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Tax

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Ministerial draft proposes amendments of legal and fiscal conditions for the Private Equity and the Venture Capital Industry

On 11 June 2008, the Federal Ministry of Finance published a draft law (Kapitalmarktstärkungs- und Innovationsgesetz 2008), including a new Investment Company Law and amendments to the Austrian Corporate Income Tax Act.

The purpose of the Investment Company Law (ICL) is to provide a corporate law basis for investments through venture capital in certain shareholdings. In order to benefit from the ICL, an investment company (IC) has to be established in the legal form of a limited partnership (KG) or public limited company (AG) with a minimum share capital of EUR 2 million and the term "Investment" as part of the company name.

The investment in a target company has to be made primarily in equity. However, debt financing (Annex Financing), by the IC, is also permitted to a limited extent.

An investment qualifies for the ICL if the target company is either a start-up business, shall become more profitable or shall become ready for an initial public offering. However, these terms are neither defined by law nor commonly used. Consequently, 'buyout' deals, for example for succession purposes, or 'secondary purchase transactions', where one investor acquires another's target company, may not qualify as investments in the sense of the ICL.

There are neither restrictions with regard to the area of business in which the target company is operating nor with regard to the extent of the shareholding.

This investment flexibility allows ICs to invest in small, medium-sized or even large enterprises, as long as the investments are considered venture capital (i.e. start-up, performance improvement or IPO) in the sense of the ICL and the holding period requirement of between one and ten years is met.

The ICL requires that executives of an IC must meet certain standards regarding qualification, experience

and personal integrity. Once again, the draft law is unclear who is entitled to verify whether executives meet these requirements and what consequences follow in the event of breach.

As a result of the Investment Fund Act (Investmentfondsgesetz) an IC is obliged to assign a depositary bank to administer the investments. However, it is unclear how the depositary bank will be able to execute its responsibilities, including control functions, and how non-securitized investments such as participations in limited partnerships and silent partnerships, can be managed.

The law includes detailed provisions concerning the protection of investors and reporting requirements. In order to improve transparency and provide detailed information to the public the management of an IC is obliged to publish an information document on a quarterly basis.

Extensive penalties, including prison sentences up to two years, complete the ministerial draft for the ICL.

The ICL provides for consequential amendments to the Austrian Corporate Income Tax Act (KStG). In particular, capital gains and losses realized from the disposal and any changes in value of directly held shares/participations are tax neutral at the level of the IC. Dividends received from the target company are tax exempt under the participation exemption regime, whereas income (profits and/or losses) allocated from a partnership to the IC is taxable at the level of the IC.

Under certain conditions and depending on the debt-to-equity ratio, interest income derived from Annex financing is also tax exempt. However, interest expenses relating to the investments in target companies are not tax deductible. Furthermore, ICs are not entitled to benefit from the group taxation regime in Austria.

On the whole, the intention of the government to strengthen and improve the sector of private equity investments is very welcome. However, a closer look at the proposed law shows that this criticised draft is not able to provide a proper framework for the Venture Capital and Private Equity industry.

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Apprentice employment – now more attractive

Thanks to new incentives, employing of apprentices is now more attractive than before.

The amendment of the professional training law, which came into force on 28 June 2008, sets out a more attractive and flexible framework of incentives for employing apprentices than before. The new apprentice incentive comprises a basic premium, an incentive for new, additional apprentice positions and quality-related incentives.

Instead of a flat-rate apprentice premium of EUR 1.000 per apprentice each year, a basic premium for apprenticeships starting after 28 June 2008 was introduced. This premium is based on the amount of the actual wage as set out in the collective contract and provides graded, tax-free, subsidies. Depending on the duration of the employment of the apprentice, the employer gets a premium from half of the wage of the apprentice and up to three times of the wage.

The “Blum Bonus II”, introduced for a limited period until 2010, is a replacement for the “Blum Bonus I”, which expired on 27 June 2008. This bonus promotes the establishment of additional apprenticeship positions in companies where no apprentices were employed before, for companies that return to apprenticeship schemes after a three year break and for new incorporated companies.

Quality-related incentives are also introduced for furthering the education of trainers, for extra training of apprentices and for learners, who need additional support as well as premiums for apprentices achieving excellent or good results in their final exams.

These incentives for apprentices are no longer administered by the local tax office, but through the apprentice centre of the respective chamber of commerce of the county.

