



Restructuring of indebtedness: Austrian tax points

This briefing sets out the key Austrian corporate income tax issues as well as specific capital duty and stamp duty issues in respect of debt restructurings. In summary, debtors may be faced with material tax consequences if third party debt is guaranteed by a related party, if the principal amount of the existing debt is reduced or if the debtor buys back its own debt at a discount. Creditors will generally be allowed to recognise tax-deductible devaluation losses if a financially distressed debtor is unable to repay debt.

Introduction

This briefing summarises key Austrian tax points relating to restructuring of indebtedness.

A key tax principle is that funding that is provided in the form of a debt instrument from a civil law perspective is also considered debt from a tax perspective except in specific exceptional circumstances. Generally speaking, apart from 'hybrid debt' (essentially subordinated debt with, in principle, unlimited maturity and profit-sharing features), these exceptions affect related-party situations in which an independent creditor would not have granted a loan under the same circumstances. An exception also applies if parties have clearly factually intended to provide equity funds but for tax reasons have presented the funding transaction as the provision of a loan (a substance-over-form approach). In these exceptional circumstances, a debt instrument may be wholly or partially recharacterised for tax purposes as equity. This would lead to the denial of interest deduction for the debtor and, if interest would actually be paid, may lead to dividend withholding tax being due. It could also lead to a different tax treatment for the creditor.

A key issue in restructuring indebtedness is therefore to establish whether and to what extent a debt instrument for tax purposes is also qualified as regular debt (which would normally be the case) and whether the proposed restructuring could change that qualification.

Debtor side

Amendment of the terms and conditions and debt-for-debt exchange

In principle, amendments to the terms and conditions (T&Cs) of a debt instrument based on negotiations between creditor and debtor would usually be treated in the same way as a debt-for-debt exchange in which one debt instrument is exchanged for another debt instrument with different conditions.

Generally, assuming that creditor and debtor have negotiated changes on an at-arm's-length basis, relatively minor amendments to a debt instrument's T&Cs should not lead to material income tax consequences. In particular:

- deferral of interest payments should in principle not negatively affect deductibility, because interest is normally deducted on an accrual basis;
- adding additional security cover should not by itself affect the tax position of the debt instrument;
- a change to the maturity term should also not affect the tax position of the debt instrument by itself; and
- if covenants have been breached and the creditor agrees not to exercise its right to demand full repayment but renegotiates the applicable interest rate, given increased risks, this should also normally be acceptable from a tax perspective.

However, the following amendments may have material income tax effects.

- If a third party loan to a distressed debtor would, as a result of the renegotiations, now be guaranteed by a party related to the debtor, the debt instrument may be considered related-party debt. This would mean that the principles for intra-group transactions could apply, which could lead to limitations or denial of interest deductibility.
- A reduction of the nominal amount of the outstanding debt would in principle lead to profit recognition for tax purposes by the debtor. However, in the event of acquittance in the course of legal proceedings for the financial restructuring of the company no profit would be recognised, due to an exemption in the Austrian Income Tax and Corporate Income Tax Act (the so-called tax exemption for profits resulting from the financial restructuring of a company).
- An amendment to the currency of the principal amount would be considered a realisation of currency exchange results under the old instrument.

If the creditor and debtor are directly or indirectly related to each other, the key issue is whether an amendment to the T&Cs will be accepted as being at arm's length. If not, the agreed conditions could be amended by the tax authorities to arm's-length conditions. This could lead to immediate profit recognition at the time of the amendment or to smaller deductions going forward or, in extreme circumstances, the debt instrument could be considered exchanged for a new instrument that should be qualified as an equity instrument. The debtor may then no longer be able to deduct any 'interest' on the instrument and dividend withholding tax may be due.

Under the Austrian Stamp Duty Act, the documented conclusion of credit agreements is generally subject to stamp duty at a rate of 0.8 per cent (stamp duty can be avoided by drawing up a document abroad in some cases). As for credits granted by related parties (shareholders' loans) to an Austrian company, stamp duty is also triggered without any documentation being drawn up, because the books and records that the Austrian debtor must keep and in which the loan is recorded will be deemed sufficient documentation for stamp duty purposes.

