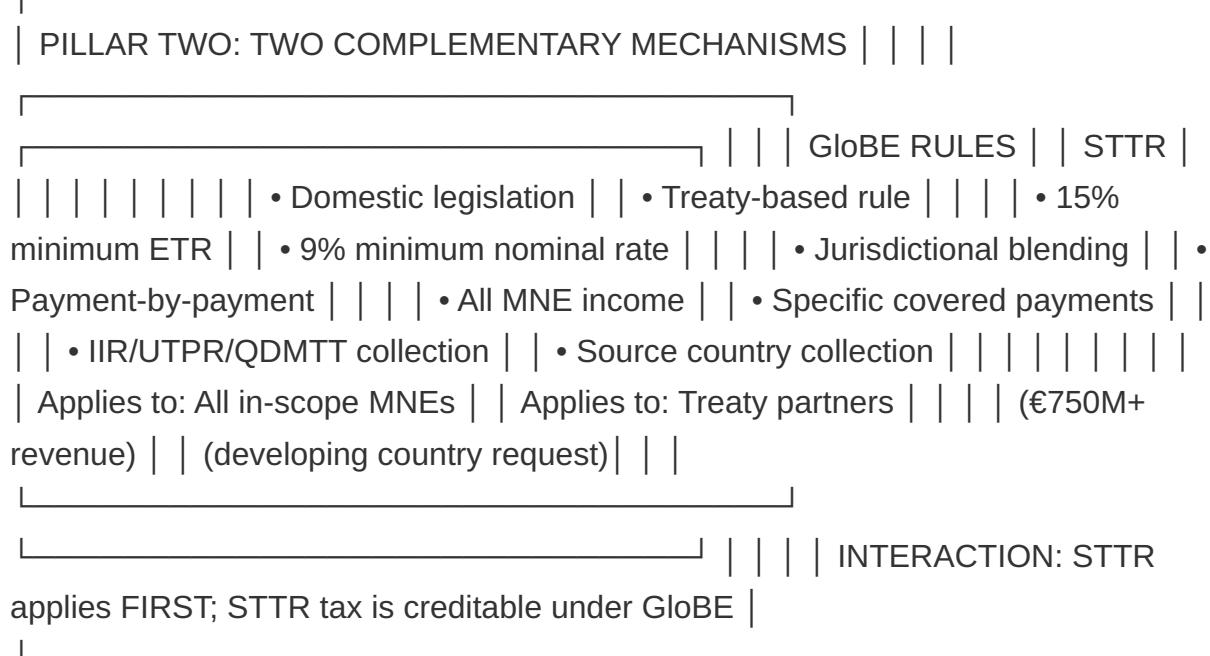# Chapter 8.1: STTR Design and Mechanics

Learning Objective

After completing this chapter, you will be able to identify payments subject to the Subject to Tax Rule (STTR), calculate the adjusted nominal tax rate and STTR specified rate, apply the mark-up proxy to exclude low-risk transactions, and understand how STTR interacts with existing tax treaties and the GloBE Rules.

```
┌
│ PILLAR TWO: TWO COMPLEMENTARY MECHANISMS │ │ │ │
┌
┌                                          │ │ │ GloBE RULES │ │ STTR │
│ │ │ │ │ │ │ │ │ • Domestic legislation │ │ • Treaty-based rule │ │ │ │ • 15%
minimum ETR │ │ • 9% minimum nominal rate │ │ │ │ • Jurisdictional blending │ │ •
Payment-by-payment │ │ │ │ • All MNE income │ │ • Specific covered payments │ │
│ │ • IIR/UTPR/QDMTT collection │ │ • Source country collection │ │ │ │ │ │ │ │ │
│ Applies to: All in-scope MNEs │ │ Applies to: Treaty partners │ │ │ │ (€750M+
revenue) │ │ (developing country request)│ │ │
┌
┌                                          │ │ │ │ INTERACTION: STTR
applies FIRST; STTR tax is creditable under GloBE │
┌
```

```
### Why STTR Exists

The STTR addresses a specific concern of **developing countries**:

| Concern | STTR Response |
|---------|---------------|
```

| Developing countries often serve as **source** jurisdictions for paym
| Existing treaties may limit withholding tax rates | STTR overrides tr
| GloBE Rules primarily benefit **residence** jurisdictions (via IIR) |

STTR Scope: Covered Income

What Payments Are Covered?

