Welcome

Keeping up with the constant flow of international tax developments worldwide can be a real challenge for multinational companies. International Tax News is a monthly publication that offers updates and analysis on developments taking place around the world, authored by specialists in PwC’s global international tax network.

We hope that you will find this publication helpful, and look forward to your comments.

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China preferential tax policies aim to promote development of the integrated circuit and software industry

China’s State Council released, on August 4, 2020, a Notice (Guo Fa [2020] No. 8) to promote development of the integrated circuit (IC) industry and software industry. The Notice formulates tax reduction and exemption preferential policies across the industry chain. Specifically, it covers investment and financing, research and development, import and export, talents, intellectual property, market applications, and international cooperation to fully support development of the IC and software industries. The key preferential CIT policies include:

• Encouraged IC enterprises or projects that produce an IC line-width less than 28 nm (inclusive) and an operating period of more than 10 years are exempt from CIT for the first ten years. Encouraged IC enterprises or projects that produce an IC line-width less than 65 nm (inclusive) and an operating period of more than 15 years are entitled to 5+5 tax holiday (five-year exemption followed by five-year 50% reduction). Encouraged IC enterprises or projects that produce an IC line-width less than 130 nm (inclusive) and an operating period of more than 10 years are entitled to 2+3 tax holiday (two-year exemption followed by three-year 50% reduction). The above incentives start from the first profit-making year for enterprises, and from the project’s first income-generating year for projects.
• Tax losses incurred by encouraged IC enterprises with an IC a line-width less than 130 nm (inclusive) are allowed to be carried forward up to 10 years, extended from the standard five years.
• Encouraged IC design/equipment/materials/packaging/testing enterprises and software enterprises are entitled to 2+3 tax holiday (two-year CIT exemption followed by three-year 50% CIT reduction), starting from the first profit-making year.
• Specific IC design enterprises and software enterprises are exempted from CIT for five years, starting from the first profit-making year, and the CIT will be levied at a reduced rate of 10% for subsequent years.

PwC observation:
In addition to preferential CIT policies, qualified enterprises shall also enjoy certain tax incentives in the import and export of equipment and products. IC and software enterprises should evaluate the applicability of tax incentives that the Notice grants based on their specific situations. For example, enterprises should analyse and plan the adoption of applicable preferential tax policies.

Long Ma
China
T: +86 (10) 6533 3103
E: Long.ma@cn.pwc.com
In response to the pandemic, the Honduras government introduced Decree 79-2020 which aids the productive sector and workers. The new legislation extends the tax obligation due dates for taxpayers categorized as small and medium until August 31, 2020 (without fines and interests) for the fiscal year 2019 corporate income tax (CIT).

The Section has an exception: there is no prorogue for the income tax return for those individuals or entities that have been operating during the state of emergency since March 16, 2020.

The Decree also extends the instalment dates for the payments on account as follows:


**PwC observation:**
Taxpayers should ensure that they comply with these tax extensions.
New tax incentives to promote Hong Kong’s insurance industry

In order to enhance Hong Kong’s insurance industry competitiveness, the Hong Kong government gazetted the Inland Revenue (Amendment) (Profits Tax Concessions for Insurance-related Businesses) Ordinance 2020 (the Ordinance) on July 24, 2020. This extends the current 8.25% concessionary profits tax rate for captive insurance and reinsurance businesses of professional reinsurers in Hong Kong to general reinsurance business of direct insurers, certain classes of general insurance business, and certain classes of insurance brokerage business.

The Ordinance will become effective (i.e., the commencement date) once determined by the Secretary for Financial Services and the Treasury and published as a notice in the Gazette. The Administration aims for the commencement date to start by the end of 2020 or early 2021. The 8.25% concessionary tax rate will apply to sums received or accrued on or after the Ordinance’s commencement date.

PwC observation:
Hong Kong’s government is committed to developing its marine and specialty risk insurance businesses while enhancing the development of high value-added maritime services. This new ordinance may provide new opportunities for the insurance industry, including those from the Belt and Road Initiative. Insurance groups wishing to enjoy the profits tax concessions should note the relevant anti-avoidance provisions and ensure they are able to meet the substantial activity threshold requirement, which will be prescribed.

New limited partnership regime for funds

On July 17, 2020, the Hong Kong government gazetted the Limited Partnership Fund (LPF) Ordinance (the Ordinance), allowing funds to be set up as Hong Kong registered limited partnerships effective August 31, 2020. The Ordinance introduces a new opt-in registration regime for LPFs to be established and operate in Hong Kong. A fund must meet the LPF Ordinance’s requirements to qualify for registration and operate in Hong Kong. Limited partnership is a common constitution form for private funds, such as private equity funds. The LPF regime gives market players flexibility in structuring the fund vehicle and operations, and more importantly aligns the fund’s domicile with their Asian operations.

