Austrian National Report on Tax Competition in Europe

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I. Introduction

The discussion about harmful tax competition, shows that national tax individualism leads to a harsh subsidy race between the Member States to attract foreign industries and businesses that can’t be won in the long run. An immediate harmonization of direct taxes, however, is not a possible short-term answer to this phenomenon as the choice of a nation’s tax system reflects the society’s conception of a fair basis of a peaceful living together. These concepts vary a lot within Europe - as David Williams points out: "The states of northern Europe have strongly egalitarian systems which absorb perhaps half of the nation’s wealth, while other systems leave more to the individual or family and provide only a 'safety net’ for the poor." As the different systems are "deeply entrenched in the democratic structures of those states"¹, a comprehensive harmonization process will take a considerable time. The new comparability of tax systems in train of the introduction of the Euro as visible common currency, however, will make people more aware of the prize differences caused by tax differences and will therefore trigger a call for lower taxes. This effect is fair tax competition². It leads to a healthy competition between the Member States for more effective and cheaper administration which are a precondition of lowering taxes. Fair tax competition should consequently initialize a process of optimizing governmental structures³. It is therefore the better alternative to tax harmonization which would rather lead to a harmonization on a higher level, as one would have to await the cost-reduction programme of the slowest Member State to lower the tax level.

II. Measures against "unfair" competition in the domestic tax system

1. General anti-avoidance rules

Sec 21 BAO⁴ lays down a general substance over form concept in tax matters stipulating that it’s only the true economic purpose and not the formal appearance of a transaction that determines its legal status. Sec 22 BAO complements this doctrine and points out that tax liability cannot be avoided or reduced by abuse of law⁵. If abuse of law is given, tax liability has to be determined according to the true economic circumstances. The methodological background of these two provisions however has been under dispute from their enactment on. Legal science and parts

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² On the difficulty to define the exakt borderline between "fair" and "unfair" tax competition cf. Pinto, EU and OECD to Fight Harmful Tax Competition: Has the Right Path Been Undertaken?, Intertax 1998, 386 seq; Sommerhalder, Harmful tax competition or harmful tax harmonisation, EC Tax Review 1999, 244 seq and Runge, Die Überlegungen zur Weiterentwicklung des deutschen AStG, in Gassner/M. Lang/Lechner, eds., Der Entwurf eines österreichischen Außensteuergesetzes (2001) 47 seq (51) illustrating changing international attitudes on “fairness” with the example of holding privileges.
³ Cf also Pinto, Intertax 1998, 387: "Good tax competition forces governments to maintain reasonably low levels of public expenditure and to find an appropriate balance between the total tax burden imposed on taxpayers and an acceptable level of public services and social infrastructures.”
⁵ For the EC law perspective cf Harris, The notion of “abus de droit” and its potential application in fiscal matters within the EU legal order, EC Tax Journal 2001, 187 seq.
of the tax administration regard them as a mere interpretation guideline that stresses the importance of a teleological construction of legal provisions. Measures of the taxpayer that are at variance with the legal objectives of a tax provision must not be recognised (so-called "Innentheorie"). As the arguing must always bear upon the objective of the concrete provision to be circumvented, this approach makes a laborious case-by-case reasoning necessary. The opposing view (parts of the tax administration and the Austrian Administrative Supreme Court) does not look at the objectives of the circumvented provisions, but examines if the measure employed is unusual and artificial (objective criterion) and can only be explained by the intention to circumvent the wording of the statute (subjective criterion). In this case the anti-abuse provision of Sec 22 BAO should constitute a separate tax event (so-called "Außentheorie")⁶. Sec 23 BAO finally cracks down on sham transactions.

As far as circumventions of foreign taxes are concerned the Austrian Administrative Supreme Court has, however, made a considerable restriction of the application of Sec 22 BAO. In its so-called second Treaty Shopping ruling⁷ it held that abuse of law within the meaning of Sec 22 is only possible if the intention is to avoid Austrian taxes. Measures of the taxpayer that make use of Austria’s treaty network in order to route income in a "tax-friendly" manner through Austria, can therefore not be opposed by applying Sec 22 BAO⁸. This could be regarded as "unfair" by foreign tax administrations. If one however follows the "Innentheorie", Sec 22 BAO is not necessary to combat misuse of treaties anyway. As the treaty provisions have also to be interpreted by their objectives, international cases have equally to be scrutinized by a substance over form principle. A closer look on many measures of taxpayers might then, for instance, raise doubts on the alleged allocation of income.

At last, a special anti-abuse provision of the Austrian Corporation Tax Act has to be mentioned: Sec 10 para 3 KStG⁹. Sec 10 para 3 KStG is only applicable to international intercompany dividends in the sense of para 2¹⁰ and provides for a switch-over from the exemption to the credit method on the domestic level. This switch-over shall take place if suspicion of abuse of law is on hand. Such a suspicion can be assumed if the business activity of the foreign subsidiary company primarily lies in various types of passive income, its income is subject to an incomparably low taxation (not more than 15 % on average) abroad and it cannot be proved that its shareholders are mostly foreigners¹¹. These three conditions are described in more detail in a regulation of the Ministry of Finance¹². Sec 10 para 3 KStG can be addressed as the Austrian type of a minimum CFC legislation in a restricted area of tax law. It shall put a stop to misuse of the national exemption method: As the exemption method always accepts the foreign tax level, its

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⁶ Cf. Gassner, Tax Avoidance Concepts – Austria, ET 1999, 93 seq. Cf Ellinger/Iro/Kramer/Sutter/Urtz, Bundesabgabenordnung and the therin cited jurisprudence. The Außentheorie has been widely criticized in legal writing for its arbitrary conditions: Shall Sec 22 BAO, for instance, not apply if a taxpayer is clever enough to name a reasonable motive other than tax avoidance or if a tax avoiding practice has become so popular that it is no longer unusual?


