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 issued new rules on Corporate Income Tax withholding for Non-Tax Resident Enterprises

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Republican tax bill will significantly impact US international tax rules

New Zealand

What the election results mean from a tax perspective

OECD

OECD releases revised Model Tax Convention

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China issued new rules on Corporate Income Tax withholding for Non-Tax Resident Enterprises

In October 2017, China’s State Administration of Taxation (SAT) released the Public Notice on the Matters Regarding Withholding corporate income tax (CIT) at Source for Non-Tax Resident Enterprises (Non-TREs) (SAT Public Notice [2017] No.37, Public Notice 37). Public Notice 37 was effective as of December 1, 2017 and replaces a series of important circulars, such as Guoshuifa [2009] No.3 and Guoshuifa [2009] No.698. Public Notice 37 has streamlined the CIT withholding regime in a comprehensive way. Public Notice 37 contains the following notable changes:

- The withholding tax obligation for dividends derived by Non-TREs arises on the day the dividends actually are paid instead of the day the resolution to declare the dividends is made.
- For the property transfer income received in installments, the CIT can be settled in installments and deferred until the relevant investment cost is fully recovered.
- Where the income is denominated in a foreign currency, it shall be converted to Renminbi (RMB) to calculate the tax liability at the exchange rate as the time the withholding obligation arises (i.e., the date when the payment actually is paid or becomes due).
- The foreign exchange conversion rule has been revised for equity transfers by Non-TREs. In particular, the transfer income or costs denominated in a currency other than RMB will be converted into RMB directly to calculate the gain, instead of being converted to the currency of the initial investment first and then to RMB. Moreover, taxpayers should adopt the exchange rate on the day the withholding obligation arises, instead of the day the income is obtained or the initial investment is made.
- The provision that non-TREs will self-report the CIT within seven days if their withholding agents fail to withhold has been removed.

PwC observation:
Public Notice 37 will bring significant changes to the way Non-TREs fulfill their Chinese tax obligation and how withholding agents perform their withholding obligation in all aspects of cross-border transactions. It was effective as of December 1, 2017, but unpaid dividends and installment payments on property transfers where withholding tax (WHT) has not been settled prior to the effective date also are eligible for Public Notice 37. Enterprises should review and arrange their relevant transactions and payment procedures to leverage fully the benefits provided in this newly released circular.

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Proposed patent box in Slovakia

Proposed changes to the Slovak Tax Act related to patent box incentives currently are in the approval process. The proposed changes were intended to be effective beginning January 1, 2018.

Under the proposal, 50% of income from the use of qualified intellectual property (IP) may be exempt from income taxes. Qualified IP includes patents, utility model protection, design, and copyrighted software. The IP must be developed by the taxpayer in Slovakia.

The exemption from income tax is granted for the IP’s depreciable life period. This is the period during which expenses incurred for IP development are capitalized and depreciated.

If a related party incurs part of the expenses for IP development, then the income tax exemption is calculated by multiplying qualified revenues by a coefficient. That coefficient is calculated by dividing the expenses incurred for development of such IP not from a related party by the total expenses incurred for IP development and then multiplying it by 1.3. However, the maximum coefficient is 1.0.

A portion of qualified IP income embedded in products that were manufactured by the taxpayer or a third party may be exempt from income taxes. The qualified IP (patent, utility model protection, design) must be used in the manufacturing process of such goods.

PwC observation:
In case of a tax audit, tax authorities or the Finance Directorate can ask the taxpayer to substantiate expenses related to the development of qualified IP. Taxpayers should be aware that the tax authorities can ask for evidence related to the taxpayer’s expenses or the related party’s expenses incurred in connection with developing the IP.
United States

Republican tax bill will significantly impact US international tax rules

President Trump on December 22 signed into law the tax reform bill H.R. 1 (Act).

The Act represents the largest overhaul of the US tax code since the Tax Reform Act of 1986. It significantly lowers corporate tax rates and reforms US international tax rules. The Act as passed by Congress generally follows the Senate bill’s approach, with some modifications, by moving toward a territorial tax system, imposing a ‘toll tax’ on the undistributed earnings and profits (E&P) of US-owned foreign corporations, eliminating the indirect foreign tax credit (FTC), and modifying the current subpart F anti-deferral provisions. The Act also generally adopts the Senate bill's provisions relating to ‘foreign derived intangible income’ (FDII), ‘global intangible low-taxed income’ (GILTI) as well as the ‘base erosion and anti-avoidance tax’ (BEAT), with certain modifications.

