DIGITALIZATION ⇄ TAXATION

PILLAR 2 : STTR

PRESENTER:TALATU TINA ALIYU
HEAD,TAX TREATIES & MAP ITPD
4TH JULY,2023

POINTS OF DISCUSSION

- **INTRODUCTION**
- **OVERVIEW OF THE TWO PILLAR SOLUTION**
- **PILLAR 2 RULES**
- **SUBJECT-TO-TAX-RULE (STTR)**
    - **Draft STTR Provision**
    - Process to assist implementation
    - Multilateral instrument to facilitate implementation

Developments in digitalization & globalization over time has impacted on economies and the lives of people around the world. These developments have brought with them challenges to the rules for taxing international business income, which were obsolete, thus, creating opportunities for base erosion and profit shifting (BEPS). Noting this fact, policy makers to restore confidence in the system and ensure that profits are taxed where economic activities take place and value is created have taken a bold move in ensuring that international tax rules are updated (via the BEPS package) to align with the realities of the globalized and digitalized world.

INTRODUCTION

OVERVIEW OF THE TWO-PILLAR SOLUTION

Pillar 1

Amount A & Amount B

The OECD/G20 Inclusive Framework on BEPS (IF) has agreed to a two-pillar solution to address the tax challenges of the digitalised economy through a statement issued on the 8th October 2021.

Pillar 2

GloBE Rules & STTR

TWO PILLAR SOLUTION

PILLAR 2 RULES

4 Rules:

Income Inclusion Rule (IIR).	Undertaxed Profit Rule (UTPR).	Subject To Tax Rule (STTR).	Switch Over Rule (SOR)

Pillar Two consists of a set of rules that provide jurisdictions with a right to “tax back” where other jurisdictions have not exercised their primary taxing rights or the payment is otherwise subject to low levels of taxation. Pillar Two consists of the Global Base Erosion rules, which are designed to ensure large multinational enterprises pay a minimum level of tax on the income arising in each jurisdiction where they operate.

STTR IN A NUTSHELL

Tax treaty-based rule. Only applicable to tax treaties

Has source State ceded taxing right on certain outbound payments been taxed at under 9% in residence State?

Applies to interest, royalties, categories of rents, fees and intra-group services

Allows source state apply additional tax which is the difference between rate taxed in residence state and 9%.

KEY CONSIDERATIONS

- Connected persons?
- Materiality threshold?
- Mark – up threshold?
- Exclusions?
- Administration; ex-post annualized charged

SUBJECT – TO – TAX - RULE (STTR)

The STTR is a treaty-based rule that applies to intragroup payments from source States that are subject to low nominal tax rates in the State of the payee. Where, under a tax treaty, a source State has ceded taxing rights on certain outbound intragroup payments, it should be able to recover some of those rights where the income in question is taxed (if at all) in the State of the payee (i.e. the residence State) at a rate below 9%. It is designed to help developing countries with lower administrative capacities to protect their tax base.

COVERED TREATIES

The STTR covers tax treaties between developing countries and tax jurisdictions with nominal domestic tax rate of below 9%. It is designed to help developing countries with lower administrative capacities to protect their tax base.

- Where developing countries (defined by World Bank released GNI from 2020 to be low income or lower middle income jurisdiction) requested for STTR in its tax treaty with low tax jurisdiction, such jurisdiction must oblige.
- Model STTR Article and Commentary not to be included in the OECD Model but contained in a separate STTR Report.

STTR PROVISION

Article [ ] - Subject to Tax Rule

- Para. 1: Taxing right in source State where covered income taxed at below minimum rate
- Para. 2: Source State taxing right limited to a specified rate
- Para. 3: Interaction with other Articles
- Para. 4: Covered income
- Para. 5: Meaning of “tax rate”
- Para. 6: Preferential adjustment
- Para. 7: Covered income attributable to permanent establishment in third jurisdiction
- Para. 8: Exclusions
- Para. 9: Mark-up Threshold
- Para. 10: Connected Persons
- Para. 11: Connected Persons – targeted anti-avoidance rule

DRAFT STTR PROVISION

Article [ ] - Subject to Tax Rule

Para. 12: Materiality Threshold

Para. 13: Application to Permanent Establishment in Source State

Para. 14: Administration

Para. 15: Implications of this Article

PARA. 1, 2, & 3

1

Provides that when the covered income dealt with under Articles 7, 11, 12, 12A & 21 do not suffer tax of up-to 9%, the source State's limitation to tax would not hold as the source State can subject that particular income to further taxation.

