REGIONAL DEVELOPMENTS

European Tax Law*

I. Austria

Two significant tax changes were recently implemented in Austria. Effective January 1, 1989, corporate tax rates were reduced and a new participation exemption scheme was introduced for Austrian corporations.

Prior to 1989, Austrian corporations (*Aktiengesellschaft* and *Gesellschaft mit beschränkter Haftung*) were subject to an income tax of 27.5 percent on distributed profits and 55 percent on retained profits. Under the new rules, Austrian corporations are now subject to a flat 30 percent rate of tax.[1]

With the extension of the participation exemption, an Austrian corporation owning 25 percent or more of a foreign subsidiary can exclude from its taxable base 100 percent of the dividends it receives from that foreign subsidiary. The exemption also applies to capital gains realized on the sale of any ownership interests in the foreign subsidiary that qualifies under these participation exemption rules.[2]

Dividends paid by the Austrian corporation to its foreign shareholders are subject to Austrian tax, the amount of which depends upon the applicable tax treaty. For example, the U.S.-Austrian double taxation convention provides for a 50 percent reduction in the statutory rate. In the case of a U.S. corporation owning 95 percent or more of an Austrian company, the maximum withholding rate is 5 percent.[3]

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1. Körperschaftsteverreformgesetz [KStG] § 22.

2. *Id.* § 10.

3. Convention for the Avoidance of Double Taxation with respect to Income Taxes, Oct. 25, 1956, United States-Austria, art. VI, 8 U.S.T. 1699, 1704, T.I.A.S. No. 3923 at 5. *See also*

Value-Added Taxes remain relatively high, currently 10 percent for essentials, 20 percent for most other goods, and 32 percent for luxury items (cars, motor boats, and the like). It is rumored, however, that as early as 1992 the rates might be reduced to 8 and 18 percent, respectively, with luxury items being taxed in the 18 percent category.

The trade tax imposed on all Austrian corporations—approximately 13.5 percent of taxable income—is still in effect, although there is an exemption for real estate companies. It is uncertain whether further exemptions or a complete repeal of the tax will be introduced.

A new Protocol to the 1970 Austria-Netherlands Income Tax Treaty was signed in December of 1989, and introduced in the Austrian Parliament in early 1990.[4] The Protocol would raise the maximum withholding rate on dividends paid (with respect to shareholdings of 25 percent or more) from 0 to 5 percent as from July 1, 1990. Real estate mortgage interest would no longer be assimilated to immovable property income, but rather would be treated under the interest income provisions. Changes would also be made to the treatment of Austrian-situs real estate or permanent establishment assets under the Dutch net worth tax.

II. France

The 1990 French Loi des finances[5] confirmed a fundamental long-term trend: the convergence of corporate tax rates on ordinary income and capital gains. The basic corporate tax rate, applicable to corporations and most other business entities, is now 37 percent (down from 39 percent and further to be reduced in 1991 to 34 percent) as from the 1990 taxable year. However, an additional tax at a rate of 5 percent is imposed to the extent that net income is distributed as dividends or "deemed" dividends.[6]

United States-based and other foreign corporations having a branch in France will also pay corporate income tax at the 37 percent rate, along with the 5 percent additional tax on amounts that "ceased to be available" to the branch during a fiscal year beginning on or after January 1, 1989. Net income is thus taxed at a 42 percent effective rate to the extent that payments are made or deemed made

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Einkommenstevergesetz [EStG] § 374 (the statutory rate of tax on dividend income is one-half of an individual's income tax rate).

4. *See* 24 Tax News Serv. (IBFD) 14 (Jan. 10, 1990); 23 Tax News Serv. (IBFD) 291 (Nov. 29, 1989).

