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ECJ Pending Cases from Austria – F.E. Familienprivatstiftung Eisenstadt and Finanzamt Linz

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I. Overview

There are currently two direct tax cases from Austria pending before the ECJ: In *F.E. Familienprivatstiftung Eisenstadt* (C-589/13) the court will have to deal with the issue of whether it is in line with the free movement of capital that Austrian law denies a private foundation the full refund of "interim tax" paid by the foundation upon a distribution that the private foundation makes to non-resident beneficiaries who are tax treaty protected (while such refund would be granted if there were no such tax treaty protection for the non-resident beneficiary).[2]

In *Finanzamt Linz* (C-66/14) the issue is whether it is in line with the freedom of establishment that the goodwill amortization on share deal acquisitions, as granted by Austrian law in the years at issue, is exclusively foreseen for the acquisition of domestic (i.e. Austrian) target companies (but no such goodwill amortization is possible for the acquisition of non-resident target companies, even if resident in another EU Member State). Further, the *Finanzamt Linz* case also includes a state aid issue as to the alleged selectivity of the grant of the goodwill amortization only in specific situations while others remain excluded from it.[3]

II. F.E. Familienprivatstiftung Eisenstadt (C-589/13)

A. Background: The "Interim Tax" Regime for Austrian Private Foundations

Since 1993, Austrian law has allowed for the establishment of private foundations (*Privatstiftungen)*. Such private foundations are independent juridical persons, established by a founder (*Stifter*), but with an independent board (*Stiftungsvorstand*) and without any ownership of the founder in the foundation or its assets. According to the foundation deed (*Stiftungsurkunde*), the board may (or even has to) grant distributions (*Zuwendungen*) to beneficiaries (*Begünstigte*) of the foundation.

Initially (i.e. in the initial version of the tax regime for private foundations), the foundation was tax exempt on its investment income and capital gains derived from the alienation of shares. The concept of the taxation of foundations was that such income should not be taxed at the level of the foundation, but only in the hands of the beneficiaries, so that such income was therefore taxed only if and to the extent that it was later distributed to the beneficiaries. Tax was then levied on the distribution in the hands of beneficiaries at an income tax rate of 25 %. The result of that regime was a deferral effect, which could be significant if no or only small amounts of distributions were made to the beneficiaries.[4]

2 See below Chapter II.
3 See below, Chapter III.
4 Metzler, in *KStG* (M. Lang et al. eds., 2009) Section 13 m.n. 6.

Over the years, the tax regime for foundations was changed to mitigate (and later abolish altogether) the deferral effect by introducing an "interim tax" (*Zwischensteuer*) for the initially exempt income in the hands of the foundation. Such interim tax was 12.5 % in the years in dispute in the *F.E. Familienprivatstiftung Eisenstadt* case. In later years it was increased to 25 % (then reaching the full level of standard Austrian corporate income tax, so that today no deferral effect exists anymore).[5] Technically, the interim tax is nothing other than a corporate income tax levied on the foundation's income. The term "interim tax" is however typically used to describe the intention of the law to levy a tax first at the level of the foundation, which is later refunded to the foundation if and to the extent that it makes distributions to beneficiaries. In other words, the sole purpose of the interim tax concept is to ensure that the above described deferral effect is mitigated (or abolished for the later years with a tax rate of 25 %).[6]

Nonetheless, the initial concept of an ultimately tax free status for the foundation for investment income and capital gains from shares has in principle still been kept in place. This is clearly demonstrated by the fact that any residual interim tax, i.e. interim tax that has not yet been refunded to the foundation because no or not enough distributions have been made to beneficiaries, is ultimately refunded in full to the foundation upon its dissolution.[7] It is therefore ensured by Austrian law that the interim tax system does not lead to a final burden for the foundation over its lifetime.

