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PwC Austrian Tax News*

Issue 10, February 2007

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Direct Taxes

Relief at source on outbound dividends to the EC

In a recent letter ruling the Austrian Ministry of Finance announced a further alternative to achieve relief at source for dividend withholding tax under the EC Parent Subsidiary Directive.

The Income Tax Act, implementing the EC Parent Subsidiary Directive, requires a minimum shareholding of 10% and a minimum holding period of one year in an Austrian subsidiary by a corporate EC shareholder to exempt dividends from withholding tax. The standard method to apply the exemption is the refund procedure, which means that the distributing company has to pay over the tax to the tax office upon distribution and the foreign EC-shareholder has to apply for a refund. The alternative exemption at source is granted only where the foreign EC shareholders business is more than mere asset management and has its own office and employees. As a consequence of these strict criteria, many EC holding companies owning Austrian subsidiaries do not qualify for the relief at source method. These companies therefore face additional administrative and financing costs to achieve the refund.

The Austrian Ministry of Finance published a written opinion on November 9, 2006 regarding the withholding tax exemption under the EC Parent Subsidiary Directive. Relief at source can be applied analogously to the decree set-out for the withholding tax exemption/reduction under the Austrian Double Tax Agreements. According to this decree relief at source is also available if the tax office has granted a refund to the same recipient within the three preceeding years. This relief at source can then apply for dividends distributed in the three years subsequent to the refund irrespective of the substance of the foreign EC-shareholder. The facts and circumstances under which the refund was granted must not be significantly different from the subsequent distributions. A significant change is also assumed by the Ministry, where the subsequent dividends significantly exceed the earlier dividends subject to refund.

Even though written opinions are not legally binding, these published opinions of the Ministry are typically applied by tax inspectors in practice.

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Holding privilege – action to be considered for the 2006 assessment period

Austrian holding companies established before 1 January, 2001 have to consider, for the 2006 assessment period, whether to opt for participation exemption in foreign companies.

Dividends and capital gains received by an Austrian corporation from participations in foreign companies are tax exempt, if at least 10% of the share capital is held for a minimum holding period of one year.

According to the old legislation (sec. 10 para 2 Austrian Corporate Income Tax Act) losses from the disposal, liquidation or write-down of shareholdings were basically deductible for corporate income tax purposes at the level of the Austrian company. These expenses have to be spread over seven years.

However, under new legislation (sec. 10 para 2 and 3 Austrian Corporate Income Tax Act) the general principle is one of a tax neutral treatment of both capital gains and losses from the disposal and write-downs of qualifying participations. Losses from the liquidation of foreign participations remain tax effective under the new rules, although the liquidation loss is reduced by any tax exempt dividends derived from the foreign subsidiary within a period of five years prior to its liquidation.

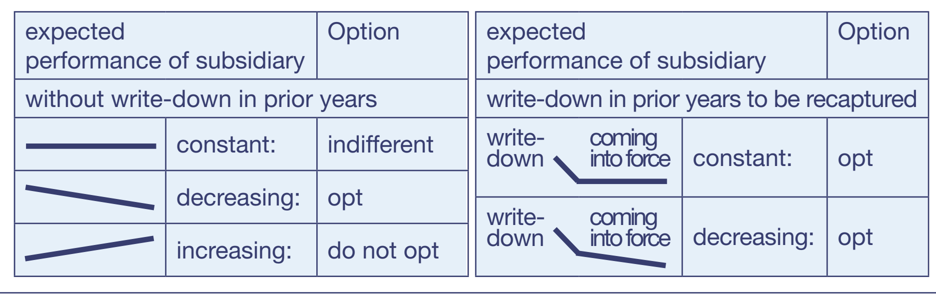
The new holding privilege rules also introduced an obligation to recapture tax effective write-downs in prior years, irrespective of the value of the underlying investment. The recapture has to be added to taxable income over seven years.

