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Direct Taxes

Germany terminates DTT with Austria in respect of inheritance tax

As previously reported in Issue 11, the Austrian inheritance tax will automatically phase out on 31 July 2008 following the decision of the Austrian Constitutional Court of 7 March 2007, which declared it a violation of constitutional principles.

According to the current Austrian DTT with Germany, German citizens that are resident in Austria are subject to Austrian inheritance tax which would lead to a nil taxation of estate with effect from August 2008. In order to avoid a significant reduction of tax revenue due in Germany, the German Government has now concluded the termination of the DTT with Austria in relation to inheritance tax with effect from 31 December 2007.

Consequently, with effect from 1 January 2008 the whole estate of deceased persons, who are resident in Austria but have a second domicile in Germany, will also be subject to inheritance tax in Germany. In addition, the distributive share of dual resident successors will also be taxed in Germany. German deceased persons or successors, who relocated their domicile within the last five years from the date of death of the deceased, are still considered to be domiciled in Germany for inheritance tax purposes. Additionally, as from next year, Austrian residents holding qualified shareholdings (more than 10%) in German corporations will be subject to German inheritance tax, notwithstanding the fact that deceased persons and successor are resident in Austria.

In order to avoid double taxation of income by reason of death in the period from January 1 to 31 July 2008, Austria and Germany have the mutual intent to ensure that the terminated DTT will temporarily remain in force until the end of July 2008 through a separate convention.

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New Double Taxation Conventions with Algeria and Saudi Arabia

Amongst the latest amendments to the Austrian Tax Treaty Network was the conclusion of Double Taxation Conventions (DTC) with Algeria and Saudi Arabia. This article highlights some of the key points.

DTC Austria / Algeria:

- Effective for business years commencing on or after 1 January 2006; in respect of withholding tax (WHT) for payments effected on or after 1 December 2006
- Creation of a permanent establishment by a construction or assembly site where the duration exceeds six months
- WHT of maximum 15% on portfolio dividends, 5% on qualified dividends (holding quota at least 10%)
- WHT of maximum 10% on interest payments; 0% in special cases (e.g. loans by financial institutions; loans relating to sale on credit; governmental loans)
- WHT of maximum 10% on royalty payments
- Algeria applies the credit method, Austria the exemption method (credit method for dividends, interest payments and royalty payments)

DTC Austria / Saudi Arabia:

- Effective from 1 January 2008
- Amongst other factors, a permanent establishment will be created by
  - a construction or assembly site, if its duration exceeds 6 months
  - the rendering of services during a period exceeding six months within any 12 months period
  - insurance enterprises of a contracting state that collect premiums in the territory of the other state or insure risks situated there
- WHT of maximum 5% on dividends
- WHT of maximum 5% on interest payments; 0% in special cases (e.g. governmental loans)
- WHT of maximum 10% on royalty payments
- Capital gains arising from the sale of qualified shareholdings and shares in real estate companies may be taxed in the source state
- Both countries apply the exemption method (credit method e.g. for dividends, interest payments, royalty payments and certain capital gains)

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Revenue Protection Act 2007 passes Council of Ministers

On 24 October 2007, the government bill in respect of the Revenue Protection Act 2007 ("Abgabensicherungsgesetz 2007") passed the Council of Ministers and has now been assigned to the Austrian Parliament for further proceedings. The following article outlines the main provisions of the Act.

Group Taxation: Clawback of amortized goodwill

If an Austrian company (AcquisitionCo) acquires a participation in an operating Austrian company (Target) from an unrelated vendor; the goodwill attributable to the assets of the Target (including hidden reserves in depreciable assets) can be amortized tax effectively over a period of 15 years. The Target and the AcquisitionCo have to form a tax group to make use of the goodwill amortization. As a consequence of the goodwill amortization the tax book value of the shares in Target is reduced by the amount of the amortized goodwill. This increases the potential tax burden upon a resale of the shares in Target.