B. Issue: No Refund of Interim Tax upon Distributions to Tax Treaty Protected Non-Resident Beneficiaries

The specific issue in the case at hand was as follows:

Unlike the system for foundations with domestic beneficiaries described above, no refund of interim tax was possible for the foundation under Austrian law upon distributions that were made to non-resident beneficiaries from tax treaty countries, who could benefit from a relief from Austrian tax on their distributions under a tax treaty concluded between their country of residence and Austria.[8] In such cases, the interim tax was refunded to the foundation only upon dissolution of the foundation (then in full).[9] Obviously, this can have a significant effect on the foundation's liquidity position as the refund may be deferred for a very long time (as typically such foundations are established for longer, i.e. up to 100 years, dissolution frequently cannot be expected in the near future).

5 With the *Budgetbegleitgesetz 2001*, BGBl I 142/2000, the interim tax of 12.5 % was introduced. By the *Budgetbegleitgesetz 2011*, BGBl I 111/2010, the interim tax was increased to 25 %.

6 Schuchter, in *Körperschaftsteuergesetz* (M. Achatz & S. Kirchmayr eds., 2011) Section 13 m.nos 150 et seqq, ErlRV 981 BlgNR 24 GP 133.

7 Sec 24 para 5 no 6 Corporate Income Tax Act.

8 Sec 24 para 5 no 4 Corporate Income Tax Act.

9 Sec 24 para 5 no 6 Corporate Income Tax Act.

Therefore, the foundation is discriminated against in so far as its right for an immediate refund of interim tax is dependent on the tax status of its beneficiaries (non-resident or resident).[10] Contrary to what one might expect, the discrimination in the case at hand is not based on a different treatment of distributions to domestic and foreign beneficiaries in general. Rather, the relevant differentiation is made by Austrian law between distributions that can be and those which cannot be taxed in Austria in the hands of beneficiaries, which is expressed by the law by making reference to the existence or non-existence of a tax treaty relief.[11]

The background to this reference to treaty protection is that under most Austrian tax treaties, distributions of foundations to their beneficiaries fall under the other income article (following Article 21 of the OECD Model). Austria as the source state is required to grant a full relief from Austrian tax on such "other income" in full (i.e. Austria cannot levy any tax on the other income). Also, the treaties applicable in the case at hand did not allow Austria to tax the distribution to the foreign beneficiaries who were resident in Belgium and Germany, respectively. The Austria/Belgium treaty treats distributions of an Austrian foundation as other income under Article 21.[12] The same is true for the old Austria/Germany treaty concluded in 1954 which was to be applied for the tax year in question[13] (in the meantime a new tax treaty with Germany has been entered into force that treats such distributions of foundations as dividends under Article 10).[14] Therefore, in applying the tax treaties applicable in the case at hand, Austria could not tax the beneficiaries on the distributions and so the foundation was denied a refund of its interim tax.[15] By contrast, had the beneficiaries been resident in Austria (or resident in a foreign country without a tax treaty with Austria), the foundation would have been granted the refund of the interim tax.

The comparison of the two situations (treaty protected non-resident beneficiary versus domestic beneficiary) makes it apparent that the foundation is in effect taxed only due to the fact that the beneficiary is resident in a tax treaty country. The foundation is therefore in a situation which may be seen as equivalent (or at

10 Simader, *ECJ Referral Regarding Interim Tax for Private Foundations (Familienprivatstiftung Eisenstadt (Case C-589/13))*, European Taxation (2014) p. 344.

11 Simader, European Taxation (2014) pp. 341 et seq.

12 Art 21 of the Austria – Belgium Income and Capital Tax Treaty (1971) reads as following: „*A resident of a Contracting State shall not be liable to tax in the other Contracting State in respect of items of income which are not expressly mentioned in the foregoing Articles unless such items of income are included in the income attributable to a permanent establishment or a fixed base maintained in the last-mentioned State by the said resident of the first-mentioned State.*"

13 2001.

