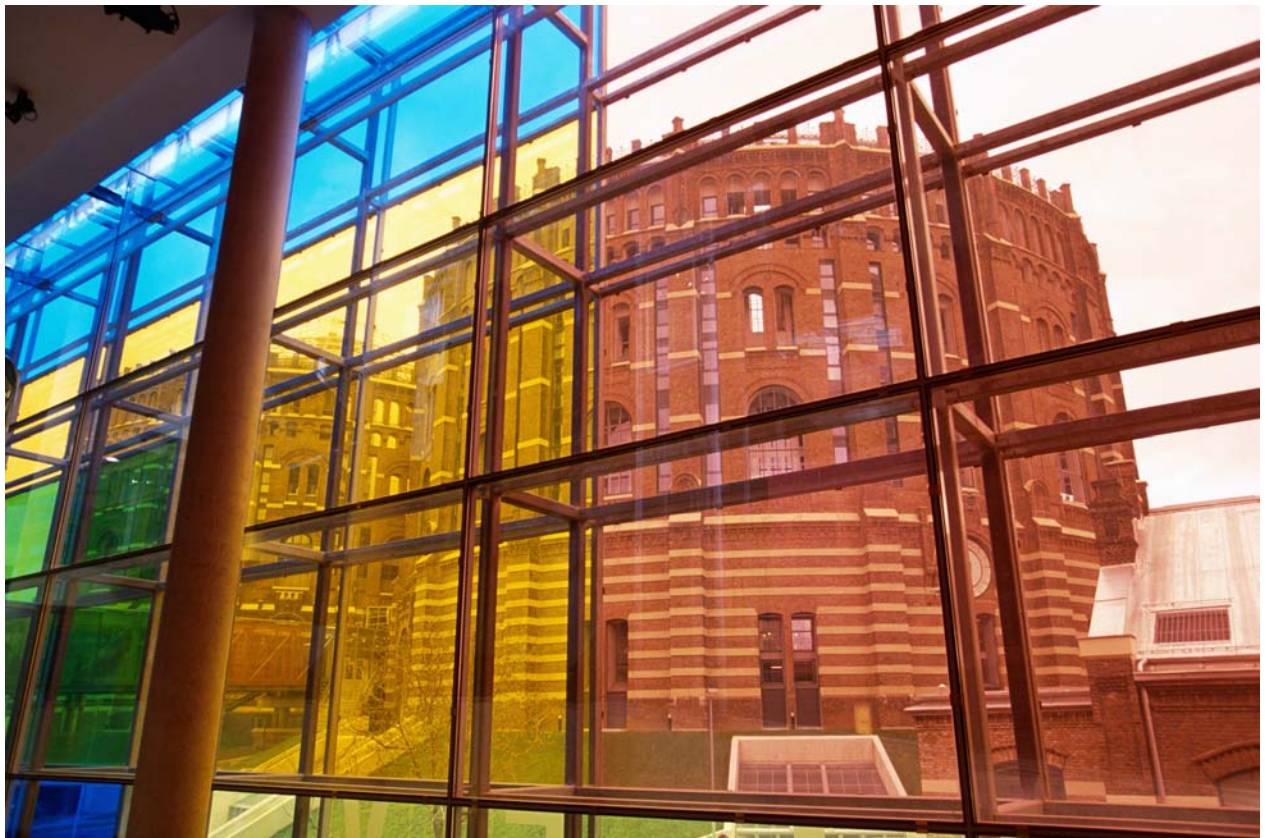


## Austrian Tax Reform 2005

increases Austria's attractiveness as a business location



The major tax reform 2005 offers a number of very interesting tax planning opportunities. Main aspects of the tax reform are the reduction of the Austrian corporate income tax rate to 25% and a new modern system of group taxation providing the possibility to offset profits and losses of group companies within Austria and cross border. The acquisition of companies in Austria becomes very tax efficient due to the possibility to deduct interest on the level of the acquisition vehicle and the depreciation of goodwill also in the case of a share deal. Austria's attractiveness as a business location will increase significantly, in particular for holding and headquarter companies. The new legal provisions will offer quite a number of interesting tax planning opportunities: group structures, transfer pricing concepts, M&A transactions and financing models should be reconsidered from a different perspective. Your PwC tax consulting team is looking forward to discussing the new options for your company.