PwC observation:
The new regulatory regime for LPFs provides another type of structure for funds to consider. Combined with the enhanced profits tax exemption for funds, this helps make Hong Kong a competitive location for establishing and operating investment funds.

Fergus Wong
Hong Kong
T: +852 2289 5518
E: fergus.wt.wong@hk.pwc.com
2020 Kenya Finance Act highlights

Recently, the number of corporate taxation regimes under the Kenya Income Tax Act (ITA) significantly increased. The main corporate tax changes include the introduction of the minimum tax and the digital services tax. The ITA already included regimes for withholding taxes, corporate income tax, capital gains tax, residential rental income tax, and a turnover tax, among others.

The newly introduced taxation bases are in the form of a transaction tax or a turnover tax. This represents a shift from a tax based on income earned, as was envisaged in the original ITA. In addition, Finance Act 2020 introduced an amnesty program in the form of a Voluntary Tax Disclosure Programme (VTDP) for a three-year period, effective January 1, 2021.

Please see our PwC Insight for more information.

PwC observation:
There are many ongoing tax reforms in Kenya based on the government's efforts to increase internally generated revenue. Taxpayers should keep abreast of these and other relevant changes that may impact prospective regional investment.

Nicholas Kahiro
Kenya
T: +254 (20) 258 5788
E: nicholas.kahiro@pwc.com

Edna Gitachu
Kenya
T: +254 (20) 285 5429
E: edna.gitachu@pwc.com
Nigeria introduces the Finance Act, 2019

In January 2020, the Finance Act (FA), 2019 was signed into law. The FA introduced sweeping changes to existing tax laws, many of which significantly affect cross-border investments into Nigeria. Key changes include:

Significant Economic Presence (SEP) rules

Income earned by certain non-resident companies (NRCs) from Nigeria will now be subject to income tax where transactions meet the SEP threshold. This is notwithstanding that such companies do not have any physical presence in Nigeria. Businesses covered by these rules include those that engage in:

1. Digital, online, or e-commerce activities (Digital PE): These businesses will be subject to income tax on profits attributable to Nigerian activities, where they earn a minimum annual revenue of NGN25m (about $70,000) from Nigeria. Such companies will be required to file annual tax returns in Nigeria.

2. Technical, Professional, Management and Consultancy services (TPMC PE): Nigerian customers are expected to deduct 10% WHT on payments to these companies. This WHT will be final tax in Nigeria, and the foreign companies will not be expected to file annual returns in Nigeria.

Please see our PwC Alert and Article for more information.

Minimum Tax

Before the tax law changes, Nigerian companies that had at least 25% foreign equity ownership were exempt from Minimum Tax (payable where companies generate low taxable profits or are loss making). This exemption has been removed.

In addition, the calculation has been simplified to 0.5% of ‘Gross Turnover’ thus removing a base that relied on capital contribution and gross profits. The term ‘gross turnover’ is defined to include more items than operating revenue, but excludes dividend income that has incurred WHT.

Taxation of dividends

Amendments have been made to tax provisions that previously imposed an additional 30% tax on certain dividend distributions.

Historically, a 30% Excess Dividends Tax (EDT) was applied to a company’s dividend distributions, where such dividends were more than the company’s total or taxable profits for the same year. This was irrespective of whether the dividends were paid from previously taxed retained earnings, tax exempt income, etc., and was particularly an issue for Nigerian holding companies that earned tax-exempt dividend income from their subsidiaries. The amendments now exempt distributions from previously taxed profits, tax-exempt profits, and profits received from Real Estate Investment Companies (REICOs).

Thin Capitalisation (Thin Cap) rules

Nigeria has introduced Thin Cap rules. These rules restrict related party loan interest deductions to 30% of a company’s Earnings Before Interest, Tax, Dividend, and Amortisation (EBITDA). Interest expenses above this cap can be carried forward for a maximum of five years, after which they will be deemed to have lapsed. Highly geared companies now risk losing the deductibility of interest payments where they exceed 30% of EBITDA.

Restrictions on foreign expense deductibility

The Transfer Pricing (TP) Regulations now restrict foreign royalty payments to 5% of EBITDA and royalties. The TP Regulations also have specific rules that apply to intercompany transactions involving capital-rich, low function entities. Such companies will be entitled to no more than a risk-free return for their loan financing activities. Management fees and other related expenses incurred outside Nigeria are deductible to the extent that they are consistent with the TP rules.

