Austrian Asset Management News Tax and Regulatory Reporting

pwc

Issue 6/7, August 2014

Editorial

Dear Clients,

We would like to give you an update on recent developments in Austria.

Over the last couple of months, more and more clients have been requesting distribution reporting from us in order to optimise the tax base for their investors. In order to understand the advantages of this reporting we are happy to provide you with a brief overview about the recent changes to distribution reporting. We are happy to discuss the impact of distribution reporting in more detail with you.

Further, the Austrian Ministry of Finance has announced that the application of the new reporting regime will be postponed by another year as the preparation and implementation work took longer than expected.

I wish you a nice remaining summer,

Thomas Steinbauer

Decision of the Federal Fiscal Court (FFC) on the taxation of an investment fund's accumulated realised capital gains

From an Austrian tax perspective, investment funds are considered transparent. Therefore, the fund's income is to be allocated directly to its investors and taxable regardless of whether the income is distributed or accumulated. While distributed income is taxable at the time of distribution, accumulated income is deemed to be distributed once a year. Accumulated income, referred to as "deemed distributed income" (DDI), is therefore taxable once a year. The fund's taxable income generally consists of interest income and dividend income less expenses as well as realised capital gains/losses.

As regards fund shares held as business assets, the following applied in the past: Only in the case of foreign funds were the fund's accumulated realised capital gains deemed to be distributed on an annual basis. Thus, in the case of foreign funds accumulated realised capital gains were taxable as DDI on an annual basis, whereas in the case of domestic funds realised capital gains were taxable only at the time of distribution or sale of the fund shares.

In this issue

In the present case the appellant invested in an Austrian investment fund, which in turn held shares in foreign investment funds (target funds). The appellant did not tax the foreign target funds' accumulated realised capital gains as DDI. In course of a tax audit this was ascertained as incorrect. The FFC considered the unequal tax treatment of foreign and domestic fund shares held as business assets as a violation against the principle of free movement of capital and allowed the applicant's appeal.

The Austrian Ministry of Finance was already aware of the unequal treatment of foreign and Austrian investment funds held as business assets before the FFC's decision. Therefore, in 2010, when the taxation of income from capital assets was reformed (introduction of the capital gains taxation), the taxation of the DDI was also amended accordingly in order to comply with the principle of free movement of capital. Consequently from funds' financial years beginning 2013, the accumulated realised capital gains are also taxable on an annual basis in the case of domestic fund shares held as business assets.

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Distribution reporting – Significantly lower taxation of Austrian investors possible

In general, distribution reporting ensures that only the taxable parts of a distribution are taxed at investor level. If a distribution is not reported to OeKB, the Austrian depository bank withholds 25% KESt on the total distribution amount received by the investor. Recent changes in Austrian tax law mean significantly lower taxation of Austrian investors in the case of distributions.

Recent changes in Austrian tax law

In the past, omitting distribution reporting was not so problematic as long as only ordinary income was distributed to the investors (distributed ordinary income was fully taxable).

Due to recent changes in Austrian tax law, from now on equalisation has to be considered on all income portions as well as on realised capital gains and losses in the course of the calculation of the Austrian tax figures. In addition, realised capital losses can now also be offset against positive ordinary income. After several discussions with the Austrian Ministry of Finance, this offset method also applies in the course of distributions. Thus, the Austrian tax base of distributions can be reduced to a minimum in a number of situations through a detailed calculation performed by the Austrian tax representative, especially if the fund distributes ordinary income and generated realised capital losses from the sale of securities during the financial year.

Benefits when distribution reporting is carried out

If not all parts of the distribution are taxable and distribution reporting is carried out, these parts are not taxed, and lower the investor's acquisition costs in respect of the capital gains taxation. Consequently, the Austrian investor benefits from lower taxation in the course of a distribution. This generally may lead to either a shift of taxation (timing difference) or a permanent difference of taxation compared to the situation where no distribution reporting is carried out.

Timing difference
If no distribution reporting is carried out and the KESt withheld on a distribution is too high, the KESt on the annual deemed distributed income (DDI) is accordingly lower. Therefore, a too high tax on a distribution should generally result in a shift of taxation only.

Permanent difference
If no distribution reporting is carried out and the KESt withheld on the distribution exceeds the KESt on the whole of the generated taxable income, this leads to a negative KESt on the DDI. As Austrian depository banks do not refund a negative KESt on the DDI, Austrian individuals suffer too high taxation on their total annual fund income.

Benefits for grandfathered fund unit's holder
In respect of capital gains taxation in Austria, all fund units purchased before 1 January 2011 are grandfathered. As for all Austrian investors it is possible that the distribution is subject to a lower tax deduction if distribution reporting is carried out. Further capital gains from the sale of fund units are tax free due to the grandfathering. For this reason, reducing the investor's acquisition costs in the course of distribution reporting does not lead to a higher taxation when selling the fund units. Thus, distribution reporting leads to a permanent tax advantage for the Austrian investor.

