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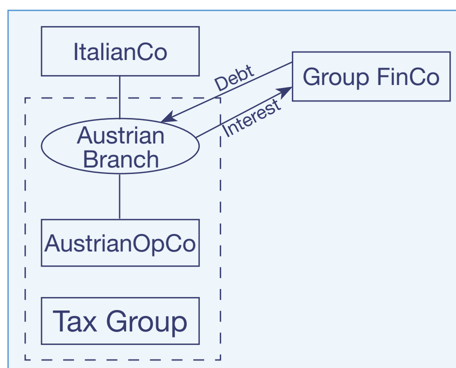
Direct Taxes

Acquisitions in Austria – double-dip structures

The new group taxation regime might also provide for a double-dip upon a debt-financed acquisition of an Austrian company.

The following article summarizes the core elements of an idea which makes use of Austria's group taxation regime to achieve a deductible interest expense in both Italy and Austria:



An Italian company establishes an Austrian branch which acquires the shares in an Austrian operating company. The acquisition is debt-financed by loans obtained from a Group Finance Company. After the acquisition the Austrian branch and the Austrian operating company form a tax group in compliance with the requirements of the Austrian Corporate Income Tax Act. Distributions from AustrianOpCo to the Austrian branch are tax exempt under the Austrian participation exemption, 5% of the dividends will be taxable in Italy. The interest expense incurred by the branch reduces the taxable income of the Austrian tax group. As the Double Taxation Agreement between Austria and Italy provides for the credit method, the taxable loss of the branch also reduces the taxable income of the Italian company in Italy. Thus, the Italian company can make use of the interest expense of the Austrian branch twice ("double dip"). The described tax benefit can be further increased, if the Group Finance Company is based in a low tax jurisdiction. It must be pointed out that the Austrian branch will have to run an operating business to qualify as a tax group parent and thus be able to form a tax group with the AustrianOpCo. With regards to the financing of the Austrian branch both Italian and Austrian thin capitalization and transfer pricing rules will have to be carefully considered. Capital gains realized upon the sale of the AustrianOpCo shares will be taxable in Austria and Italy. The exit strategy will therefore require specific tax planning. The idea described above produces substantial advantages and might also work for other EEA countries applying Double Taxation Agreements with the credit method.

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Release of partially valuable debt by shareholders does not increase tax profit

The Austrian Administrative High Court recently ruled on the corporate income tax treatment of the release for debt granted by a shareholder. In the case in question, the market value of the debt was below its face value but the debt was still valuable. Under such circumstances, according to the Austrian Administrative High Court, the release must be seen as being made totally in the function of a shareholder ("causa societatis") as an unrelated party would not grant release for a valuable debt to another unrelated party. Consequently, such a release does not result in an increase in the taxable profit of the benefited company but is treated wholly as an equity contribution by a shareholder. Further, the release may no longer be split into two transactions – namely a release given causa societatis and a release for the bad debt, made due to business reasons and which increases the taxable profits of the benefiting company. This latter opinion was expressed by the German Tax Supreme Court in 1997 and followed by some Austrian tax officers in tax inspections. Although it was criticized in Austrian tax magazines and has now been rejected by the Austrian Administrative High Court in its decision dated 23 September 2005, this decision has been welcomed by most tax experts for at least clarifying the situation. Please note however, that the debt release might be subject to capital tax at a rate of 1% depending on the circumstances.

This decision may be of interest for both companies which treated the release for such debt as (partially) increasing their taxable profit in the past and which have litigations pending and for companies currently thinking about how to refinance their Austrian affiliates.

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Dividend taxation of non-resident corporations in Austria is discriminatory according to the EC Treaty

There have been ongoing discussions in Austria over whether the Austrian taxation of outbound dividends is in breach of the EC free movement of capital regulations. The reason behind these discussions being the different treatment of domestic and cross-border dividend distributions.

In a domestic situation, any withholding tax („WHT") withheld by the dividend distributing company can be credited against Corporate Income Tax ("CIT") by corporate dividend recipient irrespective of the holding quota and period due to the domestic participation exemption. In contrast, based on the provision implementing the parent-subsidiary directive in domestic law, such an exemption for dividend payments from a domestic corporation to a EU resident corporation can only be achieved under certain conditions (minimum holding period of at least 1 year, minimum direct holding quota of at least 10%). A credit mechanism to credit Austrian WHT for non-resident corporations which do not meet these criteria generally does not exist.