Tax exemption on group reorganisations

The FA expanded tax concessions on group reorganisations to cover VAT and Capital Gains Tax (CGT). Previously, the waivers only related to Companies Income Tax (CIT). In addition, the FA introduced minimum holding requirements for companies to qualify for these concessions.

WHT exemption on foreign loans

Previously, interest paid by Nigerian companies on foreign loans could enjoy up to 100% exemption from WHT, where the loans were structured in line with certain requirements. The exemption has now been reduced by 30% across the different exemption levels, and the maximum WHT exemption that can now be enjoyed is 70%.

PwC observation:

These amendments indicate the Nigerian government’s willingness to improve the tax system and adopt OECD recommendations. However, the tax authorities’ interpretations to several provisions in the Finance Act and the SEP Order have introduced new controversies which could significantly impact PEs and non-residents.

Companies will need to act immediately, including participating in compliance and stakeholder forums for future amendments. They should immediately review and assess the impact of the provisions such as the minimum tax/SEP order and consider reviewing their footprints, group structures, or commenting on issues that the National Assembly may address before the next Finance Act.

Chukwuemeka Chime

Nigeria

T: +234 (0) 802 594 7675
E: chukwuemeka.x.chime@pwc.com
United Kingdom

Stamp Duty Land Tax – 2% non-UK resident surcharge legislation published

The UK government published draft legislation outlining a 2% Stamp Duty Land Tax (SDLT) surcharge on non-UK residents purchasing residential property in England and Northern Ireland beginning April 1, 2021. The additional 2% SDLT will apply to both non-resident individuals and non-natural persons (such as companies, trusts, partnerships) in addition to the existing residential SDLT rates of up to 15%. In other words, the top SDLT rate for non-resident individuals and non-natural persons could be as high as 17%. It will apply to residential properties such as apartments or houses, but not student accommodation. It will not apply to non-residential or mixed use land. A residential land transaction will be a ‘non-resident transaction’ and subject to the surcharge where:

- one or more of the purchasers is non-resident
- the property or land being acquired is a major interest in one or more dwellings
- the major interest is not a lease with 21 years or less to run or is itself subject to a lease that has more than 21 years to run, and
- the chargeable consideration for the transaction is £40,000 or more.

If there is more than one purchaser, the surcharge will apply where only one of them is non-UK resident.

PwC observation:

Although the draft legislation appears to be largely as expected, it does result in some unexpected outcomes.

Since the introduction of UK tax on capital gains of non-UK residents in April 2019, and corporation tax on their rental profits from April 2020, the use of non-UK resident structures to acquire UK property is becoming increasingly less attractive for many investors.

Jamie Ward
London
T: +44 7710 036773
E: jamie.w.ward@pwc.com

Sara-Jane Tovey
London
T: +44 7590 354061
E: sara-jane.tovey@pwc.com
ATO publishes guidance related to transfer pricing arrangements

The COVID-19 pandemic’s economic impacts can have flow-on effects on a range of transfer pricing arrangements for multinational groups.

Analysis and evidence for changes in approach

In response to the potential for multinationals to change transfer pricing arrangements during this time, the Australian Taxation Office (ATO) has released guidance on the analysis it expects from taxpayers to evaluate the pandemic’s impact on their business and the evidence that it may review in considering the appropriateness of a taxpayer’s approach to transfer pricing. It also outlines the expectations for those that have applied (or are applying) for an Advance Pricing Arrangement. In addition, the ATO has effectively put multinationals on notice that it will be reviewing changes to related party arrangements and examining the supporting documentation. This would apply to arrangements such as:

- early termination or repayment of liabilities under related party financing agreements that trigger tax deductions for foreign exchange losses
- changing related party agreements to:
  - avoid ongoing withholding obligations on amounts payable to overseas parties
  - reduce assessable income from rights

or property provided to overseas related parties, and
- increase contractually assumed risks and allocation of global economic losses for limited risk entities.

JobKeeper payments

The ATO also has published guidance on the treatment of JobKeeper payments in transfer pricing arrangements. Broadly, the ATO expects that the JobKeeper payment should not be taken into account in determining the price of goods or services using a cost plus methodology. The ATO is concerned when the benefits of JobKeeper payments are effectively passed through to a non-resident related entity via a change in transfer pricing arrangements. The ATO will be reviewing arrangements where the JobKeeper payment resulted in a change to the transfer price paid or received by the Australian entity and was shown to effectively shift the benefit of the government assistance to offshore related parties.

PwC observation:

Taxpayers amending their transfer pricing arrangements due to COVID-19’s impact should be aware the ATO may review these positions. Taxpayers should carefully consider and document relevant positions.

