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In this issue

"Brexit" – possible effects on revenue tax

On 29 March 2017 the United Kingdom formally informed the EU about its withdrawal from the community of states by submitting a letter invoking Article 50 of the EU Treaty. After handing over the letter, the UK and the EU now have a two-year timeframe to negotiate the conditions of the withdrawal. This timeframe can only be extended with unanimous approval from all the remaining 27 EU member states.

The actual tax-related (and other) consequences depend on the conditions of the withdrawal that are still to be negotiated. Nevertheless, we want to take this occasion to give you a short overview of the possible effects of the Brexit on revenue tax, provided there will not be wide-ranging special regulations in this area (with the result that the UK would have to be treated like any other third country in the future).

Potential changes in the case of withholding tax on dividends, interest, and royalties

Between affiliated groups of companies within the EU, the Parent-Subsidiary Directive and the Royalties Directive guarantee relief from withholding taxes in the country of the disbursing entity for dividends, interest, and royalties (i.e. reduction of all national withholding taxes to nil).

After a withdrawal from the EU such regulations would no longer be applicable relating to the UK; therefore, tax relief could only occur based on the Double Tax Treaty. Specifically, this results in the following potential changes concerning payments between entities in Austria and the UK:

- In case of outbound dividends (i.e. payment from Austria to UK), the exemption from KESt (withholding tax) according to § 94 Z 2 EStG (Austrian implementation of the Parent-Subsidiary Directive) will no longer be effective. Collection of withholding tax from dividends according to Art. 10 DBA Ö-UK (Double Taxation Agreement between Austria and the UK) to the amount of 5% (in case of participations of more than 25 %) or 15% (for all other participations) will be applicable. Based on the exemption in the UK, this causes a clear increase in the tax amount for dividend payments to UK entities.
- In case of inbound dividends (i.e. payment from UK to Austrian companies), according to national law, the UK does not collect withholding tax. For portfolio dividends and cross-holdings in Austria, this does not result in a liability to pay taxes. Both exemptions are not dependent on an EU/EEA membership, therefore there should not be any changes in the tax burden.
- The Brexit will have only marginal effects on outbound payments of interest, because foreign recipients of corporate interest are usually not subject to limited tax liability in Austria. In the case of inbound payments of interest, UK withholding tax on interest is reduced to 0% (normally 20%).There would thus be no change in the tax burden for interest payments.
- After the Brexit, both Austria and the UK will probably retain a withholding tax in the amount of 10% (basically creditable in the recipient state) for outbound royalty payments between affiliated companies if the participation is 50% or more. Whether this will lead to an actual increase in the tax burden will depend on the actual chances of recognition in individual cases.

Reorganisations, relocation / disjunction and group taxation

In addition, there are several other revenue-tax regulations relating to the status of EU/EEA countries, which is why the Brexit could result in changes in the following areas:

- Certain privileges as set out in the Reorganisation Tax Act (UmgrStG) only apply to EU/EEA countries. In case of a reorganisation based exit to the UK as a third country (leading to the loss of Austrian taxation rights), the concept of payment by instalments would no longer be applicable and hidden reserves would have to be disclosed and taxed immediately upon relocation. Also, an exchange of shares (placing capital shares in a capital company of another EU member state; according to the Merger Directive) would no longer be possible in a tax-neutral way.
- The privilege of payment by instalments at operational level is also only granted in case of a relocation to EU/EEA member states. After the Brexit, hidden reserves would have to be disclosed and taxed immediately upon relocation. Thus, if in the future assets are transferred to a permanent establishment in the UK, payment by instalments cannot be applied for concerning taxation of the contained hidden reserves.
- In cases of relocation of natural persons to the UK as a third country or in cases of gifts / inheritances of capital assets to UK residents, taxation deferral will no longer be possible (non-imposition concept), since this is also linked to EU/EEA membership.
- What is still unresolved is the question whether the withdrawal of the UK will trigger immediate subsequent taxation (in case of past taxation postponement based on non-imposition concept) or repayment of outstanding instalments.
- No changes would arise in group taxation and the recognition and subsequent taxation of losses of foreign permanent establishments, because these regulations only require the existence of comprehensive administrative assistance, which – based on Art 28 tax treaty Austria/UK – will be ensured relating to the UK even after the Brexit.