The STTR applies to specific categories of **intra-group payments** whe

STTR COVERED INCOME TYPES

| CATEGORY 1: INTEREST │ │ │ │ • All interest payments between connected persons │ │ • No mark-up threshold applies │ │ • Subject only to materiality threshold │

| CATEGORY 2: ROYALTIES │ │ │ │ • Payments for use of intellectual property │ │ • Patents, trademarks, copyrights, know-how │ │ • No mark-up threshold applies │

| CATEGORY 3: OTHER COVERED PAYMENTS │ │ │ │ • Distribution rights payments │ │ • Equipment rental (industrial, commercial, scientific) │ │ • Service fees (intra-group services) │ │ • Insurance and reinsurance premiums │ │ │ │ Note: Mark-up threshold (8.5%) applies to these payments │

| NOT COVERED │ │ │ │ • Dividends │ │ • Capital gains │ │ • Business profits (other than above categories) │ │ • Payments to unconnected persons │

Connected Persons Definition

The STTR applies only to payments between **connected persons**:

```
| Test | Threshold |
|------|-----------|
| **Direct ownership** | >50% of voting rights or capital |
| **Indirect ownership** | >50% through chain of entities |
| **Common control** | Both entities >50% owned by same person(s) |
| **De facto control** | Control as a matter of fact and circumstance |


**Example:**
```

Stratos Holdings plc (UK) │ └── 100% owns SG Ireland Ltd │ └── Pays royalties to SG Luxembourg S.à r.l. (also 100% owned by Stratos)

Result: SG Ireland and SG Luxembourg are CONNECTED PERSONS → Royalty payment is within STTR scope

```
 ## The 9% Nominal Rate Threshold


 ### Adjusted Nominal Rate


 The STTR applies when the **adjusted nominal tax rate** in the recipient
```

ADJUSTED NOMINAL RATE CALCULATION

Step 1: Identify STATUTORY rate applicable to recipient → General corporate rate OR → Special rate for specific income type

Step 2: Adjust for PREFERENTIAL ADJUSTMENTS → Permanent reductions in taxable base → Special deductions or exemptions → IP box regimes with reduced rates

Step 3: Determine ADJUSTED NOMINAL RATE → Statutory rate × (1 - preferential adjustment %)

Step 4: Compare to 9% THRESHOLD → If < 9%: STTR potentially applies → If ≥ 9%: STTR does not apply

Examples of Adjusted Nominal Rates

Jurisdiction	Statutory Rate	Preferential Regime	Adjusted Nomina
Ireland	12.5%	None	**12.5%**	No
Luxembourg	24.94%	IP box (80% exemption)	**4.99%**	**Yes**
Netherlands	25.8%	Innovation box (9% rate)	**9%**	Borderline
Singapore	17%	Pioneer status (0%)	**0%**	**Yes**
Switzerland	14%	Patent box (90% relief)	**1.4%**	**Yes**
UK	25%	Patent box (10% rate)	**10%**	No

Preferential Adjustments

The adjusted nominal rate accounts for **preferential adjustments** tha

Adjustment Type	Treatment
IP box/Patent box	Apply reduced effective rate
Participation exemption	Not a preferential adjustment (applies
Accelerated depreciation	Not preferential (timing difference)
R&D super deduction	Preferential if permanent
Notional interest deduction	Preferential adjustment
Tax holidays	Apply 0% rate for holiday period

STTR Specified Rate Calculation

When the STTR applies, the **source country** may impose additional tax

Formula

STTR SPECIFIED RATE = 9% − Adjusted Nominal Rate − Existing Treaty WHT Rate

Where: • 9% = STTR minimum rate • Adjusted Nominal Rate = Rate in recipient jurisdiction • Existing Treaty WHT = Withholding tax rate permitted under other treaty articles