In addition, taxpayers receiving JobKeeper payments should note that the ATO may review arrangements where the payment has been passed through to a non-resident entity or where the taxpayer has altered the transfer pricing arrangements.

Australia

Peter Collins
Sydney
T: +61 (0) 438 624 700
E: peter.collins@pwc.com

Jayde Thompson
Sydney
T: +61 (0) 403 678 059
E: jayde.thompson@pwc.com
Guidance on restructuring for demerger purposes

ATO Taxation Determination 2020/6 provides guidance on what constitutes a ‘restructuring’ for purposes of the demerger rules.

Demerger relief is intended to facilitate the demerging of entities by ensuring that capital gains tax considerations are not an impediment to restructuring a business. According to the determination, what constitutes a particular restructuring is essentially a question of fact and the restructuring’s scope will be critical in establishing whether or not the conditions to qualify as a demerger are satisfied. This determination is substantially the same as the draft determination TD 2019/D1.

Importantly, the ATO view is that restructuring of a demerger group is not necessarily confined to the steps or transactions that deliver the ownership interests in an entity to the owners of the head entity of the demerger group, but may include previous and subsequent transactions. Commercial understanding and the objectively inferred plan for reorganization will determine which steps or transactions form part of the demerger group’s restructuring. The determination includes a number of examples to explain the ATO’s view.

ATO revises guidance on the low tax lender rule

The ATO released a revised Draft Law Companion Ruling LCR 2019/D1. The ruling discusses the hybrid mismatch targeted integrity rule (the low tax lender rule) that aims to prevent offshore multinationals from circumventing the hybrid mismatch rules by interposing an offshore entity incorporated in a low-tax (10% or less) jurisdiction when investing or financing into Australia. The low tax lender rule, generally applicable to tax periods commencing on or after January 1, 2019, may effectively impose additional Australian tax on interest and derivative payments to foreign interposed zero or low rate related parties, irrespective of whether the arrangement involves a hybrid element. The updated draft ruling includes additional content as a result of proposed hybrid mismatch rule amendments.

PwC observation:

Taxpayers contemplating a demerger should review their position with reference to the final Taxation Determination.

PwC observation:

Taxpayers intending to invest into Australia through an interposing offshore entity incorporated in a low tax jurisdiction should determine whether the low tax lender rule and proposed amendments could impact their situation.

Peter Collins
Sydney
T: +61 (0) 438 624 700
E: peter.collins@pwc.com

Jayde Thompson
Sydney
T: +61 (0) 403 678 059
E: jayde.thompson@pwc.com

Peter Collins
Sydney
T: +61 (0) 438 624 700
E: peter.collins@pwc.com

Jayde Thompson
Sydney
T: +61 (0) 403 678 059
E: jayde.thompson@pwc.com
Spain tribunal denies EU dividend withholding tax exemption, applying ECJ doctrine

Spain’s Central Administrative Tribunal (i.e., its administrative body) recently published a ruling from an October 2019 case in which it applied the European Court of Justice (ECJ) withholding tax doctrine for the first time. The ECJ previously had denied the withholding tax exemption on dividend payments to EU parent companies in a set of Danish cases.

The Spanish law implementing the EU Parent-Subsidiary Directive provides a withholding tax exemption for dividend payments if minimum participation and holding period requirements are met. Beneficial ownership is not a material requirement; however, the withholding tax exemption could be precluded in cases where a majority of the voting rights of the EU company receiving the dividends are directly or indirectly held by non-EU persons, individuals, or legal persons.

In the case at issue, a Spanish company paid dividends to its Luxembourg parent company, which was owned by a Qatari entity. The applicable anti-avoidance provision stated that the withholding tax exemption would not be precluded if the EU parent company met one of the following three conditions:

1. It conducted a business activity directly related to its Spanish subsidiary’s business activity
2. Its business purpose was to manage its subsidiary with the necessary human and material means, or
3. It demonstrated that it was incorporated under valid economic reasons and not to fraudulently obtain access to the dividend withholding tax exemption.

Please see our PwC Insight for more information.

PwC observation:
Although the decision can be appealed, the Spanish tax authority’s current approach is to challenge the dividend withholding tax exemption based on beneficial ownership and applicable anti-avoidance provisions, including the abuse of right as a general EU law principle. There is no position on whether Spanish courts and tribunals will admit and apply the tax authority’s approach. Thus, non-resident investors holding participations in Spanish companies and receiving dividends from them should review their corresponding investment structures in order to mitigate any potential impact.

