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Direct & Indirect Taxes

Establishments in Austria

In order to commence a trade in Austria, non-resident businesses may establish a subsidiary, a registered branch office, a permanent establishment or a representation office.

Whereas a representation office does normally not trigger direct taxation in Austria, a subsidiary, a registered branch office and a permanent establishment lead to taxation.

Differences between branch office (permanent establishment) and subsidiary

Branch office/permanent establishment	Subsidiary
Limited taxation of Austrian source income	Unlimited income taxation
The profit of the business is allocated to the permanent establishments within and outside Austria	The profit of the subsidiary is determined separately
Direct and indirect determination of tax profits allowed	Direct determination of tax profits, only
No dividend withholding tax upon repatriation of profits	Profit distributions are subject to dividend withholding tax unless exempt/ reduced under the Parent/Subsidiary Directive or an applicable double tax treaty
Corporate income tax 25%	Corporate income tax 25%
Capital gains subject to corporate income tax	Under the double tax treaties applicable, capital gains are in general subject to taxation where the parent company is established
Transactions between the head office and the branch / fixed establishment are outside the scope of Value Added Tax	Transactions between the parent company and the subsidiary are subject to Value Added Tax under the general conditions

A permanent establishment is a fixed place of business of non-temporary duration through which the business is wholly or partly carried on. The activities of agents may also create a permanent establishment of the business they represent. A registered branch office rather than a mere permanent

establishment is required if a licence to carry out the business in Austria is required under Austrian trade law. The branch must be registered with the local Commercial Register.

With regard to the determination of tax profits, the two methods in place are:

- Direct method
  Profits are calculated on the basis of the permanent establishment's financial statements, taking into account all expenses attributable to the permanent establishment, including costs of management and general administration of the company but excluding deemed profit transfers.

- Indirect method
  In exceptional cases, the company's total profits may be split up among the various permanent establishments according to specific allocation schemes. For transactions between the permanent establishment and other parts of the company, appropriate arm's length principles must be applied.

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Direct Taxes

Ministry of Finance publishes view on permanent establishment issues

Recently, the Ministry of Finance issued two letter rulings clarifying their position on certain issues in connection with permanent establishments.

Fixed place of business as essential requirement for the existence of a permanent establishment

For many years, the tax authorities did not consistently answer the question of whether, on disposal of a company, premises or business space are the relevant factors in determining the existence of a permanent establishment under the OECD Model Treaty. This conflict can be traced back to ambiguous statements in the OECD Model Commentary on Article 5 of the Model Treaty.

The first ruling dealt with an Indian software company providing technical consulting services to Austrian companies without the use of any facilities in Austria, i.e. the services were carried out directly at the premises of the client.

The Austrian Ministry of Finance declared that it maintains the traditional interpretation whereby the existence of premises and the authority to dispose of them is an essential requirement for a permanent establishment to exist. Therefore, the activity of the Indian company at their client's premises does not constitute a permanent establishment. However, the Ministry pointed out that the employee's private apartments located in Austria might be viewed as fixed places of work of the Indian company if business activities other than those of a preparatory or auxiliary character are carried out through these apartments.

Mutual Agreement Procedure (MAP) in triangular cases

A further ruling dealt with a triangular relationship, where a German company held an interest in an Austrian partnership (that qualified as a permanent establishment for Double Tax Agreement ["DTA"] purposes), and the partnership had permanent establishments in CEE countries. All relevant DTA between the relevant countries allowed for the exemption method. A tax inspection in one CEE country was followed by an increase of the taxable income of a permanent establishment.

First, the question arose of whether Austria is obliged to reduce correspondingly the Austrian profit of the partnership even though the partnership is not entitled to the DTA Austria – CEE country. The Ministry answered in the affirmative and based this decision on the non-discrimination article in the DTA Austria – Germany. This provision obliges Austria to treat the partnership no less favourably than an Austrian subsidiary of the German company (which would be entitled to the benefits of the DTA Austria – CEE country).

