

# The Austrian Donations Tax Act 2008 for Foundations and Comparable Entities

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## Abstract

This article considers the recent tax amendments for Austrian private foundations and foreign foundations and trusts. After the abolition of the gifts and inheritance tax the Austrian legislature adhered to the taxation of donations to private foundations and comparable foreign foundations and entities. The transfer of assets to foundations or trusts in countries whose tax regimes facilitate tax evasion will be subject to surtax. The impact of this new law on domestic tax law and European law principles is discussed in detail.

## Introduction

Until recently, the Austrian Gifts and Inheritance Tax Act provided the basic legal framework for the taxation of natural persons as well as donations to private foundations in Austria. Gratuitous donations between natural persons were taxed at between two per cent and 60 per cent of the amount donated, depending on the degree of kinship; while donations to Austrian private foundations regularly triggered a flat rate equal to five per cent of the asset contributed. As a consequence of this advantageous tax rate, contributions to beneficiaries of a private foundation were, in addition, subject to capital gains tax at a flat rate

of 25 per cent. The establishment of a private foundation enabled the avoidance of the regular gifts and inheritance tax rates and foundations which retained profits rather than distributed assets enjoyed large-scale tax privileges. In 2007 the Austrian Supreme Court having jurisdiction over constitutional cases repealed the Gifts and Inheritance Tax Act of 1955 on the basis that valuation regulations did not apply equally to real estate assets and set a deadline for revision of the law by 1 August 2008.<sup>2</sup>

The Austrian legislature decided to dispense with the gifts and inheritance tax for natural persons, but to continue taxing donations to foundations under a new law which is supplementary to the general regulations on the taxation of private foundations. The Donations Tax Act came into force on 1 August 2008 and regularises the taxation of donations to Austrian private foundations in compliance with the Austrian Private Foundations Act 1993 and in particular, the taxation of donations to foreign foundations and trusts.<sup>3</sup> In future, contributions of capital to Austrian private foundations and donations to foreign foundations and trusts which are 'comparable' to an Austrian private foundation will be taxed at a flat tax of two and a half per cent instead of five per cent. Donations to non-comparable foreign foundations and trusts will be taxed at a penalty rate of 25 per cent in order to prevent tax evasion. These punitive measures are primarily aimed at donations to

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2. Austrian Supreme Court for constitutional cases G 54/06 of 7 March 2007 and G 23/07 of 15 June 2007 to no. 1 and 2 of art. 1 sec. 1 Austrian Gifts and Inheritance Tax Act 1955.

3. Austrian Federal Law Gazette No. 85/2008, issued on 26 June 2008.

foundations and trusts in Liechtenstein and Switzerland.<sup>4</sup> Trusts which are established under British law may also trigger these anti-avoidance measures if they do not fulfill the legal requirements provided for Austrian private foundations.

## Scope of application and tax exemptions

The Donations Tax Act 2008 for private foundations was passed as chapter VI of the Gifts Report Tax Act 2008.<sup>5</sup> In terms of the new provisions, both gratuitous donations by testamentary disposition and inter vivos contributions by the grantor—provided that either the grantor is resident or the receiving foundation is based in Austria—will be taxed. As a result, the transfer of domestic property is not compulsorily subject to donations tax. The provisions of the Donations Tax Act 2008 are also applicable to transactions resulting in an attribution of assets to foreign foundations and trusts.<sup>6</sup> A pre-condition for the tax is the transfer of property from the founder to the foundation or trust. If the foreign entity is not deemed to be discretionary and consequently, not recognised as an independent tax subject, for example due to decision-making powers vested in the founder, then an attribution to such an entity will not trigger a tax liability. On the other hand, the income of such a foreign entity will, in general, be attributed to the underlying founder.<sup>7</sup>

The Donations Tax Act 2008 provides that inter vivos donations by the founder to non-profit organisations and church organisations are tax-exempt. Donations on the basis of a testamentary disposition are exempt from taxation if shares equal to less than one per cent of the nominal capital of a capital

company are transferred to the foundation. Donations of capital assets which are subject to capital gains tax are also tax-exempt. In the past, the Austrian Gift and Inheritance Tax Act provided for an advantageous fiscal regime for the granting of a usufruct. The reservation of such a usufruct on the part of the founder reduced the tax basis of the donated asset. On the other hand, the cancellation of the usufruct after the death of the founder did not affect the basis for gift and inheritance tax.<sup>8</sup> The Donations Tax Act does not provide any such tax privileges for usufructs.

