

# Subject-to-tax Rules

**Withholding taxes in International and European Tax Law**  
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## 1. Role and Purpose of Subject-to-tax Clauses

## 2. The Use of Subject-to-tax Clauses in Tax Treaties

2.1. General subject-to-tax clauses

2.2. Specific subject-to-tax clauses

## 3. New Developments on Subject-to-tax Clauses in Tax Treaties

3.1. The Pillar Two STTR

3.2. The UN STTR

## 4. Is This The Direction Tax Treaties Should Go?

# Role and Purpose of Subject-to-tax Clauses

- **Tax treaties and the prevention of double non-taxation**

- **Single taxation as an underlying principle?**

“Income from cross-border transactions should be subject to tax once (that is, neither more *nor less than once*).” (Avi-Yonah)

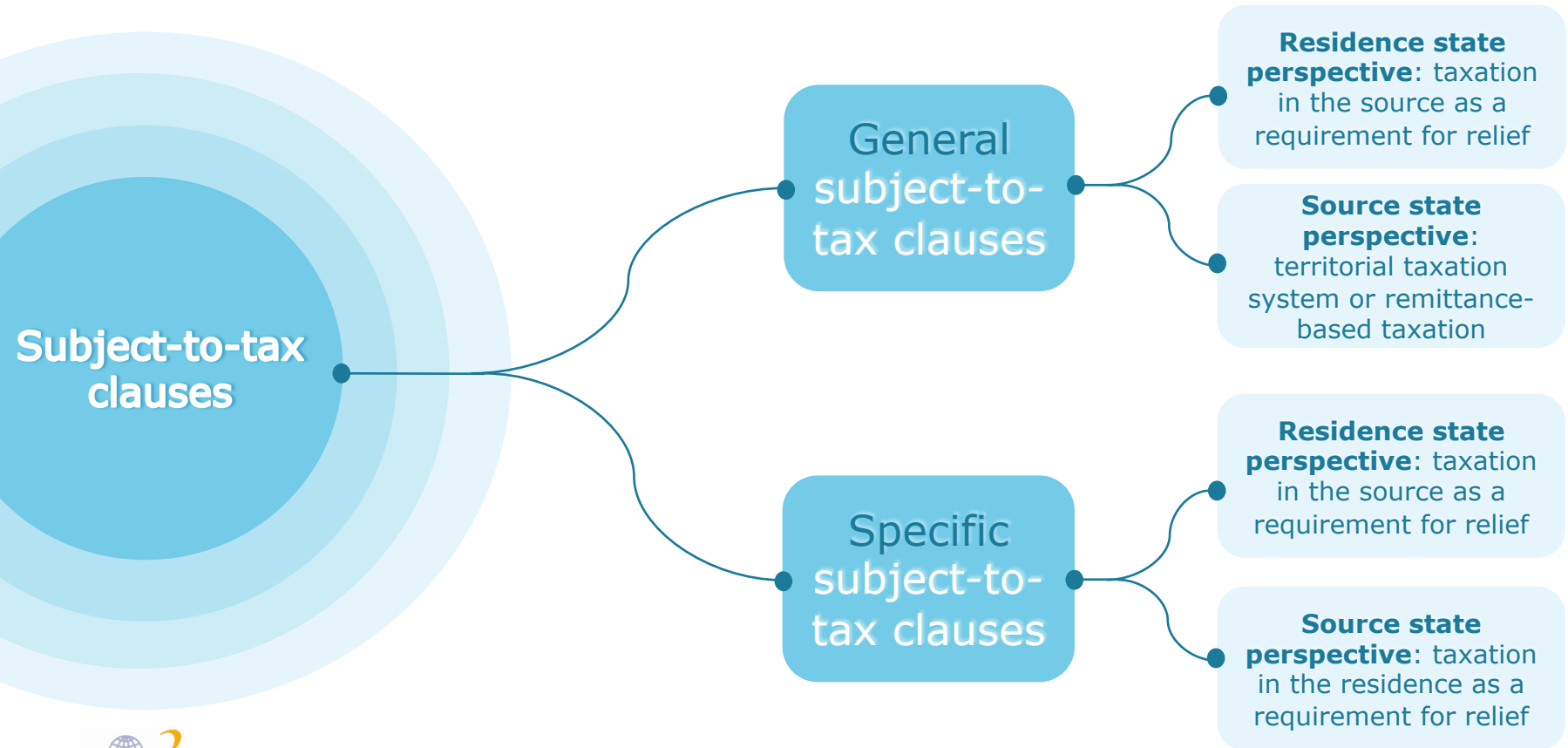
- **OECD and UN Models**

- The ‘no less than once’ side is not pursued, unless...
  - There is tax evasion or avoidance (BEPS Project – introduction of the preamble and changes to the title and provisions of the Models).
  - Otherwise provided by specific provisions.