Roberta Poza
Spain
T: +34 915 684 365
E: roberta.poza.cid@pwc.com

Enrique Sánchez de Castro
Spain
T: +34 915 684 400
E: enrique.sanchez.de_castro@pwc.com
Title: Cyprus Parliament votes to adopt EU ATAD exit taxation and hybrid mismatch rules.

The Cyprus Parliament recently voted to transpose the European Union (EU) Anti-Tax Avoidance Directive (ATAD) exit taxation and hybrid mismatch rules. These provisions became law following publication in the Cyprus Gazette and are effective January 1, 2020 (except for certain reverse hybrid mismatch provisions that will become effective in 2022). This latest development completes Cyprus’ transposition of both ATAD I and ATAD II, which the EU adopted in 2016 and 2017, respectively.

Exit taxation

A Cyprus corporate income tax payer will be subject to the Cyprus exit taxation provisions in cases where assets are transferred outside the Cyprus income tax net (outbound transfers) under certain specific circumstances in line with the Directive itself. At the time of the transfer, the taxpayer is deemed to have transferred the assets at an amount equal to their market value at that time, with profit calculated as the difference between that market value less their value for tax purposes at that time. Such deemed profit is subject to Cyprus’ income tax code general provisions, meaning it would not be taxable in all cases but rather only if such a transfer is deemed to be a taxable one of a trading nature.

Hybrid mismatch rules

The hybrid mismatch rules cover situations of ‘double deduction’ or ‘deduction without inclusion’ relating to hybrid entities, hybrid payments and financial instruments, hybridity involving permanent establishments, imported mismatches and/or tax residency mismatches. The new tax provisions also include rules on hybrid transfers and reverse hybrid entities. The hybrid mismatch rules aim to ‘neutralise’ the hybrid tax position, for example by denying a tax deduction in Cyprus for a hybrid payment made by a Cyprus entity.

PwC observation:

The second Cyprus ATAD transposition law further indicates Cyprus’ commitment to comply with all EU tax initiatives and to adapt fully to a post-BEPS international tax environment.

The new hybrid mismatch rules represent a large expansion of Cyprus’ rules in the hybridity area. Previous hybrid mismatch rules in Cyprus were limited to taxing dividends that are tax deductible in the dividend payer’s jurisdiction. Taxpayers should assess the potential impact on their arrangements, as the new rules have a much wider scope.

The exit taxation provisions, however, are limited in scope to the specific cases set out in the law, and even within these cases, the general Cyprus CIT rules should apply to exempt such transfers.

Marios Andreou
Cyprus
T: +357 22555266
E: marios.andreou@pwc.com

Stelios Violaris
Cyprus
T: +357 22555300
E: stelios.violaris@pwc.com

Eftychios G Eftychiou
Cyprus
T: +357 22 555 277
E: eftychios.eftychiou@pwc.com
Longstanding US-Hong Kong shipping agreement terminated

The US State Department announced, on August 19 the termination or suspension of several US agreements with Hong Kong, including termination of the 1989 US-Hong Kong Shipping Agreement, which generally provides a reciprocal exemption from income taxes on income earned from international shipping by US and Hong Kong shipping businesses. The official text has not yet been made available; however, we understand that it may be effective on January 1, 2021. The Hong Kong government also issued a press release in connection with this termination. The termination announcement occurred pursuant to President Trump’s Executive Order 13936, issued on July 14, 2020.

The termination may have a significant US income tax impact on shipping businesses that previously relied on the Agreement to provide an exemption from US income taxes, as well as a Hong Kong profits tax impact for US businesses that also relied on the Agreement for an exemption from those taxes, as indicated by the Hong Kong government’s press release. In some cases, third-country shipping businesses with Hong Kong owners or pools, alliances, and joint ventures with a Hong Kong connection may also be impacted by the termination.

Please see our PwC Insight for more information.

PwC observation:
Shipping businesses with a Hong Kong connection that historically have claimed a US federal income tax exemption based on a reliance on the Shipping Agreement should review their structures and business activities to determine if an exemption continues to exist. Quantification of potential US income tax exposure and possible restructuring should be considered, where feasible.
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<td>Anti-Tax Avoidance Directive</td>
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<td>BEPS</td>
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<td>double tax treaty</td>
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<td>EBITDA</td>
<td>Earnings before interest, tax, depreciation and amortization</td>
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<td>ECJ</td>
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<td>integrated circuit</td>
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For your global contact and more information on PwC’s international tax services, please contact:

**Bernard Moens**  
Global Leader International Tax Services Network  
T: +1 703 362 7644  
E: bernard.moens@pwc.com

**Geoff Jacobi**  
International Tax Services  
T: +1 202 414 1390  
E: geoff.jacobi@pwc.com

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