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In this issue

Direct Taxes

1 Amendment of research and development tax incentives limits by Richard Jerabek

2 Appeal Court on disclosure of recipients of payments by Rupert Wiesinger

2 Amendments to the Austrian Restructuring Tax Act by Rudolf Krickl

3 Recent amendments to the Austrian tax treaty network by Thomas Schneider

4 Gift tax abolished due to constitutional reasons by Alexander Boeck

5 Tax optimisation of individuals via CEE hybrid partnerships by Stephan Lugitsch, Robert Pfeiffer

Transfer Taxes

6 Extract of the current protocol for stamp duties and transaction taxes by Hannes Rasner, Oliver Elmani

Indirect Taxes

7 New reverse charge for supplies of waste materials by Sonja Drexler

M&A

7 Draft of an EU Merger Law by Daniela Mitter

8 Austrian Tax Facts & Figures

Direct Taxes

Amendment of research and development tax incentives limits

With effect from 1 January 2007 Austrian Income Tax Law restricts the availability of research and development (R&D) tax incentives to activities performed only within Austria and/or EU/EEA-states.

Over recent years, Austria has become highly attractive for international groups as a location for their R&D programs. Research and development allowances as well as premiums (like the Frascati R&D allowance with 20% or the premium with 6% of R&D cost) were granted to companies irrespective of the location where R&D activities were performed. The allowance/premium was granted if R&D was performed by the Austrian entity, by a foreign branch or if supplied by third parties domestically or in other countries. Under this flexible system, tax losses accumulated by foreign R&D branches reduced the headquarter's tax burden in Austria, even if those losses were a direct result of only R&D allowances.

From the perspective of the foreign tax administration, no tax loss was accumulated by the respective foreign R&D units for use in later periods, because Austrian tax allowances would not be recognised for local tax purposes. Consequently, the tax benefit generated by the allowance in Austria was not recaptured by the local taxation scheme, with the result that foreign R&D activities were supported by Austrian taxpayers.

From 1 January 2007 onwards, the locations where activities have to be performed, in order to qualify for Austrian R&D tax benefits, are limited to Austria and/or EU/EEA-states. In the future, Austrian companies performing R&D activities in foreign countries will have to consider whether the advantages resulting from those locations, such as low personnel costs, compensate for the disadvantage of reduced attractive Austrian tax benefits. They should also consider whether a transfer of foreign R&D units into EU/EEA states would be advantageous.

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Appeal Court on disclosure of recipients of payments

Only way to achieve tax deduction

Like most jurisdictions, Austrian Tax Law requires that the recipient of a payment must be disclosed in order for a payment to be tax deductible. This is provided for in para 162 BAO. In the case decided by the Appeal Court Vienna on 21 May 2007, the taxpayer paid certain commissions to an offshore company located in Cyprus for projects carried out in Russia. The taxpayer claimed that by proving that the offshore-company is the recipient of the payments (according to the contracts and other documents, e.g. bank transfer sheets or invoices) he was entitled to deduct the payments. The taxpayer stated that according to the wording of para 162 BAO, he need not name the shareholders of the recipients (as he does not know them) nor to give any information on what happened with the payments on the level of the offshore-company, i.e. if the payments were forwarded to another company or person as beneficial recipients.

It is not sufficient to disclose an offshore-company located in a tax haven

The Appeal Court rejected the arguments of the taxpayer and ruled that by disclosing that payments were made to the offshore-company in Cyprus, the taxpayer did not comply with para 162 BAO: Firstly, an offshore-company will not be able to render the services itself as it does not have any economic substance. Secondly, if there are good reasons to suspect that the recipient named is not the ultimate or beneficial recipient of the payments, the taxpayer must disclose the ultimate or beneficial recipient of the payments. If the named recipient is an offshore-company which is located in a tax haven, it is more or less clear that this offshore-company was not able to provide services itself and there are good reasons to suspect that the ultimate or beneficial recipient is another person or company. Accordingly, the taxpayer must name the ultimate or beneficial recipient of the payments and/or provide more evidence on the background of the recipient. Otherwise the payments/expenses are not tax deductible.