In this context the question arises as to whether there is an obligation for the state of source to provide non-resident corporations with the same preferential tax treatment as resident corporations. The EFTA court recently ruled in its „Fokus Bank" decision, that the state of source has to grant a tax credit to resident corporations and also to non-resident corporations due to the principle of free movement of capital, as the taxable situation of both companies is comparable. The EFTA court outlined that a possible WHT credit in the state of residence according to a Double Tax Treaty or the shift of tax revenue is of no legal relevance in this regard. Although the European Court of Justice ("ECJ") is not bound to the EFTA court's decisions, the free movement of capital provision in the EFTA treaty is similar to that in the EC Treaty. However, the ECJ has not yet decided on the tax treatment of foreign shareholders with respect to outbound dividends.

Another interesting question is whether the community law prohibits the state of source from levying WHT on dividend payments to non-resident corporations if national dividends are exempt from (withholding) tax. The application of an international participation exemption in the state of residence may also be of relevance in answering this questions. The Denkavit case (C-170/05) on this issue is already pending with the ECJ and may affect the Austrian situation. The Advocate General's opinion is expec-

ted on 27 April 2006. In the meantime non-resident corporations receiving dividends from Austrian companies should request for repayment of WHT with the Austrian tax authorities.

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New Administrative High Court ruling on the "Mantelkauf"

The Austrian tax authorities may deny the use of losses carried forward by a company which has been acquired, if the business and the organization of the company will be substantially changed after the share purchase.

Under Austrian tax law tax losses can be carried forward for an indefinite period of time. In the case where shares in an Austrian company are transferred to a new shareholder, the future usage of tax losses carried forward by the Austrian company may be denied if the company is considered as to have lost its "identity" ("Mantelkauf"). This is assumed where there is a substantial change in the economic structure (e.g. a substantial change of the business of the company acquired), in the organizational structure (i.e. the replacement of at least 75% of the legal representatives) and in the ownership of the company (i.e. the sale of at least 75% of the shares to another shareholder).

Based on the current administrative practice, a "Mantelkauf" was assumed, if these three criteria were each fulfilled within a period of one year. Recently, the Austrian Administrative High Court significantly extended this period. In the case at hand the Court assumed a "Mantelkauf" where the change in the ownership and the economical and organizational changes were effected within five years. The Court identified a strong relationship between the three structural measures and therefore assumed a "Mantelkauf" irrespective of the long period between the steps.

The Court ruling underlines the fact that the one year period does not represent a safe harbour rule for the "Mantelkauf". Therefore substantial structural changes to a company acquired might put at risk its tax losses even if these changes are implemented more than one year after the share acquisition.

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Outbound dividends and withholding tax

The Austrian Ministry of Finance recently published its opinion on specific issues regarding the dividend withholding tax exemption.

The Austrian withholding tax exemption for outbound dividends under the EC Parent Subsidiary Directive is subject to various requirements. Apart from the one year minimum holding requirement and the 10% minimum shareholding, the distributing company has to be directly owned by a corporate EC shareholder. Based on the wording of the law, a dividend should not qualify for the exemption where a partnership is interposed between the Austrian company and the corporate EC shareholder. In a letter ruling dated 1 August 2005, the Austrian Ministry of Finance specified and modified this requirement. The Ministry believes that this interpretation is not in line with the EC Parent Subsidiary Directive, which does not distinguish between directly and indirectly held investments. The withholding tax exemption should therefore also apply for qualifying Austrian shares held via a transparent partnership provided the partnership interest is exclusively owned by EC resident companies.

Another important issue in this context is the non-discrimination clause included in many Austrian Double Taxation Agreements. Where an Austrian company receives a dividend from an Austrian subsidiary held via a partnership this is subject to 25% dividend withholding tax to be credited against the corporate income tax of the parent. Only for directly owned investments is relief at source available. In a letter ruling dated 29 November 2004, the Ministry published its opinion on Austrian dividends collected by a German company via an operating partnership in Austria. The Ministry held the view that distributions to an Austrian limited partnership from its Austrian subsidiary have to be exempt from dividend withholding

tax at source under the non-discrimination clause laid down in the Double Taxation Agreement between Austria and Germany.

Letter rulings are not legally binding but are usually applied by Austrian tax inspectors.

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Austrian real estate – amendments to taxation of non-residents

Major amendments to the existing non-residents taxation regime for Austrian real estate were adopted in December 2005.

Regulation up to 31 December 2005

Income generated by a non-resident (individual or corporation) from leasing real estate in Austria is classified as rental income unless the real estate is part of a domestic permanent establishment of the non-resident. As a consequence, capital gains arising from the sale of real estate by non-residents are only subject to income tax where the period between purchase and sale does not exceed ten years (15 years in exceptional cases). For sales beyond the ten years period non-residents are not liable to tax on capital gains.