Outlook and practical consequences

EU legislation will remain effective until the definitive withdrawal of the UK.

It remains to be seen how the British fiscal policy will develop after withdrawal from the EU. There may be selective tax benefits for UK companies in terms of a more “aggressive” (tax) location policy on the part of the UK.

The outcome of the withdrawal negotiations and thus the future relations between the UK and the EU are difficult to predict. It is just as possible that the UK will be treated basically like any other third country as that there will be continued close involvement in EU regulations, maybe even with continued validity of some major parts of EU legislation (comparable, for instance, with the Swiss model).

In constellations that are likely to lead to a higher tax burden after the Brexit, it might make sense to reconsider corporate structures or make payments (esp. dividends) or transfers prematurely, as long as the UK is still a member of the EU. There is also a new Double Tax Treaty under negotiation between Austria and the UK, which might relax potential withholding tax burden on dividends.

Besides the effects on revenue tax, the Brexit will also play an important role in other areas, such as VAT, customs, social security, and legal/civil matters.

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Update on Double Tax Treaties 2017

In 2017 the Double Tax Treaty with Iceland entered into force. Additionally, amendments in the tax treaties with Liechtenstein and Luxembourg became legally effective.

New Double Tax Treaty between Austria and Iceland

On 1 March 2017 the Double Tax Treaty between Austria and Iceland entered into force. There was no tax treaty in place between these jurisdictions.

The tax treaty basically follows the OECD model convention, and its content essentially corresponds to the provisions of the treaty submitted to the Austrian parliament in 2016 (for more details see Austrian Tax News, Issue 55, December 2016).

The provisions of the tax treaty have effect:

- concerning taxes withheld at source, on income derived on or after 1 January 2017;
- concerning other taxes on income and taxes on capital, chargeable for any tax year beginning on or after 1 January 2017.

Amendment to the Double Tax Treaty between Austria and Liechtenstein

The Double Tax Treaty between Austria and Liechtenstein was amended by the Protocol Amendment published in 2017. Amendments to the tax treaty are mainly the following:

- Article 19 has been renamed to “Public Services” and the term “in exercising public functions” was deleted from Article 19 (1), following a decision of the Austrian Constitutional Court (V 41/2015-11), which repealed the regulation on Article 19 (1) in 2015. Such regulation stated that Article 19 (1) was to be applied to all employees of a contracting state or political subdivision in case the contracting state or political subdivision exercised public functions, irrespective of the activities performed by these employees.

- In the light of the OECD/G20 Base Erosion and Profit Shifting (BEPS) Project, a provision on the entitlement to benefits has been included in the tax treaty aimed at treaty abuse. Based on the new Article 26A, a benefit may not be granted if it is reasonable to conclude, with regard to all relevant facts and circumstances, that obtaining the benefit was one of the principal purposes of the arrangement or transaction that resulted in the benefit, unless granting the benefit is considered in line with the object and purpose of the provisions of the tax treaty.

- The provision on mutual agreement procedure (Article 25) has been redrafted, and an application for mutual agreement procedure can be made in either state (not only in the residence state of the taxpayer).

The Protocol entered into force on 1 January 2017. The amendment in connection with Article 19 (1) of the tax treaty is to be applied for tax years beginning on or after 1 January 2015. The other amendments are to be applied for tax years beginning on or after 1 January 2017.

Amendment to the Double Tax Treaty between Austria and Luxembourg

The Double Tax Treaty between Austria and Luxembourg was amended by the Protocol Amendment dated 7 July 2009 on the matter of exchange of information. A new amendment in this regard has been made in 2017 by Exchange of Notes between Austria and Luxembourg. The tax treaty should now be more in line with the OECD standard on tax transparency and exchange of information. The mentioned amendment entered into force on 1 March 2017 and applies for tax years beginning on or after 1 January 2011.

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Automatic exchange of information with Switzerland and Liechtenstein – changes based on AEI agreement

With the entry into force of the AEI agreement between Austria, Switzerland, and Liechtenstein, customer and account information of persons resident in Austria will in the future automatically be reported to the Austrian Federal Ministry of Finance (BMF) for tax purposes. The first reports for the year 2017 will be effected in 2018. Read more about which changes this brings for the so-far existing tax treaties with Switzerland and Liechtenstein.