14 Austria – Germany Income and Capital Tax Treaty (1954) (as amended through 1992).

15 In fact, the case is slightly more complex as Austrian law does not even require the foundation to pay interim tax if and to the extent distributions to (not treaty protected) beneficiaries are made in the same year, as then deviously no interim tax is required to be levied. However, this refraining from levying interim tax was denied to the foundation in the case at hand due to the beneficiaries' treaty protection. In the following, for simplification this disputed assessment of interim tax is also dealt with as a denial of refund of interim tax, although it is technically a slightly different situation.

least similar) to a case of shareholder discrimination which is protected under the non-discrimination article in many tax treaties (following Article 24 paragraph 5 of the OECD Model).[16] In the order for reference of the Austrian court, there is no indication that the foundation did actually argue for such shareholder non-discrimination, although at least the tax treaty with Belgium did include a non-discrimination clause following Article 24 paragraph 5 OECD Model. It could be that the foundation had doubts as to whether the case at hand was actually covered by shareholder non-discrimination, as this would have required, first, that the foundation was seen as an "enterprise" in the meaning of Article 24 paragraph 5 OECD Model, and, second, that the foundation was "directly or indirectly owned or controlled" by its beneficiaries. These are issues of the actual scope of Article 24 paragraph 5 OECD Model.

However, whether the protection granted by the OECD Model against shareholder non-discrimination could actually be invoked in a foundation/beneficiary relationship is not a matter of EU law, therefore it will not be further investigated here. In particular, the "ownership and control" element, which is required by Article 24 paragraph 5 OECD Model, would require careful analysis in the case of a private foundation.[17] The problem will be that it is typically in the nature of such foundations that they are neither "owned" nor "controlled" by their beneficiaries, which may be an argument against applying the shareholder non-discrimination protection in such a foundation/beneficiary relationship.[18] On the other hand, the argument has at least been advanced in the literature that there may be exceptional situations where beneficiaries do have a similar role to that of shareholders in relation to the foundation. For these cases, at least, the foundation/beneficiary relationship is claimed to be equivalent to "ownership or control" as required by Article 24 paragraph 5 of the OECD Model.[19]

C. Relevant EU Fundamental Freedom

Under EU-law, which is of primary interest here, the question is which of the fundamental freedoms is to be invoked in the case at hand. The Austrian court, in its order for reference to the ECJ, has taken the clear position that the relevant freedom is the free movement of capital.[20]

However, the Austrian court, did not provide much of an analysis on what the actual "movement of capital" was that (at least potentially) is to be protected. Obviously, this "movement of capital" cannot considered to be the distribution to the beneficiary, because such distribution is not the object of the alleged discrimina-

16 Lang, *Die „Zwischenbesteuerung" der Privatstiftung bei Zuwendungen an im Ausland ansässige Begünstigte*, JBl (2003) pp. 810 et seq.
17 Lang, JBl (2003) pp.810 et seq.
18 Lang, JBl (2003) pp.810 et seq.
19 Lang, JBl (2003) pp.810 et seq.
20 VwGH 23 October 2013, 2010/13/0130.

tion (as it is not taxed in Austria anyway). Rather, the issue is more with the tax status of the foundation itself, because the taxation of the foundation's income depends on the beneficiaries' treaty status when making a distribution. The object of discrimination is therefore the taxation of the foundation itself.[21] The Austrian court has stated that such tax on the foundation has the potential "to prevent cross-border arrangements". This is the key explanation of the court as to why there is a potential infringement of the free movement of capital.[22]

However, it is not entirely clear precisely what the "prevention of cross-border arrangements" means or who actually is prevented from entering into a cross-border arrangement in the case at hand. What is clear is that the beneficiary does not make an "investment" (or "transfer of capital") in the foundation, as it is in the nature of the foundation that its beneficiaries do not inject any capital into it (this is done by the founder). At first sight, the cross-border arrangement that potentially can be prevented by not refunding the interim tax to the foundation can be seen as the distribution payment made by the foundation to its treaty protected beneficiaries. However, it is notable that there is no (at least no direct) link between the non-refund of interim tax at the level of the foundation and the foundation's ability to make distributions to treaty protected beneficiaries. The foundation is not legally restricted in making full distributions to such treaty protected beneficiaries[23]. Rather, it is at the discretion of the board of the foundation (which has to act in accordance with the foundation deed) to whom distributions are made and in what amount. It may well be therefore, that the increased burden of tax for the foundation (through the non-refund of interim tax) would leave the amount of distribution to the treaty protected beneficiary unaffected. It is therefore at least possible that the foundation does not economically pass its tax cost on to the beneficiary through a reduced distribution payment.[24] In such cases, the ultimate burden will remain at the level of the foundation.