⁸ H. Loukota, Die Gründe für die Schaffung eines AStG, in Gassner/M. Lang/Lechner, eds., Der Entwurf eines österreichischen Außensteuergesetzes 17.

⁹ KStG means Körperschaftsteuergesetz (Corporation Tax Act). Another special anti-abuse rule exists for the distribution of investment funds: Sec 42 InvFG.

¹⁰ Sec 10 para 2 demands among others a direct participation of at least 25 % for a period of 2 years.

¹¹ For this last criterion the provision is under legitimate critics of the Code of Conduct group. See below III.3.
undifferentiated application on intercompany dividends could bring about a double non-taxation of both the business profits of the subsidiary in its home country and of the dividends received by the Austrian parent in Austria. Therefore Sec 10 para 3 KStG foresees in such cases an indirect credit for the foreign taxes paid on the profits. The credit is limited by the due domestic tax on the dividends.

2. CFC legislation

In an internal working paper of the EC-Commission about the CFC legislation in the EC-Member States the Commission defined CFC-legislation as “national laws which attribute (parts of) the undistributed income or taxes of a foreign entity to national residents if they do have a certain relation to the foreign entity, generally it is a certain interest in the foreign entity”. Austria is – if one leaves out of account Sec 10 para 3 KStG - correctly listed among the countries that have **not adopted a general CFC legislation** up to now. At the same time it is recognised that Austria applies a range of national anti abuse rules.

However, in the meantime a broad discussion has emerged in Austria whether the existing anti-abuse rules should be supplemented by a special CFC legislation or not. Therefore the Austrian Federal Ministry of Finance has published a **first draft** of a “Außensteuergesetz” which is orientated very much on the existing German scheme. The proposed CFC-scheme is applicable to all foreign entities owned by a minimum threshold of resident taxpayers of more than 50 per cent taking into account also indirect ownership and Austrian residency in the last ten years. Such companies have to pass a “comparable tax test” to stay outside the scope of the ”Außensteuergesetz”. In other words: if they cannot prove a tax burden of at least 15 per cent in either their State of statutory seat or place of effective management their passive and base company income is attributed to the resident shareholders who have to pay Austrian taxes thereof. Active business income which is defined by a detailed legal list is generally excluded from the application of the ”Außensteuergesetz”.

The draft has been received by most scholars with scepticism because of the many remaining uncertainties. A close look on the definition of low taxation as a condition of application of the ”Außensteuergesetz”, for instance, shows that the calculation methods are not clearly defined and in practice almost unadministrable. The same holds true for the German pattern, so that even high ranking German tax clerks have already admitted that 90 per cent of their own rulings are likely to be false. Above that several concerns have been uttered in legal writing about the EC compatibility.

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13 TAXUD/C2/RK/rk D(99), not yet released.
14 Besides Austria the Commission lists Belgium, Greece, Ireland, Italy, Luxembourg, Netherlands.
15 The report lists Sec 10 para 3 Körperschaftsteuergesetz 1988, Sec 21 Bundesabgabenordnung establishing an economic view in order to judge tax matters and the general abuse clause of Sec 22 Bundesabgabenordnung.
16 Cf H. Loukota, Die Gründe für die Schaffung eines AStG, in Gassner/Lang/Lechner, eds, Der Entwurf eines österreichischen Außensteuergesetzes, 19 seq.
17 Cf Sutter, Die Definition der Niedrigbesteuerung nach § 2 Abs 3 ASiG-E, in Gassner/M. Lang/Lechner, eds, Der Entwurf eines österreichischen Außensteuergesetzes (2001) 71 seq.
of CFC regulations. Franz Wassermeyer has thus resumed the criticism in wishing Austria that is does not ever let the draft become law.

3. Residence Rules

Austria does not restrict itself to pure formal criteria when defining the scope of unlimited tax liability that leads to taxation of the world wide income. Sec 26 BAO also "accepts" the habitual abode besides the domicile for natural persons and Sec 27 BAO the place of effective management apart from the statutory seat of a company for legal persons. On the accrual of hidden reserves Austria levies in special constellations (transfer of business property and private participations) even a sort of exit tax. However, Austria – with the exception of inheritance taxation – does not know any form of extended tax residence that taxes only on the ground of pure citizenship (like the USA to some extent) thereby rendering a "flee" from domestic taxation almost impossible.

