Austrian Asset Management News
Tax and Regulatory Reporting

Issue 5, March 2014

Decision of the Independent Tax Tribunal (ITT) on the qualification of foreign vehicles as investment funds for tax purposes

Editorial

Over the last couple of weeks, two rulings were published which state that some aspects of investment fund taxation within the last 10 years were not in line with EU law. With the implementation of the AIFMD in 2012, the discriminatory aspects mentioned were both removed from fund legislation by the Ministry of Finance and have put the discussion around tax discrimination to an end.

But at the same time, a new discussion arose around a newly introduced limited tax liability on interest for third country residents – which should also be applied by investment funds – fund taxation remains exciting!

Thomas Steinbauer

According to § 42(1) Austrian Investment Fund Act 1993 ("IFA 1993"), each foreign vehicle regardless of its legal form investing directly or indirectly based on risk spreading (six or more investments) is generally qualified as a foreign investment fund for Austrian tax purposes. In its decision of 21 October 2013, the ITT concluded that this provision is not consistent with the principle of the free movement of capital and therefore contravenes Article 40 of the EEA Agreement.

Background

In the present case an Austrian private foundation held 100% of the shares in two Liechtenstein corporations. Both corporations invested their whole capital in obligations, shares and precious metals.

The Austrian tax authority was of the opinion that the Liechtenstein corporations were to be treated as investment funds for Austrian tax purposes, as this form of investment corresponds to the principles of risk spreading according to § 42(1) IFA 1993. The qualification of a foreign corporation as an investment fund for Austrian tax purposes means that the corporation is treated in a tax transparent manner. Consequently the corporation's income, irrespective of whether it is distributed or accumulated, is taxable directly at the level of the Austrian investor.

In this issue

In the course of the transposition of the AIFMD into national law, the legal definition of Austrian and foreign investment funds was amended in order to comply with the principles of the free movement of capital.

As § 42(1) IFA 1993 was applicable to foreign vehicles only, an Austrian corporation investing according to the principles of risk spreading could not be qualified as an investment fund for tax purposes. Therefore, if the two corporations had been resident in Austria, distributions only would have been taxable, whereas at the level of private foundations these distributions would have been tax exempt according to § 10 of the Austrian Corporate Income Tax Act ("CITA"). The Austrian private foundation as appellant considered this as a discrimination of foreign corporations, as the exemption under § 10 CITA does not apply to investment funds.

The ITT's decision

The ITT concluded that § 42(1) IFA 1993 provides for an unequal treatment of Austrian and foreign corporations investing directly or indirectly based on risk spreading and allowed the applicant's appeal. The relevant tax authority filed a complaint against this ITT's decision with the Administrative Court.

Reaction of the Austrian Ministry of Finance

The Austrian Ministry of Finance was already aware of the unequal treatment of foreign and Austrian corporations investing based on risk spreading before the ITT's decision. Therefore, in the course of the transposition of the Alternative Investment Fund Manager Directive ("AIFMD") into national law in August 2013, the legal definition of Austrian and foreign investment funds was amended in order to comply with the principle of the free movement of capital.

According to the new provisions, which are now to be found in §§ 186 and 188 IFA 2011, each Austrian and foreign Alternative Investment Fund within the meaning of the AIFMD (exemptions apply to AIFs in real estate) as well as each Austrian and foreign UCITS fund are to be qualified as an investment fund for tax purposes irrespective of the legal form. Further, other foreign vehicles investing based on risk spreading and not subject to a tax comparable to Austrian corporate income tax are deemed to be investment funds.

In this context it should be mentioned that in 2013 the ITT had to decide on a further discrimination in the area of investment fund taxation, which has meanwhile also been eliminated: Under the old tax regime capital gains realised by an Austrian investment fund were not taxable as deemed distributed income on an annual basis, if the fund units were held as business assets. In case of foreign investment funds, however, realised capital gains had to be taxed annually. From funds' financial years beginning in 2013 realised capital gains are taxable as deemed distributed income annually irrespective of whether the investor holds units in an Austrian or foreign investment fund.

Author:
Johannes Edlbacher
johannes.edlbacher@at.pwc.com
+43 1 501 88-3627

Extension of the limited tax liability on interest income

On 28 February 2014 the Tax Amendment Act 2014 was published in the Federal Legal Gazette. The Tax Amendment Act 2014 provides, inter alia, for an extension of the limited tax liability on Austrian interest income (i.e. Austrian interest income received by non-Austrian residents will under certain circumstances be subject to 25% Austrian withholding tax from 2015). This extension could also have an impact on investment funds, as described below.

1. Under which circumstances will interest income received by non-Austrian residents be subject to Austrian withholding tax?