Second, if the Austrian tax authorities come to the conclusion that the increased profit of the CEE permanent establishments interferes with the arm's length standard, a MAP might be necessary in order to avoid double taxation. Since the partnership is nei-

ther resident in Austria nor in the CEE country, the question arises as to how a MAP can be arranged. The Ministry suggested two alternatives:

A MAP could be arranged under the DTA Germany – CEE country. The German tax authorities would then agree the MAP with the Austrian tax authorities. Of course, this scheme seems possible only in cases where the bilateral relationships between the tax authorities are very good.

However, the Ministry also considers a direct MAP arranged directly between Austria and a CEE country as possible. The Ministry based this opinion on a provision contained in most Austrian DTAs, whereby the arrangement of a MAP is permitted in cases that are not addressed by the DTA itself.

This ruling in our view is another example of the Austrian Ministry being actively engaged in the prevention of double taxation.

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Changes in Austrian Tax Law – draft legislation 2007

Austrian Tax Law changes nearly every year. These changes can have a significant impact on businesses. For the year 2007, the draft legislation has been available since 5 February 2007. We highlight the most important developments.

Severance payments have to be covered by securities

The Austrian Supreme Constitutional Court in its decision dated 6 October 2006 has abolished the requirement that provisions for severance payments and pension payments be covered by securities (“security coverage”). Shortly after the decision, the Austrian Ministry of Finance announced the re-introduction of this requirement in a manner that is in line with the Austrian constitution. With regard to provisions for pension payments, the draft legislation resolves that the security coverage will be re-introduced beginning with the business year 2007. Securities from issuers within the EC or the EEA (European Economic Area) will be eligible for security coverage. Claims covered by reinsurance (“Rückdeckungsversicherung“), i.e. an insurance that a business takes out to cover a pension plan offered to an employee, may be used to reduce the required security coverage under certain conditions. Securities or reinsurance claims used to safeguard other liabilities cannot be used as security coverage.

Interest arising from profit distribution financing is not tax deductible

Interest paid in relation to debt is considered a tax-deductible business expense if the debt is for business purposes. The Austrian tax authorities were of the opinion that profit distributions from a limited liability company are not related to the business sphere of a company. They therefore have not allowed the deduction of costs for debt financing if the debts have the purpose of funding profit distributions.

The Austrian Supreme Administrative Court in its decision dated 19 December 2006 came to the conclusion that profit distributions are related to the business sphere. Accordingly, the court decided that costs for debt financing of profit distributions may be deducted as a business expense.

The legislator reacted to this decision by drafting legislation that explicitly forbids the deduction of costs of debt financing for profit distributions and re-establishes the position of the fiscal authorities before the decision of the Austrian Supreme Administrative Court. The draft legislation shall come into effect beginning with the business year 2007.

Parent Subsidiary Directive – exemption from capital withholding tax

Profit distributions of Austrian limited liability companies to parent companies mentioned in the Annex to the Parent/Subsidiary Directive may be made without capital withholding tax under certain conditions. The Annex will be amended by the legal forms of parent companies in Bulgaria and Romania, which are eligible for the preferential treatment.

R&D allowance/premium

The allowance/premium for R&D carried out within a business has so far been limited to R&D in Austria. This limitation conflicts with EC principles. Therefore, the draft legislation extends the allowance/premium to R&D carried out within the territory of the EC/EEA.

Withholding tax for non-resident individuals

Individuals who do not have a place of abode or a normal residence in Austria are taxable in Austria on certain Austrian-source income. Such in-

come, for example, includes that from employment as a lecturer, architect, member of the supervisory board, commercial or technical advisor etc. Income tax is withheld at a special rate of 20% (except for dividends and similar investment income, which is withheld at 25%) and is withheld on gross income with no deductions for (business) expenses. According to the draft legislation, under certain conditions the individual will be allowed to opt for a withholding tax of 35% based on the net income, i.e. after deduction of (business) expenses.