As a consequence, if the investor decides to divest of Target, he may prefer to sell the shares in AcquisitionCo rather than the shares in Target itself. However, unless AcquisitionCo is also a trading company, the new investor would not be eligible for goodwill amortization under this structure. In the past, this challenge could have been resolved e.g. by merging AcquisitionCo into Target before the transaction thereby eliminating the deferred tax burden.

The Ministry of Finance identified the pre-transaction merger as an undesired loophole, which should be eliminated by the present Act.

The proposed provision stipulates a recapture clause if the participating interest in Target is eliminated by a corporate reorganisation. Structures to work around these new rules may be possible; however, exit structuring may become more complex.

Recapture rules upon the transfer of internally generated intangibles to EC permanent establishments

Generally, the Austrian tax authorities tax the fictitious capital gains of assets at the point of their intra-company transfer to another country (i.e. a permanent establishment in another country). However, if the permanent establishment is located in another EU member state, the tax liability can be deferred until the asset is actually sold. In the case where the asset is not sold within ten years, the Austrian tax authorities completely refrain from taxing the fictitious capital gains. Since many foreign jurisdictions allow for a tax neutral step up to the fair market value upon transfer to a domestic permanent establishment, the hidden reserves at the time of transfer will often remain untaxed in both countries unless the asset is sold within ten years.

Austrian Law prohibits capitalisation of internally generated IP. This generally results in a tax book value of nil. As a consequence, under certain circumstances the whole fair market value of the IP could be completely exempt from taxation by simply relocating the IP to a permanent establishment in another EC country.

The new regulation generally provides for an immediate taxation of the development costs if the transferred asset is capitalized under the foreign tax jurisdiction. Unless the taxpayer can demonstrate lower development costs, they are deemed to amount to 65% of the fair market value at the time of relocation.

Private Foundations: Exclusion of “intra-group” transfers of hidden reserves

Interim tax on capital gains realised by Private Foundations can generally be avoided by “transferring” the realised hidden reserves to a newly acquired shareholding of more than 10% within the same calendar year. Under the proposed legislation, the transfer of hidden reserves will no longer be available if the Private Foundation acquires the shareholding from related parties.

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Withholding tax refund for holding companies

The refund procedure in relation to distributions to pure holding companies has recently been subject to decisions by the Austrian Independent Financial Tribunal.

Under the EC Parent Subsidiary Directive, the Austrian withholding tax exemption for outbound dividends is subject to a number of conditions. In addition to the one year minimum holding requirement and the 10% minimum shareholding, the distributing company must be directly owned by a corporate EC shareholder.

Relief at source is denied in the case where a particular structure is not justified by economic motives but is purely aimed at tax avoidance. Relief at source is also denied if the receiving company does not have its own office space or employees and does not carry out business that exceeds mere asset management (‘active business test’). In such a case, relief of withholding tax may be achieved upon request by undergoing a refund procedure.

In a number of cases, tax offices have denied the refund due to the fact that the receiving company did not pass the active business test.

The Austrian Independent Financial Tribunal has now confirmed that failing the active business test is only an indication of abuse that may result in the denial of relief. In the following refund procedure however, a refund may not be denied solely on the basis that a corporation does not have its own office space. Provided that the structure is based on genuine economic grounds, withholding tax may be refunded regardless of failure to fulfill the requirements of the active business test.

The Austrian Independent Financial Tribunal has specified that economic grounds are applicable in the case where multiple shareholders establish a holding company for the purpose of centralizing the decision making process. A long term interposition of a foreign holding company will not be considered abusive per se.

As a result, withholding tax falls due in the case of a payment to a “non-active” corporation. However, the refund should not be jeopardized as long as the structure is based on genuine economic grounds.

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Austrian anti-abuse regulations and EU Law

The Austrian Administrative Court recently justified the restriction of EU Law through national anti-abuse regulations.

Anti-abuse clauses in Austria are very abstract in their wording and have frequently had to undergo clarification through the courts.

In general the key conclusion of the judgments is that unusual and inadequate legal structures with the sole intent of tax avoidance are deemed to be abusive. There must be a check on whether the chosen structure still remains reasonable notwithstanding the effect of tax avoidance. Cases with foreign implications have always been analyzed critically. However, it was unclear whether the application of national anti-abuse regulations violates the right of establishment.

