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PwC Austrian Tax News*

Issue 7, August 2006

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Direct Taxes

New law to support middle market

On 23 May 2006 the new law to support middle market (KMU-Förderungsgesetz 2006) was passed by the Austrian parliament. This law introduces tax incentives which are especially designed to support small and medium sized enterprises which represent the majority in the Austrian business environment.

From 2007, small and medium sized enterprises which operate in the form of a partnership or as a one man business will be granted a tax allowance up to 10% of their profit (cap of EUR 100,000). This tax allowance is limited to certain investments in property plant and equipment as well as investments in specified securities. Investments in buildings, cars, aeroplanes as well as low value assets are exempt from the tax allowance.

The law also stipulates a minimum useful life for the investments as well as a minimum holding period for the securities of at least four years. Should the actual useful life be shorter, the previously granted tax allowance is subject to a subsequent taxation (there is a special regulation for securities which allows them to be replaced within the minimum holding period).

Also from 2007, small and medium sized enterprises which calculate their tax base on the cash method of accounting will generally be allowed to carry forward losses for a period of three years. Currently these enterprises are only able to carry forward losses that occurred in the first three years of their existence (start up losses).

Furthermore with the beginning of 2007 the requirement to charge VAT and to pay it over to the tax authorities will be changed. Small businesses whose sales do not exceed EUR 30,000/year (up to now the limit has been EUR 22,000/year) do not need to charge VAT on those sales.

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Draft Protocol for amendments of the Tax Treaty between Austria and Slovenia

Austria is the most important foreign investor in Slovenia and therefore the tax treaty between Austria and Slovenia is of particular importance for Austrian enterprises. Due to interpretation conflicts of Art 12 (taxation of royalties) of the Tax Treaty, the Federal Ministry of Finance presented a draft protocol in April 2006, which amends Art 12 and some other aspects of the Tax Treaty.

Pursuant to Art 12 Sec 2 of the present Tax Treaty the source state has the right to levy 10% withholding tax on royalty income from affiliated companies owning a participation of at least 25%. According to the Austrian interpretation of Art 12 Sec 2, the source state may tax only royalty payments between affiliated companies. For all other royalty payments the source state has no right of taxation. The Slovenian tax authorities are assuming an unrestricted right to tax royalty payments between non affiliated companies, which has created double taxation issues (in particular for Austrian licensors) in the past.

In order to eliminate these interpretation differences, a general withholding tax of 5% of the gross amount of the royalty income is proposed in the draft protocol. However, this tax will not apply, in any event, to royalty payments from affiliated companies, which are resident in different member states of the EC, due to the exemption clause in the EC Directive for interest and royalty payments.

Furthermore, Art 11 Sec 2a will be inserted in the Tax Treaty. According to this new provision, interest payments, which are effected or collected by public authorities or the central bank, will be exempt from any withholding tax imposed by the source state. This exemption will also apply for loans granted or guaranteed by public export financing institutions. The treaty rate for all other interest payments will remain at 5%.

According to Art 4 of the draft protocol the amendments shall be applied on taxes regarding financial years beginning on or after the 1 January 2007.

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Taxation of foreign investment funds and life insurances

The reporting regime for foreign funds leads to the elimination of tax disadvantages for foreign investment funds. Domestic deposit income derived by individuals from reporting funds is subject to final taxation and no safeguard tax is deducted. Benefits from life insurances received by individuals are generally not considered as taxable income in Austria.

Since 1 July 2005 income from foreign investment funds, which follow a certain reporting regime with the Oesterreichische Kontrollbank (OeKB) and have a tax representative in Austria, is subject to final taxation, if the fund certificates are held on an Austrian deposit. As a result of these changes, the taxation of so called “brighter than white” reporting funds corresponds with the taxation of domestic investment funds.

One year after the implementation of the new reporting regime almost all important investment companies have entered into the reporting system in order to offer their customers the benefits of brighter than white funds. As long as the fund units are held by a private investor at domestic deposit these benefits comprise complete and immediate final taxation, the omission of safeguard tax and in case of the purchase/sale of fund certificates, only the tax on the reported net interest income is credited/deducted.