Regulation from 1 January 2006

From 1 January 2006 any income earned by a non-resident corporation holding real estate in Austria is treated as business income. This amendment is also applicable for non-resident individuals, if the Austrian real estate is part of the non-resident's business abroad. The consequence of classifying any real estate income as business income is that profits on the sale of Austrian real estate will be treated as taxable business income irrespective of the holding period. Thus, capital gains from sales after the ten years period will in future be taxable.

According to the intention of the amended legislation only hidden reserves arising from 1 January 2006 onwards shall be subject to the expanded taxation. Therefore, the fair market value at the year-end 2005, rather than the lower acquisition cost, can be deducted from the sales price to arrive at the taxable capital gain. This however does not apply to sales within the ten years period which would have been taxable under the old regime.

The changes do not affect non-resident individuals holding real estate as private property. Non-resident individuals are only liable to tax on capital gains arising from sales of privately owned Austrian real estate, if the sale is effected within the ten years period.

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Stock option plans in Austria

Austrian companies are increasingly chosing employee participation as a means of motivation and tying their employees more closely to the business. This article provides a brief summary of the main tax aspects of stock option schemes for the Austrian employer as well as its employees.

Tax aspects for the Austrian employer

Under a possible "local solution" the employer entity would be obliged to provide its employees with shares in the entity upon the exercise of stock options. If it repurchases the shares from the stock exchange or any prior shareholders the relating expenses will be deductible for tax purposes. If the company issues new shares the corporate income tax deduction for the so-called intrinsic value of the shares (i.e. fair market value of the shares at exercise less exercise price to be paid by the employees) is questionable. It might be argued that the company did not incur any related costs as the issuance of the shares only dilutes the existing shareholdings.

The Austrian tax authorities issued a letter-ruling in which they confirm that an Austrian company is entitled to deduct related arm's length recharges of other group companies, if evidence can be provided that the stock options remunerate employees for services rendered in the interest of the Austrian entity, and a written recharge agreement was established by the Austrian company and the group company which issued the plan.

Any expenses related to stock options should be spread over the period of time in which the employer receives

the benefit of the employee's services. Thus, if the stock options are subject to restrictions (e.g. the employee must still be employed by a group company upon the vesting of the stock options) they should be regarded as compensation for future services to be provided within the vesting period.

Tax aspects for the participating employees

According to the Payroll Tax Guidelines issued by the Austrian Ministry of Finance the grant of options which are not tradable/transferable or which carry conditions for the employee (e.g. the option holder has to be an employee of the company when exercising the option) does not qualify as benefit in kind at time the option is granted. In this case the taxable event occurs at the time of exercise. The difference between the fair market value of the shares at that time and the exercise price is regarded as a taxable special bonus payment which is taxed at the standard income tax rate of up to 50%.

Under the Tax Reform Act 2001 payroll tax and social security incentives were introduced for employee stock option schemes which in essence are applicable if the scheme is made available to all or a group of employees. These incentives do not therefore apply to schemes exclusively offered to a small number of key employees. To the extent that the value of the shares when granted does not exceed EUR 36,400 the portion of the tax base for the benefit in kind may be reduced by 10% for each year lapsed between grant and exercise up to a maximum of 50%. Additionally, the due date for the payroll tax might be postponed to the later of the sale of the shares and any earlier termination of the employment; but in either case no later than 31 December of the 7th year after the grant of the shares. To postpone payroll taxation the shares have to be deposited with an EMU-bank or an Austrian branch of a foreign bank or held by a trustee.

Further, an annual allowance of EUR 1,460 is available for any stock options granted in excess of the EUR 36,400 which is repayable, if the shares are not held for at least five years.

Payroll tax withholding is required by the employer company, if it is involved in the plan. In such a case, additional payroll related taxes of approximately 8% will be due, these are borne by the employer.

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Indirect Taxes

Capital tax on indirect equity contributions

Following ongoing case law in the Austrian Administrative High Court and the practice of the Austrian tax administration, indirect shareholder contributions are generally exempt from the 1% capital duty. As a consequence indirect equity contributions are frequently used to mitigate capital tax on the equity financing of Austrian companies.

In its recent decision (Senior Engineering (C-494/03)) the European Court of Justice (ECJ) ruled that contributions granted by an indirect shareholder should create a taxable event for capital tax purposes for the indirect subsidiary receiving the funds, even if the direct shareholder of the recipient is not involved in the transaction.

