

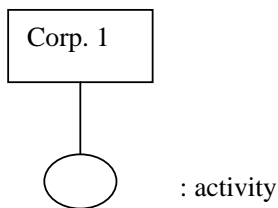
QUESTIONNAIRE ON TAKE OVER OF LOSSES – Reply from AUSTRIA

Editor: Joost van Zadelhoff (The Netherlands)

This questionnaire is designed to analyse and compare the different systems of cross-border take over of losses within the member states of FEE.

To gain full insight in these systems, the first set of questions (A) will be addressed to take over of losses **within one** country: '*incountry take over of losses*' .

The second set of questions (B) will be addressed to cross-border take over of losses .

A. Incountry take over of losses***1. Within one legal entity:***

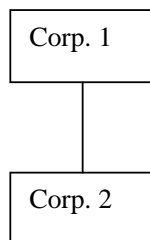
Does the tax system recognize:

- (a) Carry back of losses (if yes, state maximum years);

No carry-back of losses allowed

- (b) Carry forward of losses (if yes, state maximum of years);

There is no time limit on the carry-forward of losses. However, there is one restriction: in general, only 75% of a years' current profit can be sheltered from taxation by loss carry-forwards, whereas 25% of a year's current profits is subject to tax even if there are loss carry-forwards available. Certain capital gains (e.g. gains from the sale of a business) can be fully sheltered by tax loss carry-forwards.

2. Between two or more legal entities

Does the tax system recognize take over of losses between two corporations? (if yes, state method: *fiscal unity, transfer of losses or other method?*)

Generally no recognition of losses between two separate corporate entities, except in case of "Organschaft" (fiscal unity).

Organschaft is possible only between parent company and subsidiary if the following conditions have to be fulfilled cumulatively:

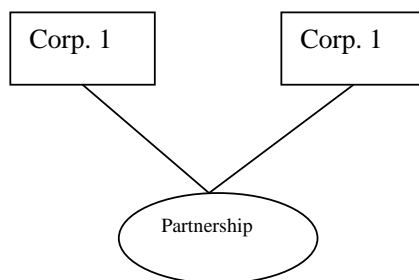
- (i) Parent company must own at least 75% of the share capital of subsidiary ("financial integration")*
- (ii) Subsidiary must effectively be managed and controlled by parent company ("organisational intergration"); general requirement that at least one executive officer of parent company ("Geschäftsführer", "Vorstand") is also an executive officer of subsidiary ("Geschäftsführer", "Vorstand"); parent company assumes certain administrative tasks for sub (e.g. accounting, marketing, HR etc)*
- (iii) Subsidiary is integrated into the business of the parent company, i.e. supports and furthers the business of the parent company ("business integration"); this usually requires that the subsidiary is buying from or selling to the parent company. A holding company is deemed not to have a business of its own: if the parent company is a mere holding company (even if it manages several subsidiaries) no "Organschaft" is possible with its subsidiaries.*
- (iv) There must be a profit and loss assumption agreement ("Ergebnisübernahmevertrag") between the parent and the subsidiary; under such agreement the parent company would assume the statutory income or cover any statutory loss of the subsidiary so that the subsidiary has a zero income for statutory purposes; the profit and loss assumption agreement must be concluded for a period of at least 5 years*

Conditions (i),(ii) and (iii) must be met as of the beginning of the subsidiary's fiscal year for which "Organschaft" is to be applied for the first time; condition (iv) has to be met before the end of the subsidiary's fiscal year for which "Organschaft" is to be applied for the first time. If one of the conditions (i) – (iii) is not fully met then this can be compensated by the other conditions being very strongly met (i.e. if business integration is weak then this can be compensated by say 100% financial integration)

The Government has announced that effective Jan 1,2005 a new system of group taxation will be introduced. The main features will be:

- Minimum participation in order to qualify for group taxation: 50% shareholding*
- Minimum period: 3 years*
- An option will be available to include foreign subsidiaries in group taxation*