However, the Austrian company may opt for treating capital gains and losses as well as write-downs as tax effective for corporate income tax purposes with the following consequences:

- capital gains are subject to 25% Austrian corporate income tax,
- write-downs and capital losses are tax effective (to be spread over a period of seven years),
- the automatic recapture of tax effective write-downs in prior years will not be triggered.

A decision is therefore required whether to 'opt' in respect of the participations of the Austrian company. The option might be beneficial for participations for which significant amounts of write-downs have been incurred in the past, such amounts might become taxable under the recapture rules, or if a significant impairment in value is expected for the foreign subsidiary. No option should be filed for participations where an increase in value is anticipated in the foreseeable future.

The following table gives some examples whether an option should be filed or not:



expected performance of subsidiary		Option
without write-down in prior years		
	constant:	indifferent
	decreasing:	opt
	increasing:	do not opt

expected performance of subsidiary		Option
write-down in prior years to be recaptured		
write-down / coming into force	constant:	opt
write-down / coming into force	decreasing:	opt

The option has to be filed for each participation individually.

For "old" holding companies, which were established before 1 January, 2001, the option has to be done in the 2006 corporate income tax return at the latest. The option cannot be changed at a later point of time. For "new" companies set up after 2000 the option must have already been effected in the 2004 corporate income tax return.

"Old" holding companies should check for all foreign participations whether the option for treating capital gains as tax effective should be filed in the 2006 tax return to optimize the tax position.

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Impact of the Cadbury Schweppes Judgement on Austrian tax law

On 12 September 2006, the European Court of Justice (ECJ) handed down the judgment in the Cadbury Schweppes case (C-196/04) about the controlled foreign company (CFC) legislation under UK law and the compatibility of this legislation with the EC Treaty. Though generally speaking Austria does not have CFC legislation, the judgement might have an important and positive impact on tax structuring in Austria.

The decision

Cadbury Schweppes is a UK resident company and the parent company of a group of companies, which included two subsidiaries that were resident in the Republic of Ireland, established in the International Financial Services Centre in Dublin and subject to tax at a rate of 10%. The Irish subsidiaries acted as group financing companies and were established solely to take advantage of a more favourable tax regime than in the UK. Under UK law, the profits of lowly taxed foreign companies controlled by a UK resident company are subject to additional taxation in the UK (a form of look-through taxation, known as the CFC charge) unless an exception applies (e.g. if a motive test is passed, or if it can be demonstrated that the foreign company exercises particular trading activities, etc.). The UK tax authority found that no exception applied and therefore issued an assessment on the parent company on the basis that the UK's CFC legislation applied. Cadbury appealed arguing that the legislation was contrary to EU law. The case was referred to the European Court of Justice for a preliminary ruling.

The ECJ decided that a company which sought to profit from tax advantages in force in a member state other than the state of residence should not be deprived of the right to rely on the provisions of the Treaty. The Court went on to hold that the UK CFC regime created a tax disadvantage for the UK resident company, which restricts the Freedom of Establishment. This measure may only be justified where it specifically relates to "wholly artificial arrangements" aimed at circumventing the application of the legislation of the Member State concerned. The Court's guidance on what may constitute a "wholly artificial arrangement" refers simply to the extent to which the CFC physically exists in terms of premises, staff and equipment and consequently the finding that the local incorporation corresponds with an actual establishment intended to carry on genuine economic activities in the host Member State.

According to our analysis, this decision might particularly impact the following areas of Austrian tax law:

Look-through taxation of deemed foreign investment funds

Assets that are subject to the laws of a foreign country and invested in accordance with the principles of risk-spreading are, irrespective of the legal form, deemed a foreign investment fund and subject to a look-through taxation.
It is not entirely clear in how far the application of this legislation to foreign resident companies is suppressed by Double Tax Treaties. With a view to the Schweppes Judgement it is questionable if Austrian tax authorities can maintain the look-through taxation for EU based subsidiaries investing in accordance with risk-spreading principles, in circumstances where the subsidiary has real substance (e.g. employees).

