

# Austrian Supreme Court on a Hybrid “Sandwich Structure” (VwGH, 15 October 2020, Ro 2019/13/0007)



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**Tax Treaty Case Law Conference**

Univ.-Prof. DDr. Georg Kofler, LL.M.



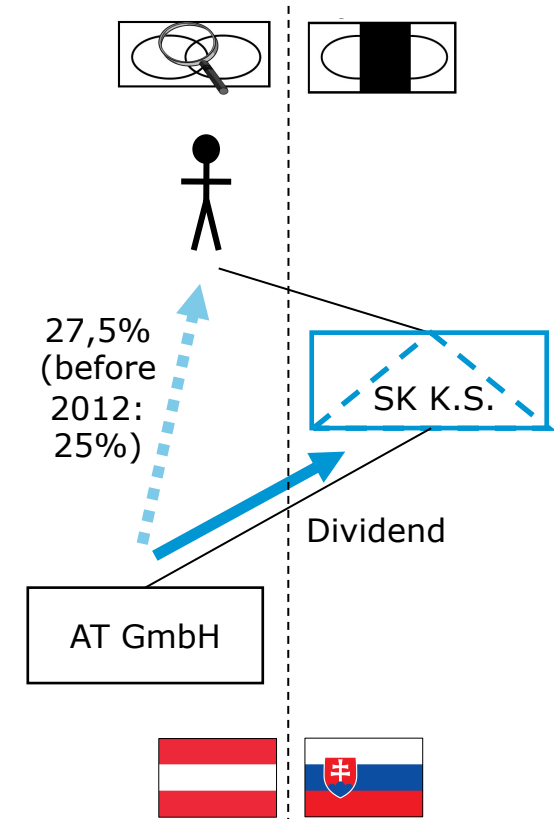
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# Introduction | Sandwich Structures

- **Hybrid "Sandwich Structures"**

- **Slovak "komanditná spoločnosť" (K.S.)** is considered as "transparent" in Austria and as "intransparent" by the Slovak Republic (EAS 2694, EAS 2783, EAS 3018)
- **"K.S. model"** (see, e.g., *Beiser*, RdW 2010, 426; *Beiser*, RdW 2011, 691; *Stradinger*, SWI 2011, 347; *Hummer/Höhfurtnner*, SWI 2021, 133)
  - An Austrian shareholder of an Austrian corporation (e.g., a GmbH) transfers the shares as equity contribution to a Slovak K.S., which subsequently receives dividends from the Austrian corporation – *Note: Exit taxation of the transfer of shares (§ 27(6) EStG)? (See also EAS 3125.)*
- **Desired result** was/is
  - avoidance of source taxation of the dividend in Austria (under domestic law/PSD),
  - exemption of the K.S.'s income on the shareholder level in Austria (under the tax treaty) and exemption on the K.S. level in the Slovak Republic (under domestic law/PSD), and
  - no taxation in Austria of any distribution from the K.S. (under domestic law) and no/low withholding taxation in the Slovak Republic (0% until 2017, 7% since 2017)



