PwC Austria
Tax

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Foundations in Liechtenstein – Austrian tax aspects

Foundations set up in and under the laws of Liechtenstein for investment management purposes have always been of interest to tax authorities.

If the founder and/or the beneficiary represent an Austrian taxable person, the question arises whether the Austrian tax authorities have fiscal access to the income of the Liechtenstein foundation or not.

Generally, income of Liechtenstein foundations should not be subject to Austrian taxation if

- it is comparable to an Austrian foundation
- the place of management is outside of Austria
- it is regarded intransparent for tax purposes and
- there is no abuse or tax avoidance.

Basically, the criterion regarding transparency is deemed to be the most important aspect for Austrian tax purposes. It is regarded as critical whether and to what extent the founder can influence and intervene in the activities of the foundation and the decisions of the foundation's board respectively. If the founder is not in a position to exert any influence, the income shall be attributable to the Liechtenstein foundation and taxed only in Liechtenstein

Recently, the Austrian Ministry of Finance published a more restrictive opinion saying that based on previous experience, the income of "asset managing" foundations in Liechtenstein is deemed to be attributable to the founder, instead of the foundation itself. Consequently, the income would be subject to taxation in Austria if the founder was tax resident in Austria.

Liechtenstein foundation law will be amended in 2008, to provide modern regulations, and at the same time granting maximum asset protection for investors in order to maintain the attractiveness of Liechtenstein for financial investments.

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New Double Taxation Convention with New Zealand

The Austrian Tax Treaty Network has been extended by the conclusion of a Double Taxation Convention between Austria and New Zealand. For the first time, the DTC will become effective beginning with the tax year 2008.

The new Double Taxation Convention between Austria and New Zealand is based on the OECD Model Convention. This article summarises some of the important aspects of the convention.

It provides that building sites or construction, assembly or installation projects only constitute a permanent establishment in the Source State if their duration is in excess of twelve months. The term permanent establishment also includes supervisory activities in connection with such operations.

Furthermore, activities in connection with the exploration or exploitation of natural resources or the provision of services (including consultancy and independent personal services), also lead to a permanent establishment in the Source State, where such activities or services will be rendered wholly or partly for more than 183 days within a twelve months period. Under certain circumstances and with regard to insurance companies, the Source State has a limited right to tax even without the constitution of a permanent establishment.

Contrary to the provisions of the OECD Model Convention, the sole taxing right for profits from international ship and aircraft operations is shifted to the State of Residency of the recipient and not to the state where effective management is situated.

Dividend payments may be taxed in the State of Residency of the receiving shareholder as well as in the Source State where the distributing company is located. Notwithstanding the OECD Model Convention, the maximum Withholding Tax (WHT) percentage is limited to 15 percent, and there is no difference in the WHT rate between portfolio dividends and dividends paid out of qualifying participations.

Interest payments may be taxed in the Source State at a maximum rate of ten percent. It should be noted that Austria will only levy WHT on interest payments under specific circumstances.

Royalties may also be taxed in the Source State at a maximum rate of ten percent whereas the term royalties is defined more broadly under the convention than in the current OECD Model Convention. Under this definition, payments for the use of, or the right to use, any industrial, commercial or scientific equipment will also be regarded as royalties. With regard to Withholding Taxes on dividend, interest and royalty payments, the convention is applicable for such payments effected on or after 1 March 2008.

The convention contains a so called 'most-favoured-nation' clause. In the event that New Zealand adopts more favourable provisions in terms of WHT rates in the future in relation to third countries, there will be immediate negotiations to adjust the relevant WHT rates under the Austria-New Zealand DTC.

According to the OECD Model Convention, income from immovable property is taxed in the state where the immovable property is situated in.

Gains from the alienation of other assets are basically taxed in the State of Residency of the seller, although gains from the alienation of shares deriving more than 50 percent of their value directly or indirectly from immovable property are taxed in the Source State.

To eliminate double taxation, Austria generally implements the exemption under progression-method, and the credit method applies for WHT on dividend, interest and royalty payments. New Zealand generally uses the credit-method to eliminate double taxation.

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Update: Amendments to the Double Taxation Convention Austria-Turkey

The new Double Taxation Convention (DTC) between Austria and Turkey is expected to become effective for tax years beginning on or after 1 January 2009. Until then, the relevant provisions of the existing DTC are still applicable.

Under the new treaty, supervisory activities in connection with building sites or assembly projects will also constitute a permanent establishment in the source state.

In addition to the general taxation right of the source state on income attributable to a permanent establishment, the new DTC between Austria and Turkey contains a "branch profits tax" at the rate of five percent. The source state may impose this tax additionally on the branch profits after tax.