Dividends and capital gains realised from lowly taxed passive companies

Dividends received from foreign investments as well as capital gains realised upon the sale of the investments are generally tax exempt provided that a minimum holding quota of 10% and a minimum holding period of one year are fulfilled. However, the exemption does not apply to investments in low taxed foreign companies receiving mainly passive income (i.e. interest, royalties, lease income, capital gains from the disposal of portfolio investments). The credit method is applied (switch-over clause) for dividends and capital gains generated from such investments, which creates a tax disadvantage for the Austrian parent company. The present ECJ decision provides strong arguments that the switch-over clause may not be applied with respect to EU based subsidiaries, if – again – the subsidiary is furnished with substance.

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Profit participation rights

Financing of companies is often a challenge. A dilemma faced by many entrepreneurs is the allocation of equity to investors without granting typical shareholder rights to the equity investor. An investment facility available under Austrian law, which meets these needs, is the profit participation right ("Genussrecht").

Profit participation rights are creditor rights conferring the holder with a contractually agreed quasi-shareholder right. Profit participation rights are not specifically regulated by the Austrian law and therefore the main elements (e.g. duration, shareholder rights, information rights, sharing of losses etc.) can be freely agreed in line with the requirements of the issuer and the investor. Usually a company decides to issue profit participation rights in order to obtain equity financing without giving voting or similar shareholder rights to investors.

Depending on the characteristics of the profit participation rights one has to distinguish between equity-like and debt-like profit participation rights.

According to Austrian case law, a profit participation has to be considered equity-like, if the criteria for equity prevail compared to the criteria for debt. Essential characteristics for equity are the sharing of losses and profits and the participation in the liquidation proceeds as well as in the hidden reserves of the company. An indefinite duration or a subordination towards other creditors are further criteria for the qualification as equity. Criteria for the qualification as debt would be for instance a minimum interest or the missing of control rights. The distinction is primarily relevant for tax purposes and the recognition in the statutory books.

Tax treatment of equity-like profit participation rights:

Profit distributions on equity-like profit participation rights are treated as dividends under Austrian tax law. As a consequence the profits allocated to the investor are non-deductible. On the other hand the dividend is exempt on the level of an Austrian corporate investor irrespective of any minimum holding requirements. The distributions are subject to 25% withholding tax, which is eliminated/refunded to Austrian corporate shareholders. For individual Austrian investors the withholding tax covers the income tax which means that no further income tax falls due on the level of the investor. For foreign investors many double tax treaties reduce the withholding tax burden even though a full exemption under the EC Parent Subsidiary Directive is not attainable. Equity-like profit participation rights in foreign companies may, however, qualify for the participation exemption under the general conditions. The redemption of the profit participation rights is tax neutral and exempt from withholding tax. Capital gains from the sale of profit participation rights are subject to 25% corporate tax in the hands of the Austrian corporate investor. For foreign investors in general double tax treaties assign the right of taxation to the country where the recipient is resident for tax purposes.

Tax treatment of debt-like profit participation rights:

Profit allocations to debt-like profit participation rights in general represent deductible interest expense, which creates taxable interest income in the hands of the investor. Any capital gains or losses on the sale or redemption of the profit participation rights are tax effective. The interest is subject to 25% withholding tax only, where the profit participation right is structured as a security. For the foreign investors, however, the interest is exempt from withholding tax, unless specific assets (e.g. Austrian real property) are used as collateral for the right.

Capital transfer tax:

The issue of both equity- and debt-like profit participation rights is subject to 1% capital tax.

In general, the decisive advantage of profit participation rights is the flexibility to create an individual investment facility which is appropriate for the issuer as well as for the investor. An advantage from a tax perspective can only be achieved in exceptional cases.

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EU Law and Austrian dividend taxation

Recently the European Court of Justice (ECJ) has heard a number of cases regarding the taxation of dividends, the decisions of which together with other cases will have a major impact on the Austrian tax law.

