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The tax reform of 2005 was a big step towards enhancing Austria's attractiveness as a location for international holding companies. The cornerstones of the 2005 tax reform are the reduction of corporate income tax from 34% to 25%, and a new modern group taxation system enabling the pooling of profits and losses of Austrian resident group companies.

Decrease of the corporate income tax rate to 25%

The reduction of the corporate income tax rate was the Austrian legislator's response to the EU enlargement process and was devised to forestall the migration of companies based in Austria to low-tax accession countries such as Hungary or Slovakia.

The 2005 Austrian Tax Reform Act became effective on January 1 2005. As of this date, the corporate income tax rate was reduced from 34% to 25% for profits derived after December 31 2004. Even though the nominal tax rate in Austria is slightly higher than in some of the accession states, Austrian tax law allows generous tax deductions for expenses as well as loss carry-forward provisions – taken together, these offset the higher tax rate in Austria. The corporate income tax rate reduces the overall tax burden for Austrian corporations (for example, stock companies and limited liability companies). Both limited and general partnerships, however, are treated as *transparent entities* for tax purposes – meaning that the shares of profits or losses are attributable to each partner, and are to be included in and taxed as part of the partner's business income.

Because the limited liability company is the predominant legal form for companies in Austria, the 2005 tax reform has had a major impact on the Austrian corporate landscape.

Group taxation

The 2005 tax reform did not only affect corporate income tax. The Austrian legislator also used it to dispense with the more than 100 year-old system of the Austrian tax (fiscal) unit (*Organschaft*).

Qualifying as a tax unit under the former system required not only a majority participation of 75% in another company, but also economic and operational control of this company (subsidiary) by the parent company, and a profit and loss transfer agreement between the parent company and its subsidiary. The new group taxation, however, no longer requires economic and operational control or a profit and loss transfer agreement.

To fall within the ambit of the new group taxation regime, the only condition for group membership will be a direct or indirect majority investment in a target corporation (subsidiary). Joint taxation is also available within a syndicate of shareholders who together hold an equity participation of over 50% and the majority in voting rights. It is mandatory that the stake of the major shareholder within the syndicate amounts to at least 40%, and that other syndicate members have a minimum stake of at least 15%. Financial control must be exercised throughout the accounting period of the subsidiary.

The new group taxation enables a resident corporation to use the tax losses of foreign subsidiaries directly held by Austrian group companies. Unlike domestic subsidiaries, tax losses of foreign subsidiaries are limited to the percentage of the shareholding of the Austrian parent company. Due to the fact that tax losses are not limited within domestic group companies, an adjustment (*Ausgleich*) is mandated by law.

Group taxation is optional, meaning that the group members have to file an application with the tax authorities, list the shareholdings held by all group members and declare that they have entered into a tax sharing agreement. The group has to have existed for at least three years, otherwise group taxation is not applicable. If a group member leaves before the period expires, the calculations have to be corrected.

Whereas pre-group loss carryforwards, and losses incurred outside the group (*Außergruppenverluste*) of group members, can only be offset against profits of the group company itself, tax loss carryforwards of the group parent can be offset against the group profit.

Equal treatment of share and asset deals

The 2005 tax reform enables the purchaser to benefit – as in an asset deal – from a step up in basis. Formerly, only an asset deal qualified the purchaser to amortize goodwill and deduct hidden reserves.

Due to the 2005 Tax Reform Act, a part of the acquisition costs of shares in a corporation (provided that the corporation in question is eligible for group membership) will be treated as goodwill. The goodwill is calculated as the difference between the equity capital of the target plus hidden reserves in nondepreciable assets on the one hand, and the acquisition costs of the shares on the other hand. The amount of goodwill is limited to 50% of the acquisition costs of the shares, and may be amortized within a period of 15 years. Also, the interest expenses in a debt financing of the shares will be deductible against the profits of the parent company.

From an M&A perspective, the 2005 tax reform will enhance the attractiveness of share deals, which in turn will be an incentive for the Austrian M&A market.