The duty of the taxpayer to have sufficient evidence

The Appeal Court confirmed the so-called “erhoehte Mitwirkungspflicht bei Auslandsachverhalten”, meaning that in case of circumstances involving foreign jurisdictions, the taxpayer must be ready to provide more evidence compared to transactions involving only Austria. If the taxpayer does business with an offshore-company located in a tax haven, the taxpayer has to collect information on the company and the ultimate or beneficial recipients of the payments when he starts doing business with this offshore-company. The taxpayer may not claim in case of a later tax audit or in proceedings before a court that he is not able to collect any information on the offshore-company due to the restrictive policy of its country of residence.

Conclusion

The decision is no surprise as it is in line with previous decisions of the Austrian Supreme Administrative Court. Therefore we do not expect an appeal by the taxpayer before the Austrian Supreme Administrative Court to succeed. However, despite the court decisions, its principles are often not adhered to in practice.

To achieve a tax deduction for such a payment, it is not sufficient to provide just

- the surname of a recipient (or to give a wrong name);
- the name of an offshore-company in a tax haven or a letter-box company without disclosing the shareholders, respectively the ultimate recipients of the payments;
- the name of a trust without disclosing the beneficiaries, respectively the ultimate recipients of the payments.

The taxpayer has to collect information on the recipients of payments which reside abroad or in other cases where there are doubts about the ultimate recipient of payments when he starts doing business in such cases. As commissions paid in respect of exports are often rather high, this is essential to avoid a nasty surprise in a tax audit.

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Amendments to the Austrian Restructuring Tax Act

Changes in Austrian Tax Law in 2007 have some significant impacts on the Austrian Restructuring Tax Act. This is an overview of the changes and additions.

Limitation of Austrian taxation rights

The Austrian Restructuring Tax Act cannot be applied if Austrian taxation rights regarding hidden reserves are reduced due to a merger. However, if the absorbing company is a resident of the EU or Norway the tax liability can be deferred by an application filed with the relevant Austrian tax office. According to the amendments this application has to be done in the last corporate income tax return of the transferring company.

The potential tax liability is indicated in an assessment notice but not assessed until the hidden reserves of the transferring company are either sold or disposed of. Provided a decrease in value has occurred abroad until the realization of the hidden reserves this decrease in value can generally be taken into account in Austria, however only up to the tax base as indicated in the assessment notice.

Additions concerning the re-transfer of participations

If Austria receives taxation rights because assets are moved into Austria in the course of a tax neutral reorganisation generally a revaluation at fair market values of those assets has to be effected. This rule does not apply in the case of a re-transfer of assets which were previously transferred abroad by a tax neutral reorganisation making use of the application for deferred taxation of the transferred hidden reserves. In those cases the adjusted book values prior to the export of the assets have to be used.

Exchange of shares due to a merger

Mergers can be effected retroactively in Austria, up to nine months. However, this relief did not cover any subsequent exchange of shares at shareholder level following the merger. The new legislation now permits a retrospective exchange of shares. Therefore, the creation of a tax group is also possible through a retroactive tax neutral merger. Another amendment indicates that the restriction of Austrian taxation rights at shareholder level because of a merger generally leads to an immediate taxation of the hidden reserves. However, if the relevant shareholder is a tax resident of another EU country the above mentioned deferral scheme is applicable. This new rule is also applicable for down-stream mergers where the grand-parent company of the two merging Austrian companies is located abroad.

Conversion of a company into a partnership

If a foreign company with Austrian shareholders is converted into a partnership and Austrian taxation rights are limited due to a double tax treaty (usually the state of residence of a partnership has the taxation rights for stakes in a partnership) the hidden reserves are taxed at the level of the shareholder. However, residents of the EU can make use of the deferral scheme. By contrast, if an Austrian company with foreign shareholders is converted into a partnership a tax neutral revaluation at fair market value of the stakes in the new established partnership has to be made in Austria.

"Import" restructurings and tax loss carry-forwards

According to various comments from the Austrian ministry of finance tax loss carry-forwards of foreign companies could be transferred to Austria through a tax neutral "Import"-reorganisation. However, on 21 December 2006 the Austrian ministry of finance withdrew its opinion and now is of the opinion that tax loss carry-forwards of foreign companies cannot be transferred to Austria.

