Add €8,000,000 to Irish tangible assets for SBIE

Deferred Tax Attributes *(Article 6.2.1(f))*

5.1 General Rule: Carry Over

When an entity joins an MNE Group, existing deferred tax attributes (DTAs, DTLs) are generally **respected**:

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 Acquired entity's DTAs and DTLs:
→ Carry over to the acquiring MNE Group
→ Treated as if they arose while under common control
→ Subject to the same 15% rate cap
```

5.2 Exception: GloBE Loss Election

The **GloBE Loss Election** (an alternative to the standard DTA approach) is a **jurisdictional attribute** that **cannot be transferred** to another MNE Group.

Attribute	Transferable?	Treatment
Accounting DTAs	Yes	Carry over
Accounting DTLs	Yes	Carry over
Tax loss carryforwards	Yes	Subject to local rules
GloBE Loss Election DTA	**No**	Lost on change of control

5.3 Practical Implication

If the selling group used the GloBE Loss Election, the acquiring group **cannot continue** using that election. The acquiring group must: 1. Determine whether to make its own GloBE Loss Election for that jurisdiction, OR 2. Apply the standard DTA approach

6. Accounting Treatment: Merger vs Acquisition Accounting

The accounting treatment of a business combination affects GloBE calculations:

6.1 Merger Accounting (Pooling of Interests)

Feature	Treatment
Asset values	Historical cost maintained
No fair value step-up	No GloBE adjustment needed
Retained earnings	Combined from both entities

6.2 Acquisition Accounting (Purchase Method)

Feature	Treatment
Asset values	Revalued to fair value
Fair value step-up	Creates new tax basis differences
Goodwill	May arise (excluded from GloBE calculations)
Deferred taxes	Recalculated on new basis differences

Impact on GloBE:

Under acquisition accounting, the fair value step-up creates new temporary differences. These affect: - Future depreciation/amortisation (GloBE Income adjustments) - Deferred tax calculations (Covered Tax adjustments)

7. Decision Flowchart: Merger/Demerger Impact

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START: Corporate restructuring occurs
          │
          ▼
┌────────────────────────────────────────────────────┐
│ What type of transaction?                          │
└────────────────────────────────────────────────────┘
          │
     ┌────┴──────────────────┐
MERGER                    DEMERGER
     │                       │
     ▼                       ▼
┌───────────────────┐  ┌─────────────────────────────┐
│ Is it acquisition │  │ Apply forward-looking test:  │
│ of ALL/SUBSTAN-   │  │                             │
│ TIALLY ALL of     │  │ Year 1: Revenue ≥ €750M?    │
│ another group?    │  │ Years 2-4: 2+ years ≥ €750M? │
```

```
└──────────────────┘  └──────────────────────────────┘
        │                     │
   ┌────┴────┐           ┌────┴────┐
  YES       NO         PASS      FAIL
   │         │           │         │
   ▼         ▼           ▼         ▼
┌────────┐ ┌────────┐ ┌────────┐ ┌────────┐
│COMBINE │ │Standard│ │Demerged│ │Demerged│
│revenues│ │rules   │ │group   │ │group   │
│retro-  │ │apply   │ │IN SCOPE│ │exits   │
│spective│ │        │ │        │ │scope   │
└────────┘ └────────┘ └────────┘ └────────┘
   │
   ▼
┌───────────────────────────────────────────────────┐
│ Combined revenues ≥ €750M in 2 of 4 prior years? │
└───────────────────────────────────────────────────┘
        │
   ┌────┴────┐
  YES       NO
   │         │
   ▼         ▼
┌────────┐ ┌────────┐
│Combined│ │Combined│
│group   │ │group   │
│IN SCOPE│ │NOT in  │
│IMMEDI- │ │scope   │
│ATELY   │ │(yet)   │
└────────┘ └────────┘
```

8. Stratos Worked Example: Acquisition of TechStart

8.1 Background

Stratos Holdings plc is considering acquiring TechStart Group, an Irish technology company with operations in Ireland and Germany.