Worked Example: Royalty Payment

Scenario: SG Germany GmbH (source) pays €5 million royalties to SG S

Item	Value
Singapore statutory rate	17%
Singapore applies pioneer status to IP income	0% effective rate
Adjusted nominal rate	**0%**
Germany-Singapore treaty WHT on royalties	0%
STTR specified rate	9% − 0% − 0% = **9%**
Royalty payment	€5,000,000
STTR tax (Germany collects)	€5,000,000 × 9% = **€450,000**

Worked Example: Interest Payment with Existing WHT

Scenario: SG Ireland Ltd (source) pays €2 million interest to a Lux

Item	Value
Luxembourg statutory rate	24.94%
Luxembourg applies participation exemption financing rules	0% on int
Adjusted nominal rate	**0%**
Ireland-Luxembourg treaty WHT on interest	0%
STTR specified rate	9% − 0% − 0% = **9%**
Interest payment	€2,000,000
STTR tax (Ireland collects)	€2,000,000 × 9% = **€180,000**

Interaction with Existing WHT

If the existing treaty already permits withholding tax, the STTR **tops

```
  **Example:** Source country treaty permits 5% WHT on royalties; recipie
```

STTR specified rate = 9% − 2% − 5% = 2%

Result: Source country can impose: • 5% under existing treaty Article • 2% additional under STTR • Total: 7% (not 9%, because treaty already permits 5%)

Wait — let's recalculate: The STTR allows collection of the DIFFERENCE between 9% and the sum of: - Adjusted nominal rate (2%) - Existing WHT under treaty (5%)

STTR specified rate = 9% − 2% − 5% = 2%

Source country total collection: • 5% (existing treaty) + 2% (STTR) = 7%

Note: If treaty already permits 5% WHT, total tax is 5% + 2% = 7% This is because the payment is subject to 5% + 2% = 7% total The remaining 2% is subject to nominal rate (2%), so total = 9%

```
  Actually, let me clarify the STTR mechanism more precisely:
```

STTR COLLECTION MECHANISM

The STTR specified rate represents the ADDITIONAL tax the source country may impose BEYOND what it can already collect under the treaty.

If: • Adjusted nominal rate in recipient = 2% • Existing treaty WHT permitted = 5% • Combined: 2% + 5% = 7%

STTR allows source country to top up to 9%: • STTR specified rate = 9% − 2% − 5% = 2%

Source country collects: • 5% under treaty + 2% under STTR = 7%

Recipient bears: • 2% domestic tax + 7% source WHT = 9% total

The 9% minimum is achieved through combination of: 1. Recipient jurisdiction tax 2. Source jurisdiction WHT under treaty 3. Source jurisdiction STTR top-up

```
## Mark-up Proxy: Substantial Activities Test

### Purpose

The **mark-up threshold** excludes low-margin payments from the STTR, s

### Application
```

MARK-UP THRESHOLD

Applies to: Service fees, equipment rental, distribution rights Does NOT apply to:
Interest, royalties

Test: Is the gross income > (Costs + 8.5% of Costs)?

If YES: Mark-up exceeds threshold → STTR may apply If NO: Mark-up within
threshold → STTR does NOT apply

```
### Calculation
```

MARK-UP THRESHOLD CALCULATION

Step 1: Identify GROSS INCOME from covered payment → Total payment received

Step 2: Identify ATTRIBUTABLE COSTS → Direct costs of earning the income →
Indirect costs reasonably attributable

Step 3: Calculate THRESHOLD AMOUNT → Costs + (Costs × 8.5%) → = Costs ×
1.085

Step 4: Apply TEST → If Gross Income > Threshold: STTR may apply → If Gross
Income ≤ Threshold: STTR does not apply

```
### Worked Example: Service Fee

**Scenario:** SG Singapore Pte Ltd provides management services to SG I

| Item | Amount |
```

Service fee received	€1,200,000
Direct costs (personnel, travel)	€800,000
Indirect costs (allocated overhead)	€200,000
Total attributable costs	**€1,000,000**
Threshold calculation	€1,000,000 × 1.085 = €1,085,000
Test: Is €1,200,000 > €1,085,000?	**Yes**
Mark-up: (€1,200,000 − €1,000,000) / €1,000,000	**20%**
Result: Mark-up (20%) exceeds 8.5% → **STTR may apply**

Worked Example: Low-Margin Service

Scenario: Same service, but lower fee.

