

## EXPLANATORY STATEMENT TO THE MULTILATERAL CONVENTION TO FACILITATE THE IMPLEMENTATION OF THE PILLAR TWO SUBJECT TO TAX RULE

*Adopted by the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (BEPS) on 15 September 2023.*

### Background

1. The *Multilateral Convention to Facilitate the Implementation of the Pillar Two Subject to Tax Rule* (the Convention) is one of the outcomes of the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (the OECD/G20 Inclusive Framework on BEPS) Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy (the OECD/G20 Inclusive Framework Two-Pillar Solution), which following years of intensive negotiations to bring the international tax system into the 21st century, was agreed upon by the OECD/G20 Inclusive Framework on BEPS as set out in the [Statement on the Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy on 8 October 2021](#) (the 2021 October Statement).
2. As part of the agreement on the OECD/G20 Inclusive Framework Two-Pillar Solution set out in the 2021 October Statement, members of the OECD/G20 Inclusive Framework on BEPS applying nominal corporate income tax rates below the minimum rate of nine per cent to interest, royalties and a defined set of other payments took on a commitment to implement the subject to tax rule (STTR) in their bilateral tax treaties when requested to do so by IF members identified as developing for this purpose (developing countries).
3. As part of the detailed implementation plan annexed to the 2021 October Statement members of the OECD/G20 Inclusive Framework on BEPS agreed to develop a multilateral instrument to facilitate the implementation of the STTR between the subset of jurisdictions described above. The aim was to provide an effective way to implement the STTR swiftly in relevant existing bilateral tax treaties. Alternatively, members of the OECD/G20 Inclusive Framework on BEPS may implement the STTR via bilateral negotiations.
4. The detailed implementation plan annexed to the 2021 October Statement mandated the development of a model treaty provision to give effect to the STTR, together with commentary explaining its operation. The STTR model treaty provision, together with its detailed commentary, are included in the Report on the Subject to Tax Rule (the STTR Report).<sup>1</sup>
5. Working Party 1 on Tax Conventions and Related Questions (Working Party 1) has developed the text of the Convention which was adopted by the OECD/G20 Inclusive Framework on BEPS on 15 September 2023 and open for signature as of 2 October 2023.
6. Delegates of Working Party 1, which represented governments of the members of the OECD/G20 Inclusive Framework on BEPS on 15 September 2023, participated in the negotiation of the Convention on an equal footing. The Co-Chairs of Working Party 1 were Aart Roelofsen of the Netherlands and Carmel Peters of New Zealand.
7. As the substance of the STTR and its associated commentary had been stabilised by Working Party 1 under the guidance of the Steering Group of the OECD/G20 Inclusive

<sup>1</sup> OECD/G20 Inclusive Framework on BEPS (2023), Report on the Subject to Tax Rule.

Framework on BEPS, the development of the Convention focused on the way in which it would implement the STTR in relevant existing bilateral tax treaties.

8. The text of this explanatory statement to accompany the Convention (“Explanatory Statement”) was prepared by Working Party 1 to provide clarification of the approach taken in the Convention and how it amends existing bilateral tax agreements covered by the Convention (“Covered Tax Agreements”). It therefore reflects the agreed understanding of the negotiators with respect to the Convention. The OECD/G20 Inclusive Framework on BEPS adopted this Explanatory Statement on 15 September 2023 at the same time as adopting the text of the Convention.

9. The development of the STTR that is implemented by the Convention also included development of detailed commentary which is intended to be used in the interpretation of the STTR. While this Explanatory Statement is intended to clarify the operation of the Convention to amend existing bilateral tax treaties, it is not intended to address the interpretation of the underlying STTR. Accordingly, the provisions contained in the Convention should be interpreted in accordance with the ordinary principles of treaty interpretation, which is that a treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in light of its object and purpose. In this regard, the object and purpose of the Convention is to facilitate the implementation of the STTR. The commentary that was developed by Working Party 1 and reflected in the STTR Report approved by the OECD/G20 Inclusive Framework on BEPS on 6 July 2023 has particular relevance in this regard.

