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BINDER GRÖSSWANG



Newsletter

New Austrian Participation Exemption

The Austrian participation exemption concept has been substantially changed by the legislator enlarging it to EU and certain EEA corporations with the goal to be consistent with Community law.

A. The New Concept

Following a ruling of the Austrian Supreme Administrative Court the Austrian Parliament passed an amended version of the Austrian participation exemption. The amended law is applicable for any corporate income tax assessment not yet completed as per June 18, 2009. It should be noted that the underlying ruling of the Administrative Court is currently questioned in the course of proceedings pending at the European Court of Justice following a preliminary ruling request by an Independent Fiscal Senate.

1. Categories of Participations

The new, or rather, the amended, participation exemption establishes seven categories of participations based on various criteria with different tax law consequences, respectively. Four of those categories are important (the remaining three categories cover particular participations in domestic corporations):

- participations in Austrian corporations ("No 1-Participations" according to their place of definition in Section 10 (1) No 1 Corporate Income Tax Act);
- participations in EU corporations, i.e. corporations listed in Schedule 2 of the EC Parent-Subsidiary Directive ("No 5-Participations");
- participations in corporations (i) that are comparable to Austrian corporations, and (ii) are located in a country of the European Economic Area (EEA) that concluded an agreement for purposes of administrative and enforcement assistance with Austria (currently only Norway) ("No 6-Participations"); and
- participations in any foreign corporations, i.e. inside or outside the EU or the EEA if (i) (a) comparable to Austrian corporations or (b) listed in Schedule 2 of the EC Parent-Subsidiary Directive, and if (ii) at least a 10% interest in the capital of the corporation is held for (iii) an uninterrupted period of at least one year ("No 7-Participations").

Note that only with respect to No 7-Participations the 10%-holding threshold and the one year holding period have to be fulfilled, as it was already the case under the old regime. The only new feature of the participation exemption is the tax exemption for No 5- and 6-Participations.

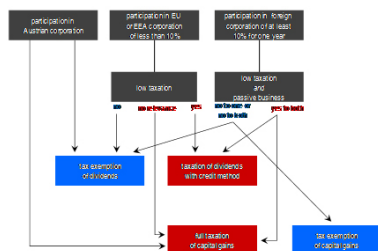
2. Tax Consequences

The tax law consequences with respect to the various categories can be summarized as follows.

- Dividends paid from Austrian corporations to Austrian corporate shareholders (i.e. dividends with respect to No-1 Participations) are tax exempt without the requirement to meet a certain holding threshold or holding period. Capital gains are fully taxable.
- Dividends paid from EU corporations and corporations of certain EEA countries (currently only Norway) to Austrian corporate shareholders (i.e. dividends with respect to No-5 and No-6 Participations) are tax exempt, also without the requirement to meet a certain holding threshold or holding period. Also in this context capital gains are fully subject to corporate income taxation.
- Dividends paid from foreign corporations, including EU and EEA corporations, to Austrian corporate shareholders or capital gains realized in that context are tax exempt if the respective participation amounts to at least 10% for an uninterrupted period of at least one year (No-7 Participations).
- The tax exemption regarding less than 10% participations in EU and certain EEA corporations (currently only Norway) (No 5- and 6-Participations) does not apply if, actually or nominally, low taxation or a tax exemption applies at the level of the foreign corporation, irrespective of what kind of business is pursued.
- The tax exemption regarding foreign participations of 10% or more (No 7-Participations) does not apply if low taxation applies and the business pursued by the respective company is passive.

In the two cases described in the last two paragraphs a switch from the exemption to the credit method applies according to which "foreign taxes underlying the respective dividends" are credited onto the Austrian taxation; the taxation basis in Austria is the dividend amount grossed-up by the respective underlying taxes. Creditable foreign taxes should, as under the old concept, cover (i) corporate income taxes paid by the distributing company or any of its direct or indirect subsidiaries as well as (ii) withholding taxes paid on the distribution itself or on any income and received distributions at the level of the distributing company or at the level of its direct or indirect subsidiaries. The law explicitly excludes the credit method with respect to capital gains.

A factual limitation to the tax credit is established by the requirement that any taxes to be credited have to be evidenced. Furthermore, corporate income taxes are only creditable if comparable to Austrian corporate income tax; turn-over taxes, value added taxes, registration charges and the like are not taken into account.



B. Critical Analysis

1. New Feature and Missing Feature

The only new, and at the same time tax beneficial feature of the new regime regarding the taxation of corporate participations relates to the taxation of dividends received from companies of the EU and from Norway (or, in the future, from other EEA countries if they enter into an agreement with Austria for purposes of administrative and enforcement assistance). It is striking that the taxation of dividends paid from countries outside the EU did not change although the free movement of capital also covers discriminations against non-EU members.

2. Further EC Law Inconsistencies

Secondly, it is not in line with Community law to impose a more restrictive tax measure aiming at the prevention of tax avoidance based on purely abstract conditions like 'low taxation'. Instead, such restrictive measures must only be imposed if a test that takes into account various circumstances arrives at the conclusion that wholly artificial arrangements were set up for the purpose of avoiding taxation. Another question is whether using the exemption method for domestic situations and the credit method for cross-border situations is discriminatory. To the rather academic discussion on this topic it may only be added that according to the ECJ a discrimination under Community law does not only occur if the tax burden of one situation is actually higher than that in another situation, but as soon as there is a mere chance that it might be higher.

3. Impracticability of the New Concept

Finally, it should be noted that for a portfolio investor the underlying taxes to be credited in Austria might not be determinable and, therefore, not creditable onto the dividend taxation at all due to practical reasons. Another obstacle to applying the credit method could be that in case of a loss situation at the level of the Austrian recipient of foreign dividends no foreign taxes are taken into account in that period, although the losses are decrease by the amount of dividends that are not generally exempt. Losses, however, should only be reduced by the amount of the distribution that would, if no losses were incurred, lead to Austrian taxation. These issues show a clear inequality between the exemption and the credit method and would not arise if the exemption method applied as it does in the purely domestic situation.

C. Conclusion

The new participation exemption regime offers more benefits than the old regime, since the tax exemption for dividends is extended to companies from most EU member states and to companies resident in Norway.

The switch from the exemption method to the credit method based on abstract criteria, however, is arbitrary and does - in our view - not conform to Community law in the context of less than 10% participations and, also, in the context of participations representing 10% or more of an interest.

The ruling of the ECJ on a preliminary ruling request of an independent fiscal senate that questioned the ruling of the Austrian Supreme Administrative Court is still outstanding and may render both the old and the new regime inapplicable due to a violation of EC law. Especially the different treatment of companies from countries outside the EU and the EU member states does not comply with the free movement of capital.

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