A change to the T&Cs of a taxable documented credit contract between the parties may result in a stamp duty-relevant addition or amendment to the contract

(eg in the case of an extension to a credit term) and therefore trigger stamp duty calculated from the value of the additional benefits only.

Debt-for-debt exchanges may benefit from a special provision providing for a kind of partial tax relief according to which the new contract will be taxable only to the extent that it exceeds the original one in its content or maturity date. This relief is dependent on several conditions, such as the existence of stamp duty-triggering documentation of the original credit contract, conclusion of the new substitute credit contract with a different creditor or the debtor's identity.

Debt-for-equity exchange

The restructuring of a company may be effected by the conversion of debt into equity, whereby the creditor's receivables (deriving, for instance, from supplies and services or credits) are contributed by means of a capital increase in kind into the company's equity. This results in a permanent waiver of the right of capital repayment by the creditor, but in return the creditor becomes the company's owner (eg participation of suppliers or banks in the company).

The following positive effects may be achieved by a debt-for-equity exchange:

- settling (or decreasing) the company's over-indebtedness;
- improving the balance sheet structure (equity/debt); and
- improving the company's credit standing.

In principle, a debt-for-equity exchange is considered as an income tax-neutral equity contribution in kind. As the new equity can be issued only against equivalent contributed value, the converted debt instrument will generally be recoverable and therefore no waiver of irrecoverable debt will occur (see below). Businesses should note, however, that if the effective value of the contribution in kind (eg contributed credit receivable) is lower than the nominal value of the participation granted in return, the creditor in his capacity as new shareholder would have to inject the difference as an additional amount into the company.

The creditor's equity contribution will be subject to a 1 per cent capital duty from the market value of the receivable contributed.

Debt waiver

A partial or full waiver of the principal amount of a debt instrument (and/or accrued interest) in principle leads to a taxable profit for the third party debtor. This may cause further liquidity problems on the level of a company in financial crisis if the company does not have sufficient loss carry-forwards available. Please note that the 75 per cent limitation for the offset of loss carry-forwards against the income of the current year does not apply to losses and profits resulting from insolvency and liquidation proceedings or from the sale of businesses, partial business divisions and acquittance in the course of legal proceedings for the company's financial restructuring.

If the creditor is related to the debtor (shareholder) and it can be shown that the credit would not have been granted by an unrelated third party creditor, the credit could be qualified as a hidden equity contribution. If it is only the subsequent debt waiver that would not have been granted by an unrelated third party creditor, the amount waived would also be considered an equity contribution for tax purposes and would not lead to profit recognition or the reduction of available tax losses for the debtor. Since the waiver of indebtedness by a shareholder of the debtor *causa societatis* (ie in principle the waiver of a recoverable receivable) is not considered a transaction at arm's length, the waiver is treated as a non-taxable capital contribution to the company. However, to the extent that the waived receivable is not recoverable, the waiver made by a shareholder of the debtor leads to a taxable profit for the debtor.

The worthlessness of a receivable may result from the character of the debtor (eg over-indebtedness or illiquidity) or from the receivable itself (eg exchange rate change of foreign currency receivables). If the receivable's market value at the time of the debt waiver is lower than its book value, its recoverability is questionable.

Liabilities between third parties that will be waived under a suspensive condition (eg injection of equity according to the restructuring plan) must no longer be mentioned in the debtor's books as liabilities from the time when the condition is met. The debt waiver leads to a taxable profit for the third party debtor at the moment of the write-off of the liability in the books only. In the event of a debt waiver concluded under a resolute condition,

the waiver is usually already effective at the moment of signing the contract regarding the debt waiver. The subsequent write-off of the liability in the books of the debtor will be taxable.

The debt waiver of a direct shareholder of the debtor triggers capital duty at 1 per cent of the receivable's nominal value (the tax base may be reduced to the current lower market value in the case of a waiver of a receivable of minor value for restructuring of indebtedness purposes) if the debt waiver may result in an objective increase in the value of the company. Therefore, if there is an objective increase in the company's value, a debt waiver of direct shareholders in the following circumstances will generally trigger capital duty:

- in the course of financial restructuring; and
- for the purposes of the coverage of losses (even if the over-indebtedness cannot be settled entirely).