Tax incentive for retained profits

Individuals obliged to prepare a balance sheet for tax purposes can, if the profit results in an increase of equity, tax the increase in equity at half the average tax rate. The incentive is limited to an increase in equity of EUR 100,000.

If the equity which has been subject to half the average tax rate is reduced within the next seven years again, an additional tax is levied to neutralise the tax incentive. The draft legislation makes clear that the additional tax is calculated based on half the average tax rate applicable for the year in which the incentive was claimed.

Investment management/management of special investment funds

Services in connection with the management of special investment funds (investment management) are currently taxable in the territory where the investment manager is resident. The draft legislation includes investment management in the list of services which are subject to VAT where the recipient (who qualifies as a taxable person) is resident. This means that investment management for investment funds or an investment company (if they qualify as taxable persons) is subject to VAT where the recipient is resident. Whether this rule is valid for special investment funds established outside the EC as well is not clear yet. According to the VAT Guidelines the intention of the Ministry of Finance appears to tax investment management services to special investment funds outside the EC in Austria.

The management of Austrian investment funds defined by the Austrian Act on Investment Funds has been exempt from VAT in the past. The exemption for the management of other investment funds, especially investment funds established outside Austria, has not been clear. Now, the VAT exemption will be extended to the management of special investment funds as defined by the Member States. The management of special investment funds established in non-EC Member States and special purpose vehicles not mentioned in the Act on Investment Funds do not appear to fall under the exemption.

Extension of the reverse charge mechanism

VAT will be accounted for by the recipient of a supply of scrap-iron, scrap-metal as well as scrap and waste of iron and metal, if he qualifies as a taxable person for VAT purposes.

Standard gasoline consumption levy (“Normverbrauchsabgabe“)

The supply of vehicles to commercial resellers of vehicles (car dealers) will continue to be outside the scope of standard gasoline consumption levy. The supply of vehicles to commercial car rental businesses such as leasing companies shall become subject to standard gasoline consumption levy in the future. The rental of the car or the leasing will on the other hand no longer be subject to standard gasoline consumption tax. The registration of a vehicle as a demonstration car shall be subject to standard gasoline consumption levy, but is tax free by way of a refund. For the refund of standard gasoline consumption levy, the identification number of the vehicle rather than the identification number of the engine is required.

Motor vehicle tax for trucks

The motor vehicle tax for trucks will be halved.

Tax on mineral oil

Beginning on 1 July 2007, the tax on mineral oil will be increased by one cent for petrol and three cents for diesel.

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2006 Amendments of the Austrian Income Tax guidelines

The amendments mainly refer to the new fiscal rules introduced in line with the recently adopted and highly significant Commercial Code and the Small and Medium Size Enterprises (SME) – Subsidy Law 2006.

1. Tax allowance for reinvested profits

The tax allowance for reinvested profits (10% of profits, up to a maximum of EUR 100,000) was introduced by the SME – Subsidy Law 2006, and is generally available to taxpayers who compute their profits according to § 4 Sec. 3 Austrian Income Tax Act (i.e. they account on cash basis). The Income Tax Guidelines explain that the allowance is granted:

"In cases where a taxpayer makes use of the lump sum deduction of expenses granted to certain branches, the tax allowance is not available, whereas in cases where a partial lump sum deduction is claimed the tax allowance is granted to sales representatives, artists and authors."

Additionally the tax allowance can only be taken if a fiscal business unit exists. This interpretation clarifies that the objective of the tax allowance is to encourage companies to use equity to finance asset investments.

2. Leasing

For contracts concluded after 1 May 2007 a full-payout lease (i.e. where the initial lease term is a minimum of 40% and a maximum of 90% of the operational useful life of the asset) is attributed to the lessee if the lessee has the option to buy the asset at an 'economically inadequate amount.' An amount is deemed to be economically adequate if it is equal to or greater than the estimated fair market value of the asset (i.e. the fiscal book value less a 20% deduction) at the end of the initial lease term.

In the case of a partial-payout lease with a purchase option equal to the residual value, the lease is attributed to the lessee if the residual value is below the estimated fair market value.