### **Approach taken in the Convention**

10. The Convention applies to Covered Tax Agreements that are existing bilateral tax treaties that are explicitly identified by each of the parties to those tax treaties (the Contracting Jurisdictions). It operates to directly amend those treaties in order to implement the STTR and other relevant accompanying provisions as annexes to those treaties.

11. The STTR is included in Annex I (The subject to tax rule) to the Convention and, where the Convention applies with respect to a Covered Tax Agreement, Annex I (The subject to tax rule) is added as an annex to the Covered Tax Agreement. A Covered Tax Agreement is any tax treaty in force between Parties to the Convention which has been notified by both Contracting Jurisdictions as an agreement they wish to be covered by the Convention.

12. The Convention does not amend the text, sequencing or numbering of existing provisions in Covered Tax Agreements. Instead, the Convention amends the Covered Tax Agreements to include the STTR and other relevant accompanying provisions as Annexes to the Covered Tax Agreement. Once included in a Covered Tax Agreement, the Annexes form an integral part of the Covered Tax Agreement.

13. The Convention, by directly amending existing bilateral tax treaties, functions like an amending protocol to a single existing bilateral tax treaty. Its functioning can be distinguished from the functioning of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (the BEPS Multilateral Convention), which applies alongside existing tax treaties and modifies their application in order to implement the measure developed in the course of the OECD/G20 Base Erosion and Profit Shifting Project.<sup>2</sup> As such, and unlike the BEPS Multilateral Convention, once

<sup>2</sup> The functioning of the BEPS Multilateral Convention is explained in paragraph 13 of the Explanatory Statement to the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting: <https://www.oecd.org/tax/treaties/explanatory-statement-multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-BEPS.pdf>. While the BEPS Multilateral Convention constituted the first use of a multilateral treaty to modify bilateral tax treaties, this mechanism had already been used in other areas. For example, a 2003 Agreement on Extradition between the European Union and the United States of America: <http://ec.europa.eu/world/agreements/downloadFile.do?fullText=yes&treatyTransId=10121>. See also Developing a

the Convention amends a relevant Covered Tax Agreement, the Convention no longer needs to be read in conjunction with the Covered Tax Agreement. As a result, Contracting Jurisdictions may wish to develop consolidated versions of their Covered Tax Agreements as they have been amended by the Convention.

14. It is important to note that the Convention is not intended to freeze in time the underlying agreement and Contracting Jurisdictions may decide to further amend the underlying agreement after it has been amended by the Convention. The right of the Contracting Jurisdictions to further amend their Covered Tax Agreements remains unaffected, irrespective of whether the further amendments relate to provisions that have been included by the Convention. This is reflected in Article 2 in Annex I (The subject to tax rule, Implications of the subject to tax rule), which provides that subsequent modifications to Covered Tax Agreements may be agreed between the Contracting Jurisdictions.

### The Annexes to the Convention

15. **Annex I (The subject to tax rule)** of the Convention includes the STTR and, as mentioned above, is added in all Covered Tax Agreements.

16. The Convention contains four other Annexes which include additional provisions that are required for the operation of the STTR in certain circumstances. Those Annexes are added in certain Covered Tax Agreements, in addition to Annex I (The subject to tax rule), where specified objective conditions are met. The provisions in Part II (Inclusion of annexes in Covered Tax Agreements) of the Convention define the conditions under which each of those other Annexes are included in a Covered Tax Agreement in addition to Annex I (The subject to tax rule):

