



# Tax Risks in International Construction Projects

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July 2021

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## Our speakers



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Tax Risks in International construction business

2

Permanent establishment risk in international construction business

- » Fixed place of business and recurring services
- » Building sites, construction and installation projects
- » Splitting up of contracts: Anti-Abuse-Rule
- » Provision of Services
- » Dependent and independent agents

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Withholding Taxes

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Recommendations for avoiding tax risks



# 1. Tax risks in International construction business



## International Contracts: taxes to be considered



- » Individual/Corporate Income Taxes
  - › Withholding Taxes
- » Value Added Taxes, Excise Duties
- » Digital Service Taxes
- » State-, City-, County- Taxes
  - › Municipality Taxes
- » Salary and Wage Taxes
  - › Withholding Tax on Salary
  - › Social Security Contributions
  - › Payroll Taxes
- » Property Tax, Real Estate Tax
- » Registration Fees and Stamp Duties
- » Customs and Excise Duties
- » Late payment interest and tax penalties
- » Professional organization's fees

## Summary of Tax Risks in international construction business

- » Wide interpretation of the term “**Permanent Establishment**” (“**PE**”)
- » **Different understanding / application of PE in Corporate Tax, VAT, Wage Tax, Business Tax**
- » Unduly deduction of **withholding taxes** (“**WHT**”)
  - › Engineering services qualified as “license fees” subject to WHT
- » Application of **domestic tax law only** without considering Tax Treaties
  - › “Treaty Override” by domestic law
- » Taxation of a contract’s **offshore-portion**
  - › Profits related to supplied equipment and components
  - › Profits related to offshore services (engineering, technical support, training)
  - › “Force of Attraction”
  - › Turnkey taxation
- » Excessive taxation on a “**deemed profit**”-basis
  - › Near East, Middle East, and South-East-Asia

## Summary of Tax Risks in international construction business

- » **Legal uncertainty** in taxing foreign companies
  - › Complicated legal framework
  - › Tax Authorities are not experienced with taxation of construction projects
  - › Foreign customers are not familiar with taxation of non-resident contractors
  - › Competence of Tax Authorities not clear
  - › Language barriers
- » **Frequent changes in tax laws**
- » **Commentary** to the OECD-MTC **not accepted (dynamic vs static interpretation)**
- » **Excessive profit taxation**
  - › Non-deductibility of business expenses
  - › Overheads, payroll-expenses, head office technical staff attributed to the PE
  - › Difference in time and method of computing a PE's profit (PoC vs. CCM)

## Summary of Tax Risks in international construction business

- » **Excessive documentation requirements**
- » **Registration requirements in non-PE projects**
- » **Reporting obligations**
- » **No contractual shifting of taxes to the customer**
  - › Even if you shift:  
Take care - it is always the contractor who is subject to tax, not the customer!
- » **Requirement to withhold taxes** from subcontractor's remuneration
  - › Liability for taxes of subcontractors
- » **Customs-related issues**
  - › Importer of Records (Registration)
  - › Customs declarations for import and export (clarification of responsibilities and the right customs procedure)
  - › Determination of Customs value as basis for Import



## How can tax authorities become aware of your activities? (1/2)

### » VAT

- › VAT registration, filing of VAT returns
- › Isolated VAT refund request

### » Employees

- › Long-term presence in the project country (visa, notification/registration requirements)
- › Payroll, income tax declaration
- › Social security

### » Other registrations / filing obligations

- › Commercial registration
- › Payments to (foreign) contractors (e.g.: Austria, Belgium, Finland, Czech Republic)

### » Marketing

- › Company signs, company cars on-site
- › Press release, social media, company website

### » Google

## How can tax authorities become aware of your activities? (2/2)

- » Tax audit of partners, customers, suppliers/subcontractors
- » Activities / investigations of other authorities
- » International cooperation / exchange of information between tax authorities
  - › Upon request / spontaneous
  - › Automatic exchange of information
    - Certain income (e.g.: employment income, royalty payments)
    - Bank data / bank accounts
    - Rulings, advanced pricing agreements (APA)
    - Country-by-Country Reporting (CbCR)
    - Cross-border tax arrangements
    - *Digital platforms* (starting 2022)
    - *Crypto assets*



## 2. Permanent establishment risk in international construction business



## Permanent establishments and double taxation



**Head office**  
(seat, place of management)



***Unlimited tax liability***  
**"Worldwide income"**



**Construction PE**



***Limited tax liability***

***Double  
taxation***

## Permanent Establishments: Domestic Tax Laws

### 1. Corporate Income Tax

- › Domestic tax laws apply a **wide interpretation** of what constitutes a PE of a non-resident enterprise
- › **Limited tax liability**
- › PEs may be subject to **business and municipality** taxes as well
- › **State, city and county taxes** which are not covered by tax treaties must be taken into consideration (e.g.: in the US, Belgium)

### 2. Individual income taxes

- › Obligation to **withhold individual income taxes** from the employees' wages and salaries if such remuneration is or has to be borne by the PE

### 3. Value Added Taxes

- › **Different PE definition** for VAT purposes
- › Existence or non-existence of a PE is relevant to determine the **place of supply and services** for VAT-purposes

## Permanent Establishments in Tax Treaties (1/2)

### 1. Corporate Income Tax in the source State

- › The main use of the PE concept is **to determine the right of a Contracting State to tax the profits** of a company of another Contracting State.
- › According to Art. 7 OECD-MTC a Contracting State **cannot tax the profits** of a company of the other Contracting State unless it **carries on its business** through a PE situated therein.

### 2. Corporate Income Tax in the residence State of an enterprise

- › **Exemption** of a PE's profits in the State of residence (Art. 23A OECD-MTC) or
- › **Tax Credit** (Art. 23B OECD-MTC)



## Permanent Establishments in Tax Treaties (2/2)

### 3. Individual Income Tax of employees (Art. 15/2c OECD-MTC)

- › The **183-days rule** does not apply if the employees' remuneration is **borne by a PE** which the employer has in the other State.

### 4. Taxation of other income (eg. Art. 10/4 OECD-MTC)

- › **Dividends, interest, royalties and other income** may be taxed in the source state if the beneficial owner of such income carries on business in the source State in which such income arises **through a PE** situated therein and the holding in respect of which the dividends are paid, the debt-claims or the rights or property in respect of which the income is paid **is effectively connected with such PE**.

