KPMG

Tax alert

Issue 14 | October 2024

Signing Ceremony - Update on the Subject-to-Tax Rules Multilateral Convention

On 19 September 2024, nine jurisdictions signed the Multilateral Convention to Facilitate the Implementation of the Pillar Two Subject to Tax Rule ("STTR MLI") at a signing ceremony in Paris, while ten more jurisdictions indicated their intention to sign the STTR MLI once their internal processes are completed.
In total, 57 jurisdictions took part in the signing ceremony. The Multilateral Convention was published by the OECD/G20 Inclusive Framework on BEPS Pillar Two on 3 October 2023.

BEPS Pillar Two Subject to Tax Rule (STTR) – A Recap

The STTR (published in July 2023) forms part of a package of rules aimed at ensuring global minimum taxation of multinational businesses under BEPS Pillar Two and is especially important for developing Inclusive Framework members to protect their tax base. BEPS Pillar Two comprises two components: (i) the Global anti-Base Erosion ("GloBE") Rules i.e. Domestic Minimum Top-up Tax (DMTT), the Income Inclusion Rule (IIR) and the Undertaxed Profits Rule (UTPR) and (ii) a tax treaty-based rule, the STTR. The STTR complements the GloBE rules and takes priority over the application of the DMTT, IIR and UTPR. The STTR is designed to ensure that certain cross-border transactions are subject to a minimum level of taxation to prevent circumstances where certain income is either taxed at very low rates or not taxed at all due to differences in tax regimes between countries.

The STTR is a treaty-based rule that applies to intragroup payments[1] such as interest, royalties, other inter-company services, etc. ("Covered Payments") from source or payer jurisdiction that are subject to low nominal tax rates in the jurisdiction of the payee. Specifically, it seeks to raise the level of taxation to a minimum of 9% on the Covered Payments that generally benefit from a treaty relief.

In other words, the STTR allows jurisdictions to "tax back" where the Covered Payments are subject to nominal tax rates below the STTR minimum rate of 9%, and domestic taxing rights over that income have been ceded under a treaty by the source or payer jurisdiction. The STTR operates by allowing the source or payer jurisdiction to apply additional tax, meaning that the tax rate applying in the residence jurisdiction is recognised in the calculation of the source jurisdiction's extra taxing right (if any).

It is crucial to note that unlike the GloBE rules under BEPS Pillar Two, the application of the STTR is not restricted to MNE groups with revenue thresholds above EURO 750 million.

[1] Under the STTR, it means (i) interest as defined in para 3 of Article 11 of OECD Model Convention, (ii) royalties as defined in para 2 of Article 12 of OECD Model Convention, (iii) payments made in consideration for the use of, or the right to use, distribution rights in respect of a product or service, (iv) insurance and reinsurance premiums, (v) fees to provide a financial guarantee, or other financing fees, (vi) rent or any other payment for the use of, or the right to use, industrial, commercial or scientific equipment, or (vii) any income received in consideration for the provision of services

Members of the Inclusive Framework that apply nominal corporate income tax rates below 9% to the Covered Payments have committed to incorporate the STTR into bilateral tax agreements with developing countries that are members of the Inclusive Framework when requested to do so. Developing countries are defined with reference to Gross National Income (GNI) per capita issued by World Bank data2 and encompass more than 70 countries.

Developing countries are often the source of significant outbound payments that can be subject to low or no taxation. The STTR provides developing countries with a more straightforward tool to help ensure they receive their fair share of tax revenue by taxing the Covered Payments when they are undertaxed in the recipient's jurisdiction, helping to protect their tax base.

STTR MLI - Signing Ceremony

The STTR is a complete and one of the ready-to-use solutions for combatting base erosion and profit shifting activities under BEPS Pillar Two. The STTR MLI that was signed on 19th September 2024 is the delivery mechanism for that solution, which allows developing countries to amend all their covered tax treaties at the same time, rather than having to pursue bilateral treaty negotiations which might be significantly time-consuming and a costly affair. The STTR MLI is open for affected countries to sign, and individual bilateral tax treaties will be amended once both the tax treaty partners have signed and ratified it following their respective legal procedures. Broadly, the treaty changes would allow for top-up tax up to 9% to be applied at source by developing countries to a wide range of Covered Payments as illustrated above.

