Austria

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I. Introduction

Currently there is no comprehensive set of domestic transfer pricing rules available in Austria. Therefore any tax issues arising from transfer pricing have to be dealt with on the basis of general rules of Austrian income tax laws. Only for specific situations (e.g. the physical intra-group transfer of assets or the cross-border rendering of intra-group services) is there statutory transfer pricing law set in Austria. In addition, the Austrian Ministry of Finance has recently presented an internal discussion draft on Austrian Transfer Pricing Guidelines, which would be the first time ever the Austrian tax administration has issued its views on transfer pricing issues in an organised and comprehensive manner. However, the discussion draft was received critically in the debate and it is currently unclear whether the Ministry of Finance will further pursue the issuance of the Transfer Pricing Guidelines or under which timetable such issuance could take place.

In absence of a dedicated domestic legal framework for transfer pricing issues, these issues are mainly solved on the basis of tax treaty law, i.e. Treaty rules following Article 9 of the OECD Model. For the interpretation of Article 9 of the OECD Model, the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (TPG) issued by the OECD are relevant. The Austrian Ministry of Finance has adopted the TPG in the sense that the Ministry has officially published the TPG as a decree in the relevant Austrian way of publication. Such a decree clarifies the position of the Ministry and makes it public, however such a decree has no legally binding effect neither on the taxpayers nor on the tax administration itself and therefore serves only as information that has, in reality, only the character of "soft law". There is a discussion as to what extent the TPG may be actually relevant for interpretation purposes. While it is undisputed that the TPG may serve as a guidance for the interpretation of the OECD Model (and tax treaties concluded by Austria on the basis of that model), the Austrian Ministry of Finance claims that the TPG should also serve as a guidance for the interpretation of Austrian domestic law provisions in the area of transfer pricing. Accordingly, in many cases the Austrian tax administration applies a "OECD conforming" approach when applying domestic tax rules to transfer pricing cases. Although this concept of adopting OECD principles for domestic law purposes is disputed in legal theory, it is nevertheless applied by tax authorities.

In the absence of clear transfer pricing rules in domestic law, general concepts of Austrian tax law on the abuse of law doctrine or the substance over form principle have particular relevance. The nature and scope of these concepts has been highly debated in Austria for years. The statutory provisions on the abuse of law (*Missbrauch*, set out in Section 22 of the Austrian Federal Fiscal Code) or substance over form (*wirtschaftliche Betrachtungsweise*, set out in Section 21 of the Austrian Federal Fiscal Code) are rather generic and therefore provide little statutory guidance as to the content of these doctrines. The prevailing scholarly doctrine on abuse of law understands the abuse of law principle as a requirement to interpret tax rules (in any field, including transfer pricing) in an economic (or substance over form) sense (rather than in the strict legalistic sense) where this is appropriate. The appropriateness of such an economic approach has to be tested for any given rule that is to be interpreted in the case at hand; taking into account its wording, object and purpose, history and any other aspects that may be relevant for interpretation. Accordingly, under this approach the abuse of law doctrine is no more (and no less) than a "warning signal" to interpret tax rules with the necessary diligence. By contrast, the Austrian tax administration (and parts of Austrian case law) have a rather different understanding of abuse of law: they understand the abuse of law as a separate test that is to be met by a certain transaction in addition to statutory law, even if a transaction would, leaving aside the abuse of law aspect, undoubtedly result in the tax effects desired by the

taxpayer. In other words, in addition to being covered by the actual scope of the law, the taxpayer would have to prove that a certain transaction is not "abusive". Under this doctrine, the abuse of law test has to ask whether the transaction is neither "unusual" nor "inappropriate" (the latter being the relevant criterion in practice). The "inappropriateness" of a transaction or structure is measured in practice by the existence of valid business (i.e. non-tax) reasons for the structure of transaction, so that the taxpayer would have to give sufficient evidence that he would have carried out the structure or transaction even if there were no positive tax effects associated with it.

II. Issue 1

In what ways has the "recharacterisation" concept discussed in Paragraphs 1.37 to 1.41 of the TPG been clarified by legislation, guidance and case law in Austria?

Austrian law does not provide for a designated "recharacterisation" concept as it is implied by the TPG. There is only the concept of a "sham transaction" (*Scheingeschäft*), stating that a transaction presented (or even designed) by the parties in order to disguise a "real" transaction is to be disregarded for tax purposes. However, this does not imply the possibility of a general recharacterisation of structures or transactions that do not meet a certain *objective* standard (e.g. being at arm's length etc) but allows for recharacterisation only if the presented "sham transaction" was not even intended in reality from the *subjective* view of the parties.