### 5. Non-Discrimination (Art. 24/3 OECD-MTC)

- › Taxation on a PE shall **not be less favorably levied** in the source State than the taxation levied on enterprises of that other State carrying on the same activities. This provision applies to taxes of every kind and description.

## PE Definition: Art 5 OECD-MTC and UN-MTC



- » Fixed Place of Business (para 1)
- » List of PE-examples (para 2)
- » **Building site, construction, installation projects (para 3)**
  - › Service-PE
  - › Special PEs (e.g.: exploitation)
- » Exceptions to the general definition (para 4)
  - › Anti-fragmentation clause (para 4.1)
- » Dependent agent (para 5)
- » Independent agent (para 6)
- » “Anti-single-entity-clause” (para 7)
- » Insurance PE’s (para 6 UN-MTC)
- » The closely related enterprise (para 8)

## Fixed Place of Business (Art. 5/1 OECD-MTC) (1/4)

*“For the purpose of this Convention a “PE” is a fixed place of business through which the business of an enterprise is wholly or partly carried on”*

### 1. Existence of a “place of business”

- › facilities, premises, machinery or equipment
- › at the “**disposal**” of the enterprise

### 2. The place of business must be “fixed”

#### › **Geographically (para 21 OECD commentary\*)**

Link between the place of business and a specific geographical point; equipment constituting the place of business must not be fixed to the soil on which it stands

#### › **Certain degree of permanency - Time-test (para 28 OECD commentary)**

“Practice shows that a PE has been considered to exist where the place of business was maintained for a period **longer than six months**”



## Fixed Place of Business (2/4)

### Typical examples for “Fixed Place of Business” in the construction industry

- » Sales office
- » Project coordination office
- » Material/machinery storage facility
  - › no PE if exemptions of art. 5/4 OECD-MTC apply:  
*“the use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise [...] provided that such activity [...] is of a preparatory or auxiliary character.”*
- » Employees working in home office
- » Service/maintenance work (recurring)
- » Server

## Fixed Place of Business (3/4)

- ✓ The place of business needs a **certain degree of permanency**.
- ✓ Normally PE's have not been considered to exist in situations where a business was maintained **for less than six months**.
- ✓ One exemption are activities of a recurrent nature (each period of time during which the place is used needs to be considered in combination with the number of times that place is used).
- ✓ OECD Example: *"The seasonal conditions at the location prevent such operations from going on for more than 3 months each year but the operations are expected to last for 5 years."*
- ✓ **The specific nature** of the relevant business **can dictate shorter recurring periods**.
- ✓ No minimum-presence in a 12-months period.

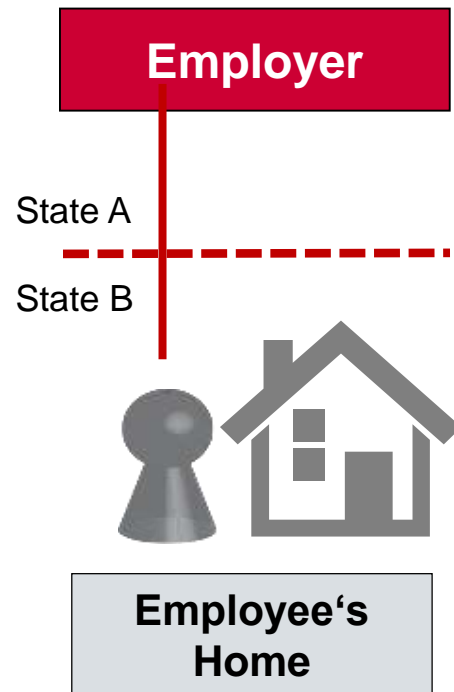
## Fixed Place of Business (4/4)

### 3. Carrying on business wholly or partly “through” the PE (para 35)

- › **By the entrepreneur** or
- › persons who are in a **paid employment relationship** with the enterprise (personnel)
- › Persons **receiving instructions** from the enterprise (para 39)
- › **Subcontractors**, if the **place is at the disposal** of the general contractor on the basis of factors showing that the enterprise clearly has **the effective power to use that site**, e.g.: because it owns or has legal possession of that site and controls access to and use of the site



## Home Office Work: Creation of a PE



- » A Home Office used on a **continuing basis** for **carrying on business activities for the enterprise** may be considered to be at the disposal of the enterprise (para 18)
- » In particular, if the enterprise (employer) **has required the individual to use that location** to carry on the enterprise's business (e.g.: if no office is rented by the enterprise where the nature of the employment clearly would have required an office)
- » **Intermittent business activities** and **teleworking** at home due to COVID-19 would normally not create a PE for the employer (OECD Secretariat Analysis 3 April 2020)

## Building sites, construction, installation (Art. 5/3 OECD-MTC) (1/4)



*A building site or construction or installation project constitutes a PE only if it lasts for more than 12 months.*

» **Definition** (para 50 OECD Commentary)

- › Wide understanding.
- › On-site-planning and supervision included.