According to an amendment of the Immobilien-Investmentfondsgesetz (Real Estate Fund Act), which is expected to be passed this summer, foreign real estate funds will be able to achieve the brighter than white status as well.

Non-reporting Funds (White, Grey and Black Funds)

White and grey funds have a tax representative in Austria, who calculates the deemed distributed income (DDI) and files DDI declarations with the Austrian Ministry of Finance once a year. The only difference is that white funds are registered for public distribution in Austria whereas grey funds are not registered. Otherwise the tax treatment of white and grey funds is identical. If fund units are held at Austrian deposit, 25% withholding tax is deducted by the depository bank in case of a distribution. The DDI which is deemed to be received by the private investor four months after the

fund's financial year end must be included in the investor's annual income tax return and is taxed at 25% (special tax rate).

Funds without a tax representative in Austria are called black Funds. As no DDI is calculated for these funds the income is subject to an unfavorable lump-sum taxation. The tax base is calculated as the higher of either 90% of the annual increase in value or 10% of the NAV at year-end. Therefore, even in years of losses, 10% of the NAV is the tax base and this is subject to 25% income tax and must be included in the investor's annual income tax return.

Safeguard Tax

For private investors of non-reporting funds, safeguard tax in the amount of 1.5% p.a. of the net asset value at year-end must be levied by the Austrian bank. The safeguard tax, which is a prepayment of income tax, can be avoided, if the investor discloses the fund certificates to the tax office.

Taxation of Life Insurances

Benefits from life insurance contracts received by individuals are generally not considered as taxable income in Austria. However, if the contract period is less than 10 years and the premiums are not paid regularly, the amount of the received benefits which exceeds the discounted premiums paid, is taxable.

Nevertheless the premiums paid for a life insurance by an individual are subject to Austrian insurance premium tax (IPT) if the policy holder has its residence or domicile at the time of paying the premium in Austria. The IPT rate amounts to 11% for pure endowment insurances and combined endowment and ordinary life insurances with a maximum contract period of 10 years and no periodical insurance payments. For all other life insurance contracts 4% IPT rate is applicable. If the insurance contract is redeemed before the 10 years have passed or if the change of the contract is qualified as a novation, the regular premium payments are subject to an additional 7% IPT.

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Direct and Indirect Taxes

Electronic filing – the direct line to the Austrian authorities

At the beginning of 2003, the Austrian tax authorities launched their official online system FinanzOnline for filing tax returns electronically. However, communications with the Austrian authorities electronically is not limited to filing tax returns. Intrastat Declarations, EC Sales Listings and, in the future, even financial statements can be sent to the competent Austrian authorities via the internet.

In recent years, the Austrian tax authorities have gradually enlarged the possibilities for companies to handle their tax compliance obligations online via the FinanzOnline system. However, the key element of FinanzOnline remains the filing of tax returns. All companies registered for VAT or corporate income tax purposes in Austria are obliged to file their corporate income tax and VAT returns electronically via the FinanzOnline system. To get access to the system, the legal representative of the company has to meet with the tax office and register personally at an Austrian tax office. As this procedure has proved to be too difficult for foreign companies, a simplified registration procedure has been agreed upon with the tax authorities in Austria: Companies can apply for access to FinanzOnline via their local tax representative, who needs a special power of attorney for the registration procedure. In addition, it is also possible that the tax representative himself files the tax returns of his client via his own FinanzOnline account. In this case no separate FinanzOnline registration of the client is required.