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Recent amendments to the Austrian tax treaty network

This article provides an overview about the latest amendments to the Austrian tax treaty network and briefly highlights some important changes.

With effect from calendar year 2008, the following new Double Taxation Conventions (DTC) will become applicable:

- DTC with Barbados (entry into force on 1 April 2007)
- DTC with the Czech Republic (entry into force on 22 March 2007)
- DTC with Latvia (entry into force on 16 May 2007)
- DTC with Pakistan (entry into force on 1 June 2007)
- DTC with Saudi Arabia (entry into force on 1 June 2007)
- DTC with Venezuela (entry into force on 17 March 2007)

Already with effect from calendar year 2007 (for Algeria: 2006/07), the following new DTCs have become applicable:

- DTC with Algeria (entry into force on 1 December 2006)
- DTC with Cuba (entry into force on 12 September 2006)
- DTC with Georgia (entry into force on 1 March 2006)
- DTC with Kazakhstan (entry into force on 1 March 2006)
- DTC with Morocco (entry into force on 12 November 2006)
- DTC with Romania (entry into force on 1 February 2006)

The following new DTCs have been signed, but the ratification procedure is still in progress:

- DTC with Denmark (signed on 25 May 2007)

- DTC with Greece (signed on 18 July 2007)

The following DTCs have been recently amended:

- Amendment to the DTC with Norway (entry into force on 1 December 2006; applicable from 2007)
- Amendment to the DTC with Sweden (entry into force on 23 June 2007; applicable from 2007) – see Austrian Tax News, Issue 9 December 2006
- Amendment to the DTC with Switzerland (entry into force on 2 February 2007; most provisions applicable from 2006)

An amendment to the DTC with Israel has been signed, but has not yet entered into force.

Czech Republic (new treaty):

- Creation of a permanent establishment by rendering of services in the other contracting state during a period in excess of six months during any twelve months period
- WHT of max. 10% on portfolio dividends, 0% on intercompany dividends (participation at least 10%)
- WHT of 0% on interest payments
- WHT of max. 5% on certain license fee payments
- Capital gains (except those resulting from the disposal of immovable property and assets attributable to a permanent establishment located in the source state) may only be taxed in the state of residence; no special provision regarding the sale of shares in real estate companies

Norway (amendment):

- WHT of max. 15% on portfolio dividends, 0% on dividends paid to corporations (no minimum holding quota)
- (Former) state of residence keeps the right to impose tax on capital gains realized by individuals upon sale of certain investments for a period of five years after the relocation of residence to the other contracting state

Romania (new treaty):

- WHT of max. 5% on portfolio dividends, 0% on intercompany dividends (participation at least 25%)
- WHT of 3% / 0% on interest payments
- WHT of max. 3% on license fee payments
- Capital gains resulting from the disposal of shares in real estate companies may be taxed in the source state

Switzerland (amendment):

- WHT of 0% on license fee payments; adapted definition of the term “license fee”
- (Former) state of residence keeps the right to tax capital gains realized by individuals upon sale of investments and certain other comparable events after relocation of residence to the other contracting state (no time constraints); exit taxation limited with the hidden reserves at the time of relocation
- Change in the tax treatment of cross-border commuters

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Gift tax abolished due to constitutional reasons

The Supreme Constitutional Court (VfGH) decided, in its decision of 15 June 2007 that the gift tax on donations is not consistent with the Austrian constitution because the valuation method used for the tax calculation of real estate is considered to be not objective. The gift tax will be abolished from 1 August 2008. However, the VfGH did not consider the gift tax itself to be inconsistent with the constitution. Due to the fact that the Austrian government considers a gift tax as necessary for a comprehensive tax system, the Ministry of Finance is already working on a succession regulation. There are two possible models: the first one is to introduce donations as an eighth category of income with a reduced tax rate. The second alternative is to introduce a capital gains tax on hidden reserves. A new regulation has to be in force by 1 August 2008. Until 31 July 2008 the current law will remain in force which means that donations are subject to gift tax.