3. Between corporations and partnership



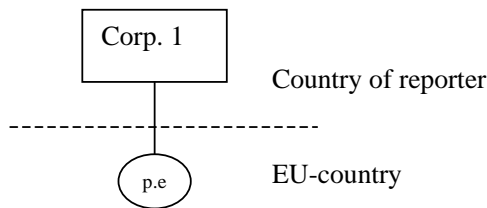
Does the tax system recognize take over of losses between corporations and a partnership? (if yes, state method: *fiscal unity, transfer of losses or other method?*)

Partnerships are generally transparent and losses incurred are allocated directly to the partners (Corp 1 and Corp 2 in the above example) and can be used to offset taxable income of the partners from other sources.

However, when the partnership is deemed to be a "tax shelter" losses incurred in such a partnership can be offset only against subsequent profits from the same partnership. A partnership is deemed to be a "tax shelter" if the main purpose of participating in the partnership is the tax advantage (§2a Income Tax Act)

B. Inwards (cross border) take over of losses: country of reporter as home country of mother corporation

4. Within one legal entity:



Does the tax system recognize foreign losses in the home-country:

1. If foreign activity = permanent establishment

Losses of a foreign p/e can be offset against profits of the head office in Austria. In case the foreign p/e turns profitable and can avail itself of loss carry-forwards the foreign losses claimed as a deduction in Austria have to be added back to taxable income of the head office (recapture) so there is no double-dip of loss carry-forwards

2. If foreign activity= not permanent establishment

In this case losses incurred by the foreign p/e are recognised at the Austrian head office

If the reporter's country recognises foreign losses: how are foreign recognised losses being calculated (is there a need to restate the loss of the foreign p/e by applying the head office country tax rules)? How is a "double-dip" (using the same loss in both countries) avoided?

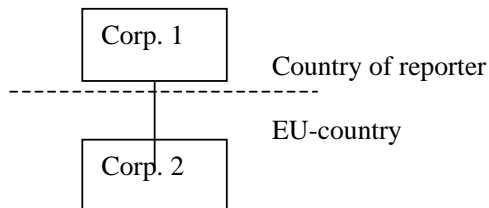
Foreign p/e losses have to be restated using Austrian tax rules.

No "double dip" possible (see below recapture rules)

If the reporter's country recognises foreign losses: What are the recapture rules (e.g. what happens when there are subsequent profits in the foreign p/e, when the foreign p/e is liquidated, when a certain number of years has elapsed etc) ?

Subsequent profits of the foreign p/e will also be taxable in

5. *Between two legal entities*



Does the tax system of Corp.1 recognize losses of foreign corporation? partnership?:

Losses from a foreign corporate entity are not recognised (cross-border "Organschaft" is not possible)but according to legislation proposed by the government will be recognised beginning as of Jan 1, 2005.

Losses incurred in a foreign partnership are treated in the same way as losses from a foreign p/e in case the foreign partnership is deemed transparent according to Austrian tax rules (irrespective of how the partnership is being treated in its home country)

If the reporter's country recognises foreign losses: how are foreign recognised losses being calculated (is there a need to restate the loss of the foreign p/e by applying the head office country tax rules) ? How is a "double-dip" (using the same loss in both countries) avoided ?

Foreign losses have to be restated applying Austrian tax rules

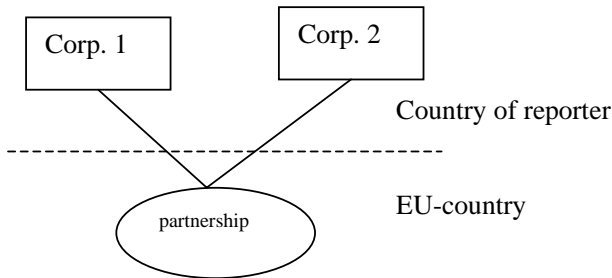
If the reporter's country recognises foreign losses: What are the recapture rules (e.g. what happens when there are subsequent profits in the foreign partnership, when the foreign partnership is liquidated, when a certain number of years has elapsed etc) ?

