Austria to enact new interest limitation rule in accordance with EU ATAD as of 2021

In 2018, Austria did not adopt the regulations of the interest limitation rule under the European Union (EU) Anti-Tax Avoidance Directive[1] (ATAD) into national law by 31 December, as required by the Directive. The Austrian Government believed that the domestic regulations of Section 12/1/9 of the *Corporate Income Tax Act* (CITA) (non-deductibility of interest paid on debt to refinance the acquisition of shares from affiliates) and Section 12/1/10 CITA (non-deductibility of interest and royalty payments to low-taxed affiliated companies) constituted equally effective rules as provided for under the ATAD.

However, the European Commission subsequently found that Austria still must implement the interest limitation rule. The other regulations of the ATAD were already adopted into national law under the *Annual Tax Act 2018* (Austrian Federal Gazette I No. 62/2018) (controlled foreign company rule, general anti-abuse rule, exit taxation). At this time, Austria does not have an interest limitation rule that limits the tax deductibility of interest expenses with reference to the earnings before interest, taxes, depreciation and amortization (EBITDA).

Accordingly, the new interest limitation rule was submitted to the Austrian Parliament on 20 November 2020 as part of the *COVID-19 Tax Measures Act*.

According to the interest limitation rule in the new Section 12a CITA, exceeding interest costs of corporations of one tax year shall only be deductible up to 30% of the taxpayers' EBITDA of that tax year from 2021 onwards. The interest limitation rule applies to all debt financing, including those with non-affiliates.

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The exceeding interest costs are to be compared to 30% of the taxpayers' tax EBITDA. The exceeding interest costs will be tax deductible up to €3 million. The new interest limitation rule also applies to Austrian permanent establishments of nonresident corporations. It does not apply to individuals. Also, the new rule only affects the tax deductibility of interest but does not re-qualify the expense.

Standalone corporations may fully deduct exceeding interest costs. This exception requires that the corporation cumulatively meets the following three prerequisites:

- The entity is not part of a consolidated group for financial accounting purposes.
- The entity has no associated enterprise.
- The entity does not have a foreign permanent establishment.

The term interest, as defined under the ATAD, also includes economically equivalent payments in connection with the raising of debt and therefore also includes financing costs in the context of finance leasing.

For existing loans, an option for a grandfathering clause provided for in the ATAD is to be implemented, whereby interest expenses incurred for loans under contracts concluded before 17 June 2016 are not taken into account in determining the exceeding interest costs; this results in the complete deductibility of such interest costs (up to the 2025 tax assessment).

The EBITDA is calculated by adding back to the income subject to CIT the tax-adjusted amounts for exceeding interest costs as well as the tax-adjusted amounts for depreciation and amortization. A regulatory authorization for a directive is provided in the draft bill.

By using the equity escape provision set forth in the ATAD, an entity may fully deduct exceeding interest costs as an operating expense, regardless of the general rule of the interest limitation rule, if it is a member of a consolidated group for financial accounting purposes (according to Austrian GAAP, IFRS or comparable accounting standards such as US GAAP) and its ratio of equity over its total assets is equal to or higher than the equivalent ratio of the consolidated group in which it is included at the balance sheet date of the current financial year. In order to avoid hardship cases, the ratio is considered to be equal if the ratio of the taxpayer's equity over its total assets is lower by up to two percentage points. The equity escape also applies to tax groups.

If exceeding interest costs cannot be deducted in the current tax period, they may be carried forward without time limitation at the request of the corporation to future tax periods. This non-deductible interest carryforward will increase interest expenses in subsequent tax periods. In order to avoid duplications, an application-linked EBITDA carryforward is to be provided, but this is limited to the following five fiscal years.

The interest limitation also applies to tax groups, as defined according to Section 9 CITA. To prevent the multiple use of the €3 million allowance, the safe harbor amount of €3 million only applies once for the whole tax group (irrespective of how many entities are in the tax group). For group members and group parents, therefore, there is no isolated application of the interest limitation, but the interest limitation rule is intended to have an effect only on the determination of tax group income and thus exclusively on the groups' corporate income tax assessment.

The new interest limitation rule of Section 12a CITA is to enter into force as of 1 January 2021 and will be applicable for the first time for fiscal years beginning after 31 December 2020. The restriction of Section 12/1/10 CITA (non-deductibility of interest and royalty payments to low-taxed affiliated companies) and Section 12/1/9 CITA (non-deductibility of interest paid on debt to refinance the acquisition of shares from affiliates) will remain unchanged in addition to the new interest limitation rule. The draft law does not include a possible exemption for long-term public infrastructure project and financial undertakings as provided for in the ATAD. The new rules also apply to real estate companies.

Future Alerts will report on any legislative developments regarding the new interest limitation rule.

Endnote

1. EU Council Directive 2016/1164 of 12 July 2016.

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