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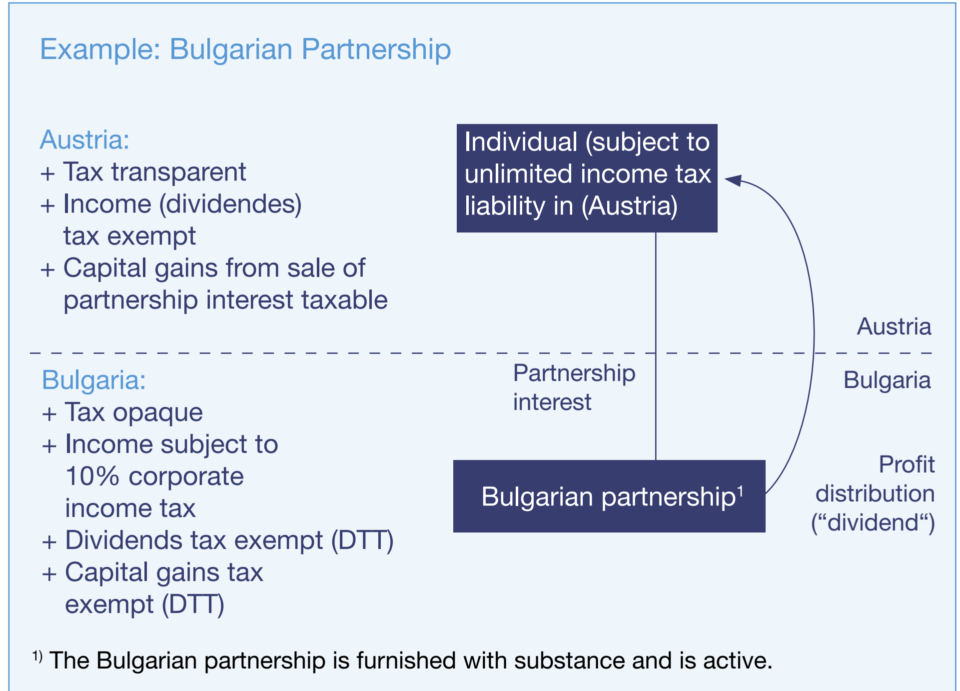
Tax optimisation of individuals via CEE hybrid partnerships

The utilisation of CEE based hybrid partnerships can constitute an interesting tax optimisation alternative for Austrian resident individuals with business activities in the CEE region. In the following article, we consider a structure where a Bulgarian hybrid partnership is used to allow the Austrian resident individual (under certain circumstances and subject to careful structuring) to derive income effectively taxed at only 10%. This structuring idea might similarly apply to hybrid partnerships in other countries of the CEE region (e.g. Slovakia and Romania).



[1] The Bulgarian partnership is furnished with substance and is active.

Scheme

The Austrian resident individual sets up a Bulgarian partnership. The partnership is furnished with substance (e.g. office space, secretary) and is subsequently used as a vehicle for operating business activities outside of Austria. For example, if the individual performs consulting services outside of Austria, the partnership would subsequently enter into the consulting agreements with the customers. Participations in other companies can possibly also be transferred to the partnership, so that the partnership rather than the individual receives future dividend and capital gain income.

Tax treatment

From a Bulgarian tax point of view, the partnership qualifies as a separate entity (quasi-company). From an Austrian view, the entity qualifies as a tax transparent partnership. Entities with these attributes are referred to as ‘hybrid’. Due to the tax opaque treatment in Bulgaria, the partnership is entitled to the benefits of the Double Tax Treaty Austria-Bulgaria.

A. Taxation of income derived by the partnership

The net income of the Bulgarian partnership is subject to Bulgarian corporate income tax at a rate of 10%. The income is sheltered from Austrian taxation by virtue of the Double Tax Treaty Austria-Bulgaria. The Bulgarian sourced income will, however, be considered when calculating the progressive tax rate for the individual’s other income.

