

SEPTEMBER 04

Overview of main changes in Austrian corporate tax law as of 2005

On May 6th 2004 the Tax Reform Act passed through the Austrian Parliament. This reform introduces some important changes for tax planning. It remains to be seen how the tax authorities will deal with the changes from 01.01.2005 on, when the Tax Reform enters into force.

1. Corporate tax rate

At present the corporate tax rate is 34 % in Austria. From 01.01.2005 on it will be reduced to 25 %. To avoid any abuse of the reduction, only profits which can be attributed to the

year 2005 will be subject to the reduced tax rate. This is of importance if the fiscal year differs from the calendar year. In this case profits can be determined on a pro rata basis or by setting up an interim balance sheet by 31.12.2004. The tax burden remains 25 % in case of accumulation of profits within the corporation. The distribution of profits by a corporation to its shareholders (if physical persons) is subject to a 25 % withholding tax. The following sample shows the current situation compared with the situation as it will be from 2005 on:

	until 2004	from 2005
Taxable profit	100,00	100,00
Corporation tax	- 34,00	- 25,00
Profit after corporation tax (= possible profit distribution)	66,00	75,00
25% withholding tax in the case of profit distribution	- 16,50	- 18,75
Profit after tax in the case of profit distribution	49,50	56,25
Total tax burden	50,50	43,75

2. Deduction of interests

In general costs related to tax-exempt income are not deductible. Until now interests paid for debt-financed acquisitions of participations have not been deductible either. In 2005 these interest payments will be deductible despite the fact that the income deriving from them is tax-exempt.

3. Income from (foreign) affiliated companies

Profits from an Austrian subsidiary are tax-exempt, if in the sphere of the parent company. To attain this effect also with a foreign subsidiary, the following conditions must be fulfilled:

- Austrian parent company
- holds at least 10 % of the share capital
- of a foreign subsidiary, which is comparable to an Austrian corporation
- during a minimum uninterrupted period of 1 year.

Capital gains at disposal of the foreign subsidiary are also tax-exempt despite the option of taxation in Austria. This option has the effect that losses upon disposal and allowable tax depreciation are also tax efficient.

Tax authorities may refuse the exemption method and switch over to full taxation in Austria, if

- the foreign subsidiary is subject to tax in an area of low taxation (average tax burden of max. 15 %) and
- the income of the subsidiary results particularly from

"passive income" (such as interests, licenses, know-how delivery, etc.).

4. Group taxation

Maybe the most significant structural measure of this tax reform is the replacement of the old restrictive group regulations dating back to the last century by a modern, economically attractive group taxation scheme. The key advantage of a group taxation scheme lies in the fact that legally independent corporations belonging to the same group of companies will be considered for tax purposes as one single entity with the consequence that profits and losses can be compensated within the group.

In the following we will just present the key points of the new group taxation scheme, which will be in force from 2005 on. It remains to be seen how the tax authorities will deal with the new situation, which is certainly a significant investment incentive in favour of Austria.

- A financial integration in the form of a (direct or indirect) participation of more than 50 % of the share capital in the case of a majority of voting rights will be sufficient for a group formation (before the new scheme a 75 % majority was required). Economic or organisational integration is no longer necessary. Also a profit/loss pooling agreement will not be necessary any more. Due to these changes also a financial holding can be parent company of the group.
- Also a more-than-one-parent-group will be possible from 2005 (especially important for joint-ventures).

As such, in the future also several companies at the top of the group may hold financial participations of more than 50 % in total. In this case, a main shareholder with a participation of at least 40 % is required. The other group parent companies must hold a participation of at least 15 % each.

- The group contract must provide for a binding group formation during at least three years and may determine the individual group members. First condition of group taxation is a so-called group request. Therefore, it is necessary to inform the tax authorities about the participation quota and the fiscal year of all group members. The group request has to be signed by the representatives of the parent company and all participating domestic companies. Upon these information tax authorities will decide by administrative ruling whether they grant the group advantages or not.
- The concept provides for a 100 % profit and loss attribution. If a parent company of the group only holds a participation of 60 % of a group subsidiary, also 100 % of the profits and/or losses will be attributed and not only a proportionate part.
- A group can also be formed jointly by domestic and foreign companies. This means that a domestic parent company of a group can make use of the losses of foreign subsidiary companies (not of profits, though) in accordance with the participation percentage. In case of future profits of the foreign subsidiary company, the domestic parent company will have to tax these profits to the extent of the losses deduced in the past. If the

group is built together with a foreign company, the shares of the foreign company must be held by the domestic parent company. Subsidiaries of foreign group member-subidiaries cannot be group members.

- If a participation in connection with the group formation is acquired after 31.12.2004, it is possible to amortise the goodwill included in the acquisition costs on a straight-line basis over a period of 15 years.

The goodwill has to be calculated as follows:

- Acquisition costs of participation
- minus proportionate equity capital of subsidiary company
- minus hidden reserves related to non-depreciable fixed assets
- basis (limited to 50% of acquisition costs)
- minus tax-effective amortisation

Result

The amortisable amount is limited to 50 % of the acquisition costs. In order to avoid abuses, acquisitions from ? group companies are excluded from goodwill amortisation. Goodwill amortisation is confined to directly held domestic participations. In view of the possible future goodwill amortisation, planned acquisitions of participations should be postponed to 2005. It has to be pointed out that amortisation of participations is tax neutral within the group, as the group parent company may directly make use of the losses of its group subsidiaries.

We hope that this introduction has given a useful overview of the forthcoming changes of Austrian corporate tax law. As mentioned before, the Austrian government has presented the tax reform as a milestone. It will be seen how far the tax competition within the EU will go in the future. For Austria the recent tax reform indubitably was a necessary measure for remaining competitive.

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