## Tax rates

The tax rate for donations to foundations has been reduced from five per cent to two and a half per cent due to the abolition of the gifts and inheritance tax. This tax rate applies to attributions to Austrian private foundations and comparable foreign foundations and entities. A pre-condition for comparable treatment is the provision by the foreign foundation or entity of the same criteria for the exercise of discretionary powers as an Austrian private foundation. As a result, criteria such as the non-existence of proprietors or shares or the existence of any other authority aside from the board of directors of the foundation will be taken into account by the tax authorities.<sup>9</sup> A distinctive advantage is that comparable foreign foundations and entities will enjoy equal tax treatment with Austrian private foundations on the level of the capital gains of the foundation and contributions to beneficiaries. Another significant change is that the tax rate for gratuitous donations to foundations and comparable entities will increase from two and a half

4. Cp. *Kerres/Proell F.*, The new tax regulations concerning the Donations Tax Act 2008, *ecolex* 2008, 567. *Proell F.*, The fiscal implications of the Gifts Report Tax Act 2008, *ZfSt* 2008.

5. The Gifts Report Tax Act 2008 provides that natural persons have to report gratuitous donations once certain thresholds have been exceeded in order to avoid tax evasion.

6. In addition to Austrian private foundations and comparable foreign entities, foundations pursuant to the Federal Foundations and Endowments Funds Act as well as foundations based on Austrian Federal State Laws also fall within the scope of the Initial Endowment Act 2008. Foundations instituted under public law and foundations of the Catholic Church are excluded; cp. *Arnold/Ludwig*, Amendments of the initial endowment tax for private foundations, *taxlex* 2007, 191.

7. Information from the Austrian Department of Treasury of 23 April 2008: I.e. foundations established under the laws of Liechtenstein are considered to be 'transparent' unless the founder is able to refute this general assumption of transparency.

8. Art. 3 sec. 2 Gifts and Inheritance Tax Act (until 31 July 2008).

9. The Austrian tax authorities in particular consider criteria such as the legal personality of the foundation, presentation of donated goods, legally permissible purpose, compulsory bodies such as a board of directors and auditor, designation of beneficiaries and limited liability of the foundation as essential.

per cent to 25 per cent where: (i) the deed of foundation and other related documents are not disclosed to the tax authorities within a certain period of time; (ii) the foreign foundation or entity is not comparable with an Austrian private foundation; or (iii) no bilateral or multilateral treaty on mutual assistance in tax matters has been concluded between Austria and the state in which the receiving foundation is registered.<sup>10</sup> The increased tax rate of 25 per cent will prevent Austrian citizens from transferring assets to foundations or trusts in countries whose tax regimes facilitate tax evasion.

### Non-disclosure of the foundation's documents

Donations to private foundations or comparable foreign foundations or entities are subject to an increased tax rate of 25 per cent if all updated documents reflecting the current administration and application of funds of such a foreign foundation or entity are not disclosed to the tax authorities. Therefore, the documents of the foundation must be disclosed no later than when the payment of the tax is due.<sup>11</sup> The purpose of this regulation is to facilitate the assessment of foreign legal entities and to permit comparisons and equality of treatment with an Austrian private foundation. As a result, it is advisable to check whether all relevant documents which are required by the tax authorities will be available by the due-date. The Austrian Corporate Income Tax Act provides for a similar provision in Article 13 concerning the disclosure of documents in respect of a private foundation. Contrary to the punitive purpose of the provisions relating to the non-disclosure of documents in the event of a donation, Article 13 only disapplies the right to choose a reduced tax rate which, in certain cases, can be advantageous for foundations. In addition, the disclosure of the

foundation's documents is not subject to as rigorous a time limit as applies to donations pursuant to the Donations Tax Act.

