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International Tax

Austria Tax Alert

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2014 tax reform enacted

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The Austrian legislature passed the 2014 tax reform act on 28 February 2014, just in time for some rules to become effective on 1 March 2014. The enacted bill reflects some changes from the draft bill circulated in January. (For details of the draft bill, see the alert dated 23 January 2014.) The following summarizes the major changes enacted by the bill that affect multinational businesses.

Capital tax

Capital tax will be abolished as from 1 January 2016.

Group taxation

Several changes are made to the tax group regime:

- **Foreign tax losses**: The tax group regime allows direct foreign subsidiaries of Austrian tax group members to be included in an Austrian tax group. As a result, tax losses of non-Austrian group members can be used temporarily in Austria, but the losses are subject to recapture and taxation in later years in the following cases: (1) they are utilizable or actually utilized in the foreign jurisdiction; (2) the foreign subsidiary ceases to be a tax group member or to exist at all; or (3) the foreign subsidiary's business is scaled down significantly.

  While this basic principle will remain in effect, as from 1 January 2015, total amount of foreign losses that can be used in a given year will be limited to 75% of the taxable income of the Austrian tax group members (including the Austrian head of the group). Foreign losses that cannot be used in a particular year will become part of the tax loss carryforwards of the head of the group.

- **Recapture of foreign losses and utilization of tax loss carryforwards**: Under the new rules, which also will apply as from 1 January 2015, income generated by the recapture of previously utilized foreign losses will be able to be fully offset against tax losses carried forward. These rules will replace the existing rules under which taxable income generated by the recapture of previously utilized foreign losses is subject to the general 75% limitation on utilizing tax loss carryforwards.

- **Foreign tax group members**: The tax reform act tightens the eligibility criteria for foreign members of an Austrian tax group. Specifically, only entities resident in the EU or in a country that has concluded a comprehensive mutual administrative assistance agreement with Austria will be eligible to be foreign group members. Group members resident in nonqualifying countries will retain this status until 31 December 2014, but membership automatically will terminate after that date. As a result, foreign losses previously utilized by the Austrian head of the tax group and not subject to recapture and taxation before 31 December 2014 will trigger recapture and taxation as of 1 January 2015.

  To mitigate the impact of this provision, income generated by the recapture will be allocated over three years, and the three-year minimum term for group participation will be deemed irrelevant for a foreign group member leaving the tax group. Taxpayers may be able to benefit from the abolition of the 75% limitation for offsetting income generated by the recapture and taxation of foreign losses, as mentioned above.

  The new rules also may have implications for Austrian group members partially owned via ineligible foreign group members.

- **Amortization of goodwill**: The amortization of goodwill for share deals is abolished for share acquisitions closing after 28 February 2014. Grandfathering rules may enable taxpayers to continue amortizing goodwill for share acquisitions that closed before 1 March 2014, but only if the target becomes a member of the group no later than the business year ending in calendar year 2015 and if the tax benefit achievable by the amortization could have affected the purchase price. According to the explanatory notes to the bill, the latter criterion will be deemed to be fulfilled if the purchaser could assume, without any doubt, that the acquisition would be eligible for the amortization of goodwill (which would have been the case for Austrian targets expected to become group members within a few years after acquisition).

Utilization of foreign branch losses

Austrian tax law permits a temporary utilization of foreign branch losses in Austria, even if an applicable tax treaty provides for the exemption method. As with the losses of foreign tax group members, a recapture mechanism applies.

As from tax assessment year 2015, the tax reform act tightens the recapture rules for branches located in jurisdictions that have not entered into a comprehensive mutual administrative assistance agreement with Austria. For these jurisdictions, branch losses previously utilized will automatically be recaptured after three years.

Grandfathering rules are provided for foreign branch losses incurred up to and including tax assessment year 2014. These losses are subject to automatic recapture in assessment year 2016, but the recapture amount will not be fully taxable in 2016; instead, the income will be spread over three years (i.e. from 2016 to 2018). The recapture rule also will not apply to losses incurred in business years ending before 1 March 2014 if the loss-making branch is sold or shut down by end of 2016. The grandfathering rules will not apply to the extent the losses would have been subject to recapture under the existing rules (e.g. if the foreign branch losses can be utilized in the foreign jurisdiction for tax assessment year 2016).

Restriction on deduction of interest and royalty payments

Under the tax reform act, Austrian tax relief no longer will be granted for intercompany interest/royalty expenses where the recipient is subject to a low tax jurisdiction or a special tax regime. Specifically, the deductibility of interest/royalty payments made to related parties will be disallowed if the payments are not "sufficiently" taxed or are not taxed at all at the level of the recipient. A tax rate of 10% at the level of the recipient will be considered sufficient for these purposes; this threshold applies to both the statutory tax rate and the effective tax rate. If the recipient is not the beneficial owner of the interest/royalties, taxation at the level of the beneficial owner will be determinative of whether the 10% threshold is satisfied. According to the explanatory notes, back-to-back structures, in particular, may give rise to questions about the identity of the beneficial owner.