General aspects

The tax treaties between Austria and Liechtenstein (in force since 1 January 2014, cf. our Newsletter of 30 January 2013) and between Austria and Switzerland (in force since 1 January 2013, cf. our Newsletter of 20 April 2012) were intended to secure the effective taxation of assets transferred abroad in the past as well as a current taxation of capital income of persons resident in Austria. They concerned natural persons who have an account or deposit with a Swiss or Liechtenstein bank. The tax treaty with Liechtenstein moreover comprised persons authorised to use transparent asset structures (foundations, trusts, or institutions with foundation-like character) as well as founders and persons entitled to contributions from non-transparent asset structures (non-transparent foundations, trusts or institutions).

Automatic exchange of information on financial accounts

The OECD Common Reporting Standard (CRS) obligates the participating countries to automatically exchange information about financial accounts and provides for increased cooperation of financial institutions in the contracting states. Financial institutions must determine the tax residency of their customers and report customer and account data of persons resident abroad to the local tax authority. The authority then forwards the information to the fiscal authority of the country of residence.

Until now more than 100 countries world-wide have committed themselves to implement the CRS standard.

Agreement between Austria and Switzerland

With the entry into force of the CRS agreement between the EU and Switzerland on 1 January 2017, which regulates the automatic exchange of information between Switzerland and the EU countries, the above-mentioned tax treaty between Austria and Switzerland dated 13 April 2012 (BGBI. III no. 192/2012) was fully repealed. As a consequence, since 1 January 2017 the former right to choose whether to subject one's assets to an anonymous withholding tax (analogous to the Austrian KESt) or to report them to the Austrian fiscal authority, does no longer exist. The first reporting of customer and account data under CRS will be effected in 2018 for the year 2017.

Agreement between Austria and Liechtenstein

The CRS agreement between Austria and Liechtenstein on the automatic exchange of information about financial accounts entered into force on 1 January 2017. The first exchange of data with Austria is planned for September 2018. Based on the thematic overlaps of the CRS treaty and the withholding-tax treaty dated 1 January 2014 (BGBI. III no. 301/2013) applicable until now, the following changes were agreed upon by the contracting states:

- Accounts and deposits of fiscally transparent asset structures existing until 31 December 2016 as well as accounts and deposits of fiscally non-transparent asset structures (foundations and trusts – independent of when they were established) are viewed as "exempted accounts" in terms of appendix 1 section VIII sub-section C no. 17 of the CRS agreement. These accounts continue to be subject to the withholding tax treaty, as long as the customer or economic owner is resident in Austria.
- At the same time, this agreement had the effect that taxation of contributions of non-transparent asset structures to beneficial owners resident in Austria was adjusted from 25% to 27.5%.

The unchanged provisions of the tax treaty continue to remain in force. This affects particularly the provisions concerning the foundation entrance tax and the provisions concerning the fiscal non-transparency of Liechtenstein asset structures.

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Austrian Supreme Administrative Court on the deductibility of due diligence costs

With its decision of February 2017 (Ro 2016/15/0006) the Austrian Supreme Administrative Court set the bar high for the immediate deductibility of due diligence costs

Decision

In its ruling the Court dealt with the question whether due diligence costs for the acquisition of a participation arising after signature of a letter of intent are directly deductible or need to be capitalized on the respective participation. Generally, starting from the point when the purchase decision was made, all costs paid to acquire the participation ("acquisition phase") need to be capitalized. Thus, pre-decision costs are directly deductible and post-decision costs need to be capitalized.

The relevant part of the decision are the remarks of the Austrian Supreme Administrative Court to the question at which point in time the purchase decision was made. According to the Court, in order to constitute a decisive event, the purchase decision only needs to be made on a rather general basis and does not have to be irrevocable. As an example the Court stated that actions supporting the selection between different investment decisions (such as market analysis or investment calculations for different alternatives) are deductible pre-decision costs; whereas reports that aim at determining the value or quality of the planned investment are post-decision costs. In the concrete case, the Court ruled that the purchase decision was made on a general basis when signing the letter of intent (which included a timetable for the further purchase process) and thus treated the subsequent due diligence costs as post-decision costs to be capitalized.