Contrary to the OECD Model Convention, speculative gains deriving from the alienation of assets within a period of one year after their acquisition may also be taxed in the source state.

With regard to independent personal services, Turkey as the source state basically loses its former right to levy a withholding tax (WHT) of ten percent on such income under the new DTC. Such income may only be taxed in the source state if it is attributable to a fixed place of business in the source state or the work is carried out in the source state for more than 183 days within a twelve months period.

The maximum WHT rate on dividend payments out of participations representing more than 25 percent of the share capital will be reduced from 25 percent to 5 percent, the WHT rate for portfolio dividends from 35 percent to 15 percent.

The new DTC provides for a scaling of maximum WHT rates on certain specified interest income.

In the future, Turkey will generally apply the credit-method to eliminate double taxation whereas Austria exempts active income using the exemption with progression-method. Under certain circumstances, the DTC provides for a matching credit system for interest income and royalty payments deriving from Turkey.

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Termination of Double Taxation Convention between Austria and Argentina

The termination of the DTC becomes effective on 1 January 2009. After this date no treaty protection against double taxation will apply between the two states. At present, it is not possible to predict when a new Double Taxation Convention might be agreed.

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Latest comments on Austrian anti-abuse legislation

It is often very difficult to define a clear border-line between tax abuse, allocation of profits and effective tax planning. Recently, during an experts' conference, a judge of the Administrative High Court made some interesting observations regarding group taxation and holding companies.

A common and tax effective way to structure an Austrian acquisition is to set up an Austrian acquisition vehicle. This vehicle is provided with debt and equity to acquire the target. A tax group is then set up to shelter the target's profits with the acquisition vehicle's interest expense ("debt push down"). Where the corresponding interest income can be sheltered in a low tax jurisdiction this acquisition structure results in a significant tax saving for the group.

In practice tax inspectors challenge this type of acquisition structure based on general anti-abuse principles. Under such principles a transaction is disregarded for tax purposes if there is insufficient commercial and economic justification for the transaction, and if the transaction is carried out in order to avoid Austrian taxes. Such abusive intent is deemed to exist if the tax burden was reduced by a transaction, which was not undertaken for sound business reasons. The experts' conference came to the conclusion that in general anti-abuse principles can be applied for debt-push-down structures only in exceptional cases, e.g. if there are no business reasons for interposing the Austrian acquisition company.

This view is also supported by the fact that the Austrian Parliament introduced tax rules which permit and govern the deductibility of interest in debt push down structures. Tax saving opportunities provided for by the legislator should not give rise to anti-abuse concerns.

Another aspect discussed in the experts' conferences is withholding tax relief. Interposing holding companies is often used to optimize Austrian withholding taxes. Austrian tax inspectors usually request substance (i.e. office and employees) on the level of the foreign holding companies to grant withholding tax relief under a double tax treaty or the EC Parent-Subsidiary Directive. According to the experts it is essential that the interposition is supported by sound business reasons and that the holding company is the beneficial owner of the respective income.

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New Case Law on the Austrian Participation Exemption

The administrative High Court of Justice recently ruled that Sec. 10 Para 2 Austrian Corporate Income Tax Act violates the freedom of movement of capital. For foreign portfolio dividends the credit method is applicable.

The Administrative High Court of Justice recently considered the question whether or not foreign dividends from a participation below ten percent (referred to as "portfolio investments") should be treated as tax exempt at the Austrian corporate investor level as the tax exemption is also applicable to Austrian portfolio dividends. The Court decided that for foreign portfolio dividends the credit method is applicable, and not the exemption method, even though in comparable situations domestic dividends are tax exempt.

For dividends arising from foreign participations in excess of a participation of ten percent, the exemption method is applicable and thus, no foreign tax may be credited in Austria.

The Independent Tax Senate had previously ruled that dividends from foreign portfolio investments should be tax exempt, and that decision is now overruled by the Administrative High Court of Justice.

Sec. 10 Para 1 Austrian Income Tax Act ('ACITA') generally exempts profit distributions from Austrian corporations.

Profit distributions from international participations are, according to Sec. 10 Para 2 ACITA, tax exempt if the requirements (minimum participation ten percent, minimum holding period one year) are both fulfilled. The Administrative High Court of Justice acknowledged that Sec. 10 Para 2 ACITA discriminates against foreign portfolio investments and does not comply with Community Law. Due to the fact that Austrian dividends are tax exempt, even below a participation of ten percent, the effective tax treatment should be the same for foreign portfolio investments.

The Austrian Ministry of Finance recently confirmed that in the case of portfolio investments in EU or Norwegian companies the following components of foreign tax paid may be credited against the Austrian tax:

- portion of foreign CIT paid by the dividend distributing company which may be allocated to the dividend distribution and
- within the limits of the specific Double Tax Treaty, foreign tax withheld at source on the dividends.