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Direct Taxes

Tax credits in Austria

The Austrian Federal Ministry of Finance outlined in a recent ruling, dated 26 May 2008, its view on crediting foreign taxes. In this article we consider the different forms of determining the maximum amount of foreign tax which can be credited against domestic income tax.

Resident corporations are taxed on their worldwide income. If a double taxation treaty is in force, double taxation is in principle mitigated either through an exemption or by granting a tax credit of up to the amount of the foreign tax. However, if the source of the income is a non-treaty country, exemption or a tax credit may be available based on unilateral relief.

There are two methods in Austria: per-country limitation and per-item limitation. Where the per-country limitation is applied, the maximum tax credit allowed is calculated for each foreign country separately. This means that foreign tax is credited against Austrian income tax up to the amount of income tax triggered by the total amount of income generated in the individual foreign country and taxable in Austria. Alternatively the maximum amount can be determined based on the per-item limitation, i.e. the maximum amount creditable is calculated for one specific source of income. Any foreign tax exceeding the maximum creditable amount in Austria cannot be carried forward to future years for Austrian tax purposes.

To benefit from double taxation relief, the recipient of the foreign income has to document each item of foreign income including the amount, the date of payment, the foreign state and the foreign income tax.

The letter ruling dated 26 May 2008 dealt with an Austrian corporation with two permanent establishments in Italy. The first permanent establishment ("permanent establishment A") generated a profit of EUR 7.9 million, the second ("permanent establishment B") a loss of EUR 15.5 million. In both cases the Austrian corporation had to pay a local tax ("IRAP") which is regarded as creditable income tax for treaty purposes; EUR 1.8 million for permanent establishment A and EUR 5.7 million for permanent establishment B. According to the Double Tax Treaty between Austria and Italy relief is granted by way of a foreign tax credit. The consolidated Italian income is subject to Austrian income tax at a rate of 25 percent, any Italian (income) tax paid is credited against the Austrian income tax up to the maximum creditable amount. Applying the per-country limitation would be disadvantageous for the Austrian corporation as the consolidated Italian income would be negative and thus no foreign tax credit would be allowed. However, according to the Federal Ministry of Finance the individual permanent establishment can be regarded as a separate income source. By applying the per-item limitation the maximum creditable amount will be determined by the income tax levied on the profit of the individual permanent establishment as both permanent establishments are regarded as two different sources of income. Based on an income tax rate of 25 percent the maximum foreign tax to be credited would amount to EUR 1.975 million for permanent establishment A and nil for permanent establishment B. Consequently, IRAP paid for permanent establishment A could be credited entirely against Austrian income tax. No creditable amount would be available for IRAP paid by permanent establishment B as a result of the loss situation.

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"Wartungserlass" 2007

On 18 June 2008, the Austrian Ministry of Finance issued an updating decree ("Wartungserlass" 2007) to the Guidelines to the Austrian Corporate Income Tax Act (KStR 2001). We outline the key issues.

The Guidelines to the Austrian Corporate Income Tax Act reflect the current approach of the Austrian fiscal authorities. The update of the decree clarifies certain open issues regarding the Austrian Corporate Income Tax Act, including the following points:

A debt waiver of a shareholder in connection with partially recoverable receivables against the company is divided into the recoverable part and the non-recoverable part of the claim. In this context, the waiver of the recoverable part will be treated as

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a contribution and will therefore not lead to taxable income at the company level. However, the waiver of the non-recoverable part is deemed to be taxable income.

The tax losses of foreign group companies can be utilized within the Austrian tax group. The updating decree clarifies certain open issues in this context. A foreign group member deriving income from a permanent establishment or other income (e.g. rental income) in Austria is in accordance with the relevant provisions of an applicable DTC subject to limited tax liability in Austria. Nevertheless, the Austrian source income reduces the overall loss of the foreign group member which can be offset within the tax group in Austria.

The foreign loss to be deducted in Austria has to be computed according to the Austrian Tax Law. The new decree stipulates that foreign group entities resident in an EU member state, Iceland, Liechtenstein or Norway are entitled to claim the Austrian allowance for research and development in the course of the conversion from the foreign result to the income according to Austrian Tax Law.

Participations of Austrian corporations in foreign corporations are only entitled to the participation exemption, if the foreign corporation is comparable to an Austrian corporation, i.e. if it shows characteristic elements of an Austrian corporation. Such elements include the legal personality under foreign law, the existence of a (profit-independent) fixed share capital in the ownership of the company or a limitation of company liabilities with the company's assets. Up to now a comparable corporation has been assumed for all legal forms listed in the EC Parent-Subsidiary-Directive. The new decree changes this view. The nature of a legal entity (i.e. corporation or partnership) has to be exclusively considered based on Austrian principles. The fact that a legal entity is included in the EC Parent-Subsidiary-Directive or has opted for corporate taxation is irrelevant for Austrian tax purposes.