- **Annex II (Additions to the subject to tax rule: Taxes computed on an alternative basis)** of the Convention contains the additional provisions required for the determination of the tax rate in paragraph 5 of Article 1 in Annex I (The subject to tax rule, Meaning of “tax rate”) for taxes computed on an alternative basis. This Annex is included in a Covered Tax Agreement in addition to Annex I (The subject to tax rule) where at least one of the Contracting Jurisdiction to the Covered Tax Agreement applies a tax computed on an alternative basis. Parties that apply such taxes on an alternative basis are required to make a notification under the Convention and identify the name of the tax and relevant legal references. That notification triggers the inclusion of Annex II (Additions to the subject to tax rule: Taxes computed on an alternative basis) in a Covered Tax Agreement.
- **Annex III (Additions to the subject to tax rule: Taxes imposed at the point of distribution)** of the Convention contains the additional provisions required for the determination of the tax rate in paragraph 5 of Article 1 in Annex I (The subject to tax rule, Meaning of “tax rate”) for taxes imposed only at the point of distribution. This Annex is included in a Covered Tax Agreement in addition to Annex I (The subject to tax rule) where at least one of the Contracting Jurisdiction to the Covered Tax Agreement imposes tax only at the point of distribution. Parties that apply such taxes only at the point of distribution are required to make a notification under the Convention and identify the name of the tax and relevant legal references. That notification triggers the inclusion of Annex III (Additions to the subject to tax rule: Taxes imposed at the point of distribution) in a Covered Tax Agreement.

Multilateral Instrument to Modify Bilateral Tax Treaties, Action 15 - 2015 Final Report p.35: [http://www.keepeek.com/Digital-Asset-Management/oecd/taxation/developing-a-multilateral-instrument-to-modify-bilateral-tax-treaties-action-15-2015-final-report\\_9789264241688-en#page1](http://www.keepeek.com/Digital-Asset-Management/oecd/taxation/developing-a-multilateral-instrument-to-modify-bilateral-tax-treaties-action-15-2015-final-report_9789264241688-en#page1). Other examples, cited in the Annex to the 2014 Report (pp. 32-34), include the European Convention on Extradition (1957), European Convention on the Repatriation of Minors (1970), the Convention for the Suppression of Unlawful Acts against the Safety of Maritime Navigation (1988), the North American Free Trade Agreement (1994) and the International Convention for the Suppression of the Financing of Terrorism (1999).

- **Annex IV (Additions to the subject to tax rule: Recognised pension fund)** of the Convention contains a definition for the purposes of subparagraph c) of paragraph 8 of Article 1 in Annex I (The subject to tax rule, Exclusions). This Annex is included in a Covered Tax Agreement in addition to Annex I (The subject to tax rule) where at least one of the Contracting Jurisdictions to the Covered Tax Agreement chooses to include that definition. Parties that choose to include such a definition for the purposes of subparagraph c) of paragraph 8 of Article 1 in Annex I (The subject to tax rule, Exclusions) are required to make a notification under the Convention and include the list of their Covered Tax Agreements in which they choose to include such a definition. A notification made with respect to a Covered Tax Agreement triggers the inclusion of Annex IV (Additions to the subject to tax rule: Recognised pension fund) in the Covered Tax Agreement.
- **Annex V (Additions to the subject to tax rule: Circuit-breaker provision)** of the Convention contains a circuit-breaker provision. This Annex is included in a Covered Tax Agreement in addition to Annex I (The subject to tax rule) where at least one of the Contracting Jurisdictions to the Covered Tax Agreement chooses to include such a circuit-breaker in its Covered Tax Agreements. Parties that choose to include the circuit-breaker in their Covered Tax Agreements are required to make a notification under the Convention and this choice will apply to all of their Covered Tax Agreements. That notification made with respect to a Party's Covered Tax Agreements triggers the inclusion of Annex V (Additions to the subject to tax rule: Circuit-breaker provision) in its Covered Tax Agreements.

17. Annex I (The subject to tax rule), Annex II (Additions to the subject to tax rule: Taxes computed on an alternative basis) and Annex III (Additions to the subject to tax rule: Taxes imposed at the point of distribution) reflect the STTR model treaty provision and additional provisions in the commentary on the STTR treaty provision with adaptations required to implement STTR in different existing bilateral tax treaties. Those adaptations include the replacement of cross-references to specific Articles and paragraphs with descriptions of those provisions. A number of paragraphs in the STTR interact with existing provisions of Covered Tax Agreements. Because existing tax treaties vary from each other, it would not be possible for the Convention to identify those provisions by referring to specific articles and paragraph numbers. Instead, where a reference to the provisions of existing tax agreements is necessary, the Convention uses descriptive language to identify those provisions.