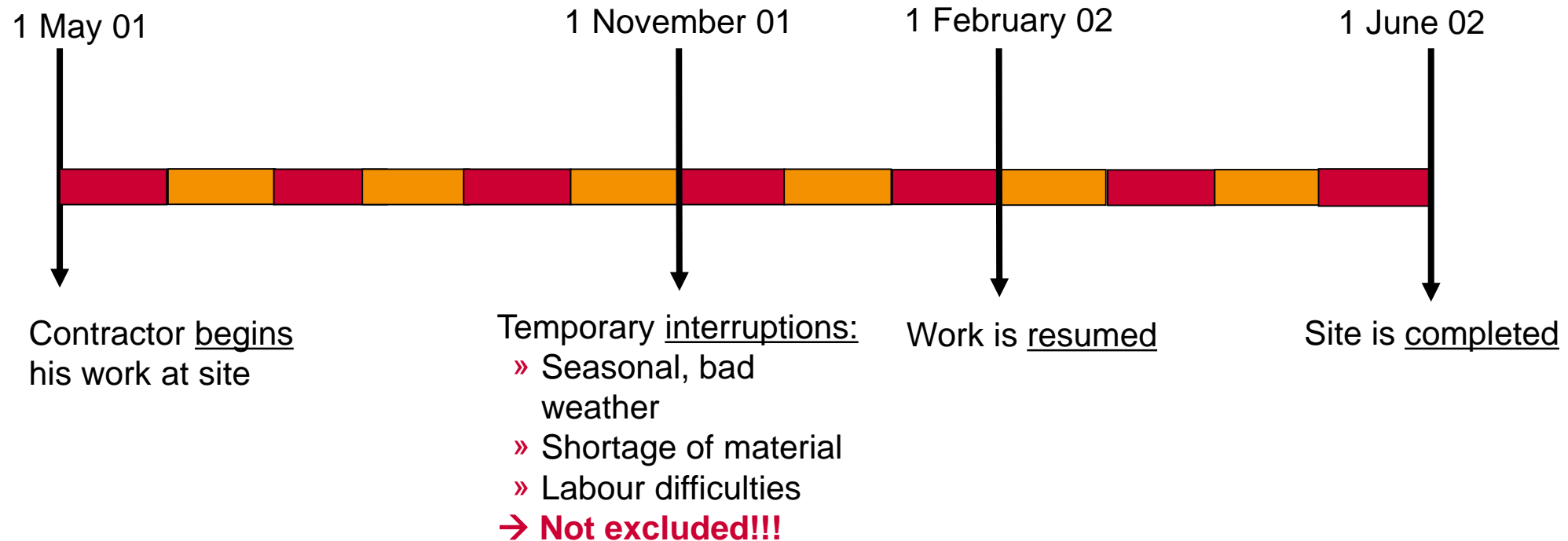
» **Anti-abuse provision** (para 51 OECD Commentary)

- › Individual assessment for each individual site/project.
- › Commercially and geographically linked sites/projects (coherent whole) are seen as single unit.

## Building sites, construction, installation: “12 months test” (2/4)

- » **“Beginning of work”** on-site triggers the 12-month term
- » **End of construction period** (para 55 OECD Commentary)
  - › Work is completed or permanently abandoned
  - › On-site testing by contractor/subcontractor to be included
  - › Guarantee / repair work not included – separate PE?
- » **Seasonal or other temporary interruptions**
  - › Included in construction period
  - › COVID-19 interruptions also included (OECD Secretariat Analysis 21.1.2021)
    - Possibility to exclude: Germany, Finland

## Building sites, construction, installation: “12 months test” (3/4)

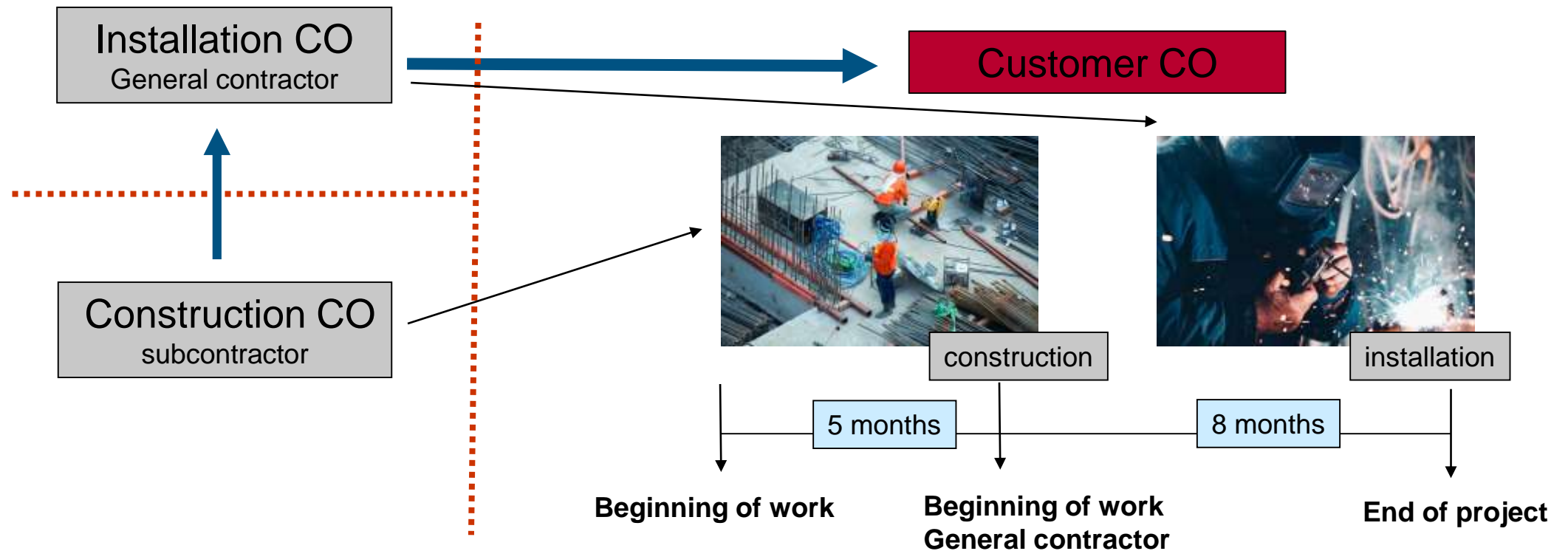


Construction Project to be regarded as a PE because **13 months elapsed** between the date the enterprise first commenced work (1 May 01) and the date he finally finished (1 June 02)