In a recent decision, the Austrian Administrative Court held that national anti-abuse regulations do not contravene EU Law. With reference to decisions of the European Court of Justice, the restriction of the right of establishment is justified if it aims at the avoidance of legal structures that are exclusively based on tax avoidance without having economic grounds.

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Decree to the Guidelines to the Austrian Restructuring Tax Act

The Austrian Ministry of Finance has recently issued an updating decree (Wartungserlass 2006/2007) to the Guidelines to the Austrian Restructuring Tax Act (UmgrStR 2002). A brief summary of the key issues is provided below.

The Guidelines to the Austrian Restructuring Tax Act can be seen as an interpretation of the current view of the Austrian fiscal authority and therefore lead to a certain degree of predictability for the taxpayer. The updating decree inserts relevant legal amendments as well as the current fiscal court view to the Guidelines and mainly comprises the points outlined below.

The so-called “non-assessment (or tax-deferral) concept” has been added in relation to cross-border restructurings within the European Union and the European Economic Area. In the case where assets are physically transferred from Austria to a corporation of another EU member state in the course of a restructuring process (e.g. a cross-border merger), the tax payment can be deferred until the actual realisation of the hidden reserves by way of disposal, liquidation or any other elimination out of the business assets of the receiving foreign corporation at a future date. Please note that the tax liability arising from the hidden reserves will become time-barred after a period of ten years.

In the case of a cross-border merger, the transferring (Austrian) corporation must opt for the non-assessment in its last corporate tax return otherwise immediate taxation will be triggered. In a case of the option, the resulting tax liability will generally be assessed but the payment is deferred until the transferred assets are sold or otherwise disposed of by the foreign receiving company. The assessment at the merger date forms the basis for the later taxation. A decrease in value abroad after the effective date of the merger will reduce the assessed tax base in Austria and therefore the resulting tax payment, if the decrease in value cannot be considered abroad (prevention of double usage of losses). The situation where an increase in value occurs after the effective date of the merger remains unconsidered in Austria.

In the event that Austria receives taxing rights because of a cross-border merger into Austria (physical asset transfer to Austria) the Austrian Restructuring Tax Act provides for a tax neutral step up to the fair market value of the transferred assets. Potential tax loss carry-forwards which have been accumulated abroad cannot be transferred to the receiving Austrian corporation. However, according to the EU Merger Directive these losses

can be utilised by the foreign permanent establishment created through the merger.

The prerequisites for the application of the Restructuring Tax Act have become more restrictive in the field of special contributions in particular. According to the new rules, a balance sheet for tax purposes detailing the tax values is mandatory as of the effective date of the special contribution. Generally, the "non assessment concept" mentioned above is also applicable for special contributions within the EU or the EEA. However, share for share transactions effected between Austrian corporations and EU corporations remain untaxed without a special option as long as certain conditions are met. As a general anti-abuse provision those transactions are taxed if the transferred shares are sold by the receiving company within a short time frame. However, this short time frame is not defined by law or decree. The general understanding is that a sale within a two year period would trigger this taxation.

The updating decree also considers the restructuring of corporations which underlie the Austrian Group Taxation Regime. For instance, the effect of corporate restructuring is shown in connection with the minimum holding percentage in group entities, the minimum existence period of a corporate tax group, goodwill amortisation within such a group and the legal break-up of a group parent company.

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Indirect Taxes

VAT News

The Austrian Ministry of Finance plans comprehensive amendments to the Austrian VAT Guidelines.

Electronic Export Evidence

On 1 July 2007 the electronic export notification was introduced as additional evidence of export. Until now, in the case of dispatch of goods the export evidence had to be provided by shipping documents (e.g. bill of lading, mailing confirmation), by an export confirmation of an EU freight forwarder or by a written export declaration, certified by the customs office of export.

In cases involving the transport of goods, the export evidence must be provided by a written export declaration, certified by the customs office of export. For exports below EUR 1,000 in total, neither a written nor an electronic declaration for customs purposes is necessary according to customs regulations. The export evidence may be provided by an export confirmation issued by the supplier and certified by the customs office of export.