Outbound Dividends

In the ECJ decision „Denkavit, C-170/05“ from 14 December, 2006 the different treatment of the taxation of dividends received by a domestic and a foreign-EU company was assessed as a breach of the freedom of establishment. In this case, whilst dividends paid to a domestic parent company were tax exempt at the level of the parent company, a domestic withholding tax was levied on dividends paid to a parent company located in another jurisdiction which consequently lead to an economic double taxation. The ECJ added that where (and only where) a Member State has a mechanism for relieving economic double taxation on a domestic payment, then that Member State must extend equivalent treatment in the cross-border case.

The ECJ decision may have an impact on the Austrian tax system, since discrimination of non-resident investors is regulated by law. Dividends paid to domestic shareholders will not trigger any withholding tax on dividends and full tax relief is granted in the course of the tax assessment irrespective of the holding quota and the holding period due to the application of the national affiliation privilege. In contrast dividends distributed to foreign shareholders are only tax exempt if the shareholding meets a number of conditions. These conditions are based on the parent subsidiary directive and require a minimum holding of 10% and a minimum holding period of one year. If these conditions are not met a withholding tax of 25% is levied. Since the national affiliation privilege is not applicable at the level of non-resident shareholders, the withholding tax can only be reduced upon the applicable of a Double Taxation Treaty.

Consequently the limited relief given in Austria infringes the freedom of establishment in all cases in which the state of residency of the foreign shareholder does not credit the Austrian withholding tax. Therefore, Austria as the source state would be required to grant a tax relief for all foreign EU parent companies concerned. This can be effected either by exempting cross-border dividends to EU-parent companies from withholding tax or by way of refund. Therefore, if a foreign EU-company receives dividends from an Austrian subsidiary which are subject to Austrian withholding tax where full credit is not granted by the state of residence, we recommend you contact your consultant or specialists from PwC.

The ECJ decision should also be considered from an Austrian point of view. Where an Austrian company holds at least 10% in a foreign EU-company and there is a prevailing non equal treatment of dividend payments to domestic and foreign shareholders in one of these countries, a breach of the freedom of establishment would exist, since according to the international affiliation privilege the foreign withholding tax could not be credited in Austria. As a consequence, the EU-source state must arrange for a tax relief of the withholding tax paid by the Austrian parent company. Regarding appeal possibilities, we would be pleased to contact our foreign PwC partner offices.

Inbound Dividends

In a further ECJ decision from 12 December, 2006 regarding the case „FII Group Litigation, C - 446/04“ the ECJ determined that the different taxation of dividends received from domestic and foreign subsidiaries breaches the freedom of establishment article of the EC treaty. For example, dividends from domestic subsidiaries are generally tax exempt whereas dividends from foreign subsidiaries are subject to corporate income tax and no tax credit is granted on the corporate income tax paid by the foreign subsidiary in the state of residency.

The ECJ found that a member state should provide for an equal treatment to dividends from other EU-member states where domestic dividends avoid an economic double taxation. Therefore, portfolio dividends from EU member states must either be tax exempt or if a tax credit system is applied both foreign withholding taxes and foreign corporate income taxes paid have to be credited on the domestic corporate income tax.

The ECJ decision in the case FII could also have an impact on the taxation of dividends in Austria. Currently Austria provides an exemption from Austrian corporation tax for domestic dividends without any requirements, whereas dividends from foreign EU-member states are subject to Austrian corporate tax, if the international affiliation privilege (i.e. minimum holding quota of 10% and minimum holding period of one year) is not applicable. However, at present the credit is restricted to a levied foreign withholding tax, whereas the foreign corporation tax paid by the subsidiary is not creditable. This has the effect that portfolio

dividends from foreign EU-member states – contrary to the ECJ decision – are economically double taxed.

Therefore, we recommend all Austrian companies receiving taxable foreign EU-dividends to appeal against the assessment or at least to keep within the time limit of appeal. PwC will support you in the establishment of an appeal or in case of any further questions.

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Indirect Taxes

Increase in duty – free allowances for travel imports from non EC Member States

The European Council decided to increase the duty – free allowances for travel imports from non EC Member States.