3. Buildings in lightweight constructions, acquired or completed after 2006

Standard tax depreciation rate (3% per annum) will now apply to buildings of lightweight construction; if a company wishes to apply higher rates, it must prove that the asset has a shorter economic life. However, a shorter useful life of a minimum of 25 years will be accepted by the tax authorities for small building constructions without the presentation of an expert opinion.

4. Gradual purchase and disposal of securities

If uniform securities to cover pension accruals are held in different deposits, the taxpayer may determine which securities have been sold. The taxation treatment then follows that determination. This also applies to cases in which uniform securities held in a collective deposit are sold, provided that the acquisition date and acquisition costs are documented in a proper way so that the disposed securities may be matched to the relevant acquisitions. If this is not the case, the oldest securities are deemed to be sold first.

5. Research and education premiums for foreign permanent establishments

For research and education expenses incurred by a foreign business (or by a foreign permanent establishment), a research or education premium (which is an alternative claim to the research and education allowance) may only be claimed for where the foreign business/permanent establishment has realised a loss for tax purposes before deducting any research or education allowance.

6. Expatriation taxation: Certificate of residence

Currently, an expatriate taxpayer living in the EU or Norway is exempt from assessment for income tax by application to the tax authorities. In the future, a certificate of residence will be required to confirm that the taxpayer has fulfilled the conditions for exemption from assessment.

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Cross-border leasing of cars

Austria levies VAT on car related expenditure incurred by taxable persons in other Member States.

In 1995, Austria implemented a rule to prevent Austrian taxable persons leasing their cars abroad in order to obtain a VAT deduction on car leasing. Businesses that lease their cars abroad and recover the input VAT incurred in the Member State must account for Austrian VAT under the self-supply rules.

The European Court of Justice ruled on 11 September 2003 (C-155/01, “Cookies World”) that the self-supply rules were contrary to Community law. The Austrian Independent Fiscal Penal also decided on 1 March 2005 upon direct application of Community law that the reintroduced legislation on the deemed self-supply does not comply with Community law.
However, Austria consulted the VAT Committee and extended its legislation to leasing expenditure incurred before 1 January 2008.

The Commission is of the opinion that these steps do not render this long-existing national measure compatible with Community legislation and has therefore issued a Reasoned Opinion to Austria dated 21 December 2006. The Commission may decide to refer this case to the ECJ, unless Austria brings their legislation into compliance within two months of receipt of this Opinion.

Based on information received from the Austrian Ministry of Finance, Austria has already commented on the Opinion of the Commission. However, this comment will be not made publicly available.

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M&A

Employment Law implications of company restructuring

Measures taken in the course of business restructuring often affect factual and contractual employment conditions. Consequently, employment law can have a significant impact on the reorganisation.

Entrepreneurial decisions concerning employees, such as relocation, reallocation of tasks, reducing the company’s headcount etc., as well as decisions concerning spin-offs, mergers or the closure of company departments, can often only be implemented in cooperation with the works council. Even if no works council exists there are significant labour law-limits to the managerial authority, mostly involving the consent of the employee concerned.

Cooperation with the Works Council in cases of Company Reorganisation

The works council is entitled to participate in many entrepreneurial decisions, particularly those decisions relating to company restructuring. The employer is obliged, for instance, to notify the works council of any envisaged “company reorganisation”, involving the closure of company divisions, their relocation or merger, changes in the work organisation, legal or ownership structure of the company. The employer is required to converse with the works council on possible measures to mitigate the adverse effects that “company reorganisation” could have on the workforce.

These talks normally result in the signing of a plant agreement, usually referred to as a “social (compensation) plan”, which is enforceable by the relevant labour court. In order to alleviate or prevent layoffs, this social plan may set out a requirement to make payments to employees (such as voluntary severance payments, bridging payments, etc), the observance of a certain order of employment termination, the limitation of layoffs to specific employees, the granting of travel expenses in case of substantial relocation of the company premises, occupational retraining, and so on.