Please see our PwC Insight for a detailed discussion on the Act’s international provisions.

PwC observation:
Some of these changes could impose significant additional burdens on both US and foreign taxpayers. With a few key exceptions, the Act’s provisions will generally impact both US and foreign corporations in tax years ending after 2017. Companies need to understand the provisions within the Act and its impact to their businesses.

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Judicial

Germany

German Federal Tax Court grants foreign corporation full participation exemption for capital gains

The German Federal Tax Court ruled in a recently published verdict that capital gains realized by a foreign corporation upon the disposal of shares in a German corporation are fully exempt from German CIT, and not effectively only 95% exempt. This exemption is available provided the capital gains are not realized through a German business, such as a permanent establishment (PE).

The decision is relevant for foreign corporate taxpayers for whom a tax treaty does not provide a German tax exemption for capital gains.

While the decision provides relief from the effective 5% tax burden, it remains to be seen how the German tax authorities and legislature will react to the decision.

PwC observation: According to the decision, capital gains realized by foreign corporate taxpayers are fully exempt from German corporate income tax when not realized through a German PE or other business.

The decision is relevant when a tax treaty exemption is not available. The commonly accepted view is that the 5% add-back already should not apply to treaty-exempt capital gains. Thus, relevant situations are those in which no tax treaty applies, or an applicable treaty does not preclude taxation of capital gains from the disposal of shares, for example, due to specific treaty rules for capital gains from the disposal of shares of ‘real-estate rich’ corporations.

PwC will monitor how the German tax authorities and German legislature react to the decision. The German tax authorities could accept the decision and grant the full exemption in comparable cases. However, the German legislature could change the rules so that the effective 5% tax burden would apply when the foreign corporate taxpayer does not have a German business.
**United States**

**Tax Court says transaction lacked substance, but waives penalty**

In *Tucker, Keith A. et ux. v. Commissioner (T.C. Memo. 2017-183)* the US Tax Court held, on September 18, 2017, that the taxpayer, Mr. Tucker, could not claim a loss deduction arising from certain foreign currency options because the underlying transaction lacked economic substance.

Under the subpart F provisions and other US tax rules, the transaction that the taxpayer implemented resulted in separation of the loss and the gain from offsetting options; the taxpayer claimed the loss (and technically was not required to report the gain as income). The Tax Court indicated that a mechanical application of US tax law in a manner that did not conform to economic reality allowed the court to apply the economic substance doctrine. The court concluded that the transaction failed the economic substance tests because the foreign currency options transaction had no reasonable expectation of any appreciable profit. It therefore denied the deductions for the loss on the options.

However, the Tax Court held that the accuracy-related penalties did not apply because the taxpayer reasonably relied on his tax advisor’s professional advice in engaging in the transaction.

*Please see our PwC Insight for more information.*

**PwC observation:** Consistent with the custom that Tax Court memoranda are limited to the application of well-established legal rules, the Tax Court’s holdings in Tucker present an elaboration of existing precedent relating to the application of the economic substance doctrine to prevent taxpayers from claiming tax benefits in a manner inconsistent with legislative intent. Although the tax planning strategy in this case is no longer feasible under current US tax rules, the Tax Court’s discussion of when the economic substance doctrine may apply in the context of international tax provisions continues to be relevant for taxpayers with cross-border transactions.
Argentina

Argentine Executive proposes comprehensive tax reform

On October 31, 2017, the Argentine Executive presented its proposal for comprehensive tax reform. The proposed measures include a reduction in the corporate income tax rate from 35% to 30% during the first two years and to 25% going forward. Prior to presenting its tax plan in September 2017, the Argentine Executive submitted to the Argentine Congress a one-time tax on an asset revaluation for tax purposes.

Please see our PwC Insight for more information.

PwC observation:
Given the wide scope, nature and relevance of the proposed changes, the tax reform may significantly affect the way multinational enterprises (MNEs) operate and organize their businesses in Argentina.

Therefore, MNEs may need to revisit the holding structures for their Argentine investments as well as for existing financing and cash repatriation structures.

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**German tax authorities release circular on non-resident taxation of royalties for software and databases**

The German tax authorities on November 2, 2017, released a circular on German non-resident income taxation and withholding tax (WHT) on royalties for the use of software and databases (the Circular).

The Circular is relevant for all foreign taxpayers with royalty income from the licensing of software or databases that are used in a German business or institution.

*Please see our PwC Insight for more information.*

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New Zealand

**What the election results mean from a tax perspective**

The recent General Election changed New Zealand’s government. Our expectation is that the new government will focus on social reform, housing issues, and a tax system review by a Tax Working Group.

