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Direct Taxes

Transfer Pricing Environment in Austria

Recent years have seen major developments in Austria in the area of transfer pricing. The following article gives a brief overview of transfer pricing in Austria and recent developments.

Although Austria has not yet implemented specific transfer pricing regulations intra-group pricing issues are getting more and more important. This is due to several factors: First, tax directors of multinational groups recognise that by means of transfer pricing the overall tax burden within the group can be efficiently reduced.

And secondly, multinational groups are becoming more and more aware of tax risk management. In this context transfer pricing aspects play an important role. Tax authorities are aware of the fact that transfer pricing is an efficient means to shift taxable profits to tax beneficial jurisdictions. They are well trained now and try to challenge transfer pricing policies. Though no specific transfer pricing audit is performed in Austria tax inspectors focus on related aspects in the course of ordinary tax audits. As a consequence, multinationals which have been ignoring transfer pricing matters successfully in the past, can no longer be complacent.

Transfer pricing framework in Austria

What are the cornerstones to be considered when dealing with transfer pricing in Austria?
Austria being a member of the OECD subscribes to the principles contained in the 1995 Guidelines on transfer pricing for multinational groups. As a consequence, the OECD Guidelines were established in Austria as an administrative decree. Although an administrative decree does not have the force of law, it is an important indication of the approach to transfer pricing which the Austrian authorities are likely to adopt.

Apart from this there are no statutory rules nor interpretative guidelines in Austria concerning transfer pricing. Statutory authority is found in the application of general legal concepts like substance over form, anti-avoidance regulations, the concepts of constructive dividends and hidden capital contributions. Furthermore related parties are supposed to structure their dealings on an arm´s length basis; i.e. in a way independent contractors would transact with each other.

Advanced pricing arrangements (APAs)

Contrary to other jurisdictions Austria has not yet established a formal procedure for obtaining an Advance Pricing Agreement (APA) with the Austrian Ministry of Finance. Under such APA criteria would be set to determine transfer prices for a fixed period of time. Such an arrangement may be unilateral involving one tax administration, bilateral or multilateral involving the agreement of two or more tax administrations. Since a formal APA is not available, a ruling might be obtained from the competent tax office on particular transfer pricing subjects. Such ruling is

not binding in a strict legal sense. In practice, however, it is followed by the tax authorities provided the full fact pattern has been presented as well as being consistently implemented in accordance with such representation. As regards legal aspects of transfer pricing subjects the Ministry of Finance offers the opportunity to raise questions and to request comments thereon from the Ministry (Express – Answering – Service; EAS). Even though these EAS-inquiries are not legally binding they provide guidance on the view of the Ministry as they are published in professional journals and are referred to in practice. In the past no significant cases have been processed through the Austrian Administrative Supreme Court regarding transfer pricing issues. However, the respective decisions of the Supreme Court in Germany can normally be used as a reference.

Burdon of proof

Basically, the burden of proof lies with the tax authorities. This means that tax authorities have to proof the incorrectness of tax returns when challenging them, not the other way round. Nevertheless, the taxpayer is obliged to cooperate, in particular in cross-border cases. This obligation is limited. According to Administrative Supreme Court decisions the tax authorities may not demand impossible, unreasonable or unnecessary information.

Transfer pricing methods

Though the OECD still favors the standard methods (comparable price method, cost plus and resale minus method) the importance of profit based methods (profit split and transactional net margins method) is increasing nowadays. This results from the fact that intellectual property is gaining relevance: for example, the profit split method is recognized as being appropriate if valuable intellectual property is involved in intra-group transactions. Furthermore profit based methods are preferablyapplied in bilateral and multilateral Advanced Pricing Agreements where complex mutual inter-company relationships have to be dealt with.

Value chain transformation (VCT)

Enterprises nowadays optimize value chains, centralize and outsource group functions not only for economic reasons but also because of their fiscal effects. In the course of implementing VCT structures functions are typically transferred to locations which offer lower cost for staff, infrastructure etc. This frequently goes along with lower tax rates and helps to reduce the group´s consolidated corporate tax rate. Based on recent experience of how tax authorities combat those VCT structures the new schemes are construed less aggressive from a tax point of view. For the same reason the new structures are equipped with more substance at those locations where the important functions and risks are moved to. The latter mirrors also a new view of the OECD, which suggeststo accept shifting profits for tax purposes, if commercial activities are transferred to the new location along with the associated risks and functions. A mere formal assignment of functions and risks would not be sufficient to achieve the intended impact for tax purposes.