5. Loi de finances pour 1990, Loi n° 89-935 du 29 déc. 1989, J.O. 30 déc. 1989, 16337 (D. et A.L.D. 1990.2.20).

6. One example of a "deemed" dividend included in the base for the 5 percent surtax is the amount of interest on loans made by shareholders that exceeds the allowable interest rate and the debt-equity limitations on related party loans. The maximum deductible interest rate, based on market rates for private sector bonds, is published regularly, and interest on loans from controlling shareholders is non-deductible if the principal loan amount exceeds 150 percent of capital (i.e., a 1.5:1 debt-equity ratio). CODE GÉNÉRAL DES IMPOTS art. 39 §§ 1, 3 (Fr.); *id.* art. 212. *See generally* Liebman & De Boeck, *Current Problems of Intercompany Financing*, 69 J. TAX'N 408 (1988).

to the home office, unless such payments result from normal commercial transactions between the branch and its head office (for example, sales of product and the like).

The tax law maintained the favorable treatment given to long-term capital gains, but with a significant rate change. Gain on the sale of capital assets held two years or more is now taxed at 19 percent—the previous rate was 15 percent (to be increased to 23 percent in 1991)—with this 19 percent rate being applicable to transactions from and after October 20, 1989. Pressure still exists to impose even higher taxes on capital gains, however, in particular, on gains derived from real estate and share transactions.[7]

In the meantime, to benefit from the long-term capital gains rate, the taxpayer must create as a reserve—and not distribute as a dividend—an amount equal to the difference between the gain and the 19 percent tax payment. Dividends attributable to the long-term capital gain in the reserve will generate an additional tax, which will bring the total rate back up to 42 percent.

Companion legislation[8] simplified the complex rules concerning imputation tax credits granted shareholders for corporate taxes deemed paid by companies in which they own shares (the so-called *avoir fiscal*) and the equalization tax (the *précompte*) payable by the companies distributing dividends if they did not, in fact, pay corporate taxes on the dividend income.

Instead of granting a credit at the shareholder level, and recovering it at the company level, the credit and the equalization tax have been eliminated if the French company is principally involved in holding participations in companies that qualify for favorable parent/subsidiary tax treatment (generally, a 10 percent holding). This new rule applies only to dividends attributable to amounts received from investments held in non-French companies.

III. Federal Republic of Germany

The German Government has indicated it intends to abolish the 0.25 percent stock exchange turnover tax as of January 1, 1991, and the 1 percent capital duty as of January 1, 1992.[9] The elimination of these indirect taxes will significantly ease the establishment, restructuring, and acquisition or disposition of German business operations.

In the months prior to German unification, West Germany continued to expand its tax treaty network with developing countries. During 1990, treaties were initialled or signed with Bolivia, Jamaica, Papua New Guinea, and Zimbabwe. In addition, the previously signed transportation income agreement between West Germany and Venezuela entered into force at the end of 1989, and a treaty

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7. *See* Int'l Herald Trib., June 7, 1990, at 16, col. 1.

8. Loi de finances rectificative pour 1989, Loi n° 89-936 du 29 déc. 1989, J.O. 30 déc. 1989, 16393 (D. et A.L.D. 1990.2.38).

9. *See* 1 MANAGING EUROPE 1 (1990).

concerning the mutual treatment of vehicles in international traffic was signed with Czechoslovakia. West Germany also reported the opening of negotiations for a comprehensive income tax treaty with Nigeria.[10]

IV. The United Kingdom

The U.K. Finance Bill for 1990 includes details concerning the tax regime that would govern European Economic Interest Groupings (so-called EEIGs), following European Community (EC) law. Most other EC Member States have promulgated analogous legislation.

In addition, clause 60 of the aforesaid Bill formally abolishes the requirement for obtaining United Kingdom Treasury consent with regard to the issuance and transfer of shares or debt obligations involving EC-based subsidiaries of U.K. companies. A notice requirement would still remain in place, pursuant to which the United Kingdom Inland Revenue must be notified of any such transactions within six months.[11] This should ease the constraints and administrative burdens placed on any reorganizations of U.K. subsidiary groups of U.S.-based multinationals.

V. European Communities

A full status report on EC tax legislation will appear in the next set of Regional Developments to be prepared by the Subcommittee.

10. *See* 24 Tax News Serv. (IBFD) 40 (Feb. 7, 1990); *id.* at 129–30 (May 2, 1990).
11. *See* Doing Bus. in Eur. (CCH) No. 214, at 9 (May 10, 1990).