The most significant changes are outlined below:

#### **Reduced corporate income tax rate of 25%**

The corporate income tax rate will be reduced from currently 34% to 25% from 2005 onwards. In the case of a deviating fiscal year (i.e. a fiscal year ending other than on December 31), the profit realized by December 31, 2004 will still be subject to the higher corporate income tax rate of 34% (This profit can either be determined on a lump-sum basis or based on an interim balance sheet as of December 31, 2004). The abolition of some tax benefits for corporations (roll-over tax credit, deemed interest on equity increases) is expected to have only an insignificant impact on the tax basis.

#### **New system of group taxation**

As a replacement for the existing "Organschaft"-concept a modern and attractive system of group taxation will be implemented. If two or more companies exercise the option to form a tax group, the taxable results of the domestic "group members" will be attributed to their respective parent company and will be taxed on the level of the "group parent". Tax losses of group companies can, thus, be consolidated with taxable profits of other group companies. Profits are only attributed for tax purposes; there is no requirement for a statutory profit/loss takeover agreement.

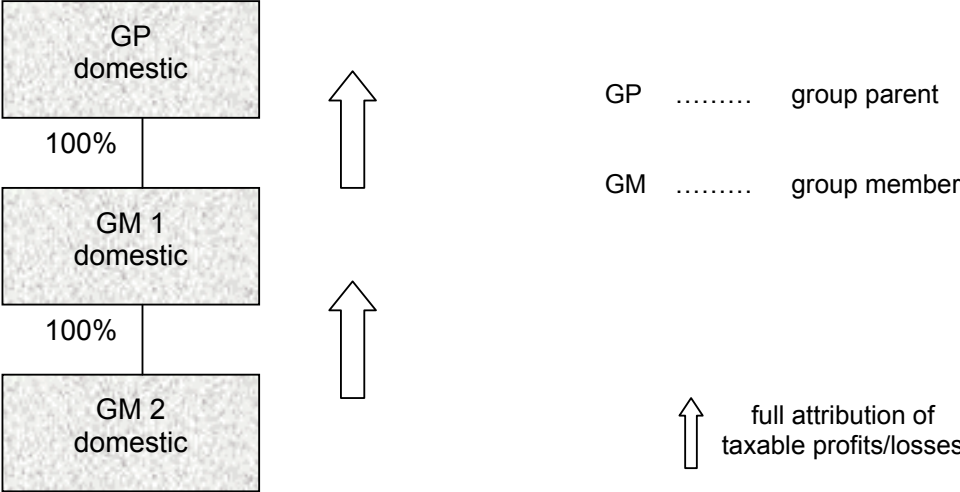
The following conditions have to be met in order to qualify as a tax group:

- a qualifying participation of more than 50% (directly or indirectly e.g. via a partnership) and
- a written application to form a tax group which has to be filed with the competent tax office and which has to include an agreement on the allocation of tax costs.