This is to achieve the objective of the same treatment of domestic and foreign portfolio dividends.

Under current law, it is already necessary to convert from the exemption to the credit method in cases of abuse and tax evasion, and for investments in companies with low taxed passive income from interest, royalties, the sale of portfolio investments and certain leasing activities above a participation of ten percent. As a consequence of the decision the credit method also becomes the normal method for all types of portfolio investments. Moreover, equal taxation of domestic and foreign portfolio dividends is not guaranteed

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by the credit method. The foreign CIT and the withholding tax may only be credited up to the amount of the Austrian CIT on the dividends. Any excess part of the foreign tax paid cannot be reclaimed in Austria. In circumstances where the dividend receiving domestic company has an annual loss, the foreign tax credit may not be carried forward to future years and is lost. In addition positive foreign dividend income reduces an annual loss carry forward, whereas the application of the exemption method would not reduce the tax loss of the current year.

Finally, it may be difficult for the individual investor to find out the portion of foreign CIT paid by the dividend distribution company abroad which is attributable to its dividends. Collaboration and early exchange of information between European authorities will be required.

A foreign withholding tax on portfolio dividends from non-EU-countries may only be credited within the limits of the specific double tax treaty against the Austrian Corporate Income Tax.

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Rise of EU-Savings Tax Rate and Reform of the Savings Taxation Directive

From 1 July 2008 the EU-Savings Tax on interest payments in Austria is going to be increased to 20 percent. In addition it is proposed that the savings tax be extended to all kind of capital income and also to all legal entities.

Principles of the EU-Savings Tax

In Austria, the European Savings Directive was implemented through the enactment of the EU-Withholding Tax Act and came into effect on 1 July 2005. As a result of bank privacy issues, Austria is excluded from the obligation to report cross border interest payments but is required to withhold EU-Savings Tax from interest payments to an individual resident in another EU-member country or one of the ten dependent and associated territories of the EU-states.

The EU-Savings Tax rate is 15 percent and will be raised to 20 percent from 1 July 2008. From 1 July 2011 the tax rate is raised to 35 percent.

Example for the calculation of the EU-Savings Tax

As regards the calculation of the EU-Savings Tax to be withheld, interest need to be taxed according to the relevant tax rate (15, 20 or 35 percent) applicable to the time period in which the interest accrued.

For example, the EU-Savings Tax on interest for a bond paid annually on the 31 July for the previous year is calculated as follows:

Interest for the year 1.8.2007 to 31.7.2008 amounting to EUR 240

1.8.2007 to 30.6.2008 – 15 % EUSt: 240/12x11= 220 x 15 % =	33.00
1.7.2008 to 31.7.2008 – 20 % EUSt: 240/12x1 = 20 x 20 % =	4.00
Sum EU-Savings Tax	37.00

Commission Staff Working Document SEC/2008/559

In April 2008 the European Commission published a working paper discussing amendments to the Savings Taxation Directive. The following key issues were raised:

- whether there is a wish to go beyond the current definition of beneficial owner and extend the scope of the EU Savings Directive to interest payments made to all legal persons, entities and arrangements, or instead maintain the current definition of beneficial owner and supplement the current possibilities with a "look-through" approach for payments leaving EU territory;

- whether drawing up a positive list of the entities concerned would be an appropriate solution to make the "paying agent on receipt" mechanism work better;

- whether paying agent obligations under the Directive could be imposed on certain non transparent entities and arrangements at the

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moment of the first distribution(s) of cash or other liquid assets following any interest payment to these entities/arrangements;

- whether a well defined "substance over form" principle should be enshrined in the Directive in order to ensure, as far as possible, that it will apply to all financial products that are equivalent to debt claims in terms of risk, flexibility and agreed return on investment;
- whether the Savings Taxation Directive is, or is not an appropriate legal instrument to accommodate rules on cooperation between member states for enabling taxation of types of investment income which are substantially different from interest, such as dividends, capital gains and "out payments" from those life insurance contracts and pension schemes where the mortality or longevity risk covered is not merely ancillary.

We will have to watch for future developments.

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Indirect Taxes

Appeal Court on VAT treatment of supplies into freeports

The Austrian VAT treatment of supplies of goods into freeports located in other EC-member states has always been disputed. A recent decision by a Tax Appeal Court brings some clarity.

Supplies into freeports

Freeports (e.g. Bremen, Hamburg, Rotterdam) are ports which are located on the territory of EU-member states (e.g. Germany, the Netherlands). According to the EU VAT Directive these freeports are part of the territory of the member states as defined for VAT purposes: they are not excluded like e.g. Mount Athos or Helgoland. However, according to domestic German VAT Law the Freeport of Bremen is excluded from the application of German VAT. This means that a company which solely carries out supplies in the freeport need not register for VAT purposes in Germany.