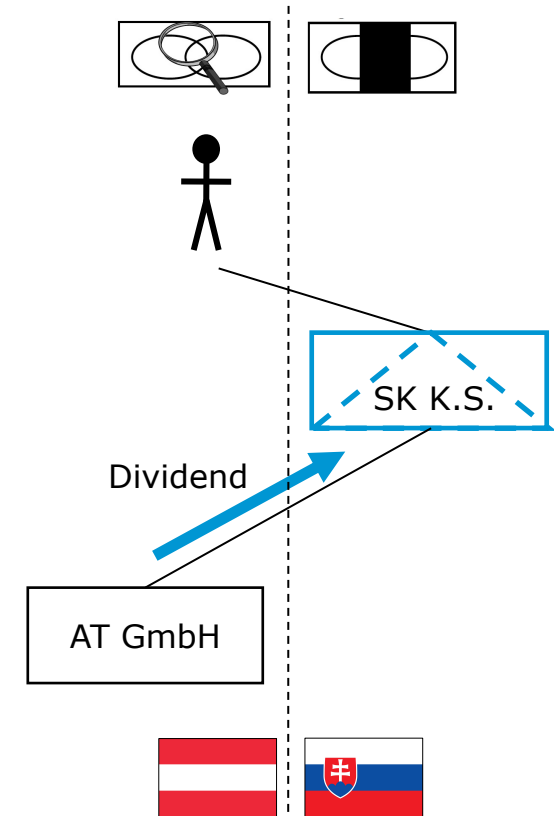
# Introduction | Sandwich Structures

## ▪ Questions from an Austrian Perspective

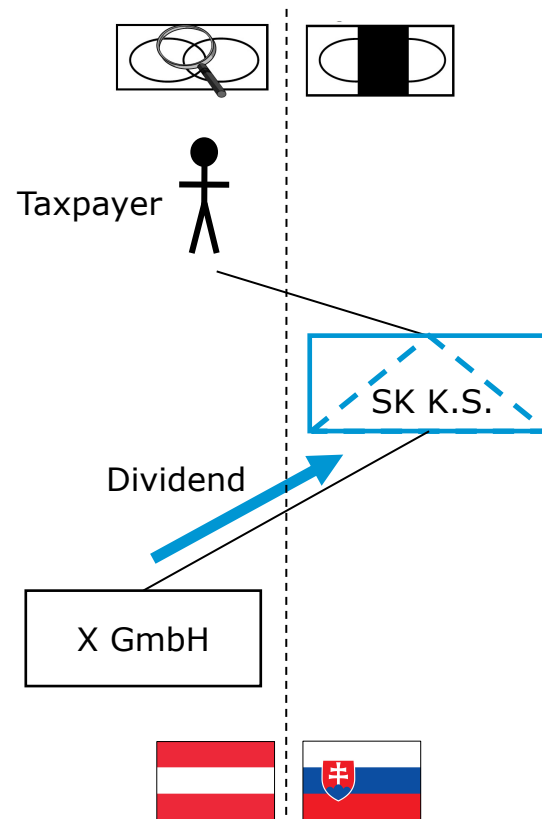
- Will the dividend to SK K.S. be **exempt from Austrian source taxation** under the Austrian implementation of the Parent-Subsidiary-Directive? *(Yes.)*
- Will the **Austrian shareholder be exempt from Austrian residence taxation** of the undistributed income of the Slovak K.S. under Art 7 and 23 of the tax treaty? *(Yes, but only if there is an effective connection between the shares and K.S.'s business activity.)*
- Will the Austrian shareholder be taxed on any **subsequent profit distribution by the Slovak K.S.** or will it be treated as a tax free withdrawal? *(No tax, no credit.)*

## ▪ Note

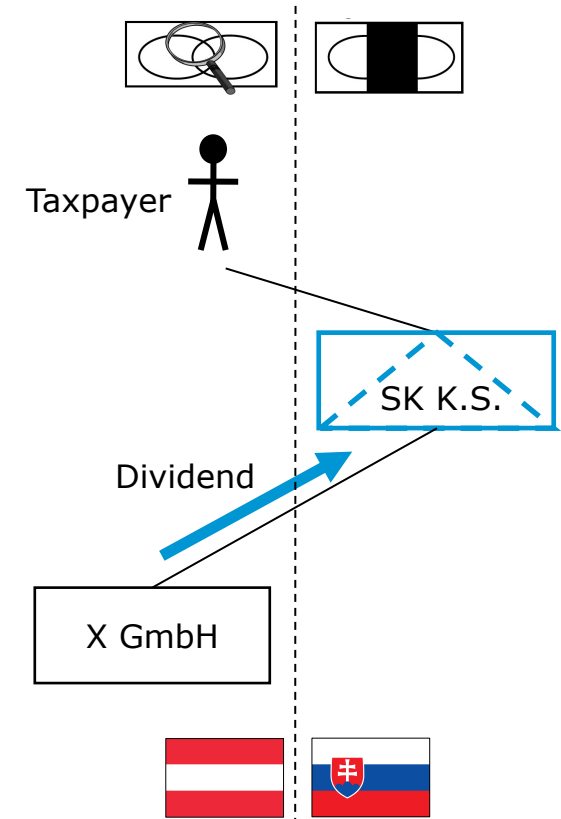
- In relation to the Slovak Republik, the **"old" treaty with the CSSR** (BGBI 1979/34, as amended) still applies (BGBI 1994/1046) ("DTC") – *The treaty, though amended by the MLI, does not include provisions similar to Art 1(2), (3) or the new wording of Art 23A(1), 23B(1) OECD MC.*