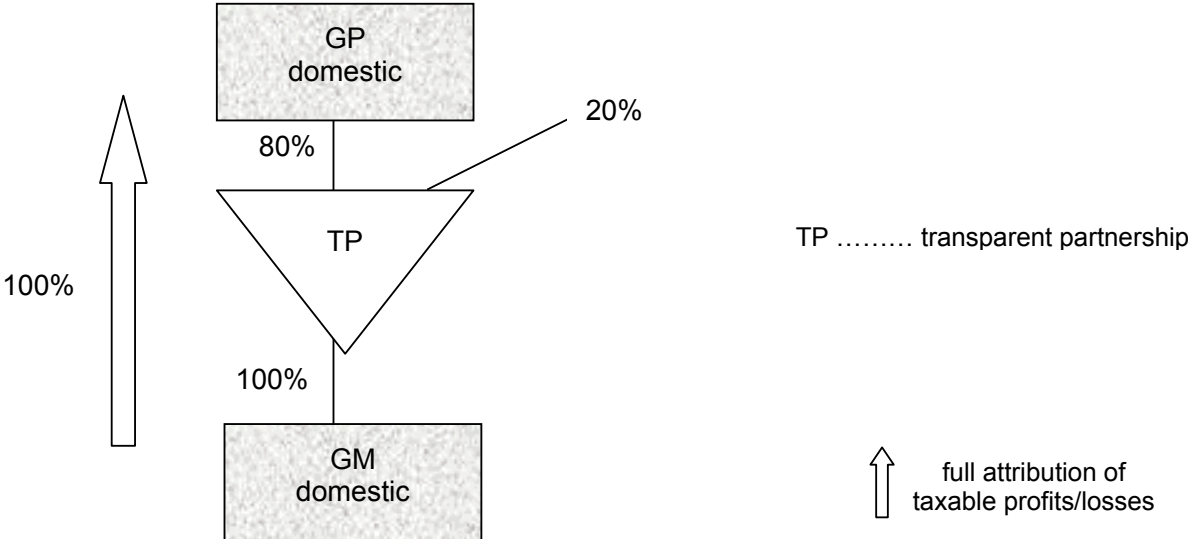
The cumbersome “Organschaft” restrictions of financial, economic and organizational integration will be abolished. In the future even mere holding companies without active business can participate in a tax group. Under certain conditions, groups with two or more parent companies may also be established, i.e. the tax group system will be useful for joint-venture structures as well. Also EU (or EEA) companies with registered branches in Austria may act as group parent.

Groups can for example be established as follows:

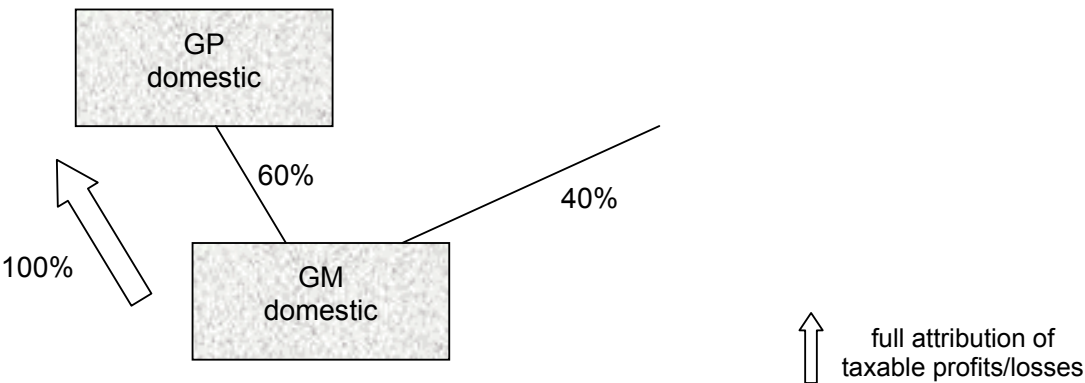
*Example 1:*



Example 2:



Example 3:



In the case of a domestic tax group, the attribution of income is effected at 100%, even in the case of existing minority shareholders (Only in the case of a tax group with more than one parent company, is a proportional profit/loss allocation applied). In order neither to advantage nor disadvantage minority shareholders, an appropriate system of tax allocations between the group companies has to be established.

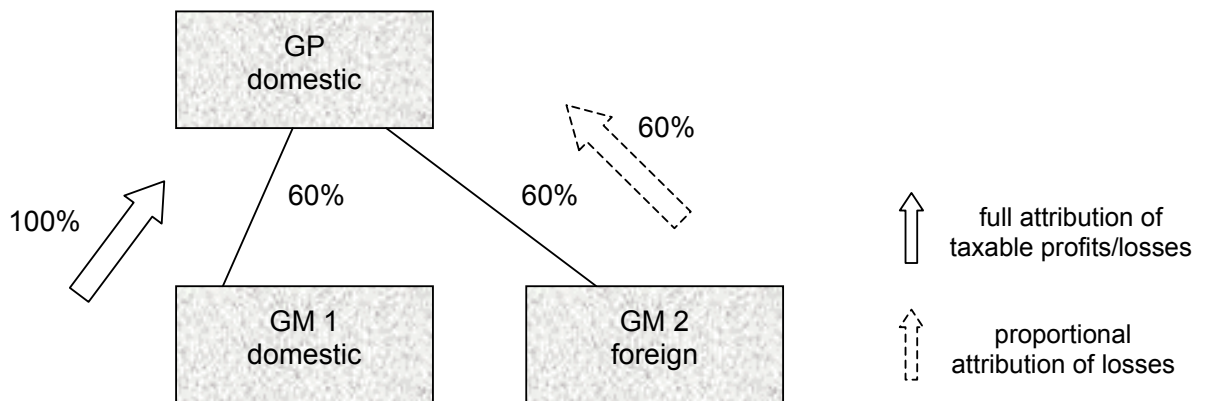
Depreciations of participations within a tax group are tax neutral.