18. Similarly, throughout Annex I (The subject to tax rule), and throughout Annex II (Additions to the subject to tax rule: Taxes computed on an alternative basis), Annex III (Additions to the subject to tax rule: Taxes imposed at the point of distribution), Annex IV (Additions to the subject to tax rule: Recognised pension fund), and Annex V (Additions to the subject to tax rule: Circuit-breaker provision), a Covered Tax Agreement is referred to as "this agreement" and a Contracting Jurisdiction is referred to as a "contracting jurisdiction". This reflects the fact that Annex I (The subject to tax rule) (and where conditions are met, one or more of Annexes II to V) will be included in a Covered Tax Agreement and adapts those references accordingly. The adapted references to "this agreement" and a "contracting jurisdiction", when an Annex is included in a Covered Tax Agreement, are sufficiently clear and neutral as to apply appropriately in Covered Tax Agreements: that are described in their title as a "Convention", an "Agreement", an "Arrangement", or using a similar term; or in which a party to the Covered Tax Agreement is referred to as a "Contracting State", "Contracting Jurisdiction", or a similar term.

## Preamble

19. The preamble describes the overall purpose of the Convention to facilitate the implementation of the STTR that was developed as part of the OECD/G20 Inclusive Framework Two-Pillar Solution and that is an integral part of achieving a consensus for developing countries.

20. The penultimate paragraph of the preamble notes that the STTR is implemented in certain existing agreements for the avoidance of double taxation on income as part of the implementation of the OECD/G20 Inclusive Framework Two-Pillar Solution and that the provisions in this Convention do not otherwise reflect the tax treaty policies of members of the OECD/G20 Inclusive Framework on BEPS. This statement, which reflects subparagraphs a) and b) of paragraph 15 of the STTR model treaty provision in the STTR Report, sets out the context in which the STTR was developed and codifies the understanding of the negotiators that the STTR does not revisit the current allocation of taxing rights between Contracting Jurisdictions to a Covered Tax Agreement.

21. The inclusion of this statement in the preamble to the Convention is intended to confirm that the STTR does not otherwise reflect the tax treaty policies of either Contracting Jurisdiction to a Covered Tax Agreement. This confirms that the inclusion of the Covered Tax Agreement does not indicate that the Contracting Jurisdictions believe there should be any change to the principles reflected in that Covered Tax Agreement, including to the allocation of taxing rights.



























































the provision described in paragraph 68 of the commentary on the model provision (“[insert the name of the tax]”) with a reference to “the tax notified by a contracting jurisdiction”. Article 4 in Part II governs such notifications. Redundant placeholder references in the provision described in paragraph 68 of the commentary on the model provision (“[insert the name of the residence State]”) are deleted or replaced with a reference to “the first-mentioned jurisdiction” in paragraph 1 of Article 1 in Annex II (Additions to the subject to tax rule: Taxes computed on an alternative basis).

150. Paragraph 2 of Article 1 in Annex II (Additions to the subject to tax rule: Taxes computed on an alternative basis) has been added to clarify the application of this Annex where a Contracting Jurisdiction applies both a tax calculated on a net income basis and a tax on an alternative basis to an item of covered income. In such case, the tax rate on that item of covered income for the purpose of applying the STTR shall be determined by adding together the tax rate determined in accordance with subparagraph a) of paragraph 5 of Article 1 in Annex I (The subject to tax rule, Meaning of “tax rate”), in the case of the tax on a net income basis, and the tax rate determined in accordance with paragraph 1, in the case of the tax calculated other than on a net income basis.

151. Changes are made in paragraph 3 of Article 1 in Annex II (Additions to the subject to tax rule: Taxes computed on an alternative basis) to the text of the provision described in paragraph 76 of the commentary on the model provision to adapt it for inclusion in a Covered Tax Agreement. References to a “Contracting State” and the “Contracting States” are replaced with references to a “contracting jurisdiction” and the “contracting jurisdictions”.