Pre-Acquisition Data:

Group	FY-4 Revenue	FY-3 Revenue	FY-2 Revenue	FY-1 Revenue
Stratos Group	€850M	€900M	€920M	€950M
TechStart Group	€45M	€52M	€58M	€65M

Question 1: Does acquiring TechStart affect Stratos's scope status?

8.2 Analysis

Step 1: Is this a combination of two consolidated groups?

TechStart Group has multiple entities under a common parent. Stratos is acquiring 100% of TechStart.

Answer: Yes — combination rule applies.

Step 2: Calculate combined historical revenues:

Year	Stratos	TechStart	Combined
FY-4	€850M	€45M	€895M
FY-3	€900M	€52M	€952M
FY-2	€920M	€58M	€978M

Year	Stratos	TechStart	Combined
FY-1	€950M	€65M	€1,015M

Step 3: Apply €750M threshold:

All four combined years exceed €750M. Stratos was already in scope, and the acquisition doesn't change this.

Conclusion: No impact on scope status (Stratos remains in scope).

8.3 Question 2: How is TechStart's partial year handled?

Acquisition Date: 1 July 2025 (mid-year)

TechStart Ireland (the main entity being acquired):

Item	Full Year	6-Month Period
GloBE Income	€8,500,000	€4,250,000
Adjusted Covered Taxes	€1,062,500	€531,250
Payroll (eligible)	€2,400,000	€1,200,000
Tangible Assets (NBV)	€5,000,000	€5,000,000*

*Assets at joining date, not prorated.

Impact on Stratos's Ireland Jurisdiction:

Item	Pre-Acquisition	TechStart (6 mo.)	Post-Acquisition Total
GloBE Income	€15,000,000	€4,250,000	**€19,250,000**
Covered Taxes	€1,770,000	€531,250	**€2,301,250**

Item	Pre-Acquisition	TechStart (6 mo.)	Post-Acquisition Total
Payroll	€8,400,000	€1,200,000	**€9,600,000**
Tangible Assets	€12,000,000	€5,000,000	**€17,000,000**

Revised Ireland ETR:

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ETR = €2,301,250 ÷ €19,250,000 = 11.95%
```

Revised Ireland SBIE (FY 2025 rates):

```
 Payroll: €9,600,000 × 9.8% = €940,800
Assets:  €17,000,000 × 7.8% = €1,326,000
Total SBIE: €2,266,800
```

Revised Excess Profit and Top-Up Tax:

```
 Excess Profit = €19,250,000 − €2,266,800 = €16,983,200
Top-Up Tax % = 15% − 11.95% = 3.05%
Top-Up Tax = €16,983,200 × 3.05% = €517,988
```

8.4 Question 3: What about TechStart's deferred tax attributes?

TechStart Ireland has: - DTA on tax losses: €400,000 (at 12.5% rate) - DTL on IP amortisation: €250,000 (at 12.5% rate)

Treatment:

Attribute	Amount	Transferable?	Treatment in Stratos
DTA on losses	€400,000	Yes	Carry over; future reversal reduces Covered Taxes

Attribute	Amount	Transferable?	Treatment in Stratos
DTL on IP	€250,000	Yes	Carry over; future reversal increases Covered Taxes

If TechStart had a GloBE Loss Election:

The GloBE Loss Election DTA would **not** transfer. Stratos would need to decide whether to: - Make its own GloBE Loss Election for Ireland (if losses exist), OR - Use the standard accounting DTA approach

9. Common Pitfalls

9.1 Pitfall 1: Assuming Mergers Provide Transition Time

Error: Believing that a newly merged group has time before Pillar Two applies.

Correct approach: Apply the retrospective combination rule. A merger can trigger **immediate** Pillar Two application if combined historical revenues exceed €750M in 2 of 4 prior years.

9.2 Pitfall 2: Prorating Tangible Assets for Partial Year

Error: Prorating tangible asset values for SBIE when an entity joins mid-year.

Correct approach: Use the asset value at the **joining date** (not prorated). Only payroll is prorated based on the consolidation period.

9.3 Pitfall 3: Transferring GloBE Loss Election

Error: Assuming an acquired entity's GloBE Loss Election continues under the new MNE Group.

Correct approach: The GloBE Loss Election is a jurisdictional attribute that **cannot be transferred**. The acquiring group must make its own election decision.

9.4 Pitfall 4: Ignoring Acquisition Accounting Impact

Error: Not considering how fair value step-ups under acquisition accounting affect deferred taxes.

Correct approach: Under acquisition accounting, new temporary differences arise. These affect future GloBE Income and Covered Tax calculations through changed depreciation/amortisation and deferred tax movements.

9.5 Pitfall 5: Incorrect Demerger Testing

Error: Applying the retrospective combination rule to demergers.

Correct approach: Demergers use the **forward-looking test**. Test Year 1 revenue alone, then test 2+ years in Years 2-4.

10. Merger/Demerger Assessment Checklist

Use this checklist when a corporate restructuring occurs:

```
 MERGER/DEMERGER IMPACT ASSESSMENT
Transaction: _________________________
Date: _________________________
Type: MERGER / DEMERGER / ACQUISITION

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SECTION A: SCOPE IMPACT (€750M THRESHOLD)
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□ If MERGER/ACQUISITION of substantially all of another group:
   □ List acquiring group revenues for FY-4 to FY-1:
     FY-4: €__________ FY-3: €__________ FY-2: €__________ FY-1: €______
   □ List target group revenues for FY-4 to FY-1:
     FY-4: €__________ FY-3: €__________ FY-2: €__________ FY-1: €______
   □ Calculate COMBINED revenues:
     FY-4: €__________ FY-3: €__________ FY-2: €__________ FY-1: €______
   □ Combined ≥ €750M in 2+ years?   YES / NO
```

☐ Result: IN SCOPE / NOT IN SCOPE

☐ If DEMERGER:
  ☐ Year 1 (first full FY): Demerged group revenue €__________
    ≥ €750M?   YES / NO
  ☐ If NO in Year 1: Not in scope (continue monitoring)
  ☐ If YES in Year 1: In scope for Year 1
  ☐ Years 2-4: Revenue ≥ €750M in 2+ years?   YES / NO
  ☐ Result: IN SCOPE / EXITS SCOPE

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SECTION B: PARTIAL YEAR TREATMENT (Entities Joining/Leaving)

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☐ Transaction date: _______________
☐ Months consolidated: _____ out of 12

☐ Joining Entity Calculations:
  ☐ GloBE Income (period consolidated):   €__________________
  ☐ Covered Taxes (period consolidated):   €__________________
  ☐ Payroll (period consolidated):   €__________________
  ☐ Tangible Assets (at joining date):   €__________________

☐ Leaving Entity Calculations:
  ☐ GloBE Income (period to leaving):   €__________________
  ☐ Covered Taxes (period to leaving):   €__________________
  ☐ Payroll (period to leaving):   €__________________
  ☐ Tangible Assets (at leaving date):   €__________________

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SECTION C: DEFERRED TAX ATTRIBUTES

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☐ Does target have DTAs?   YES / NO
  ☐ If YES, amount and nature: _________________________________

```
□ Does target have DTLs?                           YES / NO
   □ If YES, amount and nature: _________________________________

□ Did target have GloBE Loss Election?          YES / NO
   □ If YES: Election does NOT transfer. Acquiring group must decide:
     □ Make own GloBE Loss Election for jurisdiction?  YES / NO
     □ Use standard DTA approach?                      YES / NO

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SECTION D: ACCOUNTING TREATMENT
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□ Accounting method: MERGER ACCOUNTING / ACQUISITION ACCOUNTING

□ If ACQUISITION ACCOUNTING:
   □ Fair value step-up on assets?              YES / NO
   □ Amount of step-up: €__________________
   □ New deferred tax liabilities created?      YES / NO
   □ Amount: €__________________
   □ Impact on future GloBE calculations documented?   YES / NO

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SECTION E: SUMMARY
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□ Scope status post-transaction:               IN SCOPE / NOT IN SCOPE
□ GloBE calculations required for transaction year?    YES / NO
□ Special elections needed?                     YES / NO
□ Documentation complete?                       YES / NO
```