The new law specifically targets the following situations:

- The recipient entity is not subject to taxation on its interest/royalty income;
- The recipient is subject to a statutory corporate income tax rate of less than 10%, or the domestic tax law provides for a specific tax regime resulting in a corporate income tax rate of less than 10% on interest/royalty income; and
- The recipient is subject to a statutory tax rate of 10% or more, but it benefits from special tax relief (e.g. partial tax exemption, notional interest deduction, IP box regime) and, as a result, the effective tax rate on interest/royalty income is below 10%.

The explanatory notes state that the rules should not apply if the recipient's effective tax rate is below 10% merely because it is in a loss position or is part of a tax consolidation that results in losses of other entities being attributed to the recipient entity.

Tax loss carryforwards are not specifically mentioned in the explanatory notes, and the wording of the notes could be read in a way implying that only current year losses should provide an exception to the 10% threshold. Although unofficial comments made by the leading senior executive of the Ministry of Finance indicate that the utilization of tax loss carryforwards should not prevent the effective tax rate test from being satisfied, the Ministry is likely to take a closer look at the origin of tax loss carryforwards and may, for example, take a strict approach where such carryforwards have resulted from special tax regimes for interest/royalty income.

The rules apply to interest/royalty expenses accruing after 28 February 2014, even if the underlying agreement was entered into before that date. The rules apply only if the borrower/licensee is a corporate taxpayer.

Withholding tax on interest

The tax reform act revises the interest taxation rules for nonresidents and introduces a new nonresident withholding tax on certain interest payments that are subject to withholding tax on capital income (*Kapitalertragsteuer* or KESt).

The new rules mainly target interest payments made to non-EU-resident individuals, but they also encompass certain interest payments made to nonresident corporations (both non-EU and EU resident). Austrian-source interest payments made to nonresident corporations under certain publicly issued

corporate bonds, therefore, may trigger withholding tax after 28 February 2014. Normal loans, such as intercompany loans granted by nonresident group companies to Austrian group companies, are not subject to the new withholding tax rules.

An exemption is provided for interest payments by debtors that are not resident, seated or effectively managed in Austria and are not an Austrian branch of a foreign bank. Individuals resident in the EU also are exempt from the new regime, as they already are covered by the EU interest taxation rules (and the corresponding withholding rules).

The rules will apply for interest accruing after 31 December 2014.

Long-term accruals

The tax reform act introduces new discounting rules for long-term accruals, i.e. accrued liabilities with a (remaining) term of more than 12 months. While the existing rules permit only 80% of such long-term accruals to be deducted for tax purposes, the new rules will consider the actual remaining term of the long-term accrual and will require the taxpayer to discount long-term accruals using an interest rate of 3.5% per annum.

The rules will apply to all business years ending after 30 June 2014. For accruals accounted for before that date, the new rules will apply only if they lead to a lower accrual for tax purposes, in which case the profit generated by the release of the accrual will be realized over three years to mitigate the effect.

Disallowance of deduction for certain personnel expenses

The tax reform act restricts tax-deductible expenses for salaries paid to employees, or to freelancers with a contract resembling an employment contract. Employers no longer are entitled to a tax deduction for the portion of an individual's salary exceeding EUR 500,000 per year. Similar rules apply to pension accruals, personnel leasing agreements and intragroup cross charges.

The new rules apply to all expenses incurred after 28 February 2014. Additionally, regardless of whether the EUR 500,000 threshold is met, the tax reform eliminates the deduction for certain "golden handshake" payments, if they are not mandatory severance payments or eligible for preferential tax treatment at the level of the recipient.

Disallowed interest on tainted loans

The tax reform act rewords and restructures the rules limiting the interest deduction for debt-financed share acquisitions from related parties. The new provision applies to corporate taxpayers and to interest expenses accruing after 28 February 2014. According to the explanatory notes to the bill, this provision targets tax planning structures where taxpayers try to avoid an interest deduction limitation by separating the acquisition debt from the shares through certain restructurings.

The revised language suggests that a loan obtained for a related party share acquisition remains a "tainted" loan (i.e. the interest on the loan will not be deductible), even if the shares have been separated from the loan through a restructuring or have ceased to exist due to that restructuring. Although not

addressed in the explanatory notes, the wording of the act suggests that a loan might remain tainted even after the shares acquired have been sold or have ceased to exist due to liquidation. It is unclear how the Ministry of Finance will interpret the law in the revenue guidelines that are expected to be released within the next few months.

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