### Austrian and foreign foundations

In the past, Austrian tax provisions concerning foundations affected only Austrian private foundations. Donations to foreign legal entities were subject to gifts and inheritance tax at a rate of up to 60 per cent. Subsequent contributions to beneficiaries residing in Austria were taxed at a progressive income tax rate of up to 50 per cent. Thus, payments to beneficiaries through a foreign entity automatically caused a loss in value of up to 80 per cent of the amount originally donated. The new provisions provide for a tax rate of two and a half per cent for donations to foreign foundations and entities which are comparable to an Austrian private foundation. Subsequent distributions to Austrian beneficiaries are subject to a tax rate of 25 per cent, which corresponds with the Austrian capital gains tax rate.<sup>12</sup> The reduced flat rate of two and a half per cent for foreign entities will only apply if the foreign entity is comparable to an Austrian private foundation and if the country of establishment of the foreign foundation has entered into a treaty of mutual assistance in tax matters with Austria.

An increased tax rate of 25 per cent is applicable if the foundation or other foreign entity is not comparable to an Austrian private foundation. An Austrian private foundation pursuant, to the Austrian Private Foundation Act 1993, is characterised by an independent board of directors vested with discretionary powers and its own legal personality. Furthermore, an Austrian private foundation cannot be divided into shares and therefore may not have shareholders. The private foundation must also be dedicated to a certain purpose and must have beneficiaries who

10. Art 1 and Art 3 Donations Tax Act.

11. The due date for donations tax is the 15th of the second-month after the donation to the foundation or comparable foundation or asset has been made.

12. In a decision of the Austrian Tribunal for Tax Matters (UFS RV 1689-W/05 of 11.10.2006) the tribunal found that the application of the reduced flat tax rate (which is the flat rate for capital gains tax) for domestic foundations only violates the basic principle of equality and the principle of free movement of capital within the EC.

are clearly determined or at least determinable. Foundations which are controlled by the founder and non-transparent trusts which have no legal personality, as measured by the direct liability of the founder from a civil and tax law point of view, are not comparable to an Austrian private foundation and are, therefore, subject to the increased tax rate of 25 per cent.<sup>13</sup> It remains to be seen whether the final legal interpretation of this standard of comparison lies within the power of the Austrian tax authorities.<sup>14</sup> In order to compare the domestic and foreign facts of a case and laws between countries within the European Union, a common base technically has to be formed. The Austrian Donations Tax Act seems to exclude the formation of such a common base. It is likely to be the case that, at some point, an EU member will consider its foundation or trust vehicle as comparable and the matter may, as a result, come before the European Court of Justice or the Court of the European Free Trade Association to adjudicate on the legal requirements for the comparison of foreign foundations and trusts within the EEA.

### **Non-existence of a treaty on mutual assistance in matters of direct taxation**

The third case in which a donation to a foundation or any other comparable entity will be taxed at a rate of 25 per cent refers to foundations established and registered in countries which have not entered into a treaty of mutual assistance in tax matters with Austria. Within the European Union, Council Directive 77/799/EEC of 19 December 1977 on

mutual assistance in tax matters provides for the mutual exchange of information between the tax authorities of the EU Member States. Member States' competent authorities are therefore required to exchange any information which appears relevant for the correct assessment of taxes on capital income and the assessment of indirect taxes in general.<sup>15</sup> EFTA Member States, such as Iceland and Liechtenstein and non-EU countries, which have not entered into a separate agreement on mutual assistance in tax matters, are generally not obliged to guarantee similar cross-national administrative assistance.<sup>16</sup> As potential founders in Austria have traditionally preferred to transfer assets to Liechtenstein than to other tax-friendly jurisdictions, this increased tax rate particularly affects donations to foundations, establishments and trusts established under Liechtenstein law. In fact, this provision is primarily aimed at donations to foundations and other entities in Liechtenstein<sup>17</sup> though common law trusts established under US, Australian or New Zealand law are nevertheless subject to the same penalty taxation in default of any ratified bilateral or multilateral treaty on mutual assistance in tax matters with Austria.

This raises the question whether these penalty taxes are permissible in the light of the European law principle of free movement of capital.<sup>18</sup> The principle of free movement of capital comprises movements within the European Union as well as capital transfers to third countries. In a Recommendation dated 19 December 2006 relating to exit taxation and the coordination of Member States' tax policies, the European Commission stated that Member States

13. Contrary to controlled foundations, the board of a discretionary foundation may decide independently on the current administration, whereas the founder may reserve to itself the right to address "letters of wishes" to the board of the foundation in administration matters. The board of a discretionary foundation may make payments to beneficiaries in accordance with the foundation's purpose independently and at its own discretion.

