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International Tax

Austria Tax Alert

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Draft of 2014 tax reform bill released

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Austria's Ministry of Finance circulated a draft bill for the Tax Reform Act 2014, which would introduce another austerity package, on 9 January 2014. No dates for parliamentary debate on the bill have been announced, but since certain proposed rules would become effective on 1 March 2014, the legislative process would need to be finalized in February to meet this deadline. The major changes for multinational businesses proposed by the bill are summarized below.

Capital tax

Capital tax would be abolished as from 1 January 2016.

Group taxation

Significant changes are proposed to the Austrian tax group regime:

- **Goodwill amortization:** The bill proposes to abolish the amortization of goodwill for share deals, which is available under the current group tax regime. This move seems to be a response to a recent decision issued by a lower fiscal court in Austria (which has been appealed to a higher court), in which the lower court found that the current group tax rules, which require a target company to be an Austrian tax resident, violate EU law. The court opined that all EU resident target companies acquired by an Austrian group member should be eligible for goodwill amortization under EU rules. By abolishing goodwill amortization for Austrian target companies, as well as for foreign companies, this discriminatory aspect of the rules would be avoided for future acquisitions.

  The abolition of the amortization of goodwill for share deals is proposed to apply to all share acquisitions that close after 28 February 2014. Grandfathering rules would apply to qualifying share acquisitions that took place before that date, but would entitle the taxpayer to continue amortizing goodwill only if the tax benefit achievable by the amortization could have affected the purchase price. It is unclear how this provision would be interpreted in practice.
- **Foreign tax losses:** Under existing rules, direct foreign subsidiaries of Austrian tax group members may be included in an Austrian tax group. As a consequence, ongoing tax losses of non-Austrian group members can temporarily be used in Austria, but the losses are subject to recapture

and taxation in later years if they are utilizable or actually utilized in the foreign jurisdiction; if the foreign subsidiary ceases to be a tax group member or to exist at all; or if the foreign subsidiary is no longer comparable in scale.

While this basic principle would remain in effect, the bill would limit the total amount of foreign losses that can be used in a given year to 75% of the taxable income of the Austrian tax group members (including the Austrian head of the group). Foreign losses that could not be used in a particular year would become part of the group head's tax loss carryforwards. These new rules would apply as from 2015.

- **Recapture of foreign losses and utilization of tax loss carryforwards:** Under existing rules, taxable income crystallizing upon the recapture of previously utilized foreign losses is subject to the general limitation on utilizing tax loss carryforwards. Under the general limitation, only 75% of a given year's taxable income can be offset by carried-forward tax losses. According to the bill, the 75% limitation would not apply to income generated by the recapture of previously utilized foreign losses. The new rule would apply as from 2015.
- **Foreign tax group members:** The bill would tighten the eligibility criteria for foreign group members of an Austrian tax group. Specifically, only foreign group members resident in the EU or in a country that has concluded a comprehensive mutual administrative assistance agreement with Austria would be eligible to become a foreign group member. Group members resident in nonqualifying countries would remain group members until 31 December 2014, but their membership would automatically terminate after that date. As a result, foreign losses previously utilized by the Austrian head of the tax group and not yet subject to recapture and taxation before 31 December 2014 would trigger recapture and taxation as of 1 January 2015.

  To mitigate the effects of this provision, income generated by the recapture would be allocated over three years, and the three-year minimum term for group participation would be deemed irrelevant for the foreign group member leaving the tax group. Taxpayers also would be able to benefit from the abolition of the 75% limitation for income generated by the recapture and taxation of foreign losses, as mentioned above. Apart from the recapture of losses for ineligible foreign group members, the new rules could have implications for Austrian group members partially owned via such foreign group members.

Utilization of foreign branch losses

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

The draft bill proposes to tighten 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 would be subject to an automatic recapture rule after three years. Grandfathering rules are proposed for foreign branch losses incurred up to and including tax assessment year 2012. For these losses, the automatic recapture amount would not be fully taxable in 2015, but would be spread over three years (i.e. 2015 to 2017). The grandfathering rules would 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 2012).