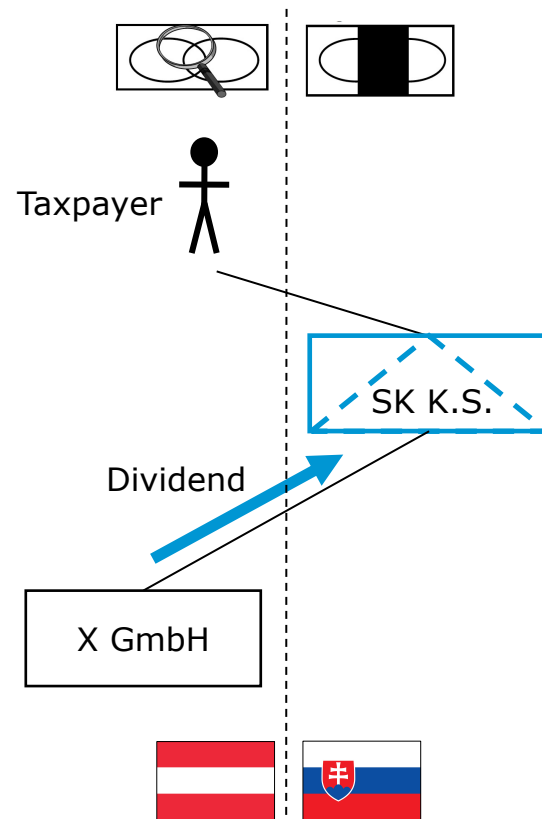
- Recent **line of case-law on hybrid "sandwich structures"**, specifically regarding the **allocation of a holding in an Austrian GmbH to a Slovak K.S.**
  - VwGH, 15 October 2020, Ro 2019/13/0007** (for taxable years 2007-2016, appeal from BFG, 10 October 2018, RV/7101777/2015, unpublished)
  - VwGH 18 October 2017, Ro 2016/13/0015** (appeal from BFG, 28 January 2016, RV/7102307/2010)
    - Continued procedure (for taxable year 2007): BFG, 15 July 2018, RV/7105347/2017 (not appealed)
    - Subsequent decision (for taxable years 2009-2011): BFG, 6 July 2020, RV/7101779/2017 (not appealed)



- The Austrian taxpayer was (effectively) the **only shareholder in the Austrian X GmbH and the Slovak K.S.**
  - Slovak K.S.'s business is in the **real estate sector** (letting and trading real estate)
  - X GmbH's business consists in its **holding and asset management functions**. X GmbH held a 25% share in Swiss Y Holding AG, which it sold in 2014 (likely free of tax under § 10(3) KStG) and subsequently purchased securities
- The taxpayer transferred her stake in X GmbH (as an **equity contribution**) to Slovak K.S. in 2007 (declaring income based on the Austrian exit tax rules and applying for deferred taxation)
- X GmbH made **several profit distributions** to Slovak K.S., including a distribution in kind of the securities in 2015 and a number of cash dividends between 2009 and 2015, without deducting withholding tax (relying on § 94a EStG and its successor, § 94(2) EStG)
- In 2016, Slovak K.S. sold the securities to the taxpayer, clearing the purchase price with the taxpayer's rights to profits

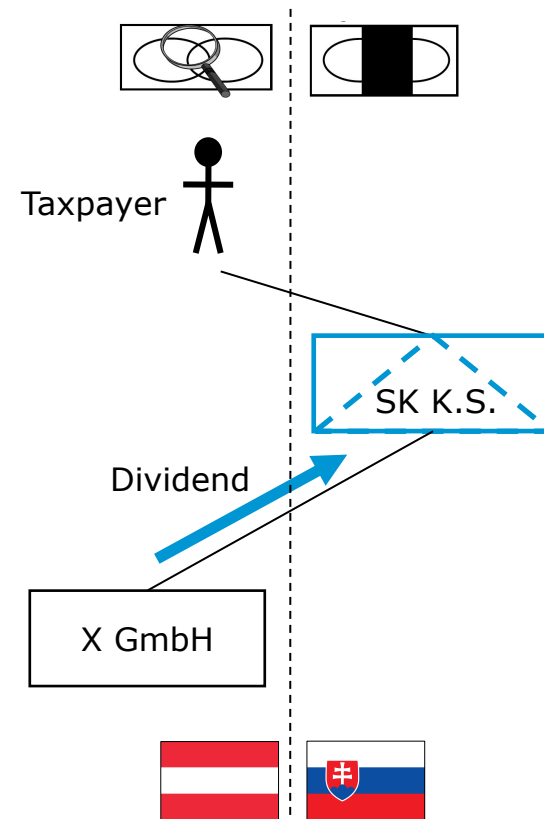


- **Implicit Starting Point: Entity qualification**
  - The **entity qualification** of the Slovak K.S. is based on **Austrian tax law** (comparability analysis under the so-called “**Typenvergleich**”), i.e., the K.S. is treated as transparent from an Austrian perspective (e.g., EAS 2694, EAS 2783, EAS 3018).
  - This determination is not influenced by the **Parent-Subsidiary-Directive** (VwGH, paras 44-45; see also EAS 2683, EAS 3018) or the **qualification under foreign (tax) law** (e.g., EAS 2248, EAS 2375, EAS 3018, EAS 3040, EAS 3217, EAS 3304).