4. Restrictions of deduction of payments to tax-haven-entities

Sec. 162 BAO is not a rule especially and exclusively targeted at payments to tax-haven-entities, but it is an important tool of the tax administration to crack down on transfers to mere letter-box companies. Sec. 162 BAO has been introduced into the Federal Fiscal Code to ensure that the administration receives the necessary information to be able to tax the recipients of payments. If their names are concealed by the taxpayer, he is not allowed to set the expenses off – even if he can prove the costs by other means (eg. by witnesses or economic plausibility recalculations). As far as payments to base companies are concerned, the Austrian Administrative Supreme Court has already confirmed for several times that the administration can demand not only to be given the name of the formal recipient, but also the name of the person behind the base company. Some authors have claimed that Sec. 162 BAO would not be applicable if there were only foreign taxes at stake, because the justification of the declaration obligation would have its background in tort law. If there was however no loss of Austrian taxes imaginable, there could also be no liability therefore. This reasoning, however, can not convince in the long run as it is simply not explainable how one can exclude a loss of Austrian taxes without knowing the identity of the recipient who could easily have at least a holiday home in Austria making him liable to tax with his world-wide income.
5. Other Measures

In tax cases the ex-officio examination of the facts normally dominates the procedure. Sec 119 para 1 and Sec 138 para 1 BAO, however, stipulate a cooperation obligation of the taxpayer in the examination of the facts. In cases with crossborder relations this obligation is enhanced because the administration has only very limited power at its disposal. It cannot order an administrative inspection or the submission of evidence from third parties abroad, the only thing it can rely on is a request for assistance by the foreign tax administration\textsuperscript{27} which is certainly not as effective\textsuperscript{28}. Therefore it is upon the taxpayer to offer evidence for his allegations as he is likely to be easily able to furnish them. The burden of proof is consequently shifted from the administration to the taxpayer.

III. Measures against "unfair" competition at the international level in which Your country is involved

1. Double taxation conventions (DTCs)

Several Austrian Double Taxation Conventions include special anti-abuse clauses. The wording and the applied tests of these clauses vary a lot. The only thing they all have in common is the goal to assure that the taxpayer can not make use of the DTC for "improper tax lowering" strategies. The most sophisticated anti-abuse clause has been introduced in the DTC-USA. Art 16 contains a limitation of benefits clause that contains various detailed tests that shall guarantee that the claimant of treaty benefits has "a 'real' connection to the treaty jurisdiction and must at least be likely to pay significant tax there"\textsuperscript{29}.

In some Austrian Double Taxation Conventions Subject to tax Clauses are incorporated. Subject to tax clauses are defined by the MC Commentary as provisions providing that "treaty benefits in the state of source are granted only if the income in question is subject to tax in the State of residence."\textsuperscript{30} Austria has introduced subject to tax clauses in several DTCs. There are basically two types of Subject to tax clauses imaginable: While the DTC- Slovenia, for

\textsuperscript{27} For the relation of the enhanced cooperation obligation and a possible request of assistance see Urzt, Erhöhte Mitwirkungspflicht des Steuerpflichtigen bei Auslandssachverhalten trotz Amtshilfemöglichkeit der Behörde? in Gassner/M. Lang, eds, Besteuerung und Bilanzierung international tätiger Unternehmen (1998) 443.


\textsuperscript{29} Ault, The Tax Treaty between Austria and the USA in the Light of the current US Treaty Policy, in Gassner/M. Lang/Lechner, eds., Das neue Doppelbesteuerungsabkommen Österreich-USA (1997) 11 (21). For the various tests in detail cf the other essays of the cited volume.

\textsuperscript{30} MC Commentary Art. 1 para 17.
instance, contains a general subject to tax clause\(^{31}\), other DTCs have adopted a subject to tax clause only within the scope of a special distribution rule\(^{32}\).

In the negotiations for a new DTC-Germany Germany has first reclaimed an **activity-clause** stipulating that only income from “productive” occupations and of capital used for such activities shall be exempt, while the credit method shall be applied in respect of “passive” income\(^{33}\). The efficiency of such clauses and their catalogues of “active” income is - for similar reasons as the domestic CFC legislations (especially legal uncertainty of the described activity tests) - under dispute\(^{34}\). Austria has therefore – apart from a regulation within the limitation of benefit framework of art 16 DTC USA - not adopted any activity clauses in its treaty network\(^{35}\). In the new DTC between Austria and Germany the activity clause has finally been dropped too and the Contracting States have agreed upon a **switch-over-clause** that is not dependent on a definition of active and passive income instead. The clause comes into force when the Contracting States attribute income to different distribution rules (characterization conflict) or to different persons leading to a double non-taxation that can not be avoided by the mutual agreement procedure of art 25 DTC Germany. Above that Germany has been granted the possibility to notify Austria other types of income on which it can apply the switch over clause to crack down on double non taxation or abusive tax planning practices.

In the context of this paper the second paragraph of art 28 DTC Austria-Germany, however, is of special interest as it explicitly mentions **“unfair tax competition” as an application test**. Art 28 para 2 DTC-Germany stipulates: "The State of Residence can apply its national anti-abuse legislation against tax evasions in order to respond to abusive tax planning or unfair tax competition"\(^{36}\). In the Protocol of the DTC “unfair tax competition” is defined in direct reference to "the work in the OECD or in the EU”. Art 28 para 2 thus transforms the results of *soft law* instruments that are per se not legally binding into legally relevant facts triggering the application of national anti-abuse rules\(^{37}\).