Item	Amount
Service fee received	€1,050,000
Total attributable costs	€1,000,000
Threshold calculation	€1,000,000 × 1.085 = €1,085,000
Test: Is €1,050,000 > €1,085,000?	**No**
Mark-up: (€1,050,000 − €1,000,000) / €1,000,000	**5%**
Result: Mark-up (5%) within 8.5% → **STTR does NOT apply**

Summary: Mark-up Threshold

Payment Type	Mark-up Threshold Applies?
Interest	**No**
Royalties	**No**
Service fees	**Yes** (8.5%)

Equipment rental	**Yes** (8.5%)
Distribution rights	**Yes** (8.5%)
Insurance premiums	**Yes** (8.5%)

Materiality Threshold

De Minimis Exclusion

The STTR includes a **materiality threshold** to exclude small payments

Source Country GDP	Materiality Threshold
≥ €40 billion	**€1,000,000** per year
< €40 billion	**€250,000** per year

Application

The threshold applies to the **aggregate** of all covered payments from

Example:

SG Germany GmbH makes the following payments to SG Singapore Pte Ltd:

• Royalties: €400,000 • Service fees: €300,000 • Interest: €200,000 • Total covered income: €900,000

Germany GDP: > €40 billion → Threshold: €1,000,000

Result: Total (€900,000) < Threshold (€1,000,000) → STTR does NOT apply to any payments

Treaty Interaction

STTR and Existing Treaty Articles

The STTR operates as a **new article** inserted into existing bilateral

TREATY STRUCTURE WITH STTR

Existing Treaty Articles: ├── Article 11: Interest (e.g., 10% WHT limit) ├── Article 12: Royalties (e.g., 5% WHT limit) ├── Article 13: Service fees (often no WHT) │ NEW STTR Article: └── Article XX: Subject to Tax Rule → Allows source country to impose additional tax → Up to STTR specified rate → On covered income taxed below 9% in recipient country

```
### Priority Rules
```

STTR PRIORITY AND INTERACTION

1. EXISTING TREATY RIGHTS PRESERVED → Source country retains any existing WHT rights → STTR tops up to 9%, not replaces

2. STTR vs GloBE RULES → STTR applies FIRST (treaty level) → STTR tax is CREDITABLE under GloBE Rules → Reduces GloBE Top-Up Tax liability

3. STTR vs QDMTT → STTR tax reduces income for QDMTT purposes → No double counting

EXAMPLE: Payment: €10 million royalty STTR tax collected by source: €900,000 (9%)

For GloBE purposes: • Recipient includes €10 million income • Credits €900,000 STTR as covered tax • ETR increased by STTR credit

```
### GloBE Interaction Example

**Before STTR:**
```

Recipient jurisdiction (Singapore, 0% on IP income): GloBE Income: €10,000,000 Covered Taxes: €0 ETR: 0% Top-Up Tax %: 15% Top-Up Tax: €10,000,000 × 15% = €1,500,000 (to UPE jurisdiction)

```
**After STTR:**
```

Source jurisdiction collects STTR: €900,000

Recipient jurisdiction (Singapore): GloBE Income: €10,000,000 Covered Taxes: €900,000 (STTR credit) ETR: 9% Top-Up Tax %: 6% Top-Up Tax: €10,000,000 × 6% = €600,000 (to UPE jurisdiction)

Total tax on payment: • STTR (source): €900,000 • GloBE Top-up (UPE): €600,000 • Total: €1,500,000 (15% effective rate achieved)

```
  ## STTR Impact Assessment Framework


  ### Step-by-Step Assessment
```