14. Cp. *Proell F*, European Law aspects in relation to punitive measures in the Donations Tax Act 2008, *taxlex* 2008, 239.

15. Last amended by EC Directive 2004/56/EC of 21 April 2004: Taxes on income and on capital are deemed to include all taxes, irrespective of the manner in which they are levied, imposed on total income, on total capital, or on elements of income or of capital, including taxes on gains from the disposal of movable or immovable property, taxes on the amounts of wages or salaries paid by enterprises, as well as taxes on capital appreciation.

16. The only EFTA Member State which has ratified an agreement on mutual assistance in tax matters is presently Norway.

17. *Financial Times*, Liechtenstein lays plans to move away from position as tax haven (15 August 2008): Liechtenstein's head of government Othmar Hasler, announced that one measure being considered in the face of tax evasion was the idea of giving governments information about people with undeclared accounts, provided that they did not suffer excessive penalties'.

18. Art 56 and 58 EC; pursuant to Appendix 1 of the EC Directive 88/361 EEC, donations and endowments to foundations fall within the scope of application of the EU-principle of free movement of capital.

may take necessary measures to prevent tax evasion.<sup>19</sup> The European Commission holds the view that Member States may legally guard against tax evasion if they have to deal with countries which have not entered into bilateral agreements on mutual assistance in tax matters. The explanatory remarks to the Donations Tax Act 2008 justify the tax penalty by citing the fact that data is difficult to collect in such countries. In light of these punitive measures, the European Court of Justice has so far differentiated between points of contact with third countries which have not entered into bilateral agreements and points of contact with EFTA countries which have not ratified such an agreement.<sup>20</sup> Consequently, the jurisdiction of the European Court of Justice does not explicitly cover cross-border penalty tax measures to the disadvantage of EFTA Member States, such as Liechtenstein.

### Donations to sub-foundations

In the past, donations from one foundation to another were subject to a reduced tax rate of two and a half per cent. With regard to foreign foundations, the Austrian tax authorities did not uniformly apply this reduced tax rate for donations to Austrian sub-foundations.<sup>21</sup> If beneficiaries with unrestricted tax liability in Austria collected benefits from a foreign foundation, such capital gains were regularly subject to income tax at a progressive rate of up to 50 per cent. In the case of a payment to an Austrian beneficiary, typical tax planning involved transferring assets from a foreign foundation to an Austrian sub-foundation. The foreign donation to the Austrian sub-foundation was taxed at a tax rate of five per cent. A subsequent distribution

to an Austrian beneficiary was subject to capital gains tax at a flat rate of 25 per cent. In order to avoid such structuring the new legal provisions provide for more comprehensive taxation of donations to sub-foundations.

In future, each donation of a foundation or comparable foundation or entity to a sub-foundation will be subject to Austrian capital gains tax provided that the payment does not comprise assets which are assigned to the founder. Capital gains tax can be avoided if the founder verifies all amounts which originate from its funds by means of a special account.<sup>22</sup> A tax-neutral payment cannot be made until the special account proves the origin of funds and it is clear that such funds are not to be regarded as profit of the foundation. The special account must at least comply with the formal accounting requirements laid down by the Austrian Commercial Code. It can be assumed that many foreign foundations or discretionary trusts will not be able to avoid capital gains tax liability in the event of a donation to an Austrian sub-foundation. Gains and appreciations in value of the foundation's assets are, in any case, subject to capital gains tax.

### Revocation of foundation

According to Austrian law, the founder may revoke the private foundation in his lifetime if he has reserved such a right in the deed of foundation.<sup>23</sup> In the event of such revocation before 31 July 2008, the founder was able to claim a refund of any donations paid. The new legal provisions no longer allow for such refunding. The provisions regarding the taxation of capital gains have been largely retained. Since all

19. COM(2006) 825 (19 December 2006): Communication from the Commission to the Council, the European Parliament and the European Economic and Social Committee about exit taxation and the need for coordination of Member States' tax policies; according to this recommendation the EEA/EFTA countries constitute a special case, as they are bound by EU provisions on free movement but not on tax legislation. The Commission considers, in order to ensure that revenue can accrue to the country being left, that tax may be demanded on exit unless bilateral agreements provide for other solutions.