There are also several Austrian treaties that include **Limitation-on-treaty-entitlement-Clauses** for specific constellations. The DTC Luxemburg, for instance, excludes Luxemburg holding companies and income derived from

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\(^{31}\) Art 24 para 1 lit d reads: ”Income derived by a resident of Austria which is considered by Austria to be taxable under this Convention in Slovenia may nevertheless be taxed in Austria if, after the conduct of a mutual agreement procedure, Slovenia exempts that income from tax by virtue of this Convention” (unofficial translation of IBFD).

\(^{32}\) Cf the DTC - Argentina (art 27 para 2), Australia (art 15 para 2 lit d), - Canada (art 12 para 3), - Denmark (art 12), France (art 10 abs 3 lit c), Germany (art 15 para 4), India (art 14 para 2 lit c), Malaysia (art 20 para 1), Norway (art 8 para 1), UK (art 13 para 5 lit c).

\(^{33}\) In detail see Vogel, Commentary\(^{3}\) Art 23 para 43 seq.

\(^{34}\) Cf. Wassermeyer, Der Wirrwarr mit den Aktivitätsklauseln im deutschen Abkommensrecht, IStR 2000, 65 seq and Wassermeyer, Die Anwendung der Anrechnungs- und Befreiungsmethode im neuen DBA Deutschland – Österreich, SWI 2000, 150 seq.

\(^{35}\) So Schuch, Der Aktivitätsvorbehalt nach dem neuen DBA Österreich – Deutschland, in Gassner/M. Lang/Lechner, eds., Das neue Doppelbesteuerungsabkommen Österreich-USA (1997) 11 (21)

\(^{36}\) Unofficial translation. Cf the original German wording: ”Der Ansässigkeitsstaat ist berechtigt, seine innerstaatlichen Rechtsvorschriften zur Abwehr von Steuerumgehungen anzuwenden, um missbräuchlichen Gestaltungen oder unfaires Steuerwettbewerb zu begegnen.”

\(^{37}\) In detail on this clause Gassner, Anwendung des Abkommens in bestimmten Fällen, in Gassner /M. Lang/Lechner, eds., Das neue Doppelbesteuerungsabkommen Österreich-Deutschland (1999) 209 seq (213).
such companies from the application of the treaty. The DTC Liechtenstein bans foreign-controlled base-companies from the application of the treaty.

Some DTCs contain special anti-abuse provisos to counteract very specific tax planning strategies. Art 15 para 5 of the DTC Netherlands is such an example stipulating an exception to the general rule of para 4 that capital gains shall only be taxable in the State of which the alienator is a resident. Art 15 para 5 reserves the other State a taxing right on the alienation of shares or "jouissance" rights of a resident company if the alienator himself has been a resident in the course of the last five years preceding the alienation. This provision shall render tax-driven emigration unattractive.

Other Austrian treaties explicitly state a general reservation to domestic anti-abuse legislation. In the treaty network of Austria such provisions can be found – for instance – in the DTC Switzerland (art 28 para 7), the DTC Usbekistan (art 23), the DTC Russia (art 23), the DTC Nepal (Protocol para 4). However it is doubtful, if such reservations are necessary at all as many legal writers consider the substance over form concept as immanent in the treaty provisions because every legal rule has to be interpreted according to its objectives. If one however sees Sec 22 as a separate taxable event (so-called "Außentheorie", see III.1.), such a proviso might be necessary.

In its recent treaty practice Austria generally insists on the treaty title "Convention between the Republic of Austria and xxxx for the avoidance of double taxation and the prevention of fiscal evasion" stressing that the avoidance of double non-taxation is an equally important objective of the Austrian DTCs. Consequently, an objective-guided interpretation must take this goal into consideration.

2. OECD

In 1998 the OECD published its Report "Harmful Tax Competition – An Emerging Global Issue” as a response of the OECD’s Committee on Fiscal Affairs to a request by some member countries that asked the Committee to “develop measures to counter the distorting effects of harmful tax competition on investment and financing decisions and the consequences for national tax bases”. The Report was approved on 9 April 1998 and laid down the general criteria for determining harmful tax practices. Since then the Committee has started to scrutinize several domestic measures.

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38 Art 26 para 1 reads: "This Convention shall not apply to holding companies within the meaning of the special Luxembourg laws (currently the Acts of July 31, 1929 and December 27, 1937). Neither shall it apply to income, derived from such holding companies by a resident of Austria or to shares in such companies, belonging to such a person” (unofficial translation of IBFD).

39 Art 26 para 1 reads: "The provisions of this Convention shall apply to companies and trusts, which are exempt under Liechtenstein tax legislation from capital, income and corporation taxes (under Articles 83 and 84 of the Tax law of January 30, 1961) only to the extent that individuals, resident in Liechtenstein and companies, foundations and Anstalten of Liechtenstein public law are directly interested in or benefit from such companies and trusts” (unofficial translation of IBFD).

40 Cf eg DTC Korea, BGBl 486/1987.


42 Luxembourg and Switzerland denied their approval and compliance with the Report.

43 In the light of these principles one can take a look around in the Austrian tax system for potentially harmful elements, such a look around has been undertaken by Bamberger, OECD Harmful Tax Competition (diploma thesis 2002) to be published on the EUCOTAX-website: http://www.wintercourse.com.
of Member States and Non-Member States. On 26 June 2000 the OECD finally released the Report “Towards Global Tax Co-operation: Progress in Identifying and Eliminating Harmful Tax Practices” that identifies 35 tax havens and 47 potentially harmful preferential tax regimes among OECD member states. **Austria is not included in the list**, but it is mentioned among those countries whose holding company regime has still to be examined, because the OECD has yet not come to terms how to treat such regimes: “In light of the complexities raised by such regimes, including their possible interaction with tax treaties and with generally applicable principles of domestic law, the Forum reached no conclusions concerning their status as potentially harmful preferential regimes”\textsuperscript{44}.