For Austrian VAT purposes it has always been disputed whether supplies of goods from Austria to a freeport are to be seen as intra-community supplies of goods (to an EU-member state) or export supplies of goods (to a place outside the EU). The documents which are required in order to zero-rate a supply are different in case of intra-community supplies of goods compared to export supplies of goods. In addition, in the circumstances of an intra-community supply of goods, a valid VAT identification number issued by a member state other than Austria is required in order to zero-rate the intra-community supply of goods.

The decision by the Tax Appeal Court Vienna dated 18 March 2008 now brings some clarity for taxpayers: Supplies of goods from Austria into the Freeport of Bremen are to be seen as intra-community supplies of goods as the Freeport of Bremen is part of the VAT territory of the EU from an EU point of view. The German exemption is not relevant for the Austrian VAT treatment. This means that the evidence for an intra-community supply of goods must be provided and that a valid foreign VAT identification number is required in order to zero-rate the supply of goods in Austria.

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Accounting errors and the Criminal Tax Act

Accounting errors happen. Especially with new businesses or where a lot of documents have to be processed. The following case shows that these accounting errors may also have consequences under the Criminal Tax Act.

Accounting errors and Criminal Law

In the course of a tax audit, a tax inspector discovered that a company had booked German Import VAT with the tax code for Austrian Import VAT, and had previously claimed and received refund of approximately EUR 25,000 of German Import VAT in Austria. The reason for these false bookings was that the company previously had only imports into Austria, and this was the first time that German Import VAT was incurred. In addition, on the first page of the Import VAT documents it was not explicitly noted whether German or Austrian Import VAT was charged.

Were these minor accounting errors which happen from time to time? – initially the tax authorities did not take this view, and commenced an examination under the Criminal Tax Act. The names of all persons involved in the false bookings (not only the bookkeepers but also the CFO and CEO) had to be officially disclosed before the tax authorities. Fortunately, the tax authorities were eventually convinced that these accounting errors were neither made on purpose nor due to gross negligence, but were excusable errors even a diligent bookkeeper could make. The opening of a criminal tax procedure could therefore be avoided.

However, this case shows that the Austrian tax authorities tend to react rigorously when confronted with accounting errors. Not only the bookkeeping staff but also the CFO and CEO are liable for underpayments of taxes due to false accounting according to Austrian law. Unfortunately, it is only possible to argue that excusable errors were made in exceptional cases; for example the Austrian High Administrative Court is of the opinion that 34 accounting errors in three years which lead to untaxed earnings of only EUR 7,300 were not excusable errors.

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Expatriates

Increase of commuter lump sum and mileage allowance

Due to increased prices of fuel, effective 1 July 2008, the commuter lump sum and the mileage allowance applicable for Austrian employees have been increased by about 15 percent.

		Number of kilometres	To 30 June 2008 per year in EUR	As from 1 July 2008 per year in EUR
Commuter lump sum (“large” allowance)	Utilization of public transports not possible or unreasonable	2-20 20-40 40-60 more than 60	297.00 1,179.00 2,052.00 2,931.00	342.00 1,356.00 2,361.00 3,372.00
Commuter lump sum (“small” allowance)	Utilization of public transports possible or reasonable	20-40 40-60 more than 60	546.00 1,080.00 1,614.00	630.00 1,242.00 1,857.00

The mileage allowance for business trips has been raised from EUR 0.376 to EUR 0.42 per kilometre. For motorbikes with a capacity of up to 250 cm³ there has been an increase from EUR 0.119 to EUR 0.14 and for motorbikes with a capacity in excess of 250 cm³ from EUR 0.212 to EUR 0.24.

The new amounts are valid from 1 July 2008 until December 2009.

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Austrian Tax Facts & Figures

Taxation of corporations

Corporate income tax rate (Basis – adjusted statutory accounts)	25%	**Non-deductible expenses (examples)**	
Dividend withholding tax	25%	Long-term accruals	20%
Witholding tax on licences/royalties	20%	Business meals	50%
Interest	0%	Excessive car expenses for luxury cars	
Significant allowances		**Tax loss carry forwards**	
Research & Development (R&D) (Alternatively premiums in cash: 8%)	up to 35%	Losses may be carried forward for an indefinite period of time	
Learning & Education (L&E) (Alternatively premiums in cash: 6%)	up to 20%	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 3,930			
Employer's share	up to 21.9%	Payroll related taxes	approx. 8.0%
Employee's share	up to 18.1%		
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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We encourage feedback on the newsletter and the content. Equally, we welcome any of your thoughts on topics that you would like to see addressed in future issues.

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