2

Pegs the additional tax on the said income under para. 1 to the difference between the tax that the income has already suffered and the minimum tax rate of 9% it should have suffered as set by the rule.

3

Provides that if the said income has been taxed at the specified rate or more in accordance with para. 2 at the source state under any other Article then the provisions of para. 1 & 2 shall not apply.

PARA. 4, 5, & 6

4

Income covered are:
interest;

- royalties;
- rent in respect of products or services;
- insurance & re-insurance premiums;
- financial guarantee & other financing fees;
- rent on ICS equipment; and
- income received for the provision of services.
- It does not cover income from rent of ship used in international traffic and income from tonnage of a ship.

5

- Defines the tax rate as the statutory rate of tax applicable in the resident State on such income.
- Where the income enjoys a preferential adjustment that shall be considered in determining the tax rate.
- Only taxes covered under Article 2 are considered.
- The CA shall communicate any change in the tax rate & tax law.

6

Preferential adjustment means a permanent reduction in the amount tax payable on a covered income in the resident State.
In form of: full or partial exemption or exclusion from income; a deduction from the tax base without regard to any corresponding payment.
No account shall be given to the provisions of Article 23A & 23B, and the term permanent reduction means a reduction that is not expected to reverse over time.

PARA. 7, 8, & 9

7

In the case of a PE in 3rd State, the tax rate shall be the statutory rate (including any preferential adjustment) applicable in the 3rd State.

8

The Article does not apply to:

- payments made by a resident if he is: an individual;
- Non-connected persons;
- a recognised pension fund;
- a non-profit organisation;
- that State itself (its political subdivision or local authority, its central bank, etc.);
- an international organisation;
- investment funds;
- entities with a single level of taxation (sole proprietorship, partnership, CIV).

9

The mark-up threshold for the covered income is an amount equals to the cost incurred + a mark-up of 8.5% on those cost.

Fiscal year payments shall be aggregated in getting the mark-up cost.

Costs associated to income earned from resident of 3rd States shall be disregarded to the extent that those cost exceeds 80% of total cost

PARA. 10, 11 & 12

10

Defines connected persons for the purpose of this Article.

11

To guard against any abuse of the Article, this paragraph provides for a disqualification of payments made by intermediaries within a 365 days period to a person(s) other than the one described in paragraph 8 and the intermediary tax rate is below 9%.

12

The materiality threshold provides that paragraph 1 & 2 applies unless the sum of the covered income is > €1m and €250,000 (for countries with GDP of €40 billion) in the fiscal year concerned.

Payments to excluded entities are included for the purpose of determining materiality threshold

PARA. 1, 2, & 3

13

Paragraph 1 & 2 do not apply to PEs in source state. In such case the provisions of Article 7 applies.

14

Tax chargeable under STTR to be determined at the end of a fiscal period, and payment levied thereafter (post-annualised charge).

CAs via mutual agreement may agree on the mode of application and administration of the provisions of this Article.

15

Provides that the Article:

- is added to the convention as part of the pillar 2 solution,
- does not a treaty policy of any contracting state,
- is implemented without prejudice to subsequent modifications made to the convention.

PROCESS TO ASSIST IN IMPLEMENTATION

Developing countries to make a binding request to IF members with low nominal rates to covered income.

The implementation process will support developing countries by:

- Clarifying the IF members within scope of commitment
- Identifying tax treaties that can be the object of the request to implement.

Methodology:

- All IF members to complete questionnaire
- Secretariat to produce documentation package (list of covered treaties, summary of responses by members and relevant rates for application of STTR)

STTR MLI

The STTR MLI is to assist developing countries with the swift implementation of the STTR into the relevant tax treaties.

- STTR MLI has limited flexibility
- Explanatory statement
- Circuit breaker provision (suspends application of STTR for a jurisdiction that ceases to be a developing country for a sustained period of 5 years)
- Annexes – Annex II Taxes computed on an alternative basis
- Annex III Taxes imposed at the point of distribution
- Annex IV Recognised pension fund
- Annex V Circuit breaker provision

THANK YOU