At least in such situations one will have to assume that the "cross-border arrangement" which is protected by the free movement of capital is the designation of treaty protected non-resident beneficiaries, such designation being made by either the founder or the foundation's board. In other words, there is a tax incentive for the board (or the founder) not to designate such treaty protected non-resident beneficiaries in order to keep the right to a full refund of interim tax for the foundation intact. This implies that the designation of a foundation's beneficiaries is actually covered under the free movement of capital, although such designation in itself neither implies a capital movement nor that such a capital movement is effected by the beneficiaries. The argument that needs to be made in order to ap-

21 Pinetz, *Vereinbarkeit der „Zwischensteuer" mit der Kapitalverkehrsfreiheit*, ecolex (2014) pp. 469 et seq.
22 VwGH 23 October 2013, 2010/13/0130.
23 Arnold, in *Privatstiftungsgesetz* (N. Arnold, ed., 2013) Section 5 m.nos 16 et seqq.
24 Ludwig, *Abgabenrechtliche Behandlung der Zuwendungen an Begünstigte*, in Stiftungshandbuch (N. Arnold & C. Ludwig) pp. 226 et seqq.

ply the freedom is therefore that the designation of beneficiaries will, at least indirectly, affect the tax position of the foundation and, if not necessarily then at least potentially, may make it less likely for the foundation to actually pay out distributions to non-resident (and treaty protected) beneficiaries.[25]

D. Justification Analysis

The Austrian referring court has proposed a justification argument in order to justify the above described discrimination. According to the Austrian court, it is the intention of Austrian law to ensure that the foundation's income is at least somehow taxed in Austria, if not in the hands of the beneficiary, then in the hands of the foundation. According to the Austrian court, it is therefore justified that the foundation is not granted a refund of the interim tax in situations where the beneficiaries cannot be taxed on their distributions in Austria.[26]

The argument of the Austrian court is very similar to the reasoning developed by the ECJ in the *ACT Group Litigation* case (C-374/04), although surprisingly, the Austrian court did not refer to that ruling in its order for reference. In *ACT Group Litigation*, the ECJ had to deal with the UK advance corporation tax (ACT) system which, in simplified terms, did foresee a credit or refund of an earlier paid ACT to a UK company when making a distribution to its UK shareholders, but no such credit or refund was granted if the shareholders were not resident in UK. There is no need to repeat the entire outcome of the *ACT Group Litigation* case here, which was ultimately decided in favour of the UK ACT system (i.e. no discrimination was found by the ECJ).[27] The key argument of the ECJ in ACT *Group Litigation* was that there was no comparable situation for an ACT credit (or refund) in terms of the shareholders being either resident or non-resident in the UK.[28] Given the non-comparability of the two situations, technically no discrimination could be identified by the ECJ. This allowed the ECJ to solve the *ACT Group Litigation* case on a comparability level, which allowed the court to avoid the otherwise necessary analysis of the "cross tax payer coherence" argument, i.e. whether the coherence of the UK ACT system could actually require that a credit/refund of ACT was denied where shareholders were not taxable on their distributions received from a UK resident company. In *ACT group litigation*, the ECJ based its ruling ultimately on a policy-based argument, emphasizing that the source state would forego taxation of income that was generated in its territory, if the source state were obliged to grant an ACT credit/refund also for dividends paid to non-resident shareholders.[29] This leads to the core of the *ACT Group Litigation* case: If a