Implications

This generally means that due diligence costs are only deductible if the due diligence is aimed at preparing information for a potential investment selection between different alternatives and if the general purchase decision concerning a particular target has not yet been taken. Proper documentation of the purchase decision process is essential. However, whether due diligence costs are deductible needs to be analyzed on an individual case basis.

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Alienation of shares of a limited liability company with immoveable property in Austria according to the Double Tax Treaty ("DTT") Austria – Australia

The Federal Ministry of Finance recently published a letter ruling regarding the alienation of shares in an Austrian immovable property company by an Australian resident (EAS 3379 as of 10 April 2017).

In the underlying case an Australian individual holds a 14% stake in an Austrian limited liability company which owns immovable property in Austria.

The question arising was whether the alienation of shares of an Austrian company owning immoveable property falls under Article 13 (2) (a) (iii) of the DTT Austria – Australia.

According to Article 13 (2) (a) (iii) of the DTT in force, shares or similar participations in an Austrian company owning immovable property are taxable in Austria only in cases where the company's assets consist

- exclusively or
- mainly

of immovable property located in Austria. Article 13 DTT Austria – Australia requires not only a predominant ownership of immovable property (meaning more than 50%), but rather a principal or exclusive participation at the level of the company.

Therefore, Austria will not have a taxation right on the gains derived from the alienation of shares under

Art 13 DTT, if the immovable property located in Austria represents only 50% or slightly more than 50% of the company's value.

Moreover, Art 13 (4) DTT Austria – Australia is only applicable for alienations of directly held shares of a limited liability company.

The letter ruling indicates that if Art 13 of the DTT is not applicable, the gains from an alienation of shares would fall under Art 21 of the DTT and therefore be taxable in Austria.

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Indirect Taxes

Austrian Supreme Administrative Court on the economic link in VAT groups

In a recent decision, the Austrian Supreme Administrative Court dealt with the prerequisite of an economic link for the assumption of a VAT group.

In the case at hand, a taxable person ("GmbH") – whose shares are ultimately fully held by X-AG – acquired and renovated real estate, deducted input VAT in connection with this acquisition, and rented parts of it to a third party and parts of it to X-AG (both rental agreements treated as subject to Austrian VAT). In the course of a tax audit for GmbH, the input VAT deduction for the above acquisition was partly denied, as the tax auditor argued that GmbH and X-AG are both members of the same VAT group (sufficient financial, economic and organizational link). Therefore, transactions between these parties are not taxable, which consequently leads to the denial of the corresponding input VAT deduction for GmbH.

GmbH argued that the economic link between the parties involved (X-AG and GmbH) is not strong enough to assume a VAT group, as this link requires a certain economic hierarchy between the parties and a subordination of one party.

The Austrian Supreme Administrative Court referred the case back to the Tax Court to establish in more detail whether GmbH is a taxable person for VAT purposes. However, the Court briefly elaborated that – should the main task of GmbH be the provision of suitable premises to X-AG – the economic link was strong enough to form a VAT group, even if this rental agreement is not the only source of income for GmbH.

Though the final decision of the Court has to be awaited, this statement shows that this requirement could be met more easily in the future.

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Recent decision of the Austrian Supreme Administrative Court on the tax treatment of severance payments under the Double Tax Treaty Austria-Germany

In its decision of 23 February 2017 (Ro 2014/15/0050), the Austrian Supreme Administrative Court held that severance payments from a German limited company to a former German employee who became resident in Austria before the actual payment are subject to Austrian taxation.

Facts of the case:
A German employee decided to terminate his employment in July 2005. As compensation for his services, the parties agreed on a severance payment in the amount of EUR 1.5 million. The severance payment was made in March 2006. In the meantime the employee had moved from Germany to Austria. Thus, at the time of the actual payment in March 2006, the employee was already resident in Austria.

The question the Austrian Supreme Administrative Court had to answer was, which state is entitled to tax the severance payment in cases where the taxpayer moved from Germany to Austria before the actual payment.