STTR IMPACT ASSESSMENT FRAMEWORK

For each intercompany payment:

```
┌─────────────────────────────────────────────────────────────────
│ STEP 1: IS THE PAYMENT COVERED INCOME? │ │ │ │ □ Interest → YES
(proceed) │ │ □ Royalties → YES (proceed) │ │ □ Service fees → YES (proceed) │
│ □ Equipment rental → YES (proceed) │ │ □ Distribution rights → YES (proceed) │
│ □ Insurance premiums → YES (proceed) │ │ □ Dividends → NO (STTR does not
apply) │ │ □ Other → NO (STTR does not apply) │
└─────────────────────────────────────────────────────────────────
│ ▼
┌─────────────────────────────────────────────────────────────────
│ STEP 2: ARE THE PARTIES CONNECTED? │ │ │ │ □ >50% common ownership?
→ YES (connected) │ │ □ Common control? → YES (connected) │ │ □ Neither →
NO (STTR does not apply) │
└─────────────────────────────────────────────────────────────────
│ ▼
┌─────────────────────────────────────────────────────────────────
│ STEP 3: DOES THE MATERIALITY THRESHOLD APPLY? │ │ │ │ Total covered
payments to recipient jurisdiction: €_ │ │ Source country GDP ≥ €40B? →
Threshold: €1,000,000 │ │ Source country GDP < €40B? → Threshold: €250,000
│ │ │ │ Total < Threshold? → NO (STTR does not apply) │ │ Total ≥ Threshold?
→ YES (proceed) │
└─────────────────────────────────────────────────────────────────
│ ▼
┌─────────────────────────────────────────────────────────────────
```

| **STEP 4: DOES THE MARK-UP THRESHOLD APPLY? (Services/Rental only)** |
| | | **For interest/royalties: SKIP (no mark-up test)** | | | | **For services/rental:** |
| | **Gross income: €_** | | Attributable costs: €_ | | **Threshold (costs × 1.085): €_**
| | | | Gross income ≤ Threshold? → NO (STTR does not apply) | | Gross income
> Threshold? → YES (proceed) |

| ▼

| STEP 5: WHAT IS THE ADJUSTED NOMINAL RATE? | | | | Recipient
jurisdiction statutory rate: _% | | Preferential adjustment (if any): _% | | Adjusted
nominal rate: _% | | | | Adjusted nominal rate ≥ 9%? → NO (STTR does not apply)
| | Adjusted nominal rate < 9%? → YES (proceed) |

| ▼

| STEP 6: CALCULATE STTR SPECIFIED RATE | | | | STTR specified rate = 9%
− Adjusted nominal rate − Existing WHT | | | | = 9% − _% − _% = _% | | | |
STTR TAX = Payment amount × Specified rate | | = €_ × _% = €_ |

7. Stratos Worked Example: STTR Assessment

7.1 Background

Stratos Holdings plc assesses STTR exposure on intercompany payments fo

Intercompany Payment Matrix

Payer	Recipient	Payment Type	Amount (€)	Notes
SG Germany	SG Singapore	Royalties	2,500,000	IP licence
SG Ireland	SG Luxembourg	Interest	3,000,000	Intercompany loan
SG Germany	SG Ireland	Service fees	1,800,000	Shared services
SG UK	SG Singapore	Distribution rights	800,000	Product distri

Assessment 1: Royalties (Germany → Singapore)

Step	Assessment
1. Covered income?	Royalties → **Yes**
2. Connected persons?	Both 100% owned by Stratos → **Yes**
3. Materiality?	€2.5M > €1M (Germany GDP > €40B) → **Exceeds**
4. Mark-up threshold?	N/A for royalties
5. Adjusted nominal rate?	Singapore 17%, but 0% under pioneer s
6. STTR specified rate?	9% − 0% − 0% (no treaty WHT) = **9%**

STTR Tax: €2,500,000 × 9% = **€225,000** (collected by Germany)

Assessment 2: Interest (Ireland → Luxembourg)

Step	Assessment
1. Covered income?	Interest → **Yes**
2. Connected persons?	Both 100% owned by Stratos → **Yes**
3. Materiality?	€3M > €1M (Ireland GDP > €40B) → **Exceeds**
4. Mark-up threshold?	N/A for interest
5. Adjusted nominal rate?	Luxembourg 24.94% general, but IP fin
6. STTR specified rate?	9% − 0% − 0% = **9%**

STTR Tax: €3,000,000 × 9% = **€270,000** (collected by Ireland)

Assessment 3: Service Fees (Germany → Ireland)