### 3. EC Code of Conduct

After the adoption of the Resolution on a Code of Conduct for business taxation by the Council and the Representatives of the Governments of the Member States on 1 December 1997 a group was established to assess the tax measures of the Member States that may fall within the Code\textsuperscript{45}. This group, chaired by Mrs. Primarolo, was confirmed by the Council on 9 March 1998 and started to screen the national tax laws in closed session. It first drew up an "Initial Indicative List of Measures that might fall under the Scope of the Code of Conduct” and on 29 November 1999 it finally presented a Report to the Council that gives a list of 66 potentially harmful tax measures, among which there are **two Austrian tax measures**: While the Initial List still comprised the intra-group relief for holdings, private foundations, exemptions from corporation tax for non-profit seeking credit institutions and for associations providing financing for SME, R&D allowances, the exemption from corporation tax for participation fund companies, investment allowances for fixed asset acquisitions and the unilateral relief of double taxation, the final list only included the intra-group relief and the unilateral relief of double taxation.

The **unilateral relief of double taxation** is laid down in Sec 48 BAO and gives the Federal Ministry of Finance wide discretionary powers as it is him to chose whether to grant - either partly or fully - an exemption or a credit. It is probably this intransparency that has raised legitimate concerns of the Primarolo group. According to the wording of Sec. 48 BAO Austria could grant an exemption of Austrian taxation even if the foreign State only levies a very low tax that creates the double taxation\textsuperscript{46}. To refute any such suspicion of misuse of this discretion power for attracting foreign businesses Austria would simply have to enact a regulation laying down the conditions of application of Sec 48 BAO.

The second Austrian measure still on the table of the Primarolo group is the general national exemption for dividends from and capital gains on holdings in foreign limited companies. The problematic part of the **international intra-**


\textsuperscript{46} If one looks for a detailed description of the objections to the listed measures in the Primarolo Report, one will search in vain for precise reproaches. Instead the Primarolo group has adopted a table as Annex B consisting of a column called “on list?” and another column called “features” that gives a short remark on the contested measures. On Sec. 48 BAO the group noted briefly: “Exemption for dividends possible even where from low tax foreign source.” In such a case a tax credit would be the “fair” alternative. According to members of the Ministry of Finance the current Austrian practice does not give an exemption anyway in case of a foreign tax level below 15% as this is also the margin for a switch-over from the exemption to the credit method in Sec. 10 para 3 KStG.
**group relief** is the counter-exception in the switch-over provision of Sec 10 para 3 KStG. This provision stipulates – as already described in II.1 – a switch-over from the exemption to the credit method in case of subsidiaries engaged in passive business operation in low tax countries. This however shall not hold true, if it can be documented that the majority of the shareholders are not unlimited liable to tax in Austria. At first one might wonder about this “escape-clause” and be rather at a loss about its background. It seems however that its background is the simple indifference of the Austrian legislator towards foreign tax losses: If it can be established that the majority of shareholders are not residents, the Austrian fiscus is not likely to lose any taxes as in most cases it would not tax limited tax liable foreigners for dividends received from third states anyway. Therefore it does not seem to be worth while to crack down on such parent companies. On the contrary: if foreigners find the Austrian group relief attractive enough to route their money through Austria into their home countries, they will set up a fully fledged parent office and create some jobs in Austria. Of course, this practice harms other States that might be not so cautious when dividends derive from Austria instead of the origin tax haven and therefore do not apply their CFC legislation. Thereby Austria becomes the accomplice and “fence” of many tax havens. This legitimate reproach can easily be turned down by simply abandoning the counter-exception in Sec 10 para 3 KStG and applying the switch-over clause in any case of low taxed foreign subsidiaries engaged in passive income – irrelevant of their ownership structure.

4. State Aid Rules

In **Point J of the Conclusions of the ECOFIN** Council Meeting on 1 December 1997 concerning taxation policy it was explicitly acknowledged that there was a certain overlap between the State Aid prohibition of art 87 enshrined in the EC-Treaty from the very beginning on and the soft law instrument of the Code of Conduct. The Council urged the Commission to "commit itself to the strict application of the aid rules concerned, taking into account, inter alia, the negative effects of aid that are brought to light in the application of this code". Furthermore the Council noted "that the Commission intends to examine or re-examine existing tax arrangements and proposed new legislation by Member States case by case, thus ensuring that the rules and objectives of the Treaty are applied consistently and equally to all.”

A thorough and effective application of the State aid prohibition to fiscal measures is indeed important, otherwise Member States would move over from granting direct subsidies to giving generous tax rebates and thereby easily escape the verdict on State aid of the ECT. Nonetheless one has to be aware that a broad interpretation of the scope of

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47 The Primarolo group therfore summarized its objections briefly: “Exemption for foreign source dividends of 25+% subsidiaries includes low tax foreign source. Relief for capital losses and exemption for capital gains”.