Whereas in the past it has usually been manufacturing functions which have been relocated abroad, increasingly distribution and service functions are now moved to other jurisdictions. Generally, a substantial tax burden might be triggered by a shift of functions. This is particularly the case if intangibles (brands, marketing assets, technology etc.) are part of the transfer. New legislation in Austria, which is based on EU Courts´ decision, might offer opportunities to mitigate this tax consequence, if appropriate tax planning is applied.

The importance of documentation

Tax audits in Austria are increasingly focused on transfer pricing issues, although there is no specific procedure for a transfer pricing investigation. Instead, transfer pricing issues are part of a normal tax audit and it is getting more and more common that the tax inspectors request detailed information regarding the transfer pricing policy at the very beginning of the audit. The success of defending a transfer pricing policy in the course of a tax audit depends on having proper documentation. At present, there are no specific rules for transfer pricing documentation enacted in Austria. Reference can been made to the OECD Guidelines, Chapter V. In addition the documentation requirements as recently enacted in Germany will most likely have an impact on the Austrian tax practice.

Adequate documentation must cover at least an overview of the group structure, a description of the type and volume of intra-group transactions, the corresponding contractual agreements as well as a description of the transfer pricing policy (transfer pricing methods, mark-ups etc.) applied. In order to defend the chosen transfer price a functional analysis, taking into account assets (specifically intangible assets) used and risks assumed, is strongly recommended.

If the intra-group transactions are very complex, it is recommended that a transfer pricing study (including benchmarking) is carried out in order to evidence the transfer pricing policy. The advantage of such a study lies beside the higher probative value towards the tax authorities also in the fact that such study can form the basis for group tax planning with transfer pricing. Thus the defensive aspect of transfer pricing can be turned to a strategic opportunity.

Considering the environment for transfer pricing as outlined above and in particular the international developments, the Austrian legislation may have to adopt several changes in the field of documentation and in transfer pricing in general. In addition it is to be expected that the existing regulations and administrative decrees will be supplemented and / or replaced by law.

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Withholding tax relief-at-source

According to new legal regulation non resident recipients of dividends, royalties and other compensations can apply for withholding tax relief at source under certain conditions.

Compensation payments to non-resident persons are subject to Austrian withholding tax (hereinafter "WHT"). Almost all double taxation agreements provide for full or at least partial relief of WHT. Under the former regulations in many cases no relief at source could be achieved. A new ordinance, effective from 1 July 2005 improves the position of non resident taxpayers as the relief provisions of the double taxation agreement can be applied automatically and thus there is no longer a need to claim a refund. In some cases (e.g. royalty payments to non-operating entities) the new rules might replace the relief at source by the refund procedure. Compensation payments can be capital income (i.e. dividends, interest, donations by Austrian private foundations, etc.), certain other compensations (i.e. licence fees, fees to supervisory board members, artists, athletes, commercial and technical consultants, etc.) as well as wage payments.

The Austrian person paying such compensations can optionally provide relief at source of WHT if following documents are obtained from the foreign taxpayer:

- Certificate of residence (form ZS-QU1 for natural persons, form ZS-QU2 for legal persons)
- For legal persons only: Declaration that the business activities exceed mere asset management, and that the body has employees and office space.

If the annual payment to the non resident taxpayer does not exceed EUR 10,000 the certificate can be replaced by a written declaration from the foreign income recipient including the following information:

In case of natural persons
- First name and surname .
- Details of all their places of residence in foreign countries including details of their main place of residence/abode.
- Declaration that they have no additional residence in Austria.

In case of corporate recipients
- Precise firm name.
- Country of foundation and the place of effective management.
- Legal persons have to declare in addition that the income is not just 'passive' and that they employ staff and maintain premises. This supplementary declaration can be replaced by documented evidence, that within the last three years the Austrian authorities have refunded WHT regarding compensation payments to this specific person.

Additional declarations for individual and corporate recipients
- Declaration that the income does not form part of the business income of an Austrian permanent establishment owned by them.
- Declaration that there is no obligation to forward the compensation to other persons.
- Exact nature and amount of the compensation.