The Tax Working Group is expected to have a broad mandate to consider options to improve the structure, fairness, and balance of the tax system. However, the primary focus will be on addressing the imbalance of taxation on gains from speculation in property and income from other sources. We expect the Group to consider whether it is appropriate to introduce a ‘capital gains tax’ in New Zealand. Any major tax proposals recommended by the Group will not be implemented unless the new government is re-elected at the 2020 General Election.

The previous government made significant proposals related to the OECD’s BEPS measures and had indicated that a number of the proposals would take effect for income years starting July 1, 2018. We expect the proposals will continue progressing under the new government.

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**PwC observation:**
Non-resident taxpayers receiving royalty payments from a German business or institution for granting software or database access should review their current contractual agreements. The Circular may help them identify whether German-source taxation applies and whether German-source tax should be withheld.

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**PwC observation:**
Given it is early days, the tax implications following the change in government is still taking shape. Existing taxpayers and any other non-residents currently investing or considering investing in New Zealand should monitor these developments.
Spanish Tax Authorities look to levy wealth tax on non-residents having indirectly owned properties in Spain

Many properties in Spain belong to non-tax resident individuals through companies. The tax authorities are currently reviewing these structures with the goal of levying wealth tax on these non-resident shareholders in Spain for the value of the properties that they own indirectly.

Please see our PwC Insight for more information.

PwC observation:
Non-residents owning real property in Spain through companies or other legal entities may want to review their individual situation and analyze the potential implications, both from a wealth tax and income tax perspective.

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Increased taxpayer rights for tax dispute resolution under new EU Directive

The EU is taking an important step forward in order to achieve more effective and efficient tax dispute resolution procedures. On October 10, 2017, the Council adopted the Directive on Tax Dispute Resolution mechanisms in the EU (the Directive). The Directive builds on the existing Convention on the elimination of double taxation in connection with the adjustment of profits of associated enterprises (90/436/EEC, the so-called ‘EU Arbitration Convention’) and aims to implement a harmonized and transparent framework in the EU in order to cope with an increasing number of double or multiple taxation cases.

The Directive introduces a more extensive scope and is no longer limited to cases of double taxation arising from transfer pricing adjustments and attribution of profits to PEs. It also implements additional safeguards in view of taxpayers’ rights, including access to the procedure, clear and shorter timeframes, and a guarantee that a solution resolving double taxation will be reached. The Directive also explicitly provides for legal remedies for taxpayers in order to ensure that competent authorities apply the provisions of the Directive and execute the solutions reached.

EU Member States must implement the Directive into their national laws by June 30, 2019. The Directive will apply to any complaint submitted from July 1, 2019 onwards relating to tax disputes concerning income or capital earned in a tax year commencing on or after January 1, 2018.

Please see our PwC Insight for more information.

PwC observation:
The Directive introduces important enhanced provisions and measures to ensure efficient and timely resolution of double taxation disputes in the EU. It introduces a mandatory and binding dispute resolution mechanism that is no longer limited to cases of double taxation arising from transfer pricing adjustments and attribution of profits to PEs. Improved access to the procedures, increased involvement for the taxpayer, clear and shorter timeframes, and an obligation for the Member States to implement a solution are the cornerstones of the Directive. Taxpayers also can call on legal remedies provided under national law to unblock the procedure at several stages in order for their rights to be honoured.

EU Member States must implement the Directive into their national laws by June 30, 2019 at the latest and are encouraged to devote sufficient resources to dispute resolution.
Netherlands

Dutch government proposes response measures for EU cases involving Dutch fiscal unity

Advocate General (AG) Camps Sánchez-Bordona on October 25, 2017, issued his opinion on two joined cases that were referred to the European Court of Justice (ECJ) by the Dutch Supreme Court. These cases raise various questions for the ECJ regarding application of the ‘per element’ approach in the Dutch fiscal unity regime with respect to interest deductibility and currency losses. The outcome of the cases may affect MNEs especially since the proposed Dutch response measures could have retroactive effect.

Please see our PwC Insight for more information.

PwC observation:
This case brings opportunities to taxpayers but also could have a significant downside. If an MNE ran into limitations based on the anti-base erosion rules or participation debt rules before and years are still open for appeal, then depending on the specific facts, it may be argued the interest deduction should not be restricted if the ECJ follows the AG’s opinion.