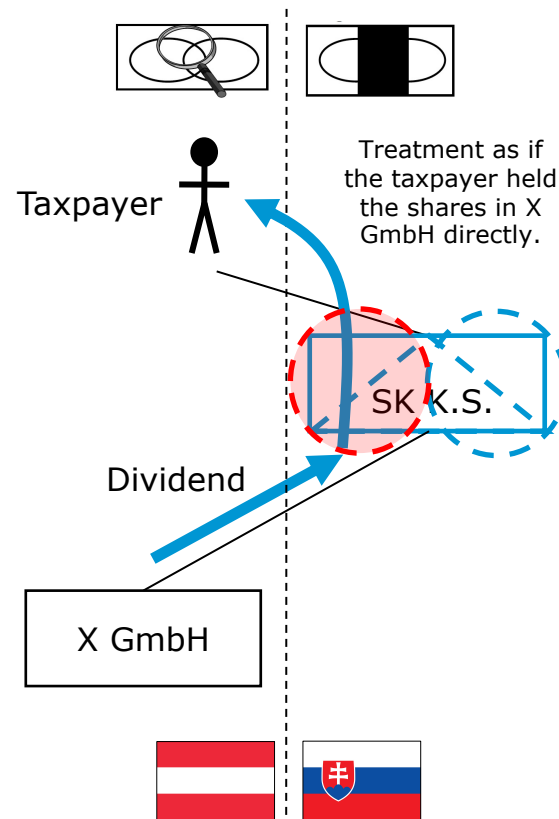




- Austria as the **source State of the dividends** (i.e., the distributions by X GmbH)
  - Despite being tax transparent from an Austrian perspective, the Slovak K.S. **is a listed legal form** in the **Parent-Subsidiary-Directive (PSD)** and hence exempt from source-based **withholding taxation** in Austria under § 94a EStG or – after April 2012 – § 94(2) EStG, if the other conditions of these provisions are met (VwGH, paras 43, 47)
  - *Note, however, that the PSD does not prohibit taxation via assessment of the dividend income on the shareholder level on a **residence basis** (VwGH, paras 44-45).*

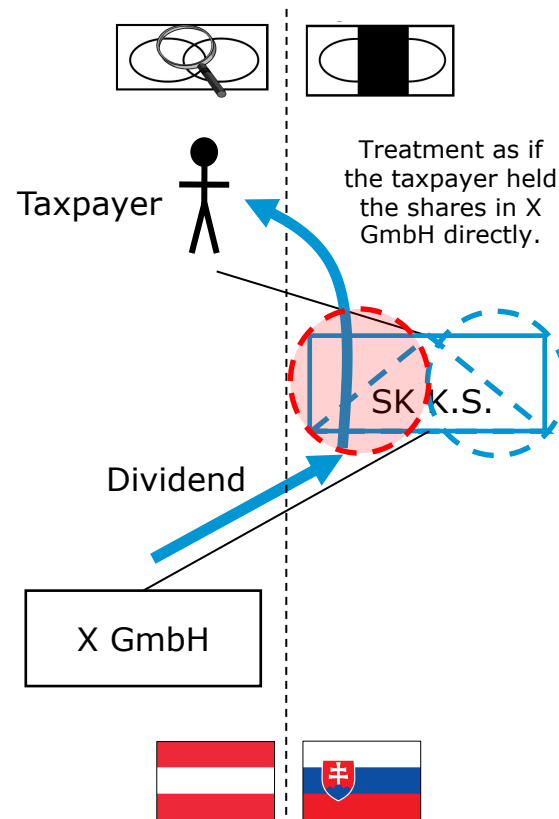


- Austria as the **residence State**
  - Implicit: The K.S., though intransparent from a Slovak perspective, is treated as **conveying a "regular" permanent establishment** to the Austrian partner, i.e., the K.S. can be "compartementalized" for tax treaty purposes ( $\neq$  PSD)
  - It is then decisive if the holding in X GmbH has an **effective connection** ("tatsächliche Zugehörigkeit") with the business activities of the Slovak K.S. to be allocated to the permanent establishment (Art 7 and 13(2)) (VwGH, paras 35-36, referring to VwGH 18 October 2017, Ro 2016/13/0015)
    - **Autonomous treaty interpretation**, no recourse to domestic law under **Art 3(2)** → No (direct) relevance of the domestic-law criteria of "necessary" or "voluntary" business property or commercial accounting (VwGH, paras 36-37, 39, referring to VwGH 18 October 2017, Ro 2016/13/0015)
    - Guided by the new **preamble to the DTC** after the MLI? (See *Loukota*, SWI 2021, 185.)