If the foreign income recipient is a non-resident, transparent partnership, the company name and address have to be declared. In certain cases relief at source is not permitted (i.e. suspicion of abuse, payment to non-resident foundations/trusts/investment funds, etc).

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Recent Changes in Austrian tax law

Recent amendments in Austrian tax law result in a number of significant changes for the Austrian taxpayer. In particular, the following issues are of interest:

1. Monthly EC Sales Listings

Currently, EC Sales Listings have to be filed on a quarterly basis by the end of the month following the respective reporting period or, if filed electronically, by the 15th of the second month following the reporting period (i.e. 15 days later).

From January 2006, taxable persons will have to file their EC Sales Listings on a monthly basis. The filing deadline is the end of the month following the month concerned. If the EC Sales Listings are submitted electronically, the filing deadline is extended to the 15th of the second month following the reporting month. Small-size businesses whose annual sales do not exceed EUR 22,000 and which therefore file VAT returns on a quarterly basis can continue to file their EC Sales Listings on a quarterly basis.

While the fiscal authorities expect this measure to enhance the screening of intra-Community movement of goods it is inevitable that this will result in an additional administrative burden for commercial activities in Austria.

2. New invoice data: VAT identification number of recipient

From July 2006, VAT invoices for supplies of goods or services exceeding the net invoice amount of EUR 10,000 must – in addition to the VAT identification number of the supplier - show the VAT identification number of the recipient if the supply is made by a taxable person established in Austria

to another taxable person. Until then, the VAT identification number of the recipient only has to be shown on the invoice in the case of supplies of services subject to the reverse-charge-system, intra-Community supplies and simplified triangulation supplies. The Austrian officials expect the new invoice data to enable a more efficient monitoring system against VAT fraud. However, at this stage it is neither apparent if and how the supplier is supposed to verify the VAT identification number of the recipient nor what consequences the declaration of an invalid VAT identification number will have on input VAT deduction.

3. Cross-border lease of passenger cars

If the leasing of passenger cars is subject to VAT in a country which grants VAT refunds to Austrian lessees, the Austrian lessee must self-account for Austrian VAT on the cross-border leasing of the vehicle. The Austrian VAT is not recoverable and represents a cost for the Austrian lessee. Although this provision was considered not to be in line with the 6th EC VAT Directive by the European Court of Justice in 2003, Austria has until now maintained the rule on self-accounting for VAT for cyclical economic reasons by authority of the EC VAT Commission. This highly criticised temporary measure has now been extended to December 31, 2007.

4. Research Incentives – Mission-orientated research

Up to the fiscal year 2004, business were granted a research allowance of 25 per cent (alternatively a premium of 8 per cent) of the expenses for research and experimental development activities if the research and development activities were carried out only by the business itself. Thus, small and mid-sized businesses were de facto excluded from these incentives. Starting with the fiscal year 2005, businesses can also take advantage of a research allowance of 25 per cent (or as an alternative of a premium of 8 per cent) of the expenses for research and experimental development activities assigned to particular institutions (e.g. to universities, the Austrian Academy of Sciences, etc.). This new measure is specifically intended to enable small and mid-sized companies to benefit from the research allowance (or premium) without having to carry out expensive research activities by themselves. To avoid a double claim of the incentive, the allowance (or premium) is only granted so long as the assigned institution does not claim the incentive for the identical research and experimental development activities itself.

5. Fiscal Penal Code tightened

In 2005, the maximum punishments for tax evasion exceeding the amount of EUR 500,000 and tax fraud committed by professional or organised means were raised to a five year prison sentence. Effective from January 1, 2006, the maximum threat of punishment for tax evasion cases exceeding EUR 3,000,000 will be raised to a seven year prison sentence.

6. Tax load on gambling

Up to August 2005, turnovers of gambling machines operated in licensed casinos were VAT exempt. Following the recent decision of the European Court of Justice on VAT exemptions for gambling and betting services, the Austrian VAT law now determines the general VAT liability of turnovers of gambling machines, regardless of being operated in a licensed casino or not. The new rule is retroactively applicable on the respective turnovers from the year 1999 onwards. To avoid possible double taxation, the general duty on gambling houses was retroactively lowered accordingly.