The announced Dutch emergency countermeasures could, however, have a significant downside for taxpayers whose current financing involves a Dutch fiscal unity (such as an equity wall). If the ECJ follows the AG’s opinion, transactions within a fiscal unity could become regarded as a result of the Dutch countermeasures, with retroactive effect to Oct 25, 2017. This could, for instance, impact the analysis under the anti-base erosion rules or participation debt rules. Taxpayers should review whether this impacts interest deductibility.

The ECJ will decide on the Dutch fiscal unity cases in the coming months. If the ECJ rules in line with the AG, MNE’s investing in the Netherlands should closely monitor the possible application of certain interest deductibility rules to transactions effected within the fiscal unity.

OECD

OECD progress report on harmful tax practices

The latest report from the OECD BEPS project has implications for Barbados. There are specific impacts to the International Business Company (IBC) and International Society with Restricted Liability (ISRL) regimes and, as a result we should expect changes to these rules. Grandfathering is permitted in some circumstances, so existing entities have certainty of their treatment until June 2021. Also, the regimes remain open to new companies until June 2018.

Please see our PwC Insight for more information.

PwC observation:
This report means there will be some uncertainty until the government is more clear on the various tax statute amendments. The business community will be relieved that Barbados is seen as a responsible and proactive jurisdiction and none of its regimes were labelled harmful or required elimination.

Furthermore, there is no immediate threat and existing businesses have a suitable time frame (until June 30, 2021) to adapt to these global changes.

The current government is committed to ensuring that Barbados remains an attractive jurisdiction to international investors, and we expect its changes to respond to investor needs, while balancing its obligations as an Inclusive Framework member.

Businesses with existing Barbados structures should wait and see what the changes bring. Others should consider whether establishing IBCs/ISRLs prior to the cut-off date of June 30, 2018 may be beneficial.

Look for future updates as the changes to domestic legislation are made in 2018.
OECD releases revised Model Tax Convention

On November 21, 2017, the OECD Council approved revisions to the OECD Model Income Tax Convention (the OECD Model), together with revisions to the accompanying Commentaries. The 2017 revisions will be incorporated in a revised version of the OECD Model and Commentaries.

Please see our PwC Insight for more information.

PwC observation:
The OECD Model is a common reference point for countries engaged in treaty negotiations. The 2017 OECD Model makes significant changes to many of the operative rules that will impact the availability and scope of treaty benefits for taxpayers resident in countries that enter into revisions to existing treaties or negotiate new treaties based on the OECD Model provisions. The revisions to the Commentaries will be more immediately important to the application and interpretation of current US income tax treaties as they can help interpret treaty language comparable to the language in the OECD Model. The courts may also look at such Commentaries for the same purpose.

Included in the revisions are updates to the positions of the OECD Model and Commentaries by countries that are not OECD members but participated in the process, adding greater transparency to how these non-OECD countries may interpret their own tax treaties and what policy positions they may take in treaty negotiations.

EU Commission opens formal State aid investigation into the UK’s CFC regime

On October 26, 2017, the European Commission (EC) announced in a press release that it has opened an investigation into the UK’s CFC regime. The investigation appears to focus on the part of the regime that deals with intra group financing commonly referred to as the ‘Finance Company Partial Exemption’ (FCPE) (described by the EC as the ‘Group Financing Exemption’).

These provisions, introduced as part of the 2012 revision of the UK’s CFC rules, may be used to calculate the amount of any CFC charge in respect of offshore financing arrangements.

The EC considers that the tax treatment results in tax benefits that are not available to other comparable taxpayers because it allows the group to provide financing to a foreign company via an offshore subsidiary and incur a reduced level of tax on the profits from these transactions. In its press release, the EC highlights its concern that the exemption may not be consistent with the UK CFC rules’ overall objective. These rules generally subject income artificially diverted to overseas subsidiaries of UK companies to full UK tax.

Regarding the investigation, a UK Treasury spokesman stated, ‘we do not believe these rules are incompatible with EU law.’

PwC observation:
This exemption has been applied by a large number of UK MNEs and foreign companies investing into the United Kingdom. The EC is expected to publish a more detailed decision in the coming weeks, which will provide further detail on their concerns and the reason for identifying this regime. This will enable a better understanding of the investigation’s potential implications for those businesses that have availed themselves of this regime.
**Treaties**

**China / Kenya**

**China and Kenya signed a Double Tax Treaty (DTT) on September 21, 2017 and an accompanying protocol**

On September 21, 2017, China and Kenya entered into a DTT. It will enter into force on the date of receipt of the latter notification for completing respective legal procedures by either side. The DTT between China and Kenya includes the following key features:

**Permanently establishment (PE)**
- The time threshold for constituting a Construction PE should be 12 months.
- The time threshold for constituting a Service PE should be 183 days within any 12 months' period.