In practice, a recharacterisation of structures or transactions is therefore often discussed on the basis of the concepts of abuse of law or substance over form (as described above in the introduction). As outlined above, the tax administration is likely to apply the abuse of law concept as a test of the "appropriateness" of the structure. If such a test is failed, the desired tax effects will simply be denied. Typically, a true recharacterisation of the structure (in the sense that for tax purposes a different set of facts is assumed that did not take place in reality but should have taken place if the structure had been carried out "appropriately") is not needed but used only as a comparator against which the "appropriateness" of the actual structure is measured. The recharacterisation of shareholders' debt into equity may serve an example for this. As Austrian law does not provide for statutory thin capitalisation rules or principles, a recharacterisation of excessive shareholders' debt into equity can only take place on the basis of the abuse of law/substance over form doctrine (under specific criteria). On that basis, excessive shareholders' debt can be reconciled as "economic equity" (*wirtschaftliches Eigenkapital*) for tax purposes. However, such reconciliation would not imply a full recharacterisation of the actual fact pattern of the shareholder loan. If such a loan was granted interest-free (which is, in addition to others, one criterion for assuming that a shareholder loan is "economic equity"), this would not imply that a dividend that is paid out by the borrowing company is also to be assumed on a pro rata basis on the shareholder loan now reconciled into economic equity. Therefore, the interest-free nature of the shareholder loan is respected as the loan does not carry any income under the actual fact pattern.

III. Issue 2

In what ways has the concept of recharacterising a transaction based on a comparison of the purported allocation of risk under the transaction with the economic substance of that transaction (as discussed in Paragraphs 1.25 to 1.27 of the TPG) been clarified by legislation, guidance and case law in Austria?

Austrian legislation and doctrine do not have much to say on the relevance of a purported allocation of risk for the recharacterisation of a transaction or structure in a transfer pricing context. One reason for this lack of relevant precedence may be that the allocation of risk is an element that is not explicitly focused on by available legislation or general tax concepts. However, the allocation of risk issues may be tested when applying the general abuse of law concept to a certain structure or transaction. Under this general concept (as it is likely to be applied by tax authorities, as discussed in detail in the introduction), it may well be that the allocation of risk may be tested for its "appropriateness" as part of the overall test as to whether the structure or transaction is considered to be "appropriate" (i.e. whether there are valid business reasons for the carrying out of the structure or transaction). Under such approach, it may be tested whether a party to a transaction assumes in economic reality such a portion of the overall risk that is in proportion to the potential rewards the party gets from it. A mismatch of allocated risk and potential reward for such risk could be used as an argument against the "appropriateness" of the structure.

IV. Issue 3

In what ways has the issue of determining the correct allocation of risk between parties to a transaction which has no market comparables (as discussed in the Business Restructurings Discussion Draft[1]*) been clarified by legislation, guidance and case law in Austria?*

There is clear evidence that the Austrian tax administration intends to follow, as a method of first choice, the Comparable Uncontrolled Price (CUP) Method. This is however conditional on whether relevant and acceptable market comparables are actually available. If no such market comparables should be available in a given case, the Austrian Ministry of Finance has indicated that it would, in principle, also be open to other methods, including the Profit Split Method, if leading to more reliable results. The actual choice of method, however, is neither governed by statutory law nor is there clear guidance available from the authorities.

As to the application of the Profit Split Method, there is equally little guidance available. The Austrian Ministry of Finance has only indicated that it would, in principle, expect that the excess profit that remains from an overall perspective after the reimbursement of routine functions should be allocated (and taxed) in the hands of the taxpayer that owns the "relevant tensible and intensible assets performing the decisive functions and therefore assumes the relevant risks".

V. Issue 4

In what ways has the concept of recharacterising transactions on the basis that an independent party would not enter into a transaction that was detrimental to it, rather than to its group, if it had the option realistically available to it not to do so (as discussed in the Business Restructurings Discussion Draft) been clarified by legislation, guidance and case law in Austria?

There is no clarification under Austrian law (or relevant guidance by tax authorities) on the issue as to whether and to what extent a member of a multinational group should or should not have to take into account effects of a structure or transaction that do not materialise within that particular member of the multinational group but within other legal group entities. Typically, such an issue is discussed in the context of the responsibilities of the directors of such a group entity which may serve as an indicator that such a structure or a transaction is also acceptable for tax purposes. In recent years, Austrian courts have clarified that the director of a group company may actually take into account such overall group effects (i.e. positive effects within other parts of the group that balance or outweigh negative effects for the Austrian company for which the director is responsible) when making the necessary business judgement for accepting a certain transaction. However, in practice the tax administration may be reluctant to accept such a general approach by testing whether the transaction is, on an isolated basis, to the benefit of the Austrian company. In this context, the tax administration may underestimate the factual circumstances where, in reality, the directors often have very little choice as to whether they should accept or refuse to enter into a certain transaction with other legal entities of their multinational group. Therefore insofar as the OECD Business Restructuring Discussion Draft can be taken into account, the discussion relating to the realistic option to enter into a transaction or not to do so could be of further assistance for the taxpayer in such discussions with the tax authorities.

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[1] The OECD Discussion Draft on the Transfer Pricing Aspects of Business Restructurings, September 2008.

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FORUM ISSN 2043-0760