- **Subject-to-tax clauses as a response to double non-taxation**

- Role: to make relief conditional upon taxation in the other state
- Purpose: aim to prevent ‘double non-taxation’
- Are they consistent with principles of interpretation and application of tax treaties?

# The Use of Subject-to-tax Clauses in Tax Treaties



### Residence state

#### Article 23(2)(a) of the Belgium-Lithuania Income Tax Treaty (1998)

“Where a resident of Belgium derives income which *is taxed* in Lithuania, ... Belgium shall exempt such income from tax”

### Source state

#### Protocol to the Germany-Zambia Income and Capital Tax Treaty (1973)

##### 2. With reference to Articles 6 to 21:

“Where *any income, ... , derived from outside of a Contracting State by a resident of that State is not subject to tax in that State by reason of its foreign origin*, the provisions of these Articles shall not apply in the other Contracting State in respect of such income.

### Residence state

#### Article 23(1)(a) of the Switzerland-United States Income Tax Treaty (1996)

"Where a resident of Switzerland derives income which, in accordance with the provisions of this Convention, may be taxed in the United States, Switzerland shall, ... , exempt such income from tax; *provided, however, that such exemption shall apply to gains referred to in paragraph 1 of Article 13 (Gains) only if actual taxation of such gains in the United States is demonstrated.*"

### Source state

#### Article 15(2)(d) of the Australia-Austria Income Tax Treaty (1986)

"2. Notwithstanding the provisions of paragraph 1, remuneration derived by an individual who is a resident of one of the Contracting States in respect of an employment exercised in the other Contracting State shall be taxable only in the first-mentioned State if:

- a) ...
- b) ...
- c) ... and

d) *the remuneration is*, or upon the application of this Article will be, *subject to tax* in the first-mentioned State."

# The Use of Subject-to-tax Clauses in Tax Treaties

## Challenges and limitations

- **Meaning of “subject to tax”**
  - Definition of the threshold at which an income item is considered “subject to tax”
    - At what %? E.g., even if taxed at 0.1%?
    - Does it need to be actually paid? E.g., no payment due to tax allowances, loss offset, deductions or credit.
- **Lack of uniformity**
  - Significant variation in their wording, structure, and application across treaties
  - No model provision and commentary to guide contracting states
- **Procedural challenges**
  - E.g., who is responsible for providing evidence that the taxpayer was subject to taxation in the other state?
  - Requirement for non-residents to submit a tax return



## Article [ ] – The subject to tax rule

### Taxing right in source Jurisdiction where covered income taxed at below minimum rate

1. Where in accordance with provisions of this agreement that:

a) provide that *profits* of an enterprise of a contracting jurisdiction shall be taxable only in that jurisdiction unless the enterprise carries on business in the other contracting jurisdiction through a permanent establishment situated therein;

b) provide that *interest or royalties* arising in a contracting jurisdiction shall be taxable only in the other contracting jurisdiction, or that limit the rate at which such interest or royalties, or at which any income paid in consideration for the provision of services, may be taxed in the first-mentioned jurisdiction; and

c) provide that *items of income* of a resident of a contracting jurisdiction that are *not classified in this agreement as income having a specific character* shall be taxable only in that jurisdiction, or that limits the rate at which such items of income may be taxed in the other contracting jurisdiction;

the tax that may be charged in a contracting jurisdiction on an item of covered income arising in that jurisdiction is limited, that income may, notwithstanding those provisions, be taxed in that jurisdiction if it is *subject to a tax rate below 9%* in the contracting jurisdiction of which the person deriving that income is a resident.

**Plus an additional 14 paragraphs...**

## Article 1(3)(a) of the UN Model

3. ...

(a) This Convention shall not affect the taxation by a Contracting State of *any income* arising in that State and derived by a resident of the other Contracting State if that income is subject to a low level of taxation in that other State within the meaning of subparagraph (b).