### **Annex III. – Additions to the subject to tax rule: Taxes imposed at the point of distribution**

#### **Article 1 – Additional provisions for taxes imposed at the point of distribution**

152. Annex III (Additions to the subject to tax rule: Taxes imposed at the point of distribution) introduces into a Covered Tax Agreement additional provisions required for the purposes of determining the tax rate for the purposes of applying Article 1 in Annex I (The subject to tax rule) where a Contracting Jurisdiction does not impose tax on an item of covered income when the income is earned, but instead imposes tax on that income at the point of profit distribution. Article 1 in Annex III (Additions to the subject to tax rule: Taxes imposed at the point of distribution) is based on the provision mandated for inclusion in the model provision in those circumstances by paragraph 74 of the commentary on the model provision in the STTR Report, which reads as follows:

***(ii) Notwithstanding subdivision (i) of subparagraph a), the tax rate with respect to an item of covered income subject to the [insert the name of the distribution tax] in [insert the name of the residence State], shall be the rate that results from dividing the total amount of such tax paid by the resident of [insert the name of the residence State] for the year in which the covered income is reflected in its financial statements and the two immediately preceding years by the total amount of its net income for that year and those two immediately preceding years reflected in those financial statements.***

153. Changes are made in Article 1 in Annex III (Additions to the subject to tax rule: Taxes imposed at the point of distribution) to the text of the provision mandated in paragraph 74 of the commentary on the model provision, to adapt it for inclusion in a Covered Tax Agreement; and to reflect its inclusion in a Covered Tax Agreement in a separate annex (Annex III (Additions to the subject to tax rule: Taxes imposed at the point of distribution)) that supplements Annex I (The subject to tax rule) rather than in the form of changes to the affected provisions of Annex I (The subject to tax rule).

154. The provision described in paragraph 74 of the commentary on the model provision is drafted as a new subdivision (ii) of subparagraph a) of paragraph 5 of the model provision, and would require subparagraph a) of paragraph 5 of the model provision to be reformatted as subdivision (i) of paragraph a) of paragraph 5 of the model provision. Because this reformatting is not a feature of paragraph 5 of Article 1 in Annex I (The subject to tax rule, Meaning of “tax rate”), and because the provision described in paragraph 74 of the commentary on the model provision is included in a separate annex (Annex III (Additions to the subject to tax rule: Taxes imposed at the point of distribution)) that supplements Annex I (The subject to tax rule), changes are made in Article 1 in Annex III (Additions to the subject to tax rule: Taxes imposed at the point of distribution) to ensure that it interacts in the way intended with subparagraph a) of paragraph 5 of Article 1 in Annex I (The subject to tax rule, Meaning of “tax rate”). The change made to accommodate this need is the deletion of the reference to “subdivision (i) of” in the first line of the provision described in paragraph 74 of the commentary on the model provision.

155. Changes are also made in Article 1 in Annex III (Additions to the subject to tax rule: Taxes imposed at the point of distribution) to include appropriate cross-references to Annex I (The subject to tax rule) and to replace the placeholder reference in the provision described in paragraph 74 of the commentary on the model provision (“[insert the name of the distribution tax]”) with a reference to “the taxes notified by a contracting jurisdiction”. Article 5 in Part II governs such notifications. Redundant placeholder references in the provision described in paragraph 74 of the commentary on the model provision (“[insert the name of the residence State]”) are deleted or replaced with a reference to “the first-mentioned jurisdiction” in Article 1 in Annex III (Additions to the subject to tax rule: Taxes imposed at the point of distribution).

#### **Annex IV. – Additions to the subject to tax rule: Recognised pension fund**

156. Annex IV (Additions to the subject to tax rule: Recognised pension fund) provides a uniform definition of the term “recognised pension fund” for the purposes of applying subparagraph c) of paragraph 8 of Article 1 in Annex I (The subject to tax rule, Exclusions) which excludes a “recognised pension fund”, a “pension fund”, a “recognised pension scheme”, or a “pension scheme” from the application of the STTR.

157. Article 6 in Part II allows a Party to choose to include Annex IV (Additions to the subject to tax rule: Recognised pension fund) in some of its Covered Tax Agreements, in addition to Annex I (The subject to tax rule).