Background of the Double Tax Treaty between Austria and Germany:
Under Article 15 para 1 Double Tax Treaty Austria-Germany, severance payments obtained by a resident of a contracting state are taxable in the state of residence only, unless the employment is exercised in the other contracting state (state of activity, i.e. Germany). Furthermore, Article 15 Double Tax Treaty Austria-Germany not only allocates taxing rights, but also aims to avoid double non-taxation. Thus, based on the subject-to-tax clause in Article 15 para 4 Double Tax Treaty, the residence state should have the taxation right in case the state of activity does not tax.

Regarding severance payments there is diverging jurisprudence in Germany and in Austria. The different allocation of the taxation right is based on a diverse opinion whether the employment is causally linked to the severance payment in the state of activity or not. From an Austrian tax court's perspective, the severance payment arises through the employment and is, thus, causally linked to the state of activity, whilst from a German tax court's perspective, the severance payment constitutes a compensation for the termination of employment, where an actual exercise is missing. The states' respective interpretations of Article 15 regarding severance payments would therefore have led to a double non-taxation of the severance payments.

In this regard, the tax authorities of both states agreed on a Memorandum of Consultation determining that the state where the employment was exercised has the right to tax severance payments. The Memorandum of Consultation is, however, non-binding. In fact, courts in both states remain with their reasoning in case taxpayers appeal. In the case at hand, the German Federal Fiscal Court in Munich decided for the allocation of the taxation right to Austria.

Decision of the Austrian Supreme Administrative Court:
From a tax treaty perspective, the Austrian Supreme Administrative Court held that at the time of the actual payment, Austria was the state of residence. As the severance payment was not taxed in Germany, in accordance with the subject-to-tax clause in Article 15 para 4 Double Tax Treaty the taxation right remains with the state of residence (i.e. Austria).

Regarding domestic law, the Austrian Supreme Administrative Court held that employment income becomes subject to Austrian income tax with the receipt of payment. The understanding that the receipt of payment is decisive for taxation is a new outcome, since it was generally understood that the facts in connection with a tax event should be overall decisive (whereas the receipt of payment would have merely indicated the timing of the cash transfer).

Implications and relevance of the decision for other cases:
The Austrian Supreme Administrative Court's decision outlines the relevance of the receipt of payment from Austrian tax law perspective. This is especially relevant for migrations to Austria where non-business income is transferred to Austria. Under domestic law, later payments (e.g. severance payments) might thus become subject to unlimited taxation in Austria.

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Austrian Tax Facts and Figures

Taxation of corporations

Corporate income tax rate (Basis – adjusted statutory accounts)	25%
Dividend withholding tax	27.5/ 25%
Witholding tax on licences/royalties	20%
Interest witholding tax	0%
Significant allowances	
Research & Development (R&D) (premium in cash)	12%

Non-deductible expenses (examples)	
Long-term accruals	3.5% per year
Interest and royalties paid to lowtaxed group companies	
Interest of debt-push down	
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 89 countries – mainly exemption method

International participation exemption for holding companies	
Conditions: Investments 10%, 1 year holding	
Dividends and Capital gains	0%
Dividend EC portfolio (shares) < 10%	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 tax cost
Foreign participations if EU-resident or third countries with comprehensive assistance agreement
Losses of foreign participations may be offset against profits of group leader up to 75%

Income in EUR	in 2017
0 to 11,000	0%
11,001 to 18,000	25%
18,001 to 31,000	35%
31,001 to 60,000	42%
60,001 to 90,000	48%
90,001 to 1,000,000	50%
above 1,000,000	55%

Social security on monthly earnings up to € 4,980			
Employer's share	up to 21.48%	Payroll related taxes	approx. 8.0%
Employee's share	up to 18.12%		
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 (Accommodation, art, cinema etc.)	13%
Reduced rate (Food, rent, public transportation etc.)	10%
VAT refund for foreign enterprises – available up to June 30 of the following year and for EU enterprises up to September 30 of the following year.	

Other taxes

Real estate transfer tax	0.5 – 3.5%
Stamp duties - Assignment agreements - Rent agreements - Suretyship agreements	 0.8% 1.0% 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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