Long-term accruals

The bill proposes new discounting rules for long-term accruals, i.e. accrued liabilities with a (remaining) term of more than 12 months. While existing rules permit only 80% of such long-term accruals to be deducted for tax purposes, the new rules would consider the actual remaining term of the long-term accrual and would require the taxpayer to discount long-term accruals using an interest rate of 3.5% per annum. The new rules would be applicable to all business years ending after 30 June 2014. For accruals already accounted for before that date, the new rules would apply only if they lead to a lower accrual for tax purposes, in which case the profit generated by the release of the accrual would be realized over three years, in order to mitigate the effect.

Disallowance of deduction for certain personnel expenses

The tax reform bill would curb tax-deductible expenses for salaries paid to employees or to freelancers with a contract resembling an employment contract. The employer would no longer be entitled to a tax deduction for the portion of an individual’s salary exceeding EUR 500,000 per year. Similar rules would apply to severance payments, personnel-related accruals, personnel leasing agreements and even intragroup cross charges. The new rules would cover all expenses incurred after 28 February 2014.

Disallowed interest on tainted loans

The bill would slightly reword and reshuffle the rules limiting the interest deduction for debt-financed share acquisitions from related parties. This provision seems designed to eliminate tax planning structures where taxpayers try to avoid a limitation on an interest deduction by separating the acquisition debt from the shares by way of certain restructurings. The wording now proposed suggests that a loan obtained for a related party share acquisition remains a “tainted” loan (i.e. the interest on the loan would not be deductible), even if the shares have been separated from the loan by way of a restructuring, have ceased to exist due to that restructuring or have been sold. This provision would apply only to corporate taxpayers and to interest expenses accruing after 28 February 2014. However, given the rather unclear wording of both the statutory provision and the explanatory notes, it remains to be seen how this provision will develop.

Limit on deduction for interest and royalty payments

The tax deductibility of interest and royalty payments made to related parties would be limited if the payments (or the predominant part of the payments) are not subject to taxation at the level of the recipient. This test seems to specifically aim at situations where special tax regimes are available for interest and royalty income (e.g. where the recipient’s tax base is reduced by a notional interest deduction). The explanatory notes to the bill do not address whether a reduction in the tax base due to tax loss carryforwards or ongoing losses from other sources of income would trigger the clause, and the draft does not address payments to a member of a tax consolidated group where the income would be taxable in the hands of the tax group head, but not at the level of the receiving tax group member.

Additionally, the deduction for interest and royalty payments to a related party would be disallowed if the recipient enjoys a tax rate below 10%, and the deduction would be limited to 50% of the expense if the applicable tax rate is above 10%, but below 15%. The bill appears to refer to the statutory tax rate rather than the effective tax rate, but this is not explicitly addressed in the draft bill. Looking at the statutory tax rate, however, would be logical, considering that a borrower or licensee usually would have no means for collecting evidence of the effective tax rate of the lender or licensor (even if they are a related party). The statutory tax rate also is used for determining whether portfolio dividends are exempt; similarly, in those situations, the recipient usually is in no position to unearth the payer's effective tax rate. Despite these points, the further development of this clause should be monitored.

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

Withholding tax on interest

The draft bill includes an amendment to Austria's right to tax interest payments made to nonresidents. Most interest payments to nonresidents that currently are not subject to Austrian taxation would be subject to nonresident taxation under the new rules, typically in the form of a withholding tax. However, the language leaves room for different interpretations.

The Austrian tax authorities' estimate of additional taxes expected to be raised under the new provision suggests that the rules would apply only to payments made to individuals resident third countries. However, the proposed wording of the law is not clear, and could be interpreted to mean that it covers all interest payments to nonresidents (e.g. also foreign corporations resident in the EU or in third countries). Even though the implications of the measure may be mitigated by the provisions in an applicable tax treaty, relief at source would depend on additional criteria, such as sufficient substance at the level of the corporate lender. Given these uncertainties and inconsistencies, the further development of this clause should be closely monitored.

The new rules on which interest payments would be subject to taxation for nonresidents are proposed to enter into force as of 1 March 2014, with a grace period for withholding obligations granted until 1 July 2014 to enable financial institutions to set up their systems properly.

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