The group taxation scheme will enter into force with the assessment 2005, i.e. it will already apply to deviating fiscal years ending in 2005. The qualifying participation must exist during the whole fiscal year during which the group taxation scheme shall apply.

**Foreign losses**

A tax group can also include foreign group members. Losses of foreign subsidiaries within a tax group can be used against Austrian profits (proportionally to the extent of direct participations held by group members). For this purpose the foreign losses have to be adapted so as to comply with Austrian tax provisions. Profits realized by foreign subsidiaries will not become subject to taxation in Austria.

*Example 4:*



Taxable profits/losses of the domestic GM 1 are attributed at 100% to the GP. Profits of the foreign GM 2 are not considered; losses are proportionally attributed to GP at 60%.

To the extent that foreign losses are used abroad at a later point in time (i.e. offset against foreign taxable profits) or if a foreign subsidiary leaves the group the tax benefit obtained from offsetting these losses against Austrian profits has to be refunded. This also applies in case of liquidation or insolvency of a foreign subsidiary. However, preceding (tax neutral) write-downs of

the shares in the foreign group member can be offset against the losses recaptured upon liquidation or insolvency.

Very similar rules apply to foreign permanent establishments. Whereas this was up to now only based on a court decision dating back to 2001, respective regulations have now been explicitly implemented into Austrian tax law.

### **Deduction of interest for the acquisition of participations**

Under current tax law, interest for the acquisition of participations can generally not be deducted. From 2005 onwards interest on loans taken out to acquire domestic or foreign participations will generally be tax deductible (as long as the arm's length principle is observed). Interest will be deductible regardless of whether the involved companies are part of a tax group or not.

### **Goodwill depreciation after the acquisition of a domestic participation**

Upon acquisition of a participation in an Austrian company after December 31, 2004 goodwill (including hidden reserves in depreciable assets) can be deducted tax effectively over a period of 15 years, if the following conditions are met:

- the acquired company must be engaged in active business;
- it must be resident for tax purposes in Austria;
- it must be a member in a tax group;
- acquisitions of participations from a related party are excluded.

The basis for goodwill depreciation is restricted to 50% of the total acquisition cost.

### **New tax planning perspectives**

- **Transfer pricing concepts** will have to be reconsidered:  
Due to the reduction of the corporate income tax rate the transfer of functions, risks and taxable profits to Austria can imply a reduction of the group's overall corporate income tax rate (transfer of central production and marketing functions to Austria, charging service fees to foreign subsidiaries, transfer of group financing functions etc.).
- **Headquarter companies, R&D centres etc.:** The low corporate income tax rate in conjunction with the benefits of the new group taxation system makes Austria very attractive

for multinational headquarters. Likewise, the very generous R&D allowance in conjunction with the low corporate income tax rate will be a strong incentive for multinational R&D centres.

- **M&A transactions** from Austria will become much more tax efficient.
- **Tax efficient timing 2004/2005:**  
The transfer of profitable transactions to 2005 can be tax beneficial. Expenses should be accelerated to 2004 from a tax planning perspective. However, certain capital gains from the sale of certain qualifying assets can be rolled over to newly acquired assets or allocated to a reserve only if the transactions are carried out before December 31, 2004.
- **Group structures** should be reconsidered, in order to make the most efficient use of the group taxation scheme. Also the group financing structure should be reviewed carefully with a view to new tax planning perspectives.

For more information please contact your Austrian International Tax Structuring Team

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