(b) Income is *subject to a low level of taxation* in that other State if:

(i) it is subject to a statutory *tax rate of \_\_\_ per cent* [the percentage is to be established through bilateral negotiations] or less; or

(ii) it is subject to a statutory tax rate higher than the rate set out in subdivision(i) but the beneficial owner of the income is entitled to a special exemption, exclusion or reduction that is linked directly to the income or the entity receiving it so that the amount of tax paid in that other State with respect to such income is less than the amount of tax that would be imposed if the tax rate set out in (i) were applied to such income without regard to such exemption, exclusion or reduction.

(c) Subparagraph (a) will not apply to income that: [exemptions, if any, appropriate in the context of the bilateral relationship between the Contracting States].



# Pillar Two STTR v. UN STTR

## Comparison table

	Pillar Two STTR	UN STTR
<b>Applicable by</b>	Source state	Source state
<b>Applicable to</b>	Certain categories of payments ("covered income") made between "connected legal persons"	All types of income for which the source state's taxing rights are limited by the treaty (including individuals)
<b>Triggered by</b>	"Adjusted nominal rate" below 9% in the residence state, being the statutory rate including the effects of any "preferential adjustment" (a permanent reduction in the covered income or the tax payable on it)	"Low level of taxation" in the residence state, meaning: (i) Statutory rate (on that payment) below % to be established bilaterally; or (ii) Statutory rate higher than %, but the beneficial owner is subject to "special exemption, exclusion or reduction"
<b>Limitations</b>	(i) Markup threshold (ii) Materiality threshold (iii) TAAR (iv) Exclusions....	None (unless established through bilateral negotiations)
<b>Approach</b>	Top-up tax (limited to "specified rate" - potentially below 9%)	Treaty taxing rights without top-up approach
<b>Chargeable</b>	Each year following that in which it applies	At the time when the payments of income are made (e.g., by withholding)

# Pillar Two STTR v. UN STTR

## Policy goal

- **Policy goal:** to assist developing countries (in the context of Pillar Two?)

"[the STTR] is an integral part of achieving a **consensus for developing countries**" (Preamble to The Multilateral Convention to Facilitate the Implementation of the Pillar Two Subject to Tax Rule)

"The STTR was developed not to revisit the current allocation of taxing rights between source and residence States. Rather it is based on an understanding that 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%. [...] By restoring taxing rights to the source State in these cases, the STTR is **designed to help developing countries – notably those with lower administrative capacities – to protect their tax base.**" (OECD (2023), Tax Challenges Arising from the Digitalisation of the Economy – Subject to Tax Rule (Pillar Two): Inclusive Framework on BEPS, Executive summary, p. 5.)

Which one better  
fulfills the intended  
purpose?

**Pillar Two STTR:** probably  
unsuitable because of its restricted  
scope and great complexity

**UN STTR:** probably more suitable  
because it is broader and less complex

# Pillar Two STTR v. UN STTR

## Which one is more beneficial?

- **As subject to tax rules:** do they address the existing challenges, or do they create additional (and new) challenges?

Issue	Pillar Two STTR	UN STTR
Meaning of "subject to tax"	Establishes a minimum tax rate	Establishes a minimum tax rate
Uniformity	To be uniformly applied. However, the use of several new and different terms, along with limitations can raise issues	Terms to be defined bilaterally (e.g., the rate, what constitutes a "special exemption, exclusion or reduction") can raise issues
Procedural challenges	Very complex to administer (ex-post annualised charge, filing of tax return, exchange of different information, etc.)	Less complex to administer (e.g., applies to current payments, no need for returns, etc.)

# Is This the Direction Tax Treaties Should Go?

- **Subject-to-tax clauses as a means to prevent double non-taxation**
  - Aligned with single taxation trend
  - Necessary? Effective? The devil is in the drafting
- **Pillar Two**
  - Do we need STTRs if Pillar Two is implemented globally?
  - Protection for source taxation still needed.
- **Exploring alternatives**
  - Adopting different SAARs: comparable outcomes?
    - Special Tax Regime provision – put forward under BEPS Action 6 as an optional measure
    - Third Country PE provision in Article 29(8) of the OECD Model
  - Revamped STTR in the UN Framework Convention on International Tax Cooperation
    - Striking the Balance: detail vs. complexity dilemma
    - Taking the best of both: integrating Pillar Two STTR with UN STTR

# Thank you!



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