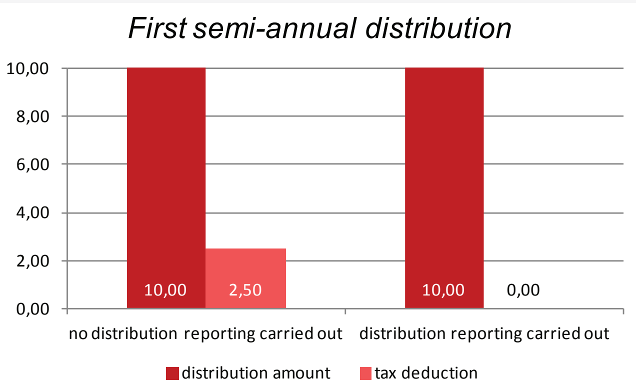
According to a market survey, more than 80% of fund units held by Austrian investors are grandfathered. It is therefore very important to carry out distribution reporting in order to ensure the best tax treatment for Austrian investors.

Example
In the case of a semi-annual distributing fund the following taxation applies for both cases (distribution reporting is carried out / is not carried out):

Permanent difference – Distributions

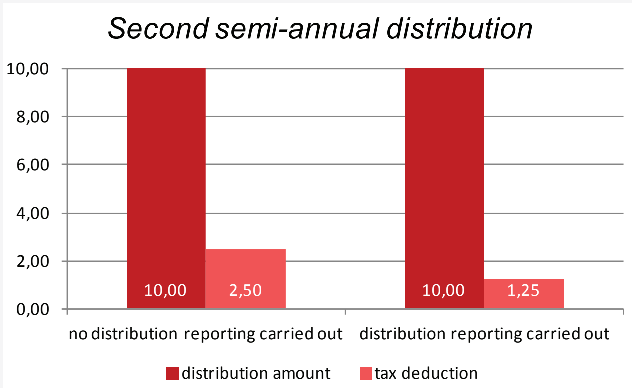
First semi-annual distribution	
Ordinary Income	10.00
Realised gains/losses	-20.00
Realised losses carried forward	0.00
Total tax base	-10.00
Distribution amount	10.00

	distribution amount	tax deduction
no distribution reporting carried out	10.00	2.50
distribution reporting carried out	10.00	0.00



Second semi-annual distribution	
Ordinary Income	10.00
Realised gains/losses	5.00
Realised losses carried forward	-10.00
Total tax base	5.00
Distribution amount	10.00

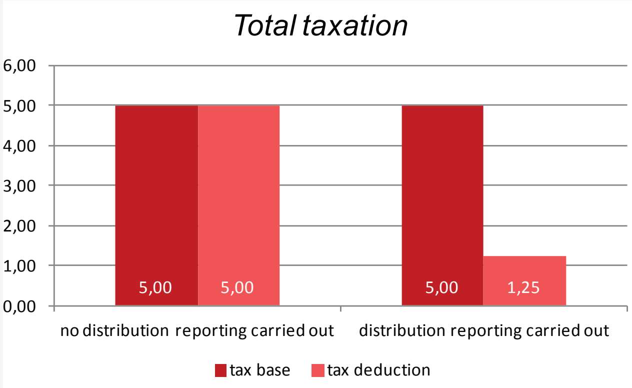
	distribution amount	tax deduction
no distribution reporting carried out	10.00	2.50
distribution reporting carried out	10.00	1.25



The unfavourable taxation in case no distribution reporting is carried out leads to the following permanent tax difference for Austrian investors:

Total annual fund income	20.00
Realised gains/losses	-15.00
Total tax base	5.00

	tax base	tax deduction
no distribution reporting carried out	5.00	5.00
distribution reporting carried out	5.00	1.25



Your line of action for the future

Do you have distributing share classes, registered as reporting funds in Austria, which currently do not report distributions to OeKB? If so, please feel welcome to get in touch with us. We will review the tax impact of the non-reporting of the distributions and can set up a reporting process in order to ensure Austrian investors do not suffer tax overpayment.

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Update on changes in the fund reporting regime

As already announced, the Austrian Ministry of Finance intends to publish a new fund reporting ordinance which is to harmonise tax reporting for domestic and foreign investment funds.

Expected changes in reporting mainly trigger consequences for the calculation and reporting process on the part of the Austrian tax representative. However, it could be necessary that the fund administrator will have to provide more detailed information on dividend and interest income received.

Background to the harmonisation

In contrast to foreign funds, in the case of domestic funds numerous details on the fund's income, such as:

- dividend and interest income per country,
- refundable and creditable withholding taxes, etc.

are published. The publication of these details creates the possibility for specific Austrian investors (especially corporate investors) to lower their tax burden.