The FinanzOnline system can be accessed under the following address: https://finanzonline.bmf.gv.at. Application forms can be downloaded under the following address: http://formulare.bmf.gv.at/Service/Formulare/BMF/FON/2003/fon1.pdf

Electronic filing of tax returns

Not only corporate income tax returns and VAT returns have to be filed electronically in Austria but the number of tax returns which must be filed electronically is increased on a step by step basis. With regard to some returns, the filing deadline is extended if they are filed electronically. The following table summarizes the most important tax returns, their filing deadline

and whether an extension is granted if the return is filed electronically:

	Filing deadline	Electronic filing deadline extension
Corporate Income Tax Return	30 April of the following year[1)]	30 June of the following year[1)]
Annual VAT return	30 April of the following year[1)]	30 June of the following year[1)]
Monthly VAT return	15th of the second following month[1)]	no extension
Monthly EC sales listing	by the end of the following month[1)]	15th of the second following month[1)]
Capital transfer tax return	15th of the second following month[1)]	no extension
Annual wage tax statements	31 January of the following year[1)]	February 28 of the following year[1)]

[1)] following the period concerned

Electronic filing of applications

In order to simplify and accelerate the communication with the Austrian tax authorities, the FinanzOnline system allows not only tax returns to be filed online, but the current balance of the tax account of a company and the status of filed applications can be reviewed online. In addition, the following applications can currently be submitted electronically via the FinanzOnline system:

- Application for confirmation of the validity of a VAT-identification number;
- Application for repayment or transfer of credit balances;
- Application for assessment of self-assessment taxes;
- Application for extension of a filing deadline;
- Application for deferment of payment;
- Appeal against an assessment.

Intrastat

Companies with inbound and/or outbound intra-community movements of goods exceeding EUR 250,000 per year have to file monthly Intrastat forms by the 10th working day following the respective month. Intrastat returns can be filed on special paper forms provided by the Austrian Statistical Authority (Statistik Austria) or electronically: Companies can report their intra-community movements of goods either by submitting data via a web based online form or – if a huge amount of data has to be reported periodically – by a special computer program, offered by the Austrian statistical authority.

The web based form can be accessed under the following address: https://www.statistik.at/IntraWeb/Controller (English version and demo mode available)

The computer program can be downloaded under the following address: http://www.statistik.at/fachbereich_06/idep_01.shtml (English manual available)

Financial statements

In Austria, financial statements have to be filed with the competent commercial register within 9 months after the balance sheet date. In the future, financial statements must also be submitted electronically in Austria: For fiscal years ending on or after 31 December 2007 all companies have to file their financial statements by electronic means (there are certain exceptions for small corporations with sales not exceeding EUR 70,000 per year). To encourage companies to file their financial statements before this obligation is effective, the fees for filing financial statements in paper will be increased as of 1 January 2007.

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Entertainment expenses and company cars

In Austria, the tax deductibility of entertainment expenses is restricted. Specific rules also apply for company cars. The following article gives an overview on the Austrian tax rules regarding entertainment expenses and company cars in the Austrian income tax and VAT law.

Basically, entertainment expenses are classified into three groups: deductible to 100%, 50% or non-deductible for income tax purposes. By contrast, 100%-input VAT relief regarding entertainment expenses is granted only for deductible or semi-deductible expenses.

Non-deductible entertainment expenses

Expenses designed to enhance the social prestige of the taxpayer and predominantly serving representation purposes are non-deductible. Typical examples are expenses for working dinners after a business transaction, visit to the theatre or the opera ball, birthday parties, etc. Expenses for common gifts to clients like flowers or stationery are also deemed to be a non-deductible expense based on the existing case law but small amounts are frequently accepted by Austrian tax offices. Non-deductible entertainment expenses do not qualify for input VAT recovery.

100%-deductible entertainment expenses

The deductibility of entertainment expenses is not restricted in the following circumstances:

- The entertainment is an imminent part of a business activity (e.g. costs of food served in the course of a training which are included in the training costs).
- Entertainment expenses qualifying as a remuneration (e.g. incentive-trips); such incentives might however be subject to income tax for the recipient.
- Entertainment does not contain representation elements at all (e.g. entertainment in context with a plant inspection or a product presentation)

For 100%-deductible entertainment expenses input VAT is fully recoverable.