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Austrian Supreme Administrative Court ruling on base companies

Recently, the Austrian Administrative High Court („Verwaltungsgerichtshof“) had to rule on an interesting case concerning base companies. This ruling was focused on the abuse in respect to a dividend repatriation from an Irish IFSC company to an Austrian parent company. An Austrian company established two IFSC subsidiaries with no substance (no office, telephone, etc.) in Ireland. The IFSC companies were financed by an equity contribution which then was reinvested in Austrian interest bearing securities. The interest was taxed in Ireland at a rate of 10% and transferred from Ireland to Austria as a dividend. The Austrian parent treated the dividend tax exempt under the participation exemption.

Based on the above background, the Austrian Administrative High Court identified the two Irish subsidiaries as ‘letterbox’ companies and Ireland as a tax haven. Thus, the interest received by the Irish IFSC companies had to be allocated directly to the beneficial owner (i.e. the Austrian parent company), with the consequence that the interest has to be taxed at the (former) Austrian corporate income tax rate of 34%. Moreover, the court held that the absence of explicit anti-abuse regulations in the Double Tax Agreement between Ireland and Austria does not restrict Austria to apply its domestic rules on abuse.

Regarding abuse, the Austrian Administrative High Court applied the principles developed in earlier rulings. Abuse is assumed if a legal construction can be seen as inadequate and unusual in the light of the economic purpose, and if the transaction was only designed to save taxes. As a consequence, the interest has to be treated as if the IFSC structure had not been implemented. Unfortunately, the Court did not make any clear

arguments why the IFSC structure in the particular circumstances was within the definition of abuse. Nor did it further explain the definition of a 'letterbox' company and 'tax haven'. Therefore, the decision does not give clear guidelines in this respect for other comparable structures. Moreover, it has to be mentioned that the decision is in contrast to the legal practice of the German Fiscal High Court in respect to IFSC- companies which held, in similar circumstances, that no abuse can be assumed for such a legal construction.

However, the Austrian case, in contrast to the German case, relates to years prior to Austria's EU accession. So there is a justifiable argument that the decision of the Court could not apply to cases after Austria's EU accession in relation to EU base companies. A reason for such an approach can be found in the German Fiscal High Court decision. There the Court held that because the interposition of a domestic company will be never seen as abuse, the same must apply in a cross boarder situation. This argument may be explained in the light of ECJ case law and freedom of establishment also for Austria even in the absence of significant substance in the foreign base company. To be on the safe side, however, the foreign company should be furnished with adequate commercial substance to defend such structures before the Austrian tax authorities. In practice, Austrian tax inspectors look for own office space and employees of the foreign company when judging substance.

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Indirect Taxes

Electronic Invoicing – legal requirements finally clarified

The Austrian Ministry of finance issued administrative guidelines to specify the requirements for electronic invoicing. The guidelines provide clarification and practical guidance but also bear some surprises, such as the termination of input tax deduction based on invoices transmitted by fax.

Almost 18 months after the ministerial decree was issued, a lot of suggestions raised by industry have been incorporated and legally enacted. The tightrope walk between practical applicability and – partially exaggerated – concerns of VAT fraud seems to have worked well. According to the ministerial decree, the conditions for electronic invoices can be met in two different ways:

- by means of an advanced electronic signature, or
- by means of electronic data interchange (EDI).

Electronic signature

The most important provisions of the administrative guideline with regard to the electronic transmission of invoices by means of an advanced electronic signature are as follows:

- There is no specific form required how the receiver of the invoice must accept and affirm that he agrees to electronic invoicing. Tacit acceptance is considered as sufficient. In practice, we recommend including a special clause in framework contracts or in the general terms and conditions.
- Track Record: The process of the creation and electronic transmission of invoices must be traceable by the tax authorities within a reasonable period of time. The preparation of up-to-date process documentation respectively the amendment of existing standard software documentation is therefore obligatory.
- Signature power: Electronic invoices can either be signed on behalf of the company by an employee or by a third party. If invoices are signed by an employee of the company on its behalf a power of attorney should be granted. If specific parts of the electronic invoicing process are outsourced to a service provider, corresponding clauses should be included in the outsourcing contract.
- Automated procedures for mass data: The transfer of multiple invoices to one specific recipient with only one signature and the use of automated mass-signing procedures are explicitly permitted.