The harmonised reporting regime will also give foreign funds the opportunity to make more detailed tax figures available to their Austrian investors within the general reporting process with the Oesterreichische Kontrollbank (OeKB).

As your tax representative, we are responsible for calculating and reporting these income details, and we understand that the implementation of the new reporting regime is preliminarily a matter for the Austrian tax representatives.

Entry into force of the harmonised reporting regime

Initially, the harmonised reporting regime should have been applicable to funds' financial years beginning in 2013, however its entry into force was postponed by one year.

By mid-July this year, a draft amendment to the current fund reporting ordinance had been issued by the Austrian Ministry of Finance. This draft amendment also includes the postponement of the entry into force of the new reporting regime again by one year. Thus, the harmonised reporting regime is to be applicable to funds' financial years beginning in 2015. In respect of the general annual tax calculation, initial reporting to OeKB will be done in April/May 2016.

These final amendments to the current fund reporting ordinance are, according to the Ministry of Finance, to be published in August/September 2014. With regard to the new fund reporting ordinance, we do not expect a draft to be issued before 2015. As always, we will keep you informed about any developments and the implications they will have.

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Update on the extension of the limited tax liability on interest income

In our previous newsletter we informed you about the extension of the limited tax liability on interest income in the course of the Tax Amendment Act 2014, which was published in the Federal Legal Gazette on 28 February 2014.

The new regulation provides for interest income
• derived from Austrian debt securities or cash deposits with an Austrian bank and
• paid via an Austrian depository bank

to be subject to 25% Austrian withholding tax ("foreigner WHT") if
• the beneficial owner of the interest paid is not resident in Austria and
• if the interest income is not 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).

What are the impacts on investment funds?

As investment funds are considered to be tax transparent according to Austrian tax law, the interest income from Austrian debt securities held by investment funds is generally subject to the "foreigner WHT" if the fund shares are held by non-Austrian investors in a deposit with an Austrian bank (insofar as EU withholding tax does not apply).

According to the latest discussions with the Austrian Ministry of Finance, interest income from Austrian debt securities held by an investment fund is not to be subject to the "foreigner WHT" if the investment in Austrian debt securities is less than 15% (in the case of distributing funds) or 25% (in the case of accumulating funds) of the fund's total net assets. In light of these percentage limitations, foreign investment funds should therefore generally be out of scope for the "foreigner WHT".

Reporting obligations

The Austrian Ministry of Finance recently published a draft on the amendment of the Fund Reporting Ordinance, which provides for an OeKB reporting of interest income from Austrian debt securities on a daily and annual basis as well as in the case of distributions in order to enable Austrian depository banks to deduct the "foreigner WHT" accordingly. If these reporting obligations are not fulfilled, a lump-sum "foreigner WHT" is to apply.

According to the draft on the amendment of the Fund Reporting Ordinance, the fund/fund administrator or the Austrian tax representative is to notify OeKB by 14 November 2014 (and by 5 December 2014 in the case of fund of funds respectively) about the tax status for the "foreigner WHT" (in or out of scope). We assume that for funds which are flagged as out of scope for the "foreigner WHT" at OeKB, the additional "foreigner WHT" reporting obligations mentioned above do not apply.

Further developments

There are still ongoing discussions on the "foreigner WHT" with the Austrian Ministry of Finance. We will keep you informed about any further developments.

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Update on the implementation of the AIFMD

Due to recent changes in the implementation of the AIFMD, a new type of investor group (qualified private investor) has been defined to ease the distribution of certain alternative investments under special circumstances.

While some alternative investments (private equity fund of funds, AIF in private equity, managed futures funds) may not be sold directly to private investors after July 2014, it is now possible to sell these products if the qualified private investor criteria are met.

Qualified private investor

For the purchases of shares of an AIF which is considered as a private equity fund of funds, an AIF in private equity or a managed futures fund after 1 August 2014, the following criteria must apply:

- The investor confirms in a separate document that he is aware of the risks in connection with alternative investments and can dispose freely of clear cash at banks or of other financial instruments amounting to more than 500,000 Euro

- The capital investment company of the AIF or (if no direct distribution is carried out) the distributing agency evaluated the knowledge and experience of the investor with similar investments

- The capital investment company or (if no direct distribution is carried out) the distributing agency is convinced that the investor is capable of realising the risks of the investment and considers the investment as appropriate for the investor

- The investment in the alternative investment fund amounts to at least 100,000 Euro

- The investment provides for additional diversification and risk spreading of the investor's portfolio

The implementation of the qualified private investor increases the possibility to distribute a wider range of alternative investment products to private investors in Austria. Therefore, if such AIFs are among your product line, this opportunity should be taken into consideration.

If you have any questions, please feel free to contact us.

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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 seven senior staff and about nine junior level staff to support you with your business challenges.

Our Asset Management Team

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