25 EU 2013/0007-1, 2010/13/0130.
26 VwGH 23 October 2013, 2010/13/0130.
27 Denys, *The ECJ case law on cross-border dividends revisited*, European Taxation (2007) pp. 224 et seqq.
28 Denys, European Taxation (2007) pp. 224 et seqq.
29 Denys, European Taxation (2007) pp. 224 et seqq.

credit/refund would also have to be granted on cross-border dividends, this would have had an impact on the UK tax system and the tax revenues generated by it, as the system of corporate income taxation relied on the revenues generated from ACT (or, precisely, its non-refund or credit to non-resident shareholders).

In *F.E. Familienprivatstiftung Eisenstadt*, it is however questionable whether the logic developed by the ECJ in *ACT Group Litigation* can really be applied. Although it is true that at first sight there are strong similarities between the two cases, a closer look makes it appear doubtful whether the present case is really comparable to *ACT Group Litigation*: unlike the UK tax system in *ACT Group Litigation,* the Austrian corporate income tax system for foundations, through the refund of interim tax, does not voluntarily "forego taxation of income generated on its territory". Rather, it is in the nature of the interim tax system that Austrian law treats foundations, in the end, conceptually as tax-free entities, as there will be a full refund of any interim tax upon dissolution of the foundation in any event (i.e. even where beneficiaries are non-resident and treaty protected).[30] In other words, the Austrian system on interim tax for a foundation has accepted, that the interim tax should, conceptually, never be a final burden for the foundation. Therefore it seems difficult to argue (as was argued by the ECJ in *ACT Group Litigation*) that the denial of interim tax refund secures that there is a tax levied on income generated by the Austrian foundation. In fact, the Austrian tax system has deliberately forgone the possibility of levying any tax from the foundation over its lifetime. This is equally as true for foundations with domestic beneficiaries as it is for foreign (treaty protected) beneficiaries. In conclusion, it seems difficult to assume that distributions to resident and non-resident (and treaty protected) beneficiaries are really not comparable situations with regard to the refund of interim tax to the foundation. Rather, the stronger argument seems to be that the two situations are indeed comparable (and a justification is therefore needed).

Such justification appears difficult. The tax treatment of the beneficiary (i.e. that he could not be taxed in Austria under the tax treaty) can only be relevant for justifying the tax position of the foundation as a coherence argument if, a "cross taxpayer coherence" were accepted.[31] The ECJ has always required the coherence argument to be supported by a direct link between the different parts of a tax system in order to justify the restriction. Such direct link is traditionally not accepted if it involves two different taxpayers (i.e. where one taxpayer, here the foundation, has to suffer a higher tax burden due to the fact that another taxpayer, here the beneficiary, is not taxed with a distribution).[32] The absence of such direct link in the foundation/beneficiary relationship is even more obvious as this relationship is a very distant one. There is no investment by the beneficiary in the foundation, the

30 Lang, JBl (2003) pp. 803 et seqq.
31 Simader, European Taxation (2014) p. 343.
32 ECJ 26 October 1999, C-294/97, *Eurowings*, [1999] ECR I-07447, para 42.

beneficiary typically also has no influence in the foundation whatsoever. Ultimately, the foundation and beneficiary are two entirely separate taxpayers. Accordingly, there should be no room for a coherence argument in justification of the non-refund of interim tax for the foundation.

The "balanced allocation of taxing rights" is also doubtful as a justification argument in the case at hand. This argument could be invoked if the national rule in question were to ensure that taxing rights are allocated properly between Austria and the country of residence of the beneficiary according to tax treaties concluded between Austria and that country of residence.[33] However, what Austrian law does by its national law is actually not protecting the agreed balance of taxing rights, but undermining it through technically complying with its international treaty obligations to the other state, while in effect levying a hidden charge on the foundation (through the non-refund of interim tax) when treaty benefits are invoked by beneficiaries.[34]