On 28 November, 2006, the European Council agreed on the proposal to increase allowance exemptions from value added tax and excise duties on goods carried by travellers entering the European Union from non EC Member States. The proposal shall revise and replace the Directive 69/169/EEC on traveller allowances and adapt the Directive to the enlarged European Union. Prior to this, the traveller allowances have not been revised since 1994.

The essential facts of the changes announced by the European Council are as follows:

- The allowance exemptions from value added tax and excise duties shall be increased from EUR 175 to EUR 430 for air and sea travellers, and from EUR 175 to EUR 300 for tourists entering the European Union by landways (including the import of goods by tourists travelling by inland waterways).
- The Member States may define different quantity limits for the import of tobacco products exempt from value added tax and excise duties such as cigarettes, cigars, cigarillos and smoking tobacco. These differences in the quantity limits depend on whether the tobacco products are imported into the European Union by aircraft or whether they enter the European Union by land or watercrossing. For tobacco products imported by travellers by aircraft, the quantity limit shall be higher than for the import of tobacco products entering the European Union by landways or watercrossing.

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Sending of official writs abroad

The Austrian tax authorities have changed their practice and are now sending official writs directly to taxable persons in other EC Member States.

Currently, businesses without a legal seat or fixed establishment in the European Community basically have to appoint a fiscal representative if they carry out transactions subject to Austrian VAT. Businesses with legal seat or fixed establishment within the European Community carrying out transactions subject to Austrian VAT can appoint a fiscal representative voluntarily. The fiscal representative is required to be a mailing agent, i.e. has to be authorized to receive writs from the tax authorities.

Up until now, the Austrian tax authorities have sent official writs for foreign businesses to an Austrian resident mailing agent only. The mailing agent was then required to forward the official writs to the taxable person abroad. If no mailing agent had been appointed the official writs would have been lodged at the tax office. The lodgement is considered as receipt of the official writ by the tax payer with all legal consequences. Recently the Austrian tax authorities changed their practice by sending official writs (in any case the notification of the tax

number and the notification on the granting of a VAT identification number) directly to businesses in other EC Member States in addition to sending them to the mailing agent. They do not send official writs to the tax payer's tax representatives abroad. This practice is relatively uncommon and as the tax authorities are legally not obliged to send official writs abroad, we recommend that businesses appoint an Austrian resident mailing agent.

The Austrian tax authorities do not send official writs to businesses in non-EC Member States as there are currently no international agreements in place.

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New Legislation

Proposed tax legislation of the new Austrian government

On 11 January 2007 a new government was appointed by the President of Austria. Austria is now governed by a coalition of the Austrian Conservative Party ("ÖVP") and the Austrian Labour Party ("SPÖ"). The coalition agreement announced immediately after the designation does not include specific information regarding changes of the tax legislation. Thus, no substantial changes of the tax system are to be expected in the near future. In particular the group taxation, which has been strongly criticized by the Austrian Labour Party in the election campaign is likely to remain unaffected.

A comprehensive reform of the tax system is planned in the new legislation period, but this is not expected to be implemented before 2010. The main areas of the new tax system will be the reduction of the overall tax burden and the support of economic growth and employment. The reform will aim at strengthening Austria as a business location as well as to spread the tax burden more simply and fairly. The tax reform will also take account of the increasingly globalized business environment and design a more efficient and competitive tax system in order to attract more foreign investors.

Additionally the effectiveness of the financial administration and the service quality provided to the tax payers should be continuously improved (e.g. the tax office will provide the taxpayers with the completed forms of the tax returns). At present no other major propositions have been announced by the new government.

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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 € 10,000	to € 25,000	(EK - 10,000) x 5,750 / 15,000		0 - 23%	38.333%
over € 25,000	to € 51,000	(EK - 25,000) x 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:
PwC PricewaterhouseCoopers GmbH, Erdbergstrasse 200, 1030 Vienna, Austria

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