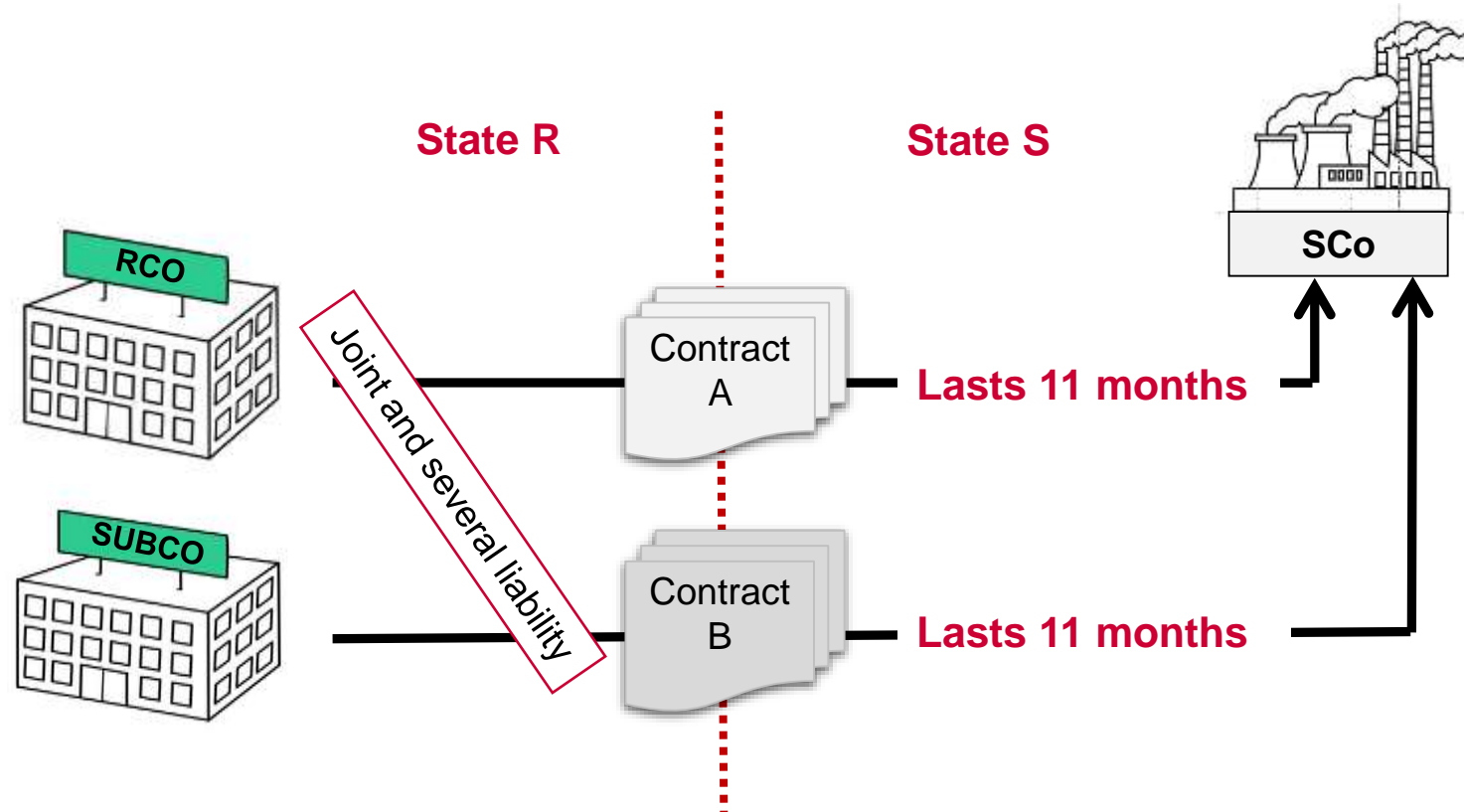
## Building sites, construction, installation: “12 months test” (4/4)

- » Time spent by a subcontractor must be considered as **time spent by general contractor** (para 54 OECD commentary)
- » Site considered to be “at the disposal of the general contractor”
  - › Legal possession, controls access and use of site, has overall responsibility



## Building sites, construction, installation

### Splitting-up of contracts: Anti-Abuse-Rule



Para 182 Example J to art. 29 OECD-MTC

## Service PE (Art. 5/3 UN-MTC)

### » Art. 5 (3) UN-MTC

*The term “permanent establishment” also encompasses:*

- (a) A building site, a construction, assembly or installation project or supervisory activities in connection therewith, but only if such site, project or activities last than six months;*
- (b) The **furnishing of services**, including **consultancy services**, by an enterprise through employees or other personnel engaged by the enterprise for such purpose, but only if activities of that nature continue (for the same or a connected project) within a Contracting State for a period or periods aggregating more than 183 days in any 12-months period commencing or ending in the fiscal year concerned.*

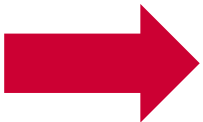
## Dependent Agent PE (1/3)

- » A Dependent Agent PE exists if the following conditions are met:
  - › Acts in a Contracting State **on behalf of an enterprise.**
  - › **Habitually concludes contracts,**
  - › **Or principal role leading to the conclusion of contracts (routinely concluded, without material modification by the enterprise).**
  - › **In the name of the enterprise.**
  
- » Exceptions
  - › The independent agent exception of Paragraph 6.
  - › Limited activities (with auxiliary or preparatory character) mentioned in Paragraph 4
  
- » A person cannot be said to be acting on behalf of an enterprise, if the enterprise is **not directly or indirectly affected** by the action.



