FRESHFIELDS BRUCKHAUS DERINGER

BRIEFING

SUMMARY JUNE 2009

Taxpayers in financial distress and insolvencies: Austrian tax aspects

This briefing discusses Austrian tax aspects affecting financially distressed and insolvent corporate taxpayers, (secondary) tax liabilities and preferential rights in relation to tax claims. It also notes the tax consequences for Austrian creditors of a debtor that is unable to pay and for Austrian shareholders holding shares in a liquidated subsidiary.

Introduction

This briefing is of a general nature and does not purport to present a complete picture of all Austrian tax aspects that could be relevant in the case of the (threatened) insolvency of a business. It sets out some key tax aspects affecting a taxpayer in financial distress or subsequent insolvency and highlights the potential tax issues for creditors and other parties that have dealt with the insolvent business. The briefing focuses on corporate taxpayers.

Taxpayer in financial distress

In principle, executive directors (members of the board) of an Austrian corporate taxpayer are not liable for the debts accrued by their business. However, there are specific tax rules on the personal liability of executive directors for the timely payment of taxes and contributions (for instance, corporate income tax, wage withholding tax, social security contributions, value added tax) which could be of particular relevance if the taxpayer is in financial distress. This personal secondary tax liability applies for the taxpayer's unpaid taxes only in the case of culpable negligence of the executive director's duties over the payment of taxes due. It is generally not considered negligence of duties if the tax was already uncollectable at the due date; although an exception applies to wage withholding tax and capital gains tax. Although executive directors are not liable for value added tax (VAT) resulting from adjustments of input VAT in the course of insolvency proceedings, the liquidator may be liable. These rules are strictly enforced and apply in addition to the general (non-tax) rules of directors' liability in cases of mismanagement.

Directors are also assigned no personal responsibility for the financial and tax affairs unless they ignore their obligation to monitor their employees internally responsible for the financial and tax affairs or if they select employees incapable of handling the financial and company's tax affairs.

Generally, during an insolvency procedure, tax claims may be qualified as mere bankruptcy claims (*Konkursforderungen*) or as privileged claims (*Masseforderungen*). A tax claim is characterised as a privileged claim (ie privileged settlement of the claims during the insolvency proceeding) if:

- it concerns the assets of the insolvent taxpayer; and
- the taxable event is effected after the opening of the insolvency procedure.

Privileged claims have the highest preference by law; only claims secured by mortgage and pledge are treated with higher preference. Privileged claims must be satisfied on their due date according to the funds available, whereas bankruptcy claims must be filed with the administrator in advance and will be satisfied at the end of the insolvency procedure as determined by the court.

As soon as the tax authorities become aware that a taxpayer is in financial distress, they will attempt to collect any tax that is already due. Before the due date

of the tax liability, the tax authorities can issue payment orders (*Sicherstellungsaufträge*) if the payment of the tax is at risk (often the case in upcoming insolvency cases). The tax authorities can seize the taxpayer's assets on the basis of a payment order (*Sicherstellungsauftrag*) without involving the courts. The receipt of such a payment order requires the taxpayer's immediate attention, because failure to respond to such a payment order may lead to immediate seizure of assets and a subsequent public sale.

Insolvency of a taxpayer

An insolvent taxpayer's tax obligations continue regardless of its insolvency, but certain issues become more prominent. A court-appointed administrator is responsible for handling the insolvent company's tax affairs. The insolvent taxpayer, represented by its executive directors, is under an obligation to assist the court-appointed administrator, especially in providing information regarding the company's current tax affairs.

Typically, when it has become clear that the insolvency proceedings are unlikely to lead to full payment of outstanding tax liabilities, the tax authorities will consider whether they can hold third parties liable for payment of the unpaid tax on the basis of specific provisions in the tax legislation. Such liability (secondary tax liability) may apply, inter alia, to:

- other members of the same fiscal unity (for taxes owed by the group parent resulting from the group members' business, such as VAT, but not corporate income tax);
- members of the taxpayer's board of directors for unpaid taxes in cases of culpable negligence; and
- Austrian entrepreneurs, as recipients of a VAT-able supply from a foreign entrepreneur (having neither its seat nor a permanent establishment in Austria), if the Austrian party fails in its obligation to pay the VAT on behalf of the foreign supplier.

Within an insolvency procedure, the administrator can decide to sell assets to third parties. The sale of assets during the insolvency procedure constitutes a VAT-able supply, attributed to the insolvent taxpayer. Hence, the insolvent taxpayer is obliged to issue a proper invoice to the purchaser. VAT claims effected by the administrator during an insolvency procedure are by nature privileged claims (*Masseforderungen*), because the taxable event (ie the sale of the assets) is effected after the opening of the insolvency procedure. In a sale of VAT-exempt real estate, possible input VAT claimed by the insolvent taxpayer resulting from previous building activities must be adjusted. Claiming repayment of input VAT from the tax office is characterised as a mere bankruptcy claim (*Konkursforderung*).

Whether an insolvency procedure ends as a result of agreement reached with the creditors or because the insolvency has become final when there are no remaining assets to pay off outstanding obligations, the non-payment of the residual obligations will normally not lead to any additional tax (effectively) payable.

Tax aspects for the creditor of an insolvent party

Generally Austrian taxpayers may take a devaluation loss when it has become plausible that the full amount of a receivable will not be received. The receivable should be valued on the lower fair market value. The creditor must provide relevant evidence for the reduction in the receivable's value or make plausible that there has been a material reduction in the market value. Insolvency of the debtor and/or non-payment is therefore not a requirement for taking this devaluation loss. If the receivable's market value increases again, the loss will have to be reversed, up to the receivable's original carrying costs. If the debtor's insolvency has become final and no further repayments can be expected, the receivable's residual carrying value can be taken as a loss.

If and to the extent that the receivable on an insolvent debtor includes VAT charged on the provision of services or the sale of goods and the total amount of the receivable is not fully paid, the VAT component in the amount receivable can be reclaimed (on a pro rata basis in the case of partial payment) from the tax authorities. The test is again that it should be plausible that the relevant amount of the receivable will not be received. Again, insolvency is not a condition, but is usually considered sufficient evidence that full payment on the receivable will not occur.

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Tax aspects for the shareholder of an insolvent party

The Austrian shareholder of a party whose insolvency has become final can generally take a tax-deductible loss on the cost price for tax purposes of the shares held in that insolvent party. Normally, a loss on a shareholding in a qualifying foreign subsidiary is not deductible. However, under the international participation exemption the taxpayer may opt for taxation of its capital gains, while benefiting from the tax-deductibility of capital losses and write-downs. This option is irrevocable and can be exercised by the taxpayer only in the year of the company's formation. Many Austrian companies establishing foreign subsidiaries in years of economic growth (2005–2007) did not opt for taxation due to their high profits at the time. At present, due to the economic downturn, Austrian parent companies are suffering tax disadvantages due to the non-deductibility of losses, which could be abolished only by liquidating subsidiaries.

A loss that has become final as a result of the liquidation of a subsidiary is, however, in principle deductible. An important condition is that the business of the foreign subsidiary is not continued by the shareholder or any other related party. This may be an issue if the group to which the insolvent party belongs attempts to continue the relevant business in some form. A further timing point is that the liquidation loss can be taken only in the year when the liquidation procedure is finalised; in complex insolvency matters this may take many years. It may be that the tax authorities, in these difficult times, take a more practical approach on a case-by-case basis.

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