20. ECJ 18 December 2007, No. C-101/05, A.

21. A statutory notice from the Austrian Tax authorities dated 14 November 1999 provided for the equality of Austrian private foundations and foundations established under Liechtenstein law. The later tax administration did not comply uniformly with that statutory notice and applied the regular tax rate of five per cent for Liechtenstein foundations.

22. The keeping of a special account reflecting all donated and distributed assets is a mandatory requirement for Austrian private foundations after 1 August 2008. Austrian private foundations established before this date and foreign foundations may prove a payment of the original assets against production of the balance sheets.

23. Art 34 Private Foundation Act 1993; legal entities may not reserve such right.

distributions by the foundation are, in the ordinary course, subject to capital gains tax, the founder may apply for the amount of his donated funds to be taken into consideration. A pre-condition for such consideration is proof of the value of the donated funds at the time of donation to the foundation.<sup>24</sup> In the past, all other payments by an Austrian private foundation, whether of regular payments to beneficiaries or other contributions in the course of a cancellation beyond a revocation, for example to a final beneficiary, were subject to capital gains tax.<sup>25</sup>

This disadvantage has been described as the fiscal 'mousetrap-effect' of the private foundation.<sup>26</sup> Donated funds were automatically subject to capital gains tax at a flat rate of 25 per cent in the event of distributions to beneficiaries made before 31 July 2008. This 'mousetrap-effect' was justified by the advantageous taxation of retained profits. The cancellation of gifts and inheritance tax in Austria required substantial changes to remedy this 'mousetrap-effect'. The new provisions render distributions by foundations tax neutral—including distributions to beneficiaries and final beneficiaries—if the assets originate from the assets of the founder and can be verified as such. As previously mentioned, a pre-condition for the tax-neutral refunding of assets is the keeping of a special account reflecting all donations which originate from the founder. However, such tax-neutral payments are subject to the following qualifications. Where generally the executive board of a corporate entity may render such a tax-neutral payment at its own discretion, the board of a foundation may not choose whether a payment of the foundation is to be regarded as a tax-neutral distribution of funds originally donated or a taxable capital gains distribution.

In addition, though gratuitous donations, in the ordinary course, do not lead to the disclosure of hidden reserves,<sup>27</sup> Austrian law requires that hidden reserves are disclosed and taxed if funds are distributed to beneficiaries or refunded to the founder.

## Conclusion

Despite the abolition of gifts and inheritance tax, the Austrian legislature adhered to the principle of taxation of donations to and distributions by private foundations. In the event of a donation to a private foundation, tax at a rate of two and a half per cent of the amount donated must be paid. A further distribution to beneficiaries is subject to capital gains tax of 25 per cent. In the past, the economic attractiveness of an Austrian private foundation was linked to the tax rates of the gifts and inheritance tax, as 40 per cent of the private foundations in Austria were established for tax reasons. Although natural persons may donate the majority of their assets without any tax burden in the future, donations to private foundations remain subject to donations and capital gains tax. Donations by Austrian founders to foreign foundations or comparable foundations and entities may be subject to a 25 per cent penalty tax if the foreign foundation or similar entity is not comparable to an Austrian private foundation or failing a treaty of mutual assistance in tax matters. These punitive measures are not presently justified by judicial precedent of the ECJ and may violate the principle of free capital movement within the EEA. It seems certain, at present, that the new provisions on the taxation of foundations in Austria will not enhance the attractiveness of the Austrian private foundation.

24. The assessment of the respective amounts depends on the classification of goods (e.g. business property, buildings or private property); Art 6 and Art 16 Income Tax Act (In general, assets may be valued at book value, real acquisition costs or part value).

25. Proell F., The 'mousetrap-effect' and the new provisions on the tax-neutral refunding of initial contributions of private foundations, ZfSt 2008.

26. Doralt W., Tax Law 2007 (8), recital 226.

27. Hidden reserves occur when assets are valued with the book value but have a higher current market price. According to civil law principles the distribution of funds of a foundation is regarded as gratuitous.