No capital duty should be triggered on the occasion of a debt waiver of a direct shareholder of an already insolvent company, because an objective increase in the company's value can not be achieved any more.

The debt waiver of a mere indirect shareholder should not trigger capital duty so far as the waiver was made in the economic interests of the indirect shareholder (along the lines of the capital duty-free grand parent contribution).

Debt buy-back

A buy-back of debt by the debtor (or an entity for tax purposes consolidated with the debtor in a fiscal unity) at a discount to the principal amount would normally lead to taxable profits on the discount for the debtor (or the fiscal unity to which it belongs). The debtor could benefit from the tax exemption for profits resulting from the financial restructuring of a company if the buy-back of debt at a discount was effected in the course of legal proceedings.

Creditor side

Austrian creditors generally value loan instruments on the basis of their original cost price (this is usually the receivable's nominal value, or the invoiced amount for trade receivables) or their lower market value (subject to the relevant due date, the agreed interest payments and the collectability). If a financially distressed debtor

is unable to repay debt, the creditor will generally be allowed to recognise a tax-deductible devaluation loss; if the creditor is obliged to use a double-entry bookkeeping, the creditor must recognise a respective devaluation in value. The creditor must either provide evidence of the circumstances relevant for the reduction in the receivable's value or at least make plausible that there has been a material reduction in the market value. Lump-sum devaluations of receivables are not allowed (under the principle of individual evaluation). However, a pooling of similar trade receivables is possible.

Any material amendment to the T&Cs that affects the market value will generally lead to the same result. Also, a receivable for overdue interest may be valued at its lower market value if the agreed payment date is postponed or the interest due is rolled up. In effect, this means that the creditor is not taxed on interest that is due but is not paid.

If, after the creditor has taken a devaluation loss, the receivable's market value increases again, the creditor may recognise the increase up to the instrument's original carrying value.

More complex tax issues will arise in the case of debt-for-equity exchanges or amendments to the T&Cs of debt instruments between related parties under non-arm's-length circumstances that cause part or all of the debt to be treated as equity funds.

Should intra-group debt be recharacterised as equity by the tax authorities, interest paid on the debt by the debtor would be considered as dividends and therefore would not be deductible as business expenses.

In a domestic case (ie Austrian debtor and Austrian creditor), dividends received by Austria-resident companies from other Austria-resident companies are exempt from corporate income tax for the recipient company (creditor) under the national participation exemption, irrespective of the percentage of the holding and the holding period. Generally, dividend withholding tax is levied on dividends distributed by an Austrian company. However, portfolio corporate shareholders (with a participation of less than 25 per cent) may credit the withholding tax against their final corporate income tax liability or claim a tax refund. No withholding dividend tax is levied on dividends distributed to corporate shareholders having a substantial participation

of at least 25 per cent in the subsidiary's nominal capital. This applies to holdings in the form of shares as well as participation rights ('hybrid debt'), but for the latter withholding tax will be levied in the first instance but a tax refund will subsequently be available.

In the case of a foreign corporate debtor and an Austria-resident corporate creditor, the recharacterised dividends are exempt from corporate income tax (implementing the EC Parent-Subsidiary Directive in Austria), if the following conditions are met:

- the payments are treated as dividends for Austrian tax purposes;
- the company has an Austrian parent company or a comparable foreign company subject to unlimited corporate income taxation in Austria;
- the subsidiary has one of the legal forms listed in the annex to the EC Parent-Subsidiary Directive or is legally comparable to an Austrian company;
- there is a substantial shareholding of at least 10 per cent; and
- there is a minimum holding period of one year.

According to the draft Tax Amendment Act 2009, dividends from EU-resident companies and companies resident in the European Economic Area (provided that administrative assistance exists: at the moment this applies only to Norway) shall be tax exempt in Austria, irrespective of the percentage of the holding and the holding period.

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