50%-deductible entertainment expenses

Expenses for working dinners are 50% deductible for income tax purposes under the condition that these expenses explicitly pursue advertising purposes and that the business reason is clearly dominant. The corresponding input VAT is 100% recoverable. For income tax purposes as well as for input VAT relief, detailed documentation is necessary to demonstrate the clear advertising nature of the event, i.e. to record the name of the business partner, the reason for the entertainment and the name of the closed transaction on the invoice.

Company cars

Passenger cars purchased or leased by companies or entrepreneurs for business purposes are regarded as business assets up to acquisition costs of EUR 40,000 (EUR 34,000 for acquisitions before 2005) including costs for extra equipment and VAT. For these purposes, costs are determined at the date of first registration. Any acquisition costs exceeding this threshold or relating proportionate leasing and operating costs (e.g. insurance expenses, repair expenses) are not deductible for income tax purposes (luxury threshold).

The acquisition costs deemed to be business related can be amortized tax effectively over a period of at least eight years. In the case of leasing of business passenger vehicles, the lease payments are considered tax deductible based on an eight-year amortization.

Any VAT incurred on the purchase, lease or use of passenger cars is not recoverable. On the other hand, no VAT falls due on the sale or private use of these vehicles. Input VAT relief is granted only for specific cars (e.g. trucks and small busses).

Special rules apply for the cross-border lease of passenger cars. Basically, the place of supply of the hiring out of means of transport is deemed to be where the supplier has established his business or has a fixed establishment which might eliminate VAT costs on cars leased from lessors outside Austria. If according to this rule the leasing of the car is subject to VAT in a country, which grants a VAT refund to Austrian lessees, the Austrian lessee must self-account for Austrian VAT on the cross-border leasing of the vehicle. The respective Austrian VAT is not recoverable. According to recent jurisdiction of the European Court of Justice, this so called “self-supply regulation” violates Community law. The Austrian government slightly changed the rules which were again brought before the Austrian courts. The respective legal proceeding is still pending.

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New reporting requirement for cross-border services as of 1 January 2006

As of 1 January 2006 companies have to report their cross-border services (service exports or imports) to Statistics Austria. A service is deemed to be cross-border, if one of the contracting parties is resident in Austria and the other one is situated abroad.

The reporting requirement is fixed and is based on threshold values. Depending on the economic sector in which the company is mainly active, these values amount to either EUR 50,000 or EUR 200,000 for service exports or imports.

A Company is obliged to report for the year 2006, if it

- is subject to the sectors C to K (without credit and insurance business) and M to O of the ÖNACE 2003 (except therefore e.g. agriculture and forestry); and
- is resident in Austria (home branch offices or operational facilities of foreign enterprises are treated as equivalent to the domicile); and
- has exceeded the threshold value in the previous year (2005) or will exceed it in the current year 2006

Service exports and imports have to be reported quarterly, starting with the 1st quarter 2006 and is due on the 15th of the subsequent month.

This deadline can be extended permanently by informal e-mail (zabil@statistik.gv.at) by a maximum of one month.

At the end of the year another report is required (up to 15th of the second month following year-end). However, this report can be avoided if the required additional data is reported with the quarterly report.

Therefore one of the following two reporting concepts can be used:

Reporting concept I:

- Quarterly report of service exports and imports sorted by partner country and
- Annual report of service exports and imports sorted by type of service

Reporting concept II (=Matrix report, only available with electronic reporting):

- Quarterly report of service exports and imports sorted by partner country and type of service

Statistics Austria has informed the companies with a potential reporting requirement about their future reporting requirement during 2005. In March 2006 the reporting documents for the 1st quarter 2006 were submitted to these companies.

Caution: The reporting requirement may exist – when the threshold value is exceeded – even though the company has not received the reporting documents. In case of a reporting violation penalties of up to EUR 5,000 could be imposed.