It is uncertain whether the ECJ ruling will change the Austrian practice applying to exempt indirect equity contributions. The Directive 69/335 only allows Member States to tax transactions which were taxable at the time the Directive became effective on 1 January 1984. The fact that indirect shareholder contributions were not taxable according to the jurisdiction of the Austrian Administrative High Court as well as the administrative practice at that time serves as a strong argument to deny capital duty on indirect equity contributions irrespective of the ECJ ruling.

The Austrian Ministry of Finance initially planned to amend the Capital Duty Guidelines and impose capital duty on indirect equity contributions effected in future. According to the latest information available no change in interpretation of this law is expected regarding the above mentioned arguments. Until a new interpretation by the Ministry is released, indirect shareholder contributions can be effected tax exempt based on the existing Guidelines. In any case changes to the Guidelines should not adversely affect indirect equity contributions in the past.

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Revision of the Double Tax Treaty between Austria and Switzerland

An amendment protocol is expected regarding the Double Tax Treaty with Switzerland abolishing the cross-border commuting provision. Austria will replace the exemption method subject to progression by the credit method.

Austrian resident cross-border commuters were subject to Austrian taxation while Switzerland only levied income tax up to 3%. The 3% Swiss tax was then credited against their Austrian income tax liability. In Austria the top income tax rate is 50% for annual income exceeding EUR 51,000. Swiss residents working in Austria were subject to 3% taxation in Austria and enjoyed the overall more favorable Swiss tax rates.

The commuting status will be abolished. Under the new regime Austrian residents working in Switzerland will be fully taxed in Austria and will get a tax credit of the higher Swiss tax rates (formerly restricted to 3%). Swiss residents working in Austria will be taxed under Austria's progressive income tax rates up to 50% for annual income exceeding EUR 51,000 and will be subject to monthly wage tax withholding.

Austria will apply the credit method on all employment income. Thus, the changes will also have an impact on persons not working as commuters but for example working under a split payroll contract in Switzerland. Austrian residents receiving employment income from a Swiss employer will no longer enjoy the tax exemption. Their income will be subject to full Austrian taxation reduced by a tax credit for the Swiss income tax under the Double Tax Treaty. For these employees the new provisions represent a considerable disadvantage.

The new rules will be applicable from 1 January 2006. For those persons suffering a loss as a result of the new provisions the date will be postponed up to 1 January 2007. Therefore, Swiss residents working as commuters in Austria will have to bear the higher Austrian progressive wage tax withholding from 1 January 2007.

The amendment of the Double Tax Treaty has not yet been ratified.

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Austrian Tax Facts & Figures

Taxation of corporations

Corporate income tax rate (Basis – adjusted statutory accounts)	25%
Dividend withholding tax	25%
Witholding tax on licences/royalties	20%
Interest	0%
Significant allowances	
Research & Development (R&D) (Alternatively premiums in cash: 8%)	up to 35%
Learning & Education (L&E) (Alternatively premiums in cash: 6%)	up to 20%

Non-deductible expenses (examples)	
Long-term accruals	20%
Business meals	50%
Excessive car expenses for luxury cars	
Tax loss carry forwards	
Losses may be carried forward for an indefinite period of time	
Usage of tax losses: 75% of taxable income	

Double taxation agreements

with 68 countries – mainly exemption method

International participation exemption for holding companies	
Conditions: Investments >10%, 1 year holding	
Dividends	0%
Capital gains	0%
Thin capitalization rules	None
CFC rules	None

Group taxation

valid from January 2005

Consolidation of tax losses with taxable profits
Conditions: Qualifying participations > 50%
Group agreement and agreement on allocation of cost
Losses of foreign participations may be offset against profits of group leader

Taxation of individuals

Individual income tax rate = Progressive rate	
below 10,000	0%
from 10,000 to 25,000	23.0%
from 25,000 to 51,000	33.5%
over 51,000	50.0%
after deducting personal expenses (limited)	

Social security on monthly earnings up to EUR 3,630	
Employer's share	up to 21.9%
Employee's share	up to 18.0%
Payroll related taxes	approx. 8.0%
Income cap for social security contributions, social security totalisation agreements with various states	

Value added tax

in line with the 6th EU directive

Standard rate	20%
Reduced rate (Food, rent, public transportation etc.)	10%
VAT refund for foreign enterprises – available up to June 30 of the following year.	

Other taxes

Real estate transfer tax	3.5%
Capital tax	1.0%
Stamp duties - Loan agreements	0.8%
Rent agreements	1.0%

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