Step	Assessment
1. Covered income?	Service fees → **Yes**
2. Connected persons?	Both 100% owned by Stratos → **Yes**
3. Materiality?	€1.8M > €1M → **Exceeds**
4. Mark-up threshold?	Gross: €1.8M; Costs: €1.5M; Threshold: €1
5. Adjusted nominal rate?	Ireland 12.5% → **≥ 9%**
6. STTR?	**Does NOT apply** (rate ≥ 9%)

STTR Tax: €0

Assessment 4: Distribution Rights (UK → Singapore)

Step	Assessment
1. Covered income?	Distribution rights → **Yes**
2. Connected persons?	Both 100% owned by Stratos → **Yes**
3. Materiality?	€800,000 < €1M → **Below threshold**
4. STTR?	**Does NOT apply** (materiality not met)

STTR Tax: €0

Summary: Stratos STTR Exposure

Payment	Payer	Recipient	STTR Tax (€)	Collecting Jurisdiction
Royalties	Germany	Singapore	**225,000**	Germany
Interest	Ireland	Luxembourg	**270,000**	Ireland
Services	Germany	Ireland	0	—
Distribution	UK	Singapore	0	—
Total			**€495,000**	

GloBE Impact

The STTR taxes increase Covered Taxes in the recipient jurisdictions:

Jurisdiction	Pre-STTR Covered Taxes	STTR Credit	Post-STTR Cover...
Singapore	€392,206	+€225,000	**€617,206**
Luxembourg	€212,500	+€270,000	**€482,500**

Singapore ETR Impact:
- Pre-STTR: €392,206 / €4,000,000 = 9.81%
- Post-STTR: €617,206 / €4,000,000 = **15.43%** (above 15% minimum!)

Result: Singapore no longer generates GloBE Top-Up Tax after STTR c

8. Common Pitfalls

Pitfall 1: Ignoring Preferential Regimes

Error: Assuming the statutory rate is the adjusted nominal rate.

Correct approach: Identify all preferential adjustments (IP boxes,

Pitfall 2: Applying Mark-up Test to Interest/Royalties

Error: Excluding interest or royalty payments because the mark-up is

Correct approach: The mark-up threshold does **not apply** to intere

Pitfall 3: Forgetting Materiality Aggregation

Error: Testing each payment individually against the materiality th

Correct approach: Aggregate **all** covered payments from the source

Pitfall 4: Double-Counting STTR in GloBE

Error: Not crediting STTR tax as Covered Taxes under GloBE.

Correct approach: STTR taxes paid are creditable under the GloBE Ru

Pitfall 5: Assuming STTR Applies to All Treaties

Error: Calculating STTR exposure without confirming the treaty has

Correct approach: STTR only applies if the relevant bilateral treat

9. STTR Assessment Checklist

STTR ASSESSMENT CHECKLIST MNE Group: _____ *Fiscal Year:* ____

SECTION A: IDENTIFY INTERCOMPANY PAYMENTS

List all intercompany payments between connected group entities:

#	Payer	Recipient	Type	Amount (€)
1				
2				
3				

SECTION B: FILTER FOR STTR SCOPE

For each payment:

☐ Is payment type covered? (Interest/Royalty/Service/Rental/Distribution) ☐ Are parties connected? (>50% common ownership) ☐ Is relevant treaty modified to include STTR?

SECTION C: AGGREGATE BY RECIPIENT JURISDICTION

Recipient Jurisdiction	Total Covered Payments (€)	Materiality Threshold (€)	Exceeds?

SECTION D: APPLY MARK-UP TEST (Services/Rental Only)

Payment	Gross (€)	Costs (€)	Threshold (€)	Mark-up %	Applies?

SECTION E: DETERMINE ADJUSTED NOMINAL RATES

Recipient Jurisdiction	Statutory Rate	Preferential Regime	Adjusted Rate	< 9%?

SECTION F: CALCULATE STTR TAX

Payment	Amount (€)	Adj. Nom. Rate	Treaty WHT	Specified Rate	STTR Tax (€)

TOTAL STTR EXPOSURE: €_____

SECTION G: GloBE IMPACT

Recipient Jurisdiction	Pre-STTR ETR	STTR Credit (€)	Post-STTR ETR

☐ STTR credits recorded as Covered Taxes in GloBE calculation ```