**Withholding tax (WHT) and capital gains**
- WHT rates on dividends, interests, and royalties paid to qualified beneficial owners (BOs) will be restricted to 5%, 10% and 10%, respectively.
- Interest paid to the government, central bank or any financial institutions wholly owned by the government could be exempt from WHT in the source country.
- The DTT contains a 'technical fees' article which allows the source country to tax technical service fees arising from that contracting country. However, the WHT on the payment to a qualified BO should not exceed 10%.
- General capital gains arising from the transfer of non-property-rich shares will only be taxable in the resident country.

**Other important features**
Some BEPS recommendations are adopted, such as the 'principle purpose test' (PPT) provision in the article of dividends, interest, and royalties and the exemption of specific preparatory and auxiliary activities in the PE article.

**PwC observation:**
The capital gains clause, the constitution threshold of a Construction PE, the restriction on WHT rate on passive income, and other provisions in the DTT will provide a lot of treaty benefits to the cross-investment between China and Kenya. It will create certainty for taxpayers in both countries and will facilitate Chinese investment in Kenya. Investors should assess and adjust their current structures/arrangements in order to fully take advantage of this new DTT, once it is enacted.

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Italy

**Update of Italian tax treaty network**

**Ratification by Italian Parliament of the Protocol to the double tax treaty (DTT) between Italy and Philippines**

Italy has ratified the Protocol amending the DTT between Italy and Philippines (signed on December 9, 2013, Law 152/2017). The Protocol updates the clauses contained in the DTT, aligning to the OECD standard, in particular with reference to:

- the repealing of the matching credit mechanism, no longer available in the hands of Italian tax residents retrieving Philippines-source income
- the updating of the exchange of tax information mechanism, in order to reflect the latest OECD developments, with the aim of enhancing the tax and administrative cooperation between the two countries.

The Philippines already was included in the ‘white list’ of countries allowing an adequate exchange of tax information with Italy (Ministerial Decree September 4, 1996).

The amendments introduced by the Protocol will enter into force upon conclusion of the exchange of notifications of the ratification measures between the two countries.

**The DTT between Italy and Barbados enters into force**

On October 17, 2017, the DTT between Italy and Barbados entered into force (signed on August 24, 2015 and ratified in Italy by Law 84/2017). The DTT applies beginning January 1, 2018.

The DTT substantially follows the OECD Model tax Convention provisions, including those related to the exchange of tax information.

With reference to the withholding tax (WHT) levied on dividends, the DTT provides for a maximum levy in the source country at 15% rate, reduced to 5% where the beneficial owner of the foreign income has had a shareholding at least equal to 10%.

Any branch profit repatriation tax applied in the source country (not provided under Italian domestic tax law nor in the OECD Model tax Convention) is capped at 5%.

WHT applied by source country on interest and royalties paid outbound is set at 5%.

Barbados is currently included, as of April 2017, in the ‘white list’ of countries allowing an adequate exchange of tax information with Italy.

**PwC observation:** The recent updates to the Italian tax treaty network is among Italy’s efforts to enhance its attractiveness to foreign investors.
## Glossary

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<td>Advocate General</td>
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<td>Base erosion and profit shifting</td>
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<td>BOs</td>
<td>beneficial owners</td>
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<td>CFC</td>
<td>Controlled Foreign Company</td>
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<td>CIT</td>
<td>Corporate Income Tax</td>
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<td>DRD</td>
<td>dividends received deduction</td>
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<td>DTT</td>
<td>Double Tax Treaty</td>
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<td>E&amp;P</td>
<td>Earnings and profits</td>
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<td>EC</td>
<td>European Commission</td>
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<td>ECJ</td>
<td>European Court of Justice</td>
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<td>EU</td>
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<td>FCPE</td>
<td>Finance Company Partial Exemption</td>
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<td>Foreign tax credit</td>
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<td>International Business Company</td>
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<td>OECD</td>
<td>Organization for economic co-operation and development</td>
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<td>Principle purpose test</td>
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Worldwide Tax Summaries:
Corporate taxes 2016/17

If you're operating globally, are you aware of changes to the myriad tax rates in all the jurisdictions where you operate? If not, we can help – download the eBook of our comprehensive tax guide, or explore rates in over 150 countries using our online tools, updated daily.