Electronic Data Interchange (EDI)

For invoices transmitted by way of EDI, an agreement between the parties involved has to be signed according to the Commission's Recommendation 1994/820/EC of 19 October 1994, ensuring the application of procedures that provide for authenticity of origin and integrity of data. If such a written agreement has not yet been set out (the administrative guidelines have not yet included this requirement), we recommend this is done as a matter of urgency. Summary invoices required in case of EDI can now be transmitted electronically if they are signed with an advanced electronic signature. This represents a major simplification for the integration of the process between supplier and customer.

Fax invoices will become obsolete

Starting on 1 January 2006, an invoice transmitted via fax (regardless of whether standard fax or computer fax) does not entitle the customer to input tax deduction unless a proper advanced signature can be attached to it. Thus, most common fax solutions no longer represent an appropriate method for invoicing.

Practical considerations

The administrative guidelines are a proper basis for a flexible and com-

pany-specific application of electronic invoicing. Invoices can also be provided in customer specific design on a secure web portal (Electronic Bill Presentment). It is also possible to send electronically signed invoices to the customer via e-mail. The signature can either be effected through a partially or fully automated mass-transfer procedure or on a single invoice basis.
Cost reduction using electronic transmission can be considerable. The greatest potential to reduce costs and to enhance effectiveness can be realized through comprehensive integration of the invoicing process between the supplier and the customer. However, advantages out of electronic invoicing cannot be fully taken as long as the preparation, transmission, verification and posting will be done without discontinuity in media.

Conclusion

On the basis of the administrative guidelines, various solutions for electronic invoicing are feasible. Nevertheless, the following question should be raised prior to implementation: Does my solution comply with all legal requirements, in particular with VAT law?

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VAT reclaim opportunity for non-EU telecom Co’s

The Austrian Administrative Supreme Court ruled that telecommunication services rendered by a telecom provide established outside the EC are not subject to Austrian VAT, when customers use their mobile phones in Austria.

The Austrian Administrative Supreme Court decided that Austria may not levy VAT on supplies of telecom services:

- rendered by a provider established outside the EC
- to its customers established outside the EC
- where these customers used a mobile phone in Austria.

The levying of Austrian VAT contradicts Art 9 of the 6th EC VAT Directive. An Austrian VAT Decree provides that the place of supply of telecom services, which would be outside the EC according to the general place of supply rules, is deemed to be in Austria if the telecom services are effectively used and enjoyed in Austria. The Decree was implemented based on Art 9 (3) (b) of the 6th EC VAT Directive in order to avoid non-taxation and distortion of competition.

The Austrian Administrative Supreme Court ruled that imposing Austrian VAT in the above-mentioned cases neither serves avoiding double taxation and non-taxation nor the distortion of competition and therefore contradicts Art 9 (3) (b) of the 6th EC VAT Directive.
Non-EC telecom providers (including accession countries‘ providers up to May 1, 2004), which had to pay VAT due under this decree, may apply for refunds of the VAT paid, subject to certain conditions.

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Austrian Tax Facts & Figures

Taxation of corporations

Corporate income tax rate (Basis – adjusted statutory accounts)	25%
Dividend withholding tax	25%
Witholding tax on licences/royalties	20%
Interest	0%
Significant allowances	
Research & Development (R&D) (Alternatively premiums in cash: 8%)	up to 35%
Learning & Education (L&E) (Alternatively premiums in cash: 6%)	up to 35%

Non-deductible expenses (examples)	
Long-term accruals	20%
Business meals	50%
Excessive car expenses for luxury cars	
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 68 countries – mainly exemption method

International participation exemption for holding companies	
Conditions: Investments >10%, 1 year holding	
Dividends	0%
Capital gains	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 cost
Losses of foreign participations may be offset against profits of group leader

Taxation of individuals

Individual income tax rate = Progressive rate	
below 10,000	0%
from 10,000 to 25,000	23.0%
from 25,000 to 51,000	33.5%
over 51,000	50.0%
after deducting personal expenses (limited)	

Social security on monthly earnings up to EUR 3,630	
Employer's share	up to 21.9%
Employee's share	up to 18.0%
Payroll related taxes	approx. 8.0%
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 (Food, rent, public transportation etc.)	10%
VAT refund for foreign enterprises – available up to June 30 of the following year.	

Other taxes

Real estate transfer tax	3.5%
Capital tax	1.0%
Stamp duties - Loan agreements	0.8%
Rent agreements	1.0%

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