Intra-community supplies of goods – EC sales listing

Where a single intra-community supply of goods is effected by several instalments over a longer period (e.g. two years) and the supplier immediately receives the total payment from the recipient of the goods, there is some uncertainty over which period the supplier should include the intra-community supply of goods on the EC sales listing.

In principle, the intra-community supply of goods must be reported on the EC sales listing for the period the intra-community supply of goods is actually effected. Therefore, each instalment has to be reported on the EC sales listing when it has been carried out. This means that the intra-community supply of goods may already be included on the EC sales listing before the invoice is issued. If the invoice is issued before the intra-community supply of goods is effected, the supply of goods must not be reported on the EC sales listing until the supply has been made.

For the purposes of simplification, the supplier may also include instalments on the EC sales listing in the period in which he received the full payment. This applies in particular, if the recipient also declares the intra-community acquisition in the period of payment.

Book evidence for intra-community and export supplies of goods

The VAT Protocol 2007 removes uncertainty in the situation where book evidence for intra-community supplies of goods and exports must be created. The book evidence in general must exist at the beginning of a VAT audit. Missing parts of the book evidence (e.g. in a case where the VAT ID number was not known at the time of supply) may be added. The

deadline granted by the authorities in such cases is generally one month. However, the retrospective preparation of the entire book evidence is not acceptable. In a recent decision (ECJ September 2007 C-146/05 Collée) the ECJ confirmed that the tax exemption of intra-community supplies of goods may not be denied because the book evidence does not exist immediately after the intra-community supply of goods has been made.

Fax invoices

The simplification regulation for invoices sent by fax has been postponed until the end of 2008. Consequently, invoices sent by fax continue to entitle the customer to the deduction of input VAT even in the case where no advanced electronic signature is added to the invoice.

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Accounting

AFRAC statement to group taxation

In a meeting on 18 September 2007 the Austrian Financial Reporting and Auditing Committee (AFRAC) published its final statement on “Questions on IFRS accounting and presentation in coherence with the introduction of group taxation”. The statement is available on the AFRAC homepage and will come into effect from 1 January 2008 although earlier application is recommended. The work group comments on the following topics:

Under the Austrian group taxation regime, the parent must bear the corporate tax liability of the entire group. A tax compensation agreement is necessary under which the group parent may allocate its corporate tax due to the members of the group. There are various methods to achieve reasonable allocation for the tax compensation. According to the AFRAC statement, tax compensation and deferred taxes should be recognised as if each group member were subject to tax on a stand alone basis. As a consequence the tax compensation should be presented as a tax expense in the income statement in line with IAS 1.81. The applied tax rate for the compensation of deferred taxes must correspond with the enacted tax rate effective at the balance sheet date.

The tax group regime provides for a tax effective goodwill amortization upon a share deal. On the other hand the amortization expense reduces the tax base of the shares in the acquired subsidiary. The AFRAC concludes that this goodwill amortization does not give rise to the recognition of a tax benefit in the sense of IAS 12.34 nor a deferred tax item according to IAS 12.67. The goodwill amortization creates an outside basis difference in respect of the acquired shares for which a deferred tax liability has to be recognized only in exceptional cases (see IAS 12.39.).

The group taxation allows the utilization of tax losses of foreign group members in Austria. The tax benefit from offsetting the tax losses of foreign tax group members is subject to recapture taxation at the time the losses are effectively used or could be used abroad by the foreign group member. The recapture also applies when the foreign group member leaves the tax group. As the cross-border loss utilization does not create a difference between the tax value and the carrying amount according to IFRS, this item should not be seen as a temporary difference for which a deferred tax liability can be recognized. According to the AFRAC statement it is reasonable to recognise a current tax liability in the sense of IAS 12.12 for utilized foreign tax losses which might be recaptured in subsequent years. In the absence of clear rules for the measurement of long term liabilities, the current tax liability for the utilized cross-border losses may be discounted.

The AFRAC statement also provides some guidelines on information specific to a tax group to be presented in the notes of the IFRS financial statements.

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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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