Even if one were to assume that there is a possible justification argument available, the proportionality of the Austrian tax measure at hand (the non-refund of interim tax) is questionable. This is because Austrian law denies the refund of interim tax in full, even if there is no full, but only partial relief from taxation in Austria under a tax treaty with the resident state of the beneficiary. This is the case in particular under treaties that treat distributions of foundations not as other income (Article 21) but as dividends (Article 10), typically granting the source state a limited right to tax (e.g. 15 %).[35] In other words, what triggers the non-refund of the interim tax is the mere existence of any kind of treaty protection for the beneficiary, even if it is only in part. This illustrates that the Austrian system is not proportional (although this proportionality issue is not relevant in the *F.E. Familienprivatstiftung Eisenstadt* case, as the applicable treaties in this case treat the distribution of the foundation as other income without any Austrian source taxation right).

III. Finanzamt Linz (C-66/14)

A. Background: The Austrian Goodwill Amortization on Share Deals

Under rules introduced in 2005 onwards, Austrian acquiring companies had to amortize the "goodwill element" of the purchase price in share deal acquisitions of target companies over 15 years. The "goodwill element" of the purchase price

33 ECJ 13 December 2005, C-446/03, *Marks & Spencer* [2005] ECR I-10837, para 43.
34 Similar: Pinetz, ecolex (2014) pp. 469 et seq.
35 Eg. Austria – Germany Income and Capital Tax Treaty (2000) (as amended through 2010), Art 10 para 2.

was defined by a formula set by law (so that it was easily calculable). The amortization was mandatory, however it required that the target company was included in an Austrian tax group (as such inclusion was optional, there was a de facto optionality of goodwill amortization).[36]

In effect, such goodwill amortization could lead to a significant tax deduction over time, as the purchase price amounts involved (and the included goodwill elements) could be very large. However, the intention behind the Austrian law was not to grant a permanent tax advantage, rather the tax advantage was to be of a temporary nature only. This was technically achieved in such way that any amounts deducted as goodwill amortization necessarily led to a fictitious step-down in acquisition cost for the acquired shares (i.e. the goodwill amortization created simultaneously an unrealized gain in the shareholding). Against the background of the Austrian tax system of treating capital gains from shares (at least for shares in domestic subsidiaries) as fully taxable, this would lead to a recapture of the amortization upon a future sale of the shares. This made the tax advantage, at least conceptually, only temporary.

B. Issue: Goodwill Amortization Only Possible for Acquisitions of Austrian Resident Target Companies

The issue of the *Finanzamt Linz* case now is that goodwill amortization was reserved by Austrian law only for the acquisition of Austrian resident target companies. By contrast, acquisitions of non-resident target companies were generally excluded from goodwill amortization, even if the foreign target company was resident in another EU Member State.

This obvious discrimination of the Austrian buyer in making an acquisition of an EU target (against making such acquisition of an Austrian target) was identified by literature early on. It was noted that this could trigger a breach of freedom of establishment.[37] However, the issue was for a long time not brought up in practice before a lower tax court (*Unabhängiger Finanzsenat*) ruled in 2013 that there was indeed such a breach of the freedom of establishment and that the goodwill amortization had to be granted for acquisitions of EU targets too.[38] Moreover, the lower court had argued that this breach would be an *acte claire*, so that there would be no need to refer the issue to the ECJ. The tax administration (i.e. the *Finanzamt Linz*) appealed this lower court ruling to the Austrian supreme tax court (*Verwaltungsgerichtshof*) which ultimately referred the issue to the ECJ.[39]

36 Stefaner & Weninger, in *KStG*, Section 9 m.nos 90 et seqq.
37 Mayr, *Zweifelsfragen zur Gruppenbesteuerung*, RdW (2004) pp. 445 et seqq.
38 UFS Linz, 16 April 2013, RV/0073-L/11, RV/0074-L/11, RV/0801-L/12, RV/0802-L/12, RV/0798-L/12.
39 VwGH of 30 January 2014, EU 2014/0001, 2013/15/0186.