Further questions and hints:

1) Classification of your company is based on ÖNACE 2003
2) Are services rendered to or obtained from foreign contracting parties? (also applies to private contracting parties or connected enterprises)
3) Does the sum of service exports or imports reach the trade-specific threshold values? (see www.statistik.at/_downloads/dienstleistungsverkehr/erlauterung.pdf)
4) When a threshold value is exceeded, reporting forms or the registration form for electronic reporting can be found under www.netquest.at.
5) Contact your software provider to adapt your accounting program and table of accounts to the new regulations.

If you have any questions regarding reporting requirements as well as to check the relevant threshold values, your PwC consultant will be happy to assist you.

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International assignment of employees between group companies and the interpretation of "international employer"

In the case of short-term international assignments between group companies the function of the employer can be taken on by the foreign company.

The entitlement to levy income tax on employment income in the case of international assignments is provided for in article 15 of the OECD Model Tax Convention. This states that the state of residence is entitled to levy income tax on employment income unless the dependent work is carried out in the other country.

The state of activity will lose its entitlement to levy income tax on employment income if the requirements of the so called 183-days-rule are fulfilled.

Those requirements are as follows:
- The employee is present in the state of activity for a period or periods in aggregate of no more than 183 days during the tax/calendar year concerned or during any 12 months period.

And
- The remuneration is paid by, or on behalf of, an employer who is not a resident of the state of activity

And
- The remuneration is not borne by a permanent establishment which the employer maintains in the state of activity.

If all the above conditions are fulfilled the tax entitlement remains with the state of residence. For employees who are assigned abroad for a short period and who are resident in Austria, the monthly wage tax withholding requirement in Austria will continue.

Currently there is a discussion regarding a proposed OECD-clarification of the scope of para 2 of the 183-days-clause. According to the suggested clarification the term "employer" as used in the 183-days-clause should relate, in the case of cross-border hiring out of labor, to the user of the personnel rather than to the civil employer, who is the supplier of the personnel.

According to the current interpretation of Austrian national tax law, the employer in the case of international assignments of employees by professional suppliers of personnel, is the Austrian supplying company which continues to pay the salaries to the employees.

For international assignments between group companies a rule based on economic considerations has been developed in order to define the "employer".

The foreign group company will be considered as "employer" if the employee is integrated in the organization of that company. Such economic integration will be considered as existent, if the typical employer functions, such as the decision-making power concerning salary and termination of employment, have been transferred to the foreign group company.

Some countries, such as Germany apply a different approach. Here, the "employer" in the case of international group company assignment from Austria will be the German group company after an assignment period of 3 months. The integration of the employee in the organization of the German company shall not be required. Austria will not, however, exempt the income of short term assignees from mandatory wage tax withholding. The arising double taxation can in certain cases be avoided by filing an application according to para 48 Austrian Act on Federal Duties ("Bundesabgabenordnung").

According to the proposed OECD-clarification the "employer" shall be defined by some objective criteria that can easily be verified. For example, the "employer" will be the foreign company rather than the Austrian legal employer, where the foreign company:
- takes on the responsibility or the risk for the results of the activity of the employee,
- is entitled to give directives to the employee and
- bears the costs for this activity in an economic sense.

Thus in most cases the state of activity will obtain the right to levy income tax on salaries of short term assignees. Austria as the state of main residence will in most cases be obliged to exempt this income subject to progression.

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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

Annual taxable		Income Tax		Effective Tax Rate	Marginal Tax Rate
to	€ 10,000	€ 0		0%	0%
over to	€ 10,000 € 25,000	$\frac{(EK - 10,000) \times 5,750}{15,000}$		0 - 23%	38.333%
over to	€ 25,000 € 51,000	$\frac{(EK - 25,000) \times 11,335}{26,000}$	+ 5,750	23 - 33.5%	43.596%
over	€ 51,000	(EK - 51,000) x 50%	+ 17,085	> 33.5%	50%

Social security on monthly earnings up to EUR 3,630			
Employer's share	up to 21.9%	Payroll related taxes	approx. 8.0%
Employee's share	up to 18.0%		
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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Copyright & Publisher:
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