



New Ordinance issued by the Austrian Ministry of Finance on Controlled foreign Company (CFC) legislation





As of 1 January 2019, Austria transposed CFC legislation into national law according to the requirements of the EU Anti-Tax Avoidance Directive (ATAD). On 25 January 2019, the Ministry of Finance issued an Ordinance to resolve uncertainties regarding the new CFC legislation.

In the following, we present the most significant aspects and conditions of the CFC legislation and the Ordinance, as well as possible areas of action.

Even after the issue of the Ordinance, most of the law's complexity remains. We therefore strongly recommend analyzing its applicability on a case-by-case basis. For structuring purposes, especially the participations of the CFC should be considered carefully, as distributions from participations or sale of participations can either be qualified as active or passive income at the level of the CFC.

It should further be kept in mind that, underlying the CFC legislation, Austrian tax law provides for a so-called switch-over rule. The conditions of the switch-over rule generally coincide with the CFC legislation except in case of a significant lower minimum participation percentage of only 5% or more in a foreign corporation. The consequence would be the taxation of dividend or capital gain income instead of its ordinary exemption (= switch-over) at the level of the Austrian shareholding company.

An entity is regarded as a CFC if its shareholder, an Austrian corporation, holds more than 50% of the voting rights or capital or is entitled to more than 50% of the profits. The Ordinance expressly states that the determination of the minimum participation threshold is calculated by adding the directly held shares of the Austrian company and the directly held shares of affiliated companies of the Austrian corporation (Sec 2 of the Ordinance). A company can be considered affiliated if participations exceed 25%.

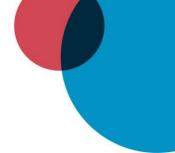
Further conditions for the application of the CFC rules are that

- 1. The passive income of the CFC amounts to at least one-third of total income. The Ordinance states that the threshold must be calculated each financial year. If the passive income of the financial year does not exceed 41.625% or if the active income is negative, the calculation period can be extended to include the previous two financial years (Sec 2 para 2 of the Ordinance). As such, the threshold can be calculated including a total period of three financial years.
- 2. The CFC is subject to a low tax rate, with an effective tax rate of 12.5% or less. The effective tax rate is assessed by dividing the foreign taxes levied against the income of the CFC. Foreign taxes of the CFC generally comprises any taxes comparable to the Austrian CIT (Sec 1 para 3 of the Ordinance). The income of the CFC must be calculated in line with Austrian tax rules. Therefore, the Ordinance expressly states that differences by law in depreciation, recognition of accruals, or offset of losses alone cannot lead to a low taxation (Sec 1 para 4). If the total income calculated in line with Austrian rules is negative, the nominal tax rate of 12.5% is applied. (Sec 1 para 5 of the Ordinance).

When applying the CFC legislation, Austria decided to use the so-called categorical approach, in which only passive income of the CFC is included in the Austrian corporation's tax base. Passive income is non-distributed income from interest, royalties, financial leasing, insurance, banking, and, in special circumstances, invoicing functions. Dividends are only regarded as passive income if they are received from a low-taxed (same effective tax rate as the CFC tax rate of 12.5%) and majorly

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passive income generating entity, or if the dividend payments are tax deductible at the level of the distributing entity (so-called switch-over regulations).

However, for CFCs that have a substantive economic activity, the Austrian legislator has decided to use the carve-out rule of the ATAD, which exempts these entities from the Austrian CFC legislation. The Ordinance lays down further conditions to qualify as a substantive economic activity. Generally, and depending on the economic activity at hand, proper staff, equipment, assets, and premises are required. The sole holding of participations and/or its sale does not account for a substantive economic activity, if not proven otherwise (Sec 4 of the Ordinance).

If the conditions of the Austrian CFC legislation are fulfilled, passive income of the CFC is included at the level of the Austrian corporation and taxed at a CIT rate of 25%. Certain taxes of the CFC, especially those comparable to Austrian CIT, can be credited. In addition, the Austrian law allows for credit of taxes imposed due to foreign CFC legislations that were levied at the level of its directly or indirectly held participations. Taxes of the CFC that cannot be credited may be carried forward. Further details that clarify the percentage of participation for the inclusion of passive income are specified in Sec 5 of the Ordinance.