B. Taxation of profit distributions from the partnership to the Austrian individual

Profit distributions of the partnership should be entirely tax-exempt. From a Bulgarian perspective, profit distributions are treated as dividends. Since Article 8 of the Double Tax Treaty provides for a zero withholding tax rate on dividends, no tax will be levied. From an Austrian perspective, profit distributions are not viewed as dividends but as tax neutral profit withdrawals and are therefore not subject to Austrian taxation.

Requirements and observations

The scheme is available only if the individual performs the respective business activity outside of Austria and at least to a certain extent within Bulgaria. Furthermore, the following requirements should be met:

- The legal characteristics of the partnership have to be comparable to the characteristics of an Austrian partnership. This particularly means that the partnership should not have the status of a legal entity. The partners should be jointly and severally liable for the partnership’s liabilities. The partnership should not be subject to minimum capital requirements, and the transfer of partnership interests should be subject to the approval of the partners. A Bulgarian KD (Komanditno drushestwo) or Z.d.s. (Zabiratelno drushestwo) should comply with all or most of these requirements subject to proper wording of the partnership deed.
- The Bulgarian partnership has to be furnished with reasonable substance (such as secretary, office space, office infrastructure, etc.) and an operating business.
- Sound business reasons for implementing the structure should be demonstrable.

- The place of effective management of the partnership should be within Bulgaria. This means that all major business decisions shall be effected in Bulgaria and correspondingly documented.
- The Austrian resident individual should not regularly perform the business activity of the partnership within Austria. If this happens, the partnership will constitute a taxable presence in Austria (i.e. a "permanent establishment"). As a consequence, the profits of the partnership will be subject to Austrian taxation to the extent they are attributable to the Austrian permanent establishment (i.e. caused by business activity within Austria). Even if this is the case, the structure might still be of benefit as the tax treatment should apply to at least some of the income.

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Transfer Taxes

Extract of the current protocol for stamp duties and transaction taxes

Important aspects of the protocol are described below.

Promise of a non repayable shareholder contribution

A non repayable shareholder contribution made by the shareholder is treated as a taxable event according to the Capital Transfer Tax Act. According to the current protocol, the tax liability arises at the date on which the commitment to the shareholder contribution is made. The date of the effective payment of the contribution is not relevant.

This view is different to previous and prevailing opinion. According to previous practice and case law (see High Court decisions and respective literature), the legal obligation for paying a specific amount in the future is not subject to capital transfer tax. Although the Directive regarding accumulation of capital provides for the taxation of the legal obligation, there has been no implementation into national law to date.

Grandparent contribution and profit transfer agreement between a parent company and its subsidiary

Where a contribution is paid directly by the grandparent company to its sub-subsidiary, in circumstances where there is an existing profit and loss transfer agreement between the parent company and its subsidiary, the contribution is attributable to the direct parent company and is therefore subject to capital transfer tax.

Commitment of loss assumption of the following business year

Following the protocol capital transfer tax issues were discussed, if the limited partner commits to the assumption of the (predicted) losses to incur at the level of the limited partnership in advance. According to administrative practice, the obligation for the loss assumption in the course of a profit and loss transfer agreement is not subject to capital transfer tax as in this case the losses have no effect on the capital. In case of a financial commitment concluded by the limited partner at the beginning of the fiscal year the resulting payments effected by the limited partner are qualified as voluntary shareholder contribution which is subject to capital transfer tax.

Partial retransfer of real estate

According to Article 17 para 1 Z 2 Real Estate Transfer Tax Act, real estate transfer tax will not be assessed or the assessment will be amended (mitigation) on application by the taxpayer, if the acquisition has been cancelled completely based on a legal title. The period for filing the respective application form is five years (from the year following the year in which the initial transaction which was subject to real estate transfer tax was effected).

The protocol clarifies that the provisions of Article 17 Real Estate Transfer Tax Act are also applicable in case of a partial cancellation. As a consequence the taxpayer can apply for (respective) amendment of the assessed real estate tax.

Inheritance tax exemption for foreign capital investments

The inheritance of certain foreign bond securities is tax exempt from inheritance tax according to Article 15 para 1 Z 17 Inheritance Tax Act. This is applicable, if the income at the date of death of the testator is subject to the special tax rate (25%) according to Article 37 para 8 Income Tax Act. In this case, the date of inflow of the taxable income, the payment of the income tax, as well as the income to be considered in the income tax return of the testator is irrelevant.

