Tax Challenges Arising from the Digitalisation of the Economy – Subject to Tax Rule (Pillar Two)

INCLUSIVE FRAMEWORK ON BEPS

OECD
BETTER POLICIES FOR BETTER LIVES

This document is released by the OECD Secretariat to assist understanding of the Subject to Tax Rule (STTR) Model Provisions. It has not been agreed by the OECD/G20 Inclusive Framework on BEPS and is not to be used to interpret the STTR Model Provisions.

The Subject to Tax Rule in a Nutshell

Overview

The Subject to Tax Rule (STTR) is an integral part of the consensus achieved on Pillar Two and is especially important for developing Inclusive Framework members. Pillar Two comprises: two interlocking domestic rules – the IIR and UTPR (together the Global anti-Base Erosion Rules (GloBE Rules)) – and a treaty-based rule, the STTR. The GloBE Rules provide jurisdictions with a right to "tax back" up to the agreed minimum rate where other jurisdictions have not exercised taxing rights or income is otherwise subject to low levels of taxation. The STTR complements those rules and adapts the underlying principles and mechanisms to a treaty context. The STTR allows source jurisdictions to "tax back" where defined categories of intra-group covered income are subject to nominal corporate income tax rates below the STTR minimum rate, and domestic taxing rights over that income have been ceded under a treaty. The STTR takes priority over the GloBE Rules (STTR tax is creditable under those rules) and is designed to help developing Inclusive Framework members to protect their tax base.

The STTR is a model treaty provision that allows jurisdictions to impose limited additional taxation on certain cross-border payments between connected companies where the recipient is subject to a nominal corporate income tax rate below 9%. The STTR applies to interest, royalties and a specified list of other payments ('Covered Income'), including all intra-group service payments. Where the STTR applies, the payor jurisdiction can impose additional tax on the gross amount of Covered Income up to 9% of the income. This 9% figure is reduced by (a) the nominal tax rate in the recipient jurisdiction and (b) any existing taxing right of the payor jurisdiction under the applicable tax treaty.[1]

The STTR does not itself impose a tax obligation but allows jurisdictions to impose a tax where they otherwise would be unable to do so under the other provisions of the treaty. Where no bilateral income tax treaty applies, source jurisdictions are already able to impose tax on these payments and the STTR has no work to do. For the same reason, the STTR does not apply to a category of Covered Income (for example, interest or royalties) where the source state can already impose an amount of tax that is greater than the STTR rate of 9% on the relevant category under another treaty provision.

Members of the Inclusive Framework that apply nominal corporate income tax rates below 9% to any category of Covered Income have committed to implement the STTR into their bilateral treaties with Inclusive Framework members that are considered as developing countries when requested to do so.

[1] For example, if a payor jurisdiction can impose a 5% withholding tax on a payment of Covered Income and the recipient is subject to a 1% nominal tax rate, the payor jurisdiction *retains* the 5% withholding tax right but can impose an additional tax under the STTR equal to 3% of the Covered Income amount (9% - 5% - 1% = 3%).

Scope

The STTR covers payments between connected persons. Two entities will be connected if both entities are under the control of the same person (or persons) either legally (direct or indirect ownership of more than 50% of the interests in the parties) or as a matter of fact and circumstance. However, the STTR will not apply where the recipient is:

- an individual
- a non-profit organisation;
- a State, or part of a State;
- an international organisation;
- an investment fund that meets certain conditions (including pension funds); or
- a holding vehicle wholly, or almost wholly, owned by an excluded recipient.

A 'targeted anti-avoidance rule' prevents the use of intermediaries to avoid the STTR.

Covered Income

The STTR only applies with respect to the following 'Covered Income':

i. interest;
ii. royalties;
iii. payments for distribution rights for a product or service;
iv. insurance or reinsurance premiums;
v. payments of guarantee or financing fees;
vi. rental payments for industrial, commercial or scientific equipment; and
vii. payments for services.

Nominal tax rate

The STTR generally relies upon the nominal rate of tax (rather than the effective tax rate which is used under the GloBE Rules). This will generally be the statutory tax rate applicable to the type of income. However, the nominal tax rate is lowered if the statutory rate is subject to a 'preferential adjustment'. A preferential adjustment is one that:

- results in a permanent reduction of the amount of tax payable;
- is provided by an exemption or exclusion from income, a deduction computed by reference to the income without a corresponding payment, or a tax credit calculated by reference to the amount of the income (excluding foreign tax credits); and
- is directly linked to the Covered Income, or arises under a regime that provides a tax preference for income from geographically mobile activities (those that meet the final requirements of Final Report on BEPS Action 5).

There are also provisions for determining the nominal tax rate for taxes calculated other than on a net income basis and taxes applied at the point of actual or deemed profit distribution.

Other key aspects of the rule

Mark-up threshold: the STTR only applies to Covered Income (other than interest and royalties) where the amount of Covered Income exceeds the costs incurred in earning that income plus a mark-up of 8.5%. Under certain circumstances, some payments to connected parties may not be taken into account in calculating the relevant costs for applying this rule.

Materiality threshold: the STTR only applies if the aggregate sum of Covered Income paid in a fiscal year exceeds EUR 1 million (or EUR 250 000 for jurisdictions with GDP below EUR 40 billion).

STTR taxes: taxes imposed under the STTR are levied after the end of the fiscal year in which they arise (an ex-post annualised charge).

Elimination of double taxation: the applicable treaty is amended to preserve the position that would have applied before application of the STTR. The recipient jurisdiction is neither required to exempt the Covered Income because of tax payable under the STTR, nor to provide a tax credit for tax payable under the STTR.

Implementation

A multilateral instrument will facilitate the implementation of the STTR. That multilateral instrument will, with respect to all tax treaties it covers, amend treaties and include the STTR. Alternatively, the STTR can be implemented into relevant tax treaties individually via bilateral negotiations. In addition, there is a process to assist developing Inclusive Framework members to implement the STTR into their tax treaties.