Limited managerial scope in cases of work reorganisation

In the course of a business restructuring the re-allocation of employees (locally or as regards tasks and responsibilities) may become necessary. There may be the need, for instance, to downgrade one of two department heads following the merger of several departments. In all cases of employee re-allocation the following legal restrictions – both on the level of the individual work contract as well as on the works constitution level – need to be taken into consideration.

The change in tasks, responsibilities, place of work or working conditions must be set out in the individual labour contract. If an employer, subsequent to the conclusion of the individual contract, enacts a re-allocation exceeding the scope permitted by the contract, the re-allocation is deemed to be a change in the employment agreement and as such requires the employee's consent.

A permanent disadvantageous re-allocation (e.g. salary decrease, longer distance to the working place, different working time regime, downgrading, etc.) can only be implemented – apart from with the aforementioned individual employee's consent – upon prior agreement with the works council.

Reduction of headcounts in the course of business restructuring

Should the reduction of the company's staff number become necessary in the wake of company reorganisation, the employer is legally obliged to let his decisions be guided by social considerations. Occupational retraining and the allocation of different tasks and responsibilities needs to be given priority over redundancies. The employees due to be dismissed should to be selected on a socially acceptable basis. In particular, the dismissal of elderly, longer-serving employees needs to be justified. Where these principles are breached, the employee or the works council may appeal against the terminations to the labour court. This may either result in the continuing employment of the employee concerned or an obligation for the employer to make additional payments to that employee.

The works council should be involved in the process of termination of employment. The employer can only give notice to an employee if the said mandatory notification process has been adhered to. In the case of mass dismissals (20 employees or more), the employer is required to notify the labour authority.

Works Council and plant agreements

Company reorganisation might also affect the existing works council and the legal effect of existing plant agreements. In the event of a spin-off, for instance, the works council of the outsourcing company shall retain its authority, for a maximum of four months, with respect to the staff employed in the spin-off company until a new works council is established. Existing plant agreements shall remain effective during that time.

If a company is being incorporated into another company without retaining its former business identity, the first company's works council's authority shall come to an end. Plant agreements shall remain in effect in as far as the issues they concern are not covered by the existing plant agreements of the incorporating company. Furthermore, these agreements shall only be applicable to employees who were under the authority of the works council before the acquisition; the employees who were not under the works council's authority shall not be covered.

In the event of a merger of several companies into a new company all works councils shall retain their functions, forming one integrated works council until its members are re-elected (up to a maximum of one year after the merger). This will lead to an above average number of works council members within the workforce. Moreover, plant agreements made within the integrated companies remain in place for the employees of those individual companies, resulting in a coexistence of several different legal regimes within the merged company.

Consequently, in the run-up to a business restructuring project this last option (i.e. the merger of several companies to form a new company) should be avoided whenever possible.

Transfer of business

If a single company department is spun-off this process is referred to as a transfer of business. Most importantly, a transfer of business will result in the automatic transfer of any employment contracts from the transferor to the transferee, including any supplementary agreements. It is inadmissible to take on only some selected employees while rejecting the transfer of the remaining work force.

In the case of a transfer of business, the employer may not terminate any employment contracts by the simple giving of notice to the employee. However, the employer may terminate the employee's contract if it is by mutual consent and renegotiated with more favourable terms for the employee. Despite the prohibition on redundancies the employer is free to dismiss employees for any business reasons except the transfer of business.

Importance of one Uniform Employment Law Regime

As set out before, a company reorganisation involving the merger of diverse employee groups with differing interests can sometimes bring about a complex and unclear employment law regime within the post-merger company. This may hamper the overall comprehensive integration of all employees, complicating the process of forming a new corporate identity. Thus, any substantial legal differences, e.g. relating to remuneration, pension schemes, supplementary benefits, working time systems, etc, should be harmonized as soon as possible.

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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	$\frac{(EK - 10{,}000) \times 5{,}750}{15{,}000}$		0 - 23%	38.333%
over € 25,000	to € 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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