As a general rule tax loss carry forwards of a company are forfeited where there is a significant change of the shareholders in combination with a substantial change of the organizational and economic structure of the company ("Mantelkauf"). The update of the decree extends the "Mantelkauf" provisions to expenses in connection with the write-down of participations. The write-down has to be spread-over seven years for tax purposes. If a "Mantelkauf" is effected within the seven-year period the part of the write-down not yet expensed will be forfeited.

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Indirect Taxes

VAT Fraud

VAT fraud has increased dramatically over the past years. As a result of fraud, which is often committed within organized criminal structures, the budget of the EC and the EC Member States experience damages amounting to billions of Euro. Accordingly, the Commission as well as the EC Member States have made the combat of VAT fraud one of their top priorities.

"Carousel" fraud is the most common type of fraud. In this scheme local supplies of goods with VAT and intra-Community supplies without VAT are combined. The goods go round in circles (or not at all) and the VAT charged is not paid to the tax office, while the parties claim input VAT deductions based on VAT invoiced. Another type of fraud concerns the foundation of businesses without any substance and with the sole purpose of the VAT fraud. The business is registered with the local tax office in order to receive a VAT number and uses counterfeit invoices to obtain an input VAT deduction. Under the Penal Code, VAT fraud is punished with penalties and imprisonment. However, a common problem for the tax authorities is that they cannot trace the missing trader nor recover the VAT due. Therefore, the tax authorities try to counter the VAT fraud through measures against the business partners of the fraudulent parties.

In this connection, Austria introduced a new provision into the VAT Act which shall help to fight fraud and also to make claims against other taxable persons involved in the fraud:
From 1 January 2008 a taxable person is not allowed to deduct input VAT if he knew or should have known that he was participating in a transaction connected with fraudulent evasion of VAT. The denial of input VAT deduction also applies if any

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other supply in a chain of supplies prior or subsequent to the fraudulent supply is connected with fraudulent evasion of VAT (and the taxable person knew or should have known this fact).

Although it should be clear under what circumstances a taxpayer "knows" about a VAT fraud, if active knowledge can be established, the meaning of "should have known" is not clearly defined in the VAT Act. Based on comments by the Austrian tax authorities a party "should have known" of a VAT fraud if the conditions of the transactions are very unusual e.g. huge cash payments, the taxable person never takes delivery, the seller presents a prospective buyer to the customer, the seller does not have an office although the turnover is huge, invoices are issued by third parties, meetings in the middle of the night.

The new Austrian legislation is generally based on the decision of the ECJ as of 6 July 2006, C-439/04, "Axel Kittel". As a consequence the Austrian tax authorities have announced, that they will apply the new legislations also on transactions carried out before the new legislation came into force (as they think that the new legislation is mainly a clarification of principles in EU VAT Law). "Alex Kittel" concerned a carousel fraud from Belgium to Luxembourg and back to Belgium. The Belgian taxable person did not and could not know about the fraud. However, from a Belgian civil law point of view the contract regarding the transaction of goods was null and void and the recipient not entitled to deduct the VAT paid. The ECJ decided that a taxable person loses the right to deduct the VAT only if he knew or should have known that he was participating in a transaction connected with fraudulent evasion of VAT, independent of the validity of the contract according to the civil law. Otherwise the good faith principle protects the taxpayer.

The Austrian tax authorities have tried to fight VAT fraud in the past, inter alia with the measures included in Art. 27 para. 9 of the Austrian VAT Act. This Article held the recipient liable if the supplier did not pay the VAT to the tax office and the recipient was aware of that. It proved cumbersome for the Austrian tax authorities to prove that the recipient was aware of the VAT fraud. At the end of 2007 this clause was abolished (and replaced by the measure mentioned above). Another measure in the Austrian VAT Act against the VAT fraud (Art. 27 para. 4 Austrian VAT Act) provides that the recipient has to withhold the VAT and pay it to the tax office in the name and on account of the recipient (under a joint liability), if the supplier is a non resident taxable person.

In addition, the Austrian tax authorities are very strict: if an invoice does not contain all criteria for a valid VAT invoice (e.g. precise description of the goods or services supplied) input VAT deduction may be denied.