## Dependent Agent PE (2/3)

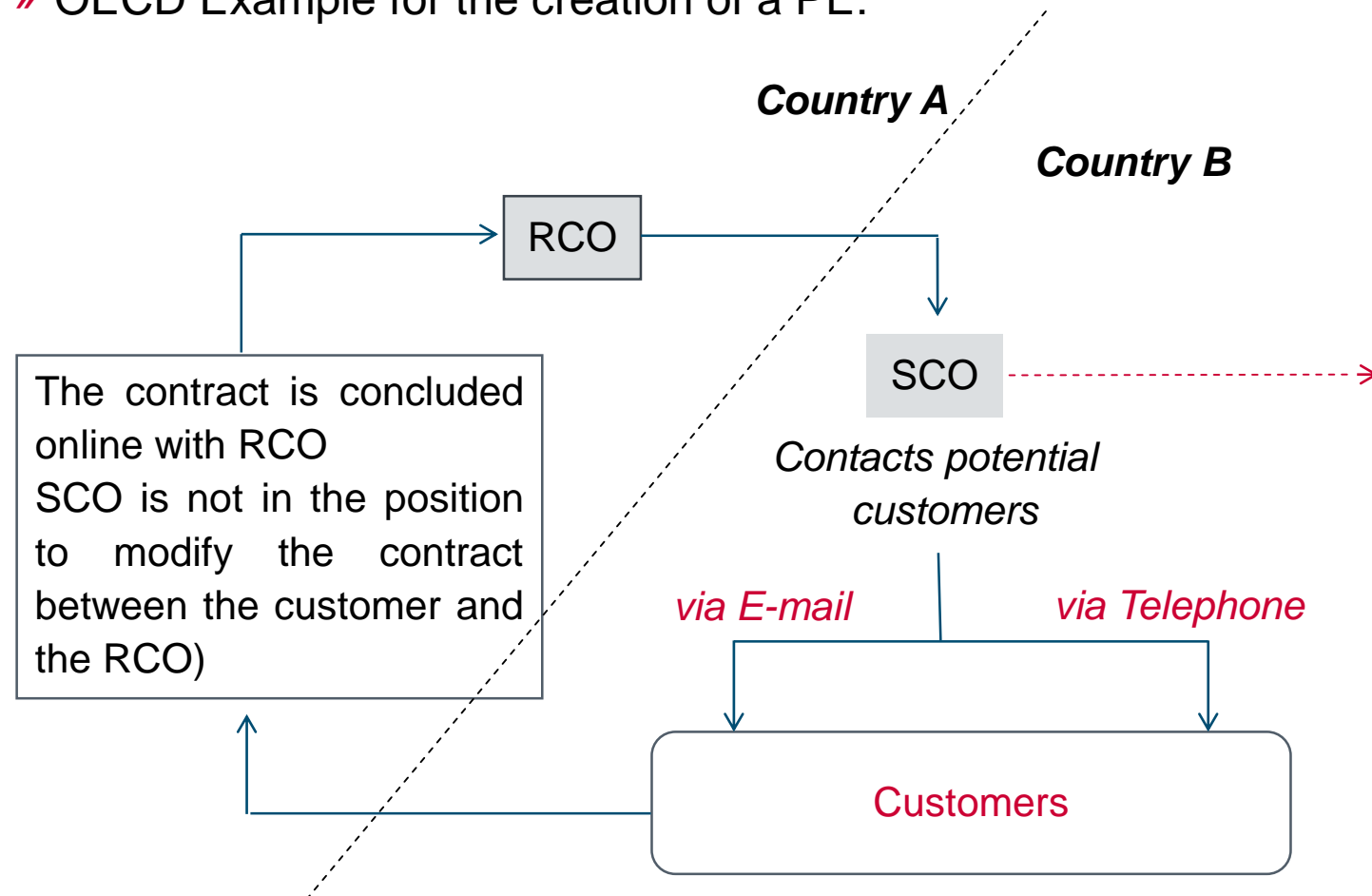
- » The phrase “concludes contracts” covers the following situations:
  - › Active negotiation.
  - › Negotiation of all elements & details in that state even if signed by another person outside that State
- » The OECD defines the phrase “habitually” as:
  - › **No precise frequency test is provided by the OECD**
  - › **“Habitually” depends on the nature of the contracts and business** of the enterprise
- » If contracts are reviewed and approved in a third state without resulting in a modification of the key aspects of these contracts, this would mean they are not technically concluded in that country.



- › **Activities without authority to conclude an agreement** could now be regarded as a PE.
- › The **decision** whether it is a PE **will vary** in every case, as it is based on rather **subjective criteria**.

## Dependent Agent PE (3/3)

» OECD Example for the creation of a PE:

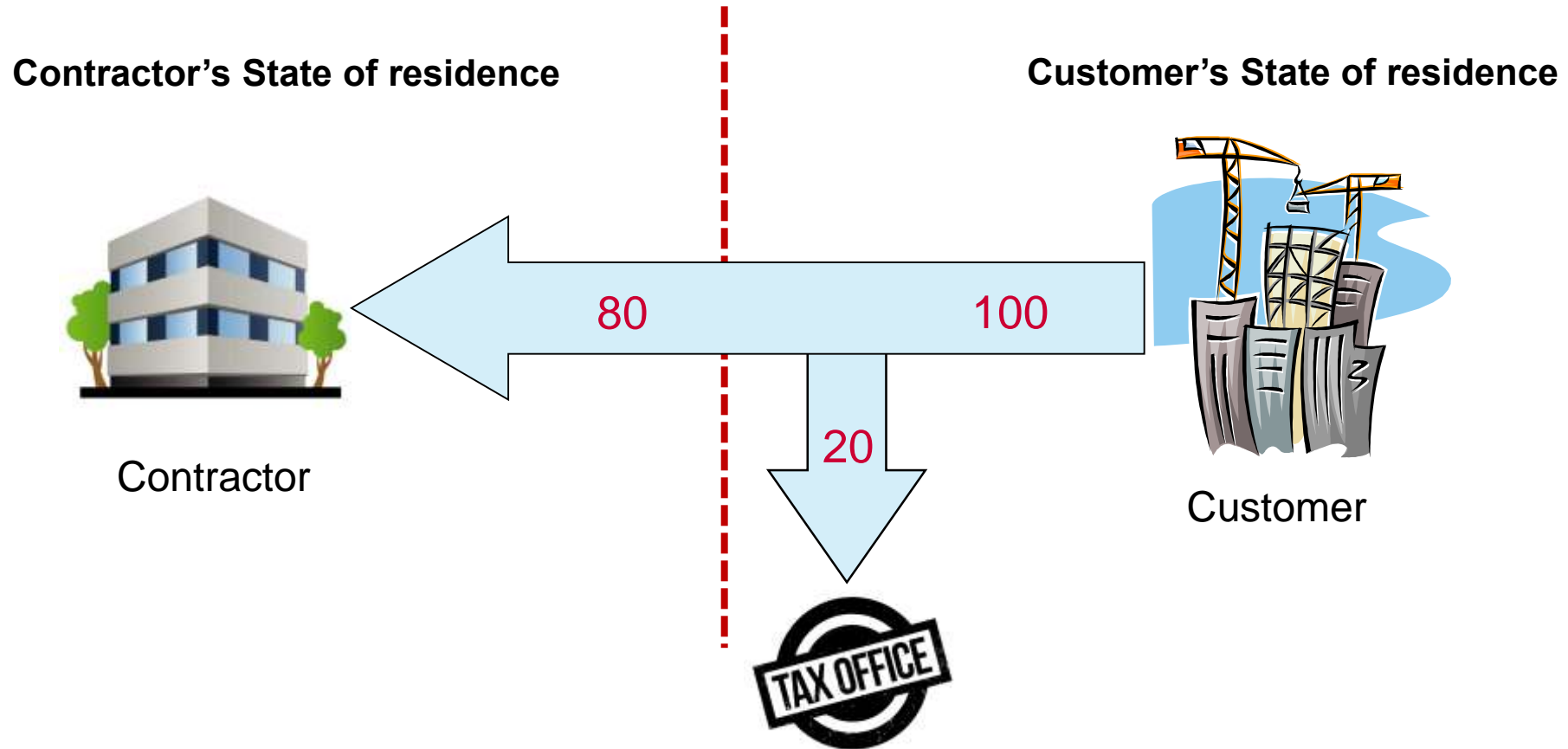


- ✓ Wholly-owned subsidiary
- ✓ Trying to convince customers to buy RCO's products
- ✓ Use their relationship building skills
- ✓ Indicates that a contract must be concluded online with RCO
- ✓ Explains the standard terms of RCO's
- ✓ Informs about the prices
- ✓ SCO's employees cannot vary the terms of the contracts



### 3. Withholding taxes

## Beware of Withholding Taxes (1/4) - Deductions at source



## Beware of Withholding Taxes (2/4)

### **Types of income threatened by deductions at source**

- » Dividends, interest, royalties
- » Engineering services
- » Construction, installation, commissioning
- » Commercial and technical assistance
- » Consulting services
- » Repair and maintenance
- » Training of customer's personnel
- » Hiring-out of labor
- » Cost-sharing agreements
- » Rental of equipment



## Beware of Withholding Taxes (3/4) - Double Tax Treaty Regulations

### » **Art 12 OECD/UN-MTC**

- › Art 12 (2) defines term “royalty” to include payments of any kind receive as a consideration “... for information concerning industrial, commercial or scientific experience”
- › Some countries apply art 12 on “active income” (e.g.: engineering services, consulting, short term supervision)

### » **Art 12a UN-MTC**

- › Right to deduct WHT on “Fees for Technical Services”
- › No physical presence required – off-shore services targeted
- › Services of a managerial, technical or consultancy nature

### » **Art 12b UN-MTC**

- › Right to deduct WHT on “Automated digital services”
- › No physical presence required – off-shore services targeted

## Beware of Withholding Taxes (4/4)

- » **Contract for the supply of know how** (para 11.3 Commentary on art 12 OECD-MTC)
  - › Supply of information that already exists is sold after its development or creation and includes specific provisions concerning confidentiality
- » **Contracts for the provision of services**
  - › Performing services which may require the use of special knowledge, skill and expertise **without transferring such special knowledge**, skill or expertise to the other party
  - › **Examples:** after-sales services, services under a warranty, pure technical assistance, opinion given by an engineer, advocate or consultant
- » **Mixed contracts** (para 11.6 commentary on art 12 OECD-MTC)
  - › Break down to the various parts and determine tax treatment to individual parts
  - › Parts of an ancillary and largely unimportant character treated like the principal part

## How to deal with withholding tax risk – as a contractor

- » Agree on prices net of taxes in the contract
  - › “*The contract price is to be understood net without any VAT and WHT levied in the country of project execution*”.
- » Provide certificate of residency/registration to customer
- » Coordination with customer
- » Services at risk of WHT
  - › Possible risk in words such as “know how”, “turnkey”, “engineering”, etc.
  - › Do not mention in contract (e.g.: include engineering services in the price of goods delivered)
  - › If not avoidable: define and split prices!
- » Include a contract clause to avoid WHT:
  - › “*The Buyer shall inform Seller in advance if he intends to withhold taxes upon payment to the contract. The Seller shall submit to the Buyer before the respective payment of the Buyer a certificate of residence or another necessary document to avoid withholding taxes and/or a copy of registration within the country of the Buyer.*”

## How to deal with withholding tax risk – as a customer/general contractor

- » When in doubt deduct WHT – liability!
- » Get information about your obligations before paying your contractors
- » Ask for certificate of residence / registration before payment
- » Watch out for contract clauses “price net of WHT”
- » Pay attention to reporting obligations with regards to payments to contractors
  - › e.g.: Austria, Belgium, Czech Republic, Finland



## 4. Remote Services



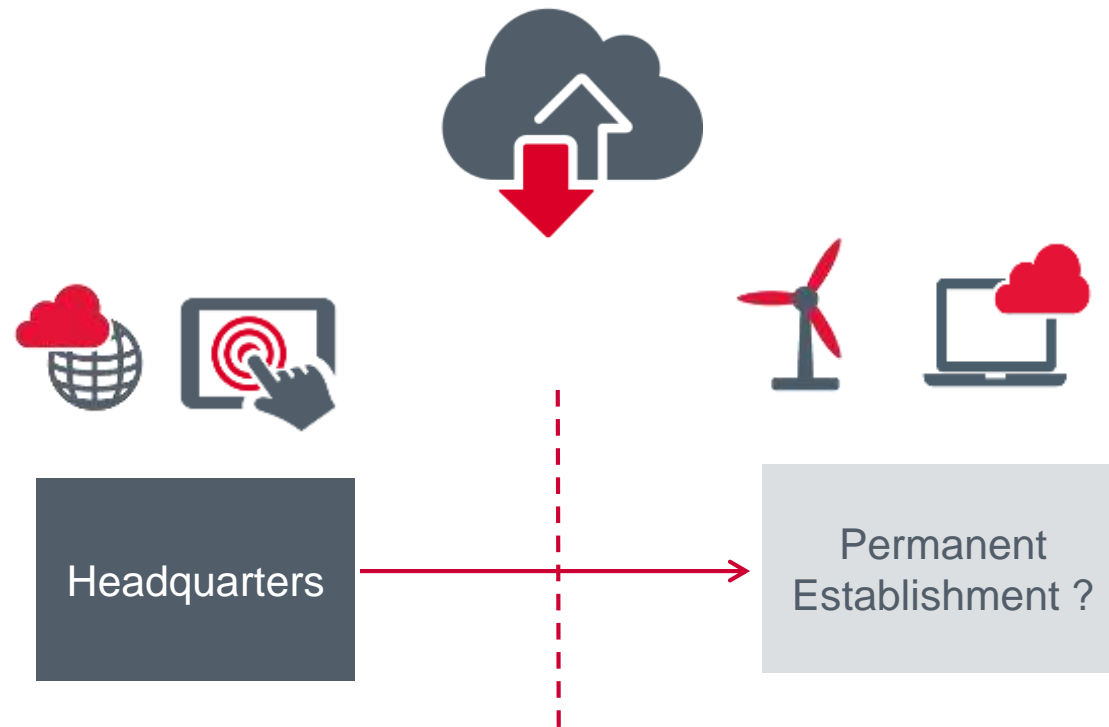
## Permanent Establishment – General Conditions