In view of the above, the signing ceremony of the STTR MLI is a cornerstone as it is another concrete step towards strengthening global minimum taxation. While the actual implementation of the STTR MLI will potentially require further processes (e.g., domestic legislative processes in impacted contracting parties), signing STTR MLI will definitely allow the early adopters to swiftly implement the STTR. In this connection, the jurisdictions that have signed or indicated intention to sign the MLI are:

Signing jurisdictions	Comprehensive tax treaty with Singapore?
1. Barbados	Yes
2. Belize	No
3. Benin	No
4. Cabo Verde	No
5. Congo (Dem. Rep.)	No
6. Indonesia	Yes
7. Romania	Yes
8. San Marino	Yes
9. Türkiye	Yes

Intention to sign	Comprehensive tax treaty with Singapore?
1. Belgium	Yes
2. Bulgaria	Yes
3. Costa Rica	No
4. Mongolia	Yes
5. Portugal	Yes
6. Senegal	No
7. Seychelles	Yes
8. Thailand	Yes
9. Ukraine	Yes
10. Uzbekistan	Yes

In respect of the above, it is interesting to note that while Barbados, Romania and San Marino have signed the STTR MLI, their GNI per capita *(calculated using the World Bank Atlas method)* in 2019[3] was USD 17,820, USD 12,670 and USD 44,390 respectively which is well- above the prescribed threshold limit of USD 12,535, to fall under the category of developing countries. Therefore, it seems that Barbados, Romania and San Marino may not be able to collect any top-up tax under the STTR even after signing the STTR MLI. In this regard, as clarified by the OECD, Jurisdictions that are not developing countries for the purpose of the STTR, are free to request implementation of the STTR in their tax treaties if they wish to do so.

[2] For this purpose, developing countries are defined as those with GNI per capita, calculated using the World Bank Atlas method (https://datahelpdesk.worldbank.org/knowledgebase/articles/378832-what-is-the-world-bank-atlasmethod), of USD 12,535 or less in 2019 to be regularly updated

[3] **Source:** https://data.worldbank.org/indicator/NY.GNP.PCAP.CD?end=2019&most_recent_year_desc=true&start=2018

Singapore - Potential Impact

This development marks a significant milestone in international tax regulations, and will no doubt have its potential impact on Singapore, particularly in the context of tax treaties with jurisdictions that have signed up for the convention, such as Indonesia.

Singapore, being a member of the Inclusive Framework, has committed to implement STTR in their bilateral tax treaties when requested to do so by IF members identified as developing country. Thus, a developing IF member can request for changes in the bilateral tax treaty where a nominal corporate income tax rate is applied below 9% to the Covered Payments by Singapore. This means, for example, since Indonesia is a developing country for the STTR purposes, and if the tax treaty between Singapore and Indonesia is identified as a Covered Tax Agreement by both Indonesia and Singapore by way of signing the STTR MLI, the STTR MLI will operate to directly amend this treaty in order to implement the STTR and other relevant accompanying provisions as annexes to the treaty.

EXAMPLE: ***To illustrate in the case of Indonesia -***

- Royalties include any payments for information concerning industrial, commercial or scientific experience within its ambit for the STTR purposes. Under Article 12(2)(b) of the Singapore – Indonesia tax treaty, such royalties are subject to source taxation in Indonesia at the rate of 8%.
- Let's assume that an Indonesian company pays the above-mentioned royalties to a Singapore company which is a 'connected person'[4]. Further, assume that such royalties qualify as a foreign sourced income in Singapore which is only taxable on remittance or deemed remittance basis under the Singapore domestic tax law.
- Per Para 6 of STTR, the subject royalties that is taxable only once it is repatriated or deemed as repatriated shall be treated as subject to a 'preferential adjustment' if that income is not repatriated or deemed as repatriated (and thereby brought within the charge to taxation) in the accounting period that the income arises or within three years following the end of that fiscal year. Thus, where the 'preferential adjustment' is applicable in the present example, it would generally result in a permanent reduction of tax which means no corporate tax is levied in Singapore on the foreign-sourced royalties.
- Having said the above, Indonesia may be able to collect additional tax up to 1% under the STTR (i.e. STTR minimum rate of 9% - 8% withholding tax in Indonesia) where the foreign-sourced royalties is subject to the 'preferential adjustment' and hence, it is considered that 0% corporate tax is payable in Singapore.
- For completeness, there should be no additional tax under STTR in Indonesia if the foreign-sourced royalties are repatriated in Singapore and subjected to corporate tax in Singapore, as the 'preferential adjustment' provision would not be applicable.
- Separately, it is also pertinent to note that any taxes under the STTR are not eligible for foreign tax credits in the residence country.
- Given the potential impact of the STTR, Singaporean companies should look into their unremitted foreign sourced income which may be subject to the preferential adjustments and also, other Covered Payments where the nominal corporate income tax applied is below the STTR minimum rate of 9%.

It is worthwhile to note that Singapore has a robust network of tax treaties which means the introduction of the STTR could have significant implications for Singaporean businesses engaging in transactions with counterparts. This may not just be limited to the higher tax burden but also on the administrative and compliance burden. This will be an important area to be closely monitored.

How we can help

As a committed tax advisor to our clients, we welcome any opportunity to discuss the relevance of the above matters/ case to your business. KPMG's BEPS specialists can support clients with BEPS Pillar Two impact assessment including potential impact of STTR and getting Pillar Two compliant-ready.

[4] Defined in Para 10 of the STTR published in July 2023

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