For the future, additional measures are discussed in Austria (like in other Member States): One alternative could be a general reverse charge system as proposed by Austria in the past.

However, as this requires unanimous consent of all Member States, it is unlikely that Austria will be successful. Measures which are more likely to be introduced are more burdensome reporting obligations and ad-hoc cross-border inspections by the VAT authorities of the EC Member States.

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Legal

Prevention of social fraud in the construction industry

By means of the introduction of a liability for contracting entities the systematic evasion of social security contributions in the construction sector can be prevented.

In the construction industry, the introduction of the "Reverse Charge Systems" resulted in reduction of fraud in relation to VAT. A further regulation shall enter into force such that all contracting entities dealing with construction services, other than private persons and final buyers, shall be liable for any arrears of their sub contracting firms of up to 20 percent of the value of the order or invoice.

The Austrian Health Authority will establish a Service Centre, to which the contracting construction company will pay 20 percent of the invoice for the subcontractor, which will exempt the contracting company from liability. In addition, a list of approved subcontractors will be kept. That exhaustive list of all contractors that are exempt from liability is called HFU-list. Contracting companies can directly pay subcontractors mentioned in this list and be automatically exempt from liability. As soon as the technical infrastructure has been provided, these new arrangements will enter into force.

Applications for inclusion in the HFU-list can be filed from 1 November 2008. It is very unlikely that these provisions will become effective before 1 January 2009.

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Prevention of VAT fraud in the construction sector – Reverse Charge

In October 2002, a reverse charge mechanism was introduced to combat VAT fraud in the construction sector (similar to the recently introduced mechanism to combat social security fraud).

Under the Austrian VAT Act supplies of services in the construction sector are subject to reverse charge if the recipient is a taxable person

- who himself was engaged to carry out these construction services; or
- who usually carries out construction services.

Construction services in this connection include the production, repair, maintenance, alteration or removal of buildings, and the hiring out of staff in the construction sector. The Austrian VAT Guidelines contain a detailed description of both services falling under the definition of construction services as well as of recipients who might be assumed to usually carry out construction services. In addition, if it is disputed whether specific services fall under the definition of construction services, the parties may agree on the VAT treatment.

The application of the reverse charge mechanism means that the services are to be invoiced without Austrian VAT. The VAT liability is accounted for and declared by the recipient of the supply (who – under the general conditions – is entitled to deduct the same amounts as input VAT). Austrian VAT invoiced erroneously is owed based on the invoice by the issuer of the invoice and the recipient is not entitled to deduct the VAT. The reverse charge mechanism helped to combat the VAT fraud where subcontractors received the gross payments but did not pay the VAT to the authorities.

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Expatriates

Tax implications of using frequent flyer miles acquired on business travel for personal use

The Wage Tax Regulations Decree 2008 (“Lohnsteuerrichtlinien-Wartungserlass 2008”) finally provides clarification on one of the hot topics of the last few years – frequent flyer miles!

A new section has been included (222d) which, under the headline of “personal use of certain benefits in kind”, includes explicit provisions on the tax implications of frequent flyer miles and benefits of other customer loyalty programmes.

Under civil law, frequent flyer miles earned by an employee on business trips belong to the employer, provided that the employer paid for the trip. Where the employee makes personal use of the frequent flyer miles, they become a benefit and taxable for income tax purposes (wage tax withholding).

Where the employee is prohibited from using frequent flyer miles for personal use, or declares in writing that he/she is not part of a customer loyalty programme, the miles are not classed as a benefit in kind. Frequent flyer miles used for business purposes (including upgrades) are also not considered as a taxable benefit.

The provisions are consistent with the position of the Austrian Independent Fiscal Senate (“UFS”) introduced in October 2007 and January 2008: that an employee must provide his employer all the documents relating to the acquisition and use of frequent flyer miles so that the employer may comply with his tax obligations.

Generally, a fringe benefit is calculated using the normal median price where consumed. Due to the difficulty of assessing the benefit in kind afforded by frequent flyer miles, the Wage Tax Regulations impose a lump sum assessment of 1.5 percent of the expenses borne by the employer which generated the benefit (e.g. flight costs, hotel costs).

Example

An employer spends EUR 10,000 over the course of a year on business flights for an employee, who then uses the frequent flyer miles for personal use.

The taxable amount is EUR 150 (1.5 percent of EUR 10,000) and must be levied on the December payroll at the latest.

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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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