### ARTICLE 5 – OECD Model Tax Convention

1. **Fixed Place** (Permanent)
2. **Place of the business**  
(At the disposal of the enterprise)
3. **Through which the business is carried on**

## Is our business carried on through Remote Services?



**Article 5** - OECD Commentaries on the Articles of the Model Tax Convention

**41.** Also, a **permanent establishment** may exist if the **business of the enterprise is carried on mainly through automatic equipment**, the activities of the personnel being restricted to setting up, operating, controlling and maintaining such equipment



## Is personnel required at all?

**Article 5** - OECD Commentaries on the Articles of the Model Tax Convention

**39. There are different ways in which an enterprise may carry on its business.** In most cases, the business of an enterprise is carried on by [...] **personnel.**

**127. Where an enterprise operates computer equipment** at a particular location, **a permanent establishment may exist even though no Personnel** of that enterprise is required at that location for the operation of the equipment. The **presence of personnel is not necessary to consider that an enterprise wholly or partly carries on its business at a location [...].**





## 5. Digital Service Taxes

## Digital Services Tax (DST)



- » **More than 90 countries** implemented the taxation of digital services
- » The **main goal** was to **tax the GAFA companies** (no physical presence needed)
- » **But the Industry 4.0 is highly affected** as well
- » Common in scope services: **Online marketplaces**, digital content (e.g.: **software**), **remote services**, **IT Infrastructure**, online advertisement and the **sale or transfer of user data**

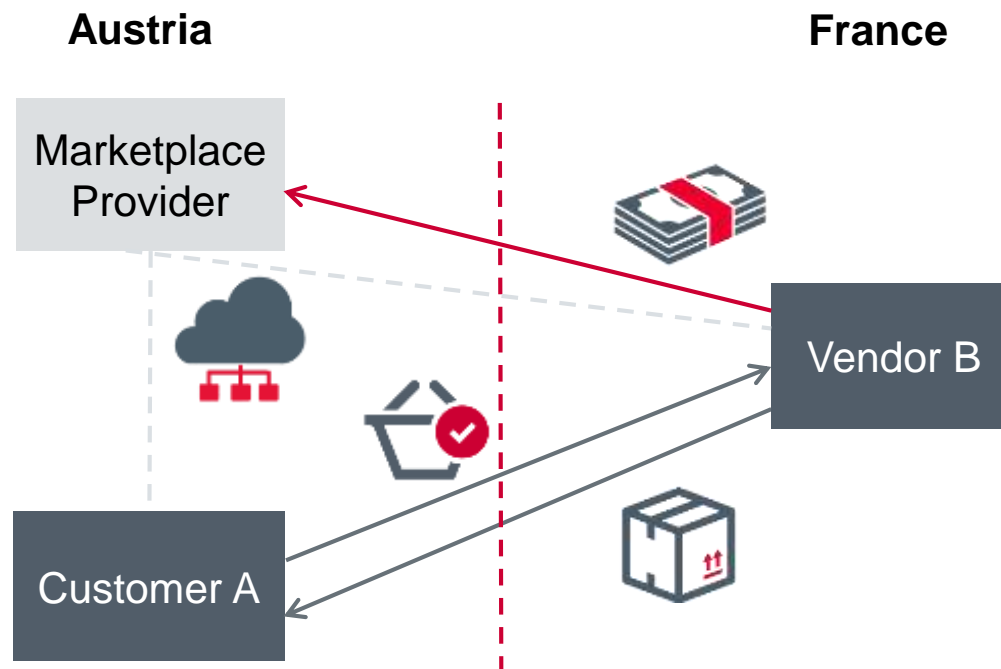


**Be aware of:**

- **Local thresholds**
- **Data collection**



## Example of taxable revenues (online marketplace)



Example: A company provides an online marketplace where user can buy and sell products from each other. The marketplace is monetized by a provision for each transaction.

- » **If one participant (A or B) in the transaction is located (according to the IP address) in France (DST country), the provision paid to the marketplace provider is subject to DST in France**
- » **A physical presence of the marketplace provider is not required!**





## 6. Recommendations

## 10 tips for avoiding tax risks in setting up construction contracts

**1** Make use of **professional tax advice** before construction contracts are signed

- › Renegotiation of signed contracts is time consuming, expensive and often impossible
- › Tax planning opportunities get lost

**2** When preparing an offer, **tax cost and cost of tax compliance have to be calculated**

- › Contract price should include the source countries' taxes in case the tax credit or exemption method is not sufficient to avoid double taxation (e.g.: Lump sum taxation in China, exemption of the actual PE-profit in the State of residence)
- › Do not underestimate compliance costs

## 10 tips for avoiding tax risks in setting up construction contracts

### 3 Structure your contracts under consideration

- › Of the source states' domestic law (wording of contractual tax clauses, scope of supply....)
- › “Contract split” only if useful, necessary and implementable
- › “Price split/shift” makes sense if source country applies “offshore taxation” (e.g.: shifting of prices into items which are not subject to source-state-taxation)

### 4 In developing countries please avoid stimulus words like

- › “Turnkey” (to avoid taxation of offshore-supplies/services)
- › “Know-How”, “Software” (to avoid withholding taxes)

## 10 tips for avoiding tax risks in setting up construction contracts

### 5 **Make careful use of contractual tax shifting**

- › VAT/Sales and Use Taxes have to be excluded
- › Withholding Taxes should be shifted if final taxation is achieved
- › Take care when shifting corporate and income taxes

### 6 **Coordinate tax procedures in the source state with your customer**

(he might not be familiar with taxation of non-resident suppliers), in particular with respect to:

- › Withholding taxes and lump sum taxation (e.g.: China)
  - › VAT-invoicing
  - › Formal procedures required
- » **Do the same in relation to subcontractors/consortium partners!**