158. A Party might choose to include the definition of the term “recognised pension fund” in Annex IV (Additions to the subject to tax rule: Recognised pension fund) for the purposes of applying subparagraph c) of paragraph 8 of Article 1 in Annex I (The subject to tax rule, Exclusions) in a Covered Tax Agreement when the Covered Tax Agreement does not include a definition of the term “recognised pension fund”, “pension fund”, “recognised pension scheme”, or “pension scheme”, or where such a definition is included in the Covered Tax Agreement but a Contracting Jurisdiction prefers to apply the definition in Annex IV (Additions to the subject to tax rule: Recognised pension fund) for the purposes of applying subparagraph c) of paragraph 8 of Article 1 in Annex I (The subject to tax rule, Exclusions).

159. The definition of the term “recognised pension fund” is based on the definition in subparagraph i) of paragraph 1 of Article 3 of the OECD Model which was included in 2017, when this term was added to paragraph 1 of Article 4 of the OECD Model in order to ensure that a pension fund that meets the definition is considered as a resident of the Contracting State in which it is established. The definition in Annex IV (Additions to the subject to tax rule: Recognised pension fund) also includes the provisions in paragraph 10.8, and additional language based on paragraph 10.10, of the Commentary on Article 3 of the OECD Model.

160. Such an addition was included in the Commentary on the OECD Model for funds that can be established in States for the main purpose of providing retirement benefits to individuals but that do not formally constitute a separate person under the taxation laws of the State in which they are established. The aim was to ensure that, where the taxation laws of the State in which those funds are established provide that the investment assets of the funds constitute a separate and distinct patrimony the income of which is not allocated to any person for tax purposes, they will be considered, for the purposes of a tax treaty, as a separate person treated as such under the taxation law of that State and all the assets and income to which the arrangement applies shall be treated as assets held and income derived by that separate person and not by another person.

#### ***Article 1 – Definition for the exclusion in subparagraph c) of paragraph 8 of Article 1 in Annex I (The subject to tax rule)***

##### ***Paragraph 1***

161. Paragraph 1 provides that, when Annex IV (Additions to the subject to tax rule: Recognised pension fund) is included in a Covered Tax Agreement in addition to Annex I (The subject to tax rule), the term “recognised pension fund” in subparagraph c) of paragraph 8 of Article 1 in Annex I (The subject to tax rule, Exclusions) takes its meaning from paragraph 2 of Article 1 in Annex IV (Additions to the subject to tax rule: Recognised pension fund). Paragraph 1 also provides that the definition in paragraph 2 supersedes a definition of “recognised pension fund”, “pension fund”, “recognised pension scheme”, or “pension scheme” included elsewhere in a Covered Tax Agreement, but only for the purposes of subparagraph c) of paragraph 8 of Article 1 in Annex I (The subject to tax rule, Exclusions).

*Paragraph 2*

162. Paragraph 2 contains the definition of the term “recognised pension fund” that will apply for the purposes of applying subparagraph c) of paragraph 8 of Article 1 in Annex I (The subject to tax rule, Exclusions).

163. Subparagraph a) provides that the term “recognised pension fund” of a jurisdiction means an entity or arrangement established in that jurisdiction that is treated as a separate person under the taxation laws of that jurisdiction and:

- Under subdivision (i), that is established and operated exclusively or almost exclusively to administer or provide retirement benefits and ancillary or incidental benefits or other similar amount to individuals and that is regulated as such by that jurisdiction or one of its political subdivisions or local authorities; or
- Under subdivision (ii), that is established and operated exclusively or almost exclusively to invest funds for the benefit of entities or arrangements referred to in subdivision (i).

164. Subparagraph b) includes an arrangement which is not treated as a separate person under the taxation law of the Contracting Jurisdiction in which that arrangement is established in the case where it meets either of the conditions in subdivisions (i) or (ii) of subparagraph a). Such an arrangement will be considered, for the purposes of Annex IV (Additions to the subject to tax rule: Recognised pension fund) and Annex I (The subject to tax rule), as a separate person treated as such under the taxation law of that jurisdiction and all the assets and income to which the arrangement applies will be treated as assets held and income derived by that separate person and not by another person.