Interest income within the meaning of the Austrian EU Withholding Tax Act received by individual or corporate investors who are not resident in Austria will be subject to limited tax liability in Austria under the following circumstances:

- The debtor of the interest income must be resident in Austria (i.e. the interest income is derived from Austrian debt securities or from cash deposits with an Austrian bank) and
- the interest income must be paid to the investor via an Austrian depositary bank and
- the interest income must not be subject to 35% EU withholding tax (interest income is subject to EU withholding tax if the interest income is paid to individuals who are resident in an EU Member State other than Austria).

If any one of these requirements is not fulfilled, the investor is not subject to limited tax liability in Austria. If, however, all criteria are met, then Austrian depositary banks are under an obligation to deduct 25% Austrian withholding tax.

Examples:

- An individual investor subject to unlimited tax liability in Germany holds Austrian bonds in a deposit with an Austrian bank: As the interest income is subject to EU withholding tax, Austrian limited tax liability does not apply.
- A corporate investor subject to unlimited tax liability in Germany holds Austrian bonds in a deposit with an Austrian bank: Under these circumstances the interest income is subject to 25% Austrian withholding tax (debtor is resident in Austria, interest income is paid out by Austrian depositary bank, EU withholding tax does not apply).
- An individual investor subject to unlimited tax liability in the US holds German bonds in a deposit with an Austrian bank: The interest income derived from the bond is not subject to limited tax liability as the debtor is not resident in Austria.
- An individual investor subject to unlimited tax liability in the US holds Austrian bonds in a deposit with an Austrian bank: The interest income derived from the bond is subject to 25% Austrian withholding tax (debtor is resident in Austria, interest income is paid out by Austrian depositary bank, EU withholding tax does not apply).
- An individual investor subject to unlimited tax liability in the US holds Austrian bonds in a deposit with a bank in the US: As the interest income is not paid out by an Austrian depositary bank, it is not subject to Austrian withholding tax.

2. When will the limited tax liability come into force?

The extension of limited tax liability in Austria and the related obligation for Austrian depositary banks to deduct Austrian 25% withholding tax will come into force on 1 January 2015.

3. What might this mean for foreign investment funds?

As shown in the following example, the impact of the extension of the limited tax liability on foreign investment funds remains unclear:

A SICAV in Luxembourg is invested in Austrian bonds. Shares in this SICAV are held by an individual investor subject to unlimited tax liability in the US in a deposit with an Austrian bank.

Step 1 – Interest income is paid to the fund
Our understanding is that the interest income paid to the fund should not be subject to limited tax liability as it is not paid out via an Austrian depositary bank.

Step 2 – Taxation of the interest income received by the US investor
As investment funds are considered to be tax transparent according to Austrian tax law, we understand that the interest income from the Austrian bonds should be subject to 25% Austrian withholding tax (interest income paid out by Austrian depositary bank, EU withholding tax does not apply).

To enable Austrian banks to deduct the 25% Austrian withholding tax in this case, a separate calculation and reporting of the Austrian interest income would be required.

So far, the Austrian Ministry of Finance has not taken a clear stance on this issue.

4. Further discussions

The Austrian fund industry will demand clarification on the impact of the extension of limited tax liability on foreign investment funds. We will keep you informed on any further developments.

Author:
Constantin Alexander Vana
constantin.a.vana@at.pwc.com
+43 1 501 88-3561

Who we are and how our Asset Management team can assist you

We are the Austrian market leader with regards to the tax representation of foreign funds in Austria. Thus, our clients are benefiting from our extensive experience with the calculation of the annual DDI and distribution figures as well as the reporting process itself.

This includes also support with the implementation, analysis and testing of technical tax and regulatory reporting requirements for funds and fund management companies.

We use high-end technical infrastructure for data processing and have a dedicated team of eight senior staff and about six junior level staff to support you with your business challenges. Since two year's we have broaden our service with a separate Consulting branch, also working closely together with the Asset Management team of PwC Germany.

Our Asset Management Consulting services include transformation and distribution services, clearing, depositary and custodian issues, portfolio and collateral management as well as regulatory consulting.

Our Asset Management Team

Thomas Steinbauer Asset Management Tax Leader Partner, Tax	+43 1 501 88-3639	thomas.steinbauer@at.pwc.com
Johannes Edlbacher Senior Manager, Tax	+43 1 501 88-3627	johannes.edlbacher@at.pwc.com
Isabella Prock Manager, Tax	+43 1 501 88-3424	isabella.prock@at.pwc.com
Stefan Perklin Manager, Tax	+43 1 501 88-3735	stefan.perklin@at.pwc.com
Johanna Schaller Manager, Tax	+43 1 501 88-3635	johanna.schaller@at.pwc.com

PwC Austia
Erdbergstraße 200, 1030 Vienna
www.pwc.at

Copyright and Publisher: PwC Österreich GmbH Wirtschaftsprüfungsgesellschaft, Erdbergstraße 200, 1030 Vienna, Austria
Editor: Thomas Steinbauer, thomas.steinbauer@at.pwc.com
Distribution: Carola Soto Vallejos, please send an e-mail to carola.soto.vallejos@at.pwc.com to subscribe or unsubscribe to this newsletter