48 An exception however would be the case of a participation that belongs to a domestic permanent establishment of the foreigner.

49 Resolution of the Council and the Representatives of the Governments of the Member States, meeting within the Council of 1 December 1997 on a code of conduct for business taxation - Taxation of saving, OJ C 002 , 1 January 1998 p 1 seq.

50 On 12th December 1998 the European Commission published its "Notice on the application of the State aid rules to measures relating to direct business taxation" (OJ C-384/3) explaining its point of view on the application of the State Aid Prohibition in tax matters. For an analysis of the various tests of art 87 ECT and of the procedural background see Sutter, The Adria Wien Pipeline Case and the State Aid Provisions of the EC Treaty in tax matters, ET 2001, 239 – 250.
art 87 ECT restricts national taxation sovereignty to a great extent, although there has been almost no explicit harmonization legislation on the EC-level so far concerning direct taxation. The ECJ, however, has already adopted an extensive construction of the State aid prohibition as it has on the one hand enlarged the selectivity criterion to larger and larger groups of undertakings sharing just some sort of generic feature and has on the other hand refused to undertake any serious market analysis on the effect of the national measure on competition and intra-community trade turning these two criteria of art 87 ECT into almost void tests. The State Aid Prohibition has thereby become more and more a vehicle of introducing a judiciary control under a kind of principle of equality that does not exist as such in the ECT. Because of this far reaching field of application “the administrative and the judicial control of fiscal aids” has already been addressed in literature as the “only pillar that will allow progress to be made” in the fight against harmful tax competition.

The State aid rules, however, are no appropriate substitute for tax harmonization by legislative acts as they can only force Member States to give up – maybe reasonable – exceptions, but cannot bring about equal starting conditions between the Member States. For this structural deficiency the European Community should not exclusively rely on them as the means to bring about an even balance in tax competition. This would surely overdo the role art 87 ECT was ascribed to by the founders of the EC and raise expectations art 87 ECT can simply not fulfil. This can easily be shown on the example of the Austrian Energy Tax Refund Act that has come to set the background of the first preliminary proceedings before the ECJ ever initiated by a national constitutional court. The Austrian Energy Tax Refund Act was simultaneously passed with the introduction of energy taxation on the delivery and consumption of electricity and natural gas in Austria and enabled business enterprises whose central business activity could be proven to lie in the production of tangible goods, to file an application for a refund of the energy taxes exceeding a certain ceiling that had to be determined in relation to the turnover structure of the business. The explanatory parliamentary materials explained the necessity of such ceilings with reference to the competition situation in the production sector: As energy taxation was not harmonized within the European Union and there were still several Member States without any energy taxation, the sole introduction of energy taxation in Austria without any

51 Art 94 as the only possible competence provision makes an unanimous vote in the Council necessary. Above that the subsidiarity principle of art 5 ECT must be respected, ie it must be argued why it is more efficient to regulate something on the Community than on the national level (comparative efficiency test). Cf Lehner, Der Einfluss des Europarechts auf die Doppelbesteuerungsabkommen, IStR 2001, 329 seq (330).

52 ECJ Case C-75/97 Belgium v Commission [1999] ECR I-3671, para 28 to 31; 8.11.2001, C-143/99 Adria Wien Pipeline para 48. Critical on this vast construction Advocate General Mischo, C-143/99 para 48: “A measure geared towards a large number of types of goods, listed individually, is not necessarily the same as a measure geared towards the whole primary and secondary sector of a national economy.”


54 So Santos, Ponit J of the Code of Conduct or the Primacy of Politics over Administration, ET 2000, 420.


56 72 BglNR XX. GP 204. The restriction of the energy rebate to the productive sector could have been well justified as firstly the productive and the service sector are in no competition situation that could be distorted (see the Conclusions of the Advocate General para 78) and secondly, the Austrian energy tax could be considered as a lump-sum taxation on the use of difusal energy (heating, lighting, …) only, whereas the productive energy should be spared out (see Sutter, ET 2001, 249). The only thing not justifiable was the restriction to undertakings whose activity is shown to consist primarily in the production of tangible goods thus favouring pure production businesses at the cost of mixed production/service companies. The ECJ, however, did not go that deep into the problem and considered already the exclusion of the service sector as basis for assuming a preferential character of the measure.
accompanying measures would have meant a tremendous economic disadvantage for Austrian producers and brought some of them on the curb of economic ruin. Austrian undertakings did therefore not consider themselves as aided by the energy taxation package of parliament at any time as they were certainly worse off than before its introduction\textsuperscript{57}. The ECJ, however, did not accept the "package-argument"\textsuperscript{58} and declared the rebate as illicit aid. At the same time it refused to take up the Advocate General’s suggestions to reshape the State aid prohibition in tax matters in a more cautious and sensitive way.

After the Adria Wien Pipeline ruling it will thus be hardly possible anymore to justify deviations from the general tax scheme\textsuperscript{59}. National tax legislation will thus be hardly imaginable without cooperation with the EC-Commission anymore as new tax acts regularly can’t go without various – economically or politically necessary – deviations for certain groups of taxpayers. Art 87 ECT in its construction by the ECJ has thus brought a far-reaching influence of the EC-Commission (and not the EC Council!) on national tax legislation. By threatening not to approve the planned deviations of a Member State, the Commission will now be able to push its ideas on taxation policy through more easily\textsuperscript{60}. This \textbf{shift in legislative competence in tax matters} by the way of art 87 ECT would probably have surprised the founders of the ECT.

