

Profit Distribution versus Equity Repayment in Austria

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When making a distribution to the shareholder, an Austrian company may have the possibility to choose how such distribution is treated and how it is taxed. The rules and timing constraints are of great importance. Following an Austrian Administrative Supreme Court Decision (*Erkenntnis des Verwaltungsgerichtshofes* dated 05.02.2021, Ro 2019/13/0027), this article explains the Austrian tax situation in relation to profit distributions on the one hand and equity repayments on the other hand.

Treating a distribution as capital repayment can save a lot of Austrian taxation

Profit distributions made by corporations are generally subject to a withholding tax at the rate of 27.5% if the recipient is a natural person. For most Austrian tax residents this withholding tax finally covers the tax liability on the dividend income. This is different if the individual shareholder applies for regular taxation of the dividend. Such application makes sense if the person's total taxable income is low so that his average income tax rate is less than 27.5%.

If the recipient is a corporation, the withholding tax rate is reduced to 25% (corresponding to the corporate tax rate), but in many cases exemptions apply either on basis of domestic provisions (participation exemption) or on basis of double tax treaties.¹

Equity repayments, however, are never subject to withholding tax. It is hereby not relevant whether the recipient is a natural person or a corporation. The repayment of equity just reduces the acquisition costs and thus increases the tax basis in case of a later disposal of the participation.

When does a company have the option how to treat a distribution?

Until 2015, corporations were free to decide whether a payment to its shareholders shall be qualified as profit distribution or as equity repayment for tax purposes (provided that both kinds of payment were allowed under company law accounting rules).

In 2015, the Austrian income tax law was amended so that equity contributions should only be possible after all profit amounts were distributed. However, this amendment did not enter into force and was overruled by a subsequent amendment that restored the freedom of choice. However, such choice is only possible, if the company has sufficient equity amounts as well as sufficient profit amounts to be distributed. In case that there are no sufficient profit amounts, dividend payments must be qualified as equity repayments, whereas payments must be qualified as dividend distributions in case that there is not sufficient equity available to be repaid.

The available equity resulting from shareholder contributions and the available profit amount resulting from the company's business activities (the company's internal financing, in German "*Innenfinanzierung*") is calculated according to tax provisions on basis of the equity and profits

¹ It should be noted that dividends received by an Austrian corporation from another Austrian corporation are always exempt from corporate tax but might not be exempt from withholding tax; in this case withholding tax on dividends is refunded or treated as corporate tax prepayment.

shown in the financial statements and must be disclosed in a separate table as part of the corporate income tax return.

In case there is sufficient equity as well as sufficient profit available to cover the distribution, the choice of qualification has to be made ultimately at the end of the calendar year. Regularly the choice is made in the withholding tax return that must be filed within one week after the distribution. A qualification of (hidden) distributions as equity repayments after the end of the calendar year is not possible.

Court decides that deadline for choice must be read strictly

The decision of the Austrian Administrative Supreme Court mentioned at the beginning of this article confirmed this point of view pursuant to an appeal of the Austrian tax authority against a decision of the Austrian Federal Finance Court (*Bundesfinanzgericht* or *BFG*). In its decision, the *BFG* was of the opinion that the option for qualification of a (hidden) distribution as equity repayment can be executed without time limits. In the case at hand, a company sold shares in a participation, but part of the purchase price was not paid to the company but to its shareholder. This was discovered during a tax audit and withholding tax was charged retrospectively. This tax charge was contested by the company that missed-out on the payment, favouring its parent. This company argued that part of the payment made to the shareholder should be considered as equity repayment. The *BFG* followed this argument. The *VwGH* repealed this decision, however, arguing that the qualification as equity repayment must be exerted until the end of the calendar year in which the payment was made. As the hidden distribution in the case at hand was made in 2009 and the qualification as equity repayment was only brought forward in the appeal against the tax charge some years later, withholding tax had to be paid.