Same rules as for a p/e apply to foreign partnerships (if partnership is deemed transparent)

Would a write-down of the investment in the foreign subsidiary or a loss upon sale/liquidation of the foreign subsidiary be tax deductible at the parent company ?

Gains and losses from the sale of a foreign subsidiary are not taxable / not tax deductible; however, losses from the liquidation or bankruptcy of a foreign subsidiary can be claimed as a deduction over a 7-year period to the extent these losses exceed the tax-exempt dividends received in the 5 preceding years. The Austrian parent company can elect alternatively to have capital gains and capital losses from the sale of a foreign subsidiary fully taxable or tax deductible.

6. Between legal entity and partnership



Does the tax system of Corp.1 recognize losses of foreign partnership:

(a) if the partnership=permanent establishment

Losses from the sale / liquidation of a foreign p/e or partnership are treated in the same way as current income / loss from the foreign p/e or partnership losses from a participation in a foreign partnership will generally be recognised in Austria (with subsequent recapture if profits are arising from the participation in the foreign partnership)

(c) if the partnership= not permanent establishment

This depends. In general the loss will be recognised

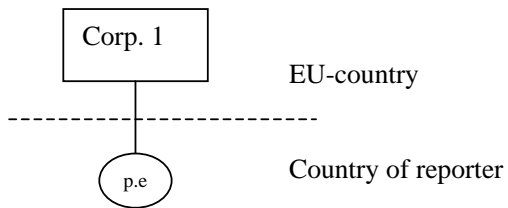
If the reporter's country recognises foreign losses: how are foreign recognised losses being calculated (is there a need to restate the loss of the foreign p/e by applying the head office country tax rules) ? How is a "double-dip" (using the same loss in both countries) avoided ?

Foreign losses to be restated according to Austrian tax rules.

If the reporter's country recognises foreign losses: What are the recapture rules (e.g. what happens when there are subsequent profits in the foreign p/e, when the foreign p/e is liquidated, when a certain number of years has elapsed etc) ?

Recapture only when there is a profit.

C. Outwards (cross border) take over of losses: your country as home country of daughter comp.

7. Within one legal entity

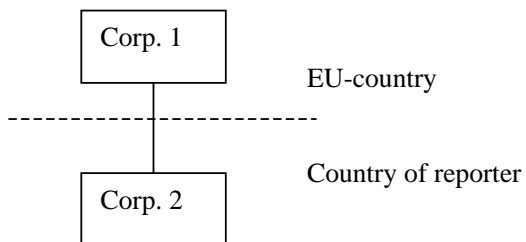
Does the tax system recognize losses of Corp. 1 in the home-country of the 'activities':

- (a) If activity = permanent establishment

No

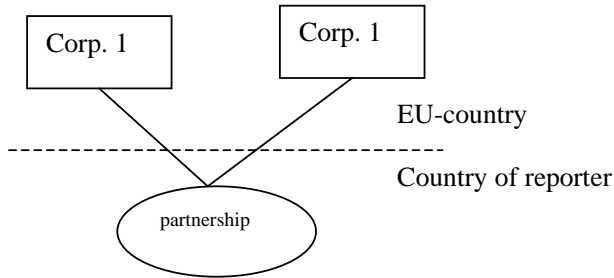
- (b) If activity= not permanent establishment

No

8. Between two legal entities

Does the tax system of Corp.2 recognize losses of foreign Corp. 1?:

No

9. Between partnership and corporation

Does the tax system of the partnership recognize losses of Corp. 1 or Corp.2?:

- (a) if the partnership=permanent establishment

No

- (b) if the partnership= not permanent establishment

No

When losses arise in a foreign p/e or partnership the tax treatment could be different depending on whether the applicable tax treaty operates the exemption or the credit method for foreign income Is this the same for your country? Austria has changed its rules and now allows the recognition of losses irrespective of whether the treaty operates under the exemption or the credit method.