There are two more structural deficiencies embedded in the State aid rules: they clearly favour smaller and "younger" Member States. As soon as a State measure is applicable to the entire national territory and all sectors of the economy it can no longer be State aid. Therefore the EC Commission has been helpless against the introduction of a generally low corporate tax rate in Ireland, while it brought a German tax provision successfully before the ECJ that gave all businesses in former East Germany – a region larger and higher populated than Ireland - a better refinancing possibility\textsuperscript{61}. The procedural distinction of art 88 ECT between existing aids that were in operation when the EC-Treaty came into force on 1 January 1958 or on a later Accession date and new aids create another imbalance of the EC State aid rules. Existing aid measures are in a far better procedural position, as they are as long compatible with the common market as the Commission has not stated otherwise. In contrast to this, new measures must be notified to the Commission and are automatically regarded as illicit aid in case of breach of the notification obligation. This puts

\textsuperscript{57} Advocate General Mischo has acknowledged this situation and suggested a sensitive approach to redefine the scope of the State aid prohibition. He suggested to reanimate the test of distortion of competition and affection of intra-Community trade stating that reliefs in package with new burdens couldn’t be seen isolatedly as an aid measure when the negative impact of the package prevailed. One would have to compare the situation before the introduction of a State measure and afterwards (para 67 seq). According to the Advocate General "a Member State which introduces ecology taxes, without being obliged to do so by a Community provision, has a perfect right to proceed in a cautious manner" (para 76).

\textsuperscript{58} It declared it "irrelevant that the situation of the presumed beneficiary of the measure is better or worse in comparison with the situation under the law as it previously stood, or has not altered". For the ECJ "the only question to be determined is whether, under a particular statutory scheme, a State measure is such as to favour certain undertakings or the production of certain goods within the meaning of Article 92 (1) of the Treaty in comparison with other undertakings which are in a legal and factual situation that is comparable in the light of the objective pursued by the measure in question" (para 41).

\textsuperscript{59} Above all, the benchmark tax system test helps little in removing uncertainties about the limits of art 87 ECT, as it is often not easy to tell what still makes up the general scheme and what makes up an exception: cf Schön, Taxation and State Aid Law in the European Union, CMLR 1999, 911 seq (930) and Sutter, ET 2001, 241.

\textsuperscript{60} The ECJ has already declared in various rulings that the Commission enjoys a wide discretion in its approval practice under the discretionary exemptions of art 87 para 3 ECT, see Sutter, ET 2001, 244 seq.
Member States that have acceded the European Communities on a later date in an advantageous position. One just has to think of a national preferential tax measure that has – without prior notification to the EC-Commission - been adopted both in Austria and Germany in 1992. While the German provision constitutes illicit State aid that mustn’t be granted, Austria can pay the aid as long as the Commission has not opened ex officio an examination procedure and declared the measure incompatible with the common market. This structural imbalance of art 88 ECT could only be adjusted by special provisions in the Accession Acts of new Member States – an opportunity that ought to be kept in mind in the current Accession negotiations.  

A forth potential deficiency lies in the "standstill clause" of art 88 para 3 last sentence ECT that is - according to the case law of the ECJ - directly applicable and can thus be invoked by any person before national courts. The ECJ has repeatedly pointed out that if the notification requirement wasn’t backed by such a directly applicable standstill clause, it would hardly be respected by the Member States. The standstill clause is thus important to prevent faits accomplis for the Commission. However, the exact consequences national courts have to draw from a non-notification are still unclear in many respects. The ECJ has not taken a clear stand on this issue up to now and referred broadly to the national laws: "National courts must offer to individuals the certain prospect that all appropriate conclusions will be drawn from an infringement of that provision, in accordance with their national law, as regards the validity of measures giving effect to the aid, the recovery of financial support granted in disregard of that provision and possible interim measures." 

In the Adria Wien Pipeline Case the Austrian Constitutional Court has already pointed out in its order of 10 March 1999 referring to the ECJ for a preliminary ruling that it sees generally two possible conclusions to draw from a breach of the notification obligation. It could either regard the whole Energy Refund Act as inapplicable and grant no more aid to any claimant or it could only consider the restriction to the industry inapplicable and grant the reimbursement to any undertaking. In the latter case the rebate of the Energy Refund Act is extended – by court
ruling - to all undertakings. It then constitutes, of course, no longer an aid measure in the sense of art 87 ECT and turns into a general economic measure not granted to specific undertakings. This approach has eventually been adopted by the Austrian Constitutional Court after having received the response of the ECJ that the current rebate system infringes art 87 ECT. It is deplorable that the ECJ has not taken the opportunity to comment on this second possible consequence to draw from a non-notification. In my view, it is quite doubtful if the national courts really have both alternatives – enlarging or denying the aid - on hand. If one draws the parallel to the classical aid situation where the State grants a certain cash amount to an individual undertaking (what has been the historical common pattern in 1958), nobody would come to the idea that a national court has to grant the subsidy to all undertakings in order to satisfy the standstill clause of the ECT. Why should there be a difference when the aid is granted indirectly or to more than one undertaking?