We point out that the inheritance tax will be abolished as of 31 July 2008.

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New reverse charge for supplies of waste materials

Based on Article 19 para 1d of the Austrian VAT Act, the tax authorities have published a new VAT Decree introducing a new reverse charge for supplies of certain waste materials.

As of 1 July 2007 the reverse charge system applies to all supplies of used iron, scrap and other waste materials (e.g. used paper, waste paper, recovered glass, used plastics). The recipient of the supply has to account for the VAT but will, in general, be granted a VAT recovery in the same VAT period. The new VAT Decree is also applicable on the sorting, cutting, dividing (including disassembling) and pressing of the materials mentioned in Article 1 of the VAT Decree.

Moreover, the supply (sorting, cutting, etc.) of disuseable items which consist of several different materials is subject to the reverse charge system provided that the compensation is predominantly paid for materials mentioned in Article 1 of the VAT Decree (e.g. a central-heating boiler made of stainless-steel including insulating). The new rules only apply on supplies which are taxable in Austria. They do neither apply on zero-rated exports nor on intra-community supplies or on supplies which are outside the scope of Austrian VAT. Although many businesses still face issues regarding the implementation of the new rules (definition issues, issues concerning the adaption of the IT-systems etc.), the Austrian tax authorities refused to grant a tolerance period. If tax payers do not apply the reverse charge system in cases where further clarification is needed or IT-issues are faced, the tax authorities may raise objections.

The Austrian Ministry of Finance announced that instead of granting a tolerance period, guidelines regarding the application of the VAT Decree will be released.

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M&A

Draft of an EU Merger Law

The main idea of the Directive 2005/56/EC is to facilitate cross-border merger operations of limited liability companies within the European Union.

This draft of an EU Merger Law – embedded in the GesRÄG (Gesellschaftsrechts-Änderungsgesetz or Law Amending the Act on Limited Liability Companies) 2007 – is based on the Directive 2005/56/EC concerning the cross-border merger of limited liability companies and has to be implemented by 15 December 2007 at the latest. The Directive is designed to facilitate cross-border merger operations of limited liability companies in the European Union and focuses primarily on public limited companies (“Aktiengesellschaften”) and private limited companies (“Gesellschaften mit beschränkter Haftung”). It was decided to implement the Directive not by amendments to the AktG (“Aktiengesetz” or Stock Corporation Act) and in the GmbHG (“Gesetz über Gesellschaften mit beschränkter Haftung” or Act on Limited Liability Companies), but to enact a separate law for this purpose. This way the entire process shall remain traceable and any subsequent amendments to the law will be easier to make. The term ”limited liability companies” as used in the Directive corresponds to the “AG” and “GmbH” in the Draft Law. Therefore the draft law is applicable when a cross-border merger of Austrian AGs and GmbHs takes place with limited liability companies which were founded under the law of another member state and either have their statutory seat, their head office or their headquarters in the European Union.

Similarities to national mergers

The draft law, for the most part, stipulates that the regulations relevant for national mergers shall be applicable. The main reason is that the Directive only allows for such cross-border mergers that are also possible at national level. These shall basically be treated like national mergers. Based on the principle of equal treatment of national and cross-border mergers, the draft law refers to the relevant regulations of the “AktG” and “GmbHG”. The ability of entering into a merger depends on the personnel statute of the companies involved. The time when the cross-border merger takes effect shall, however, be governed by the law of the company created through the merger. For instance, if an Austrian AG is merged into a German AG, the merger takes effect with the registration in the German trade register. The management or executives of the merging companies have to draw up a detailed plan for the cross-border merger. The minimum contents of the plan correspond approximately to the requirements of the merger contract in accordance with Article 220 para 1 AktG and go beyond that. The law is expected to take effect on 15 December 2007.

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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	(EK - 10,000) x 5,750 / 15,000		0 - 23%	38.333%
over to	€ 25,000 € 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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