## 10 tips for avoiding tax risks in setting up construction contracts

- 7 Don't be afraid of foreign Tax Authorities
  - › It can make sense to contact Tax Officers before contractual work starts in the source state
  - › There may be room for negotiation
- 8 Indisputable PEs should be registered as soon as possible
  - › To meet formal requirements (VAT-invoices)
  - › To issue down payments including VAT
  - › To claim input-VAT
  - › To avoid withholding taxes
- 9 Collect your tax receipts
  - › Taxes withheld are contractor's taxes
- 10 Take care that your tax structure lives in practice

Locally rooted – Globally connected

wts global

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**Florentine Bub****Partner****Education**

- » Certified Tax Advisor
- » Master's degree in law

**Professional Background (Former Position)**

- » Since 2019 Partner at WTS
- » More than 15 years experience in Siemens Group Tax Department (Germany, Austria)
- » 3 years at Arthur Andersen Vienna

**Specialization**

- » International Tax Law
- » International Project Business Consulting
- » International Permanent Establishment Compliance
- » Taxation of digital economy
- » Tools and processes in a multinational group

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## Mag. Matthias Mitterlehner

### Partner, Head of International Tax

**Specialization**

- » International Tax
- » International M&A
- » International Project Consulting
- » International Establishments
- » International Assignments
- » Tax Compliance

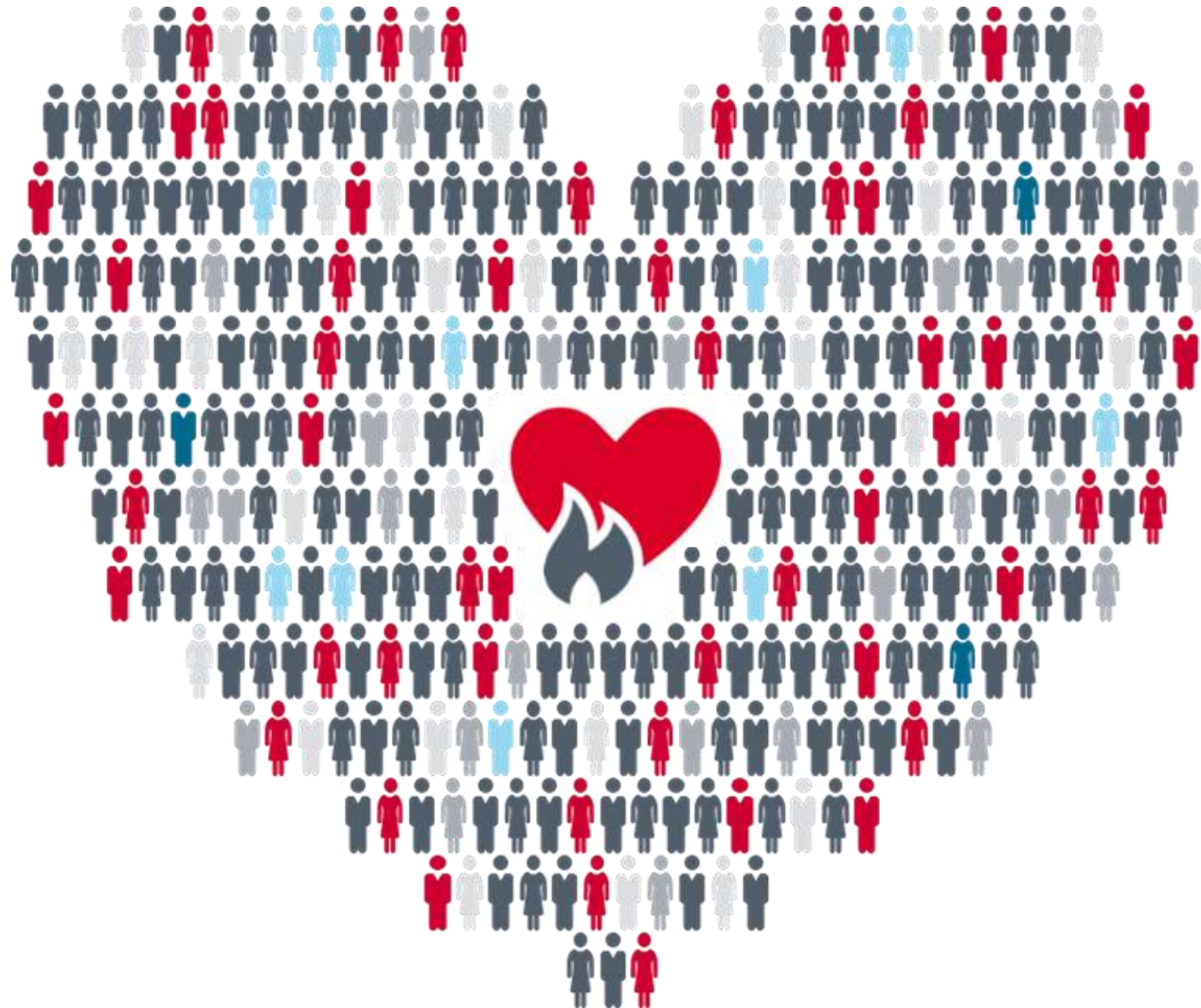
**Functions**

- » Co-head of the WTS Global Service Line „International Corporate Tax“
- » Member of the International Fiscal Association (IFA)
- » Lecturer of seminars, author of various publications
- » External lecturer at the Johannes Kepler University, Linz

**Awards**

- » 2020 Tax Compliance Expert of the Year in Austria (Global Advisory Experts)

## Our global key values



**Innovative:** Designing tax digitisation proactively



**Passionate:** Offering speedy top quality customised solutions



**Excellent:** Internationally, regionally or locally recognized



**Reliable:** Rapid response time with one single point of contact



## Locally rooted – Globally connected



Highly ranked independent tax firms with  
**no annual audits**



Fully dedicated CEO team  
**central management**



Strict quality criteria and steady  
**regular quality reviews**



Closely connected global tax practice  
**strong governance**

## About WTS Global

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- » The member firms of WTS Global are carefully selected through stringent quality reviews. They are strong local players in their home market who are united by the ambition of building a truly global practice that develops the tax leaders of the future and anticipates the new digital tax world.
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