Above that, the approach of the Austrian Constitutional Court clearly overdoes the role ascribed to the national courts by the review machinery established by art 88 ECT. When a national court draws the conclusion to grant an aid to all undertakings, it does no longer only safeguard the notification to the Commission, it renders it unnecessary! This seems in contradiction with the ECJ-ruling that the national courts must not rule on the compatibility of aid measures with the common market as the final determination on that matter is in the exclusive responsibility of the Commission, subject to review by the Court of Justice. If a State measure is enlarged to a general economic measure by the national court, the EC-Commission is put out of the game, as an approval by it is then no longer necessary. The wording of art 88 para 3 last sentence ECT, however, only says that the Member State ”shall not put its proposed measures into effect” before the end of the procedure before the Commission, it does not say that the Member State should grant the aid in the meantime to all undertakings as a general measure. A court that draws this conclusion arrogates - without any necessity out of EC law - a competence normally solely attributed to the legislator and not to the judiciary. For these reasons it is very likely to leave thereby the role ascribed to it in the triangle of powers of art 88 ECT.

IV. Conclusions

Although Austria has – apart from Sec 10 para 3 for inter-company dividends – for good reasons no general CFC legislation, it possesses a range of possibilities in the domestic tax system to hamper the use of benefits granted by foreign States in ”unfair” tax competition. The anti-abuse rules, the allocation of income principles, the residence rules, the obligation to name the recipients of payments and the procedural situation in cross-border cases make it possible for the tax administration to examine thoroughly the economic reasonableness of the taxpayers’ allegations making various tax planning strategies unattractive that want to make use of such ”unfair” tax competition.

modification, car l’État finlandais devrait décider quelles règles de déductibilité seraient applicables à l’ensemble des cotisations de retraite. »


69 C-143/99, para 29. See also ECJ, C-354/90 FNCE para 14.

70 See Sutter, ET 2000, 246 seq.

71 Gassner, Neun und noch viel mehr Gründe gegen ein österreichisches Außensteuergesetz, SWI 2001, 295 ff.
However, even if the available domestic measures can not fight *all* forms of unfair tax competition, one has to observe the proportionality of the applied means and **must refrain to call reflex-like for certain tools** of which their efficiency is all but clear. This holds true for a special CFC-regime of the German type which dates from the early 70ies and has proven to be almost not administrable as well as for special anti-abuse clauses in double taxation convention. Their place should be filled by a construction of legal rules guided by their objectives and by a more critical allocation of income. Such instruments are both an effective and in their reasoning verifiable way of counteracting abuse of law.

While the OECD has - up to now - not brought forward any harmful tax practice of Austria, the EC Primarolo Group lists Austria with **two measures**: the unilateral relief of double taxation of Sec. 48 BAO and the international group-relief system in Sec 10 para 2 and 3 KStG. As Austria has always declared its support of the initiatives of OECD and EC and its principal willingness to comply with the results of the screening process, Austria should be very likely to enforce the recommendations of the EC. This especially holds true as the necessary amendments should – as pointed out in III.3. – be easy to implement and of relatively minor systematic change.

Something that has – up to now - not been discussed in the framework of OECD and EU is, whether the **lack of application of the Austrian anti-avoidance rule of Sec 22 BAO to foreign taxes** might in itself be regarded as a form of **Austrian “unfair” tax competition**. This paper has shown that Austrian anti-abuse rules are still very often exclusively targeted at the prevention of losses of Austrian taxes whereas tax planning strategies of detriment to foreign fisc are seen with the tranquillity of a curious bystander not involved. In 2000 the Austrian Administrative Supreme Court even hindered the tax administration to counteract crossborder tax planning strategies stressing that Sec 22 BAO was not applicable if only foreign taxes were circumvented. This ruling, however, can already be challenged de lege lata, as an objective driven interpretation of the DTC would probably have led to another result. Before the background of the international developments in the fight of ”unfair” tax competition it even ought to be.

On the level of Austrian DTC the international developments have already exercised a remarkable influence: In the **DTC Austria – Germany “unfair tax competition”** has even been accepted as the starting point for a switch-over clause from the exemption to the credit method. Unfair tax competition is thereby defined in reference to the work of the OECD and the EC. Their definitive recommendations that are still to be awaited will consequently have an immediate legal impact in Austria.

On the European level the State aid prohibition of art 87 ECT has become the most popular weapon against preferential tax regimes. The importance of the application of the State aid rules to tax benefits as indirect forms of State aid shall thereby not be questioned in principle. Nonetheless, it must be pointed out that the interpretation of the ECJ is a very broad one restricting the sovereignty of the Member States in tax legislation to a questionable extent. This tendency is even stiffened if national courts apply the stand-still clause of art 88 para 3 last sentence ECT in the way that they grant an aid measure to all instead of only some business enterprises. Such an application of the ECT leads to an exclusion of the national legislator beyond the objectives of art 87 seq ECT. When referring to the **State aid rules** as the most effective control mechanism against ”unfair” tax competition, one should therefore be aware of
their "deficiencies" elaborated in this report. As the example of energy taxation shows, the State aid prohibition of art 87 seq ECT is not always an appropriate substitute for lacking unanimity for a tax coordination by legislative acts as legislative acts are the only way to curb harmful tax competition and take the overall picture into account at the same time.