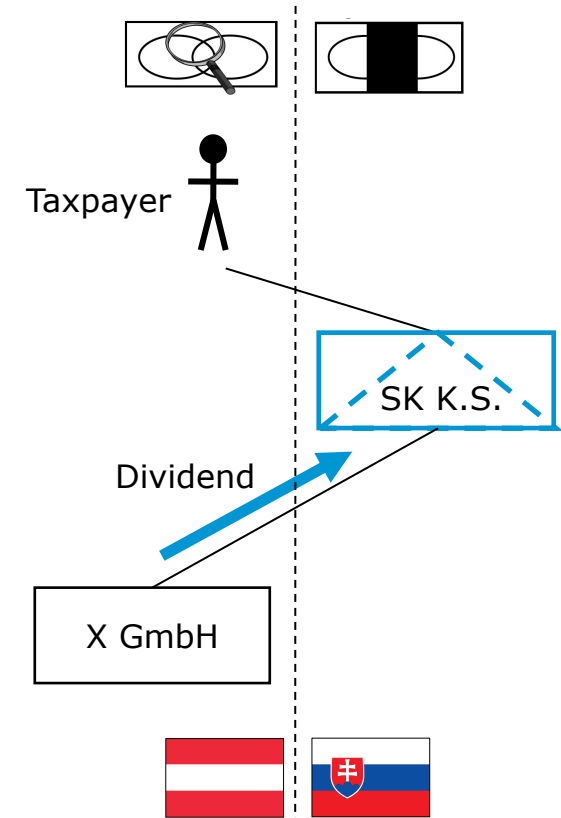




- Austria as the **residence State**
  - In the concrete case, there was **no such effective connection** between the holding in X GmbH and K.S.'s business, the mere strengthening of credit-worthiness is not sufficient (paras 37-38)
  - Hence, Austria **may tax** (Art 21) and is **not restricted** (by Art 23) in taxing the dividend income K.S. receives from X GmbH (VwGH, para. 35).
  - This taxation is not a prohibited withholding taxation within the meaning of the **Parent-Subsidiary-Directive** (VwGH, paras 44-45).
  - **No exit tax** if the holding in X GmbH did not become "functionally connected" with the Slovak K.S. (under Art 13(2)), as in such case (under Art 13(4)) **Austria would not lose its right to tax the capital gains** (VwGH, para. 50).

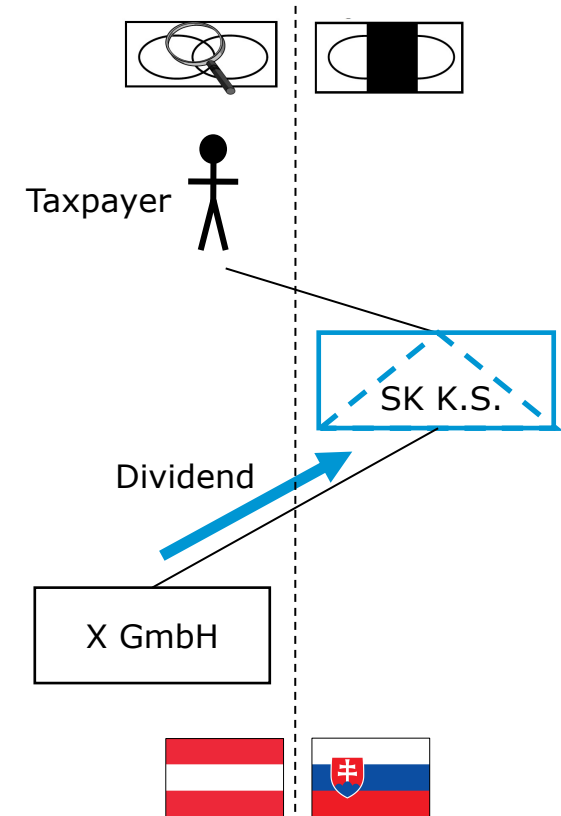


- **Austrian Source Taxation of X GmbH's distributions?**
  - **Parent-Subsidiary-Directive ("PSD")**
    - The VwGH confirmed that the **PSD-based withholding tax exemption** under § 94a EStG (old) and § 94(2) EStG (new, since 2012) applies because the Slovak K.S. has a legal form listed in the PSD (Annex I Part A lit y of Directive 2011/96/EU)
    - This is **irrespective of the hybridity** of the recipient (VwGH, paras 43, 47; but contra *Beiser*, RdW 2010, 426-427, and *Jirousek* in *Straudinger*, SWI 2011, 347-348) and irrespective of whether the **holding is functionally connected** with a permanent establishment in the Slovak Republic (VwGH, paras 43, 47; BFG, 6 July 2020, RV/7101779/2017)
    - As for hybrid entities, that result was largely undisputed with regard to (1) Art 5 PSD (see, e.g., para. 3.3.5.2., KOM(2009)179), (2) § 94a EStG (which referred to a recipient "company"; e.g., EAS 2783), but doubts might have existed for (3) § 94(2) EStG (which refers to a recipient "corporation" and could have been read as requiring comparability with a corporation under Austrian law)



# Comments | Source Taxation

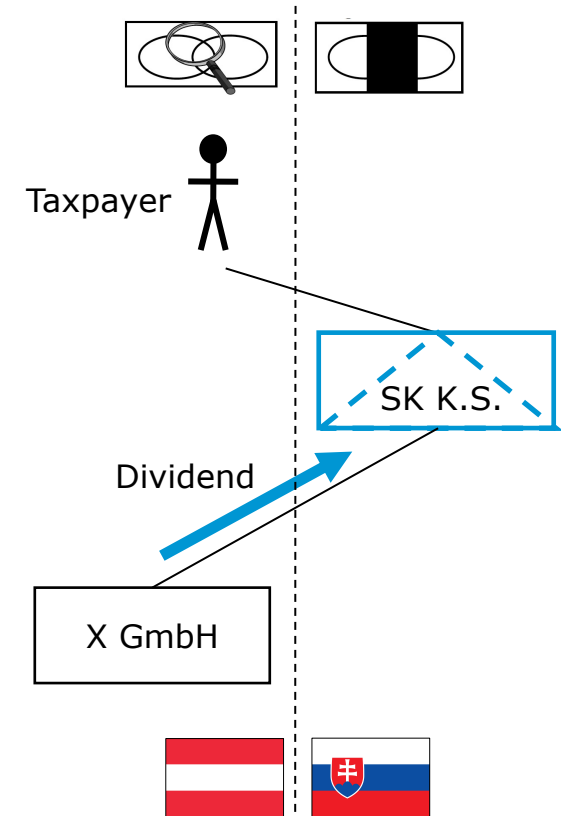
- **Austrian Source Taxation of X GmbH's distributions?**
  - **What if the the withholding tax exemption would not have applied? Would at least Art 10(2) DTC apply?**
    - In principle, Art 10 DTC (and any limit to source taxation) **does not apply** since, from an Austrian perspective, the distribution is not cross-border but rather from an Austrian GmbH to an Austrian shareholder (BFG, 6 July 2020, [RV/7101779/2017](#); Ex 16 PSR [majority opinion])
      - Hence, no relevance for Austrian taxation that the K.S. is a resident of the Slovak Republic, i.e., the perspective of the source State of the dividend is decisive (*Lang*, SWI 2020, 644)
      - What about Ex 16 (minority opinion) and Art 1(2), (3) OECD MC 2017?
    - However, there would be no Austrian **withholding taxation because of Art 7 DTC** if the holding was effectively connected with K.S.'s business in the Slovak Republic ([EAS 2783](#), [EAS 3168](#))



# Comments | Residence Taxation

- **Which Treaty Provision?**

- **Underlying assumption** → The **distributive rule in Art 7(1)**, i.e., taxation of the K.S. as a resident in the Slovak Republic, **does not prevent** taxation of the respective income share in the **partner's State**, i.e., Austria (see, e.g., paras 125-129 and Ex 16 PSR; Art 1 no. 6.1 OECD MC Comm. before 2017, and now Art 1(3) OECD MC)
- For the application of Art 7(2) and 23(2) or Art 21(1), we then need to distinguish **between two situations**, depending on whether an **effective connection** exists.

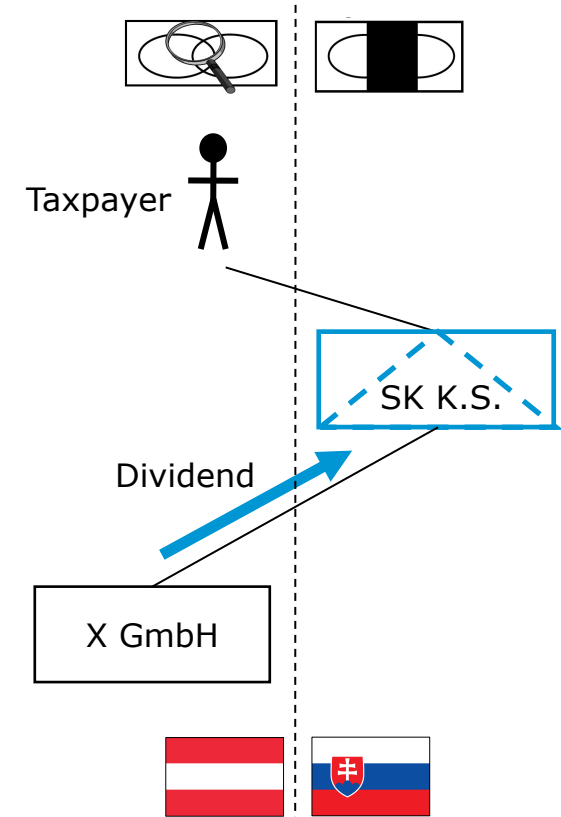


# Comments | Residence Taxation

- **Which Treaty Provision?**

- **Two situations**

- **Situation 1:** The holding/dividend **is attributable to a permanent establishment** in the Slovak Republic (e.g., active business *and* effective connection of the shares)
    - Application of **Arts 7, (13(2)) and 23(2)(a)**, i.e., exemption with progression in Austria (BFG 6 July 2020, RV/7101779/2017) – See also EAS 231, EAS 1228, EAS 2683, EAS 3018, EAS 3040, EAS 3217, EAS 3303, para. 135 and Ex 18 PSR).
    - Contra: Taxation of the undistributed income under **Art 10(1)** (e.g., *Aigner/Aigner*, SWI 2000, 254, and *Lang*, SWI 2020, 659-650, versus para. 137 PSR).

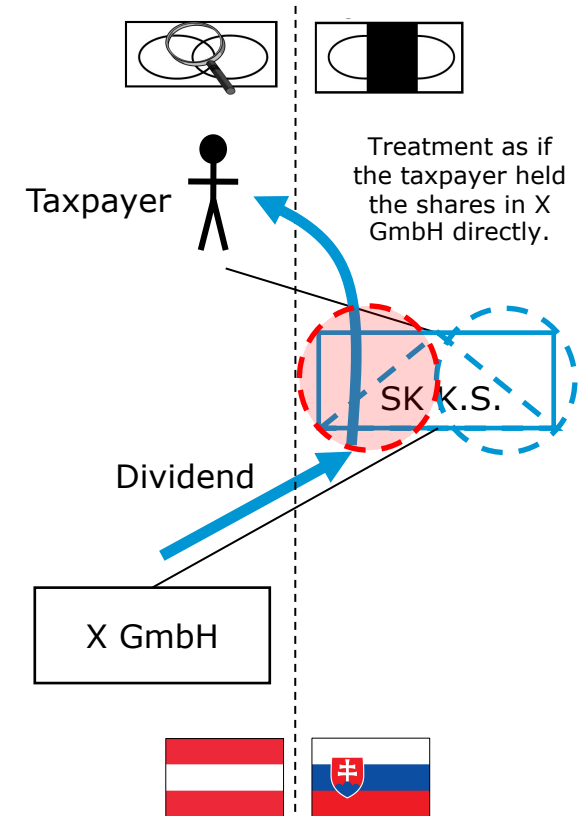


# Comments | Residence Taxation

- **Which Treaty Provision?**

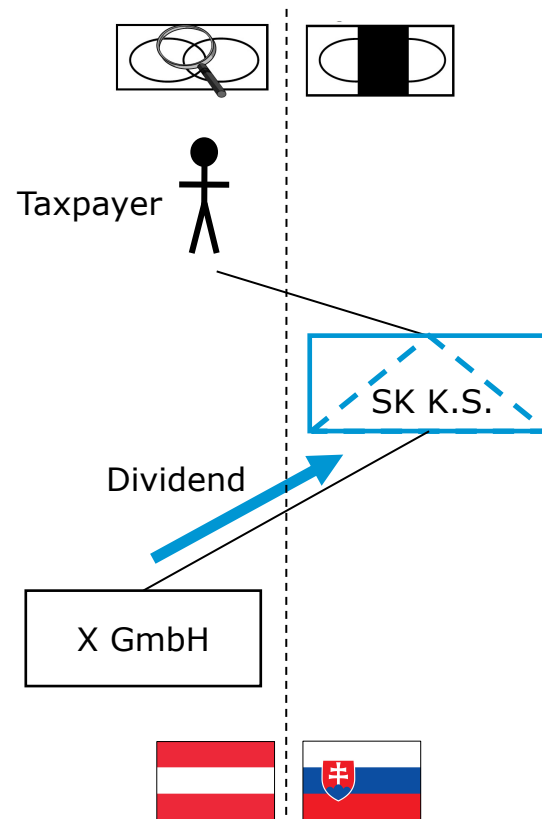
- **Two situations**

- **Situation 2:** The holding/dividend **is not attributable to a permanent establishment** in the Slovak Republic (e.g., no effective connection, mere passive asset management)
      - Taxation of the income at the Austrian shareholder level under **Art 21(1)** (*Lang*, SWI 2020, 647; *Loukota*, SWI 2021, 190), as Art 10(1) does not apply for lack of a cross-border situation (BFG, 6 July 2020, RV/7101779/2017; see also, e.g., EAS 3018, EAS 3304; contra possibly BFG 10 October 2018, RV/7101777/2015)
      - Irrelevance of income attribution to the K.S. under Slovak law (note that the dividends received from X GmbH are exempt in the Slovak Republic), no relief for any residence-based Slovak tax in Austria for lack of double taxation (EAS 3018; now: Art 23 OECD MC after the 2017 Update)



# Comments | *Functional Relation*

- **When Does such "Effective Connection" Exist?**
  - **Function and use** of the participation in the business/permanent establishment (BFG, 28 January 2016, [RV/7102307/2010](#); VwGH 18 October 2017, [Ro 2016/13/0015](#))
    - Focus on **significant people functions** regarding the holding ([EAS 3304](#); [EAS 342](#); *Dziurdz*, SWI 2020, 521)
    - Administrative practice in Austria relies on the **Authorized OECD Approach** and "economic ownership" (e.g., Art 10 no. 32.1 OECD MC. Comm.; [EAS 3304](#), [EAS 3317](#), [EAS 3421](#))
  - "Effective connection" accepted by the BFG where a K.S. and an Austrian GmbH were active **in the same business sector** (marketing under the same branding) (BFG, 15 November 2018, [RV/7105347/2017](#), and BFG, 6 July 2020, [RV/7101779/2017](#)), but declined where this was not the case (VwGH, paras 36-38)
  - In any event, the mere "strengthening" of the balance sheet or the creditworthiness is not sufficient (VwGH, para. 38)



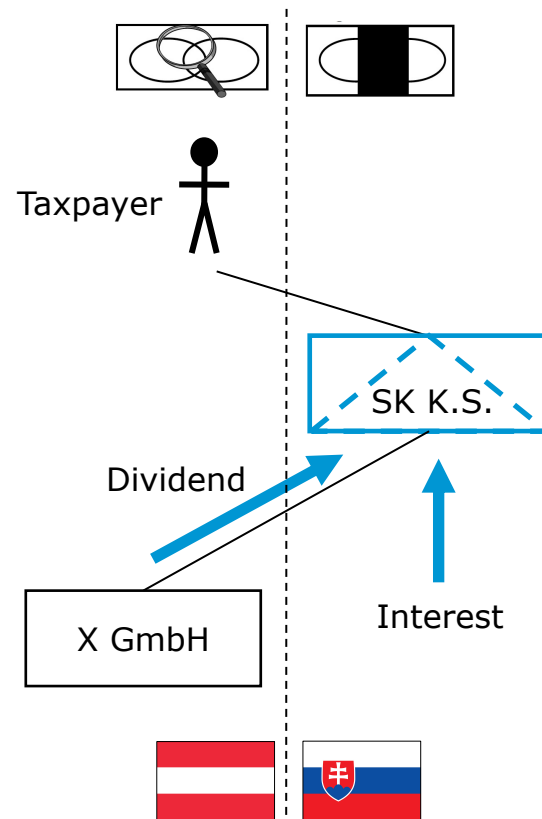


# Comments | *Interest Income of K.S.*

- **An Interesting "Side Topic"**