## **Annex V. – Additions to the subject to tax rule: Circuit-breaker provision**

165. Annex V (Additions to the subject to tax rule: Circuit-breaker provision) contains an optional circuit-breaker provision which could suspend the application of the provisions in Annex I (The subject to tax rule) with respect to a Covered Tax Agreement where a Contracting Jurisdiction to the Covered Tax Agreement, which was considered as a developing country for the purposes of the commitment to implement the STTR described in paragraph 2 of this Explanatory Statement, ceases to be a developing country as defined for a sustained period of five consecutive years.

166. When the circuit-breaker applies in a Covered Tax Agreement, its effect is not to remove the STTR from the Covered Tax Agreement. Instead, it suspends the application of the STTR. The circuit-breaker could then subsequently apply to “reactivate” the application of the provisions in Annex I (The subject to tax rule). For such a reactivation, the Contracting Jurisdiction that had ceased to be a developing country for a sustained period of five consecutive years, needs to subsequently again become a developing country as defined at any point in time.

167. Article 7 in Part II allows a Party to choose to include Annex V (Additions to the subject to tax rule: Circuit-breaker provision) in its Covered Tax Agreement, in addition to Annex I (The subject to tax rule).

### **Article 1 – Circuit-breaker provision**

#### *Paragraph 1*

168. Paragraph 1 provides that the application of the provisions in Annex I (The subject to tax rule) is suspended in a Covered Tax Agreement where the following conditions are met:

- Under subparagraph a), a Contracting Jurisdiction to the Covered Tax Agreement was not classified as a high-income economy by the World Bank Group based on its gross national income per capita using the World Bank Atlas method at any time since 1 July 2020; and
- Under subparagraph b), that same Jurisdiction is classified as a high-income economy by the World Bank Group based on its gross national income per capita using the World Bank Atlas method for a period of five consecutive years at any time following the date on which the provisions in Annex I (The subject to tax rule) started to have effect in accordance with Article 12 (Entry into effect).

169. The condition in subparagraph a) applies by reference to the World Bank Group's classifications of jurisdictions as low-income, lower-middle-income, upper-middle-income, and high-income by reference to GNI per capita using the World Bank Atlas method. For the purposes of the commitment to implement the STTR described in paragraph 2 of this Explanatory Statement, a jurisdiction is classified as developing if it is not a high-income jurisdiction according to this measure. The condition in subparagraph a) is therefore met if a jurisdiction is classified as developing at any time since 1 July 2020.

170. The condition in subparagraph b) applies by reference to the same measure and is met if a jurisdiction that has met the condition in subparagraph a) (that is, a jurisdiction that was classified as developing at any time since 1 July 2020) is classified as high-income (and so is not classified as developing) for a period of five consecutive years at any time following the date on which the provisions in Annex I (The subject to tax rule) started to have effect.

171. When triggered, the circuit-breaker provision suspends the application of Annex I (The subject to tax rule) as of the first day of the fiscal year beginning on or after the expiration of a period of six calendar months from the date on which the Contracting Jurisdiction mentioned in subparagraphs a) and b) is classified as a high-income economy

by the World Bank Group based on its gross national income per capita using the World Bank Atlas method for a period of five consecutive years.

*Paragraph 2*

172. Paragraph 2 provides that, when paragraph 1 applied and suspended the application of Annex I (The subject to tax rule) in a Covered Tax Agreement, the application of the provisions in Annex I (The subject to tax rule) can be reactivated in the Covered Tax Agreement when the Contracting Jurisdiction mentioned in subparagraphs a) and b) of paragraph 1 (i.e. the developing country that became a high-income economy) ceases to be classified as a high-income economy.

173. When triggered, paragraph 2 reactivates the application of Annex I (The subject to tax rule) on the first day of a fiscal year beginning on or after the expiration of a period of six calendar months from the date on which the Contracting Jurisdiction mentioned in subparagraphs a) and b) of paragraph 1 first ceases to be classified as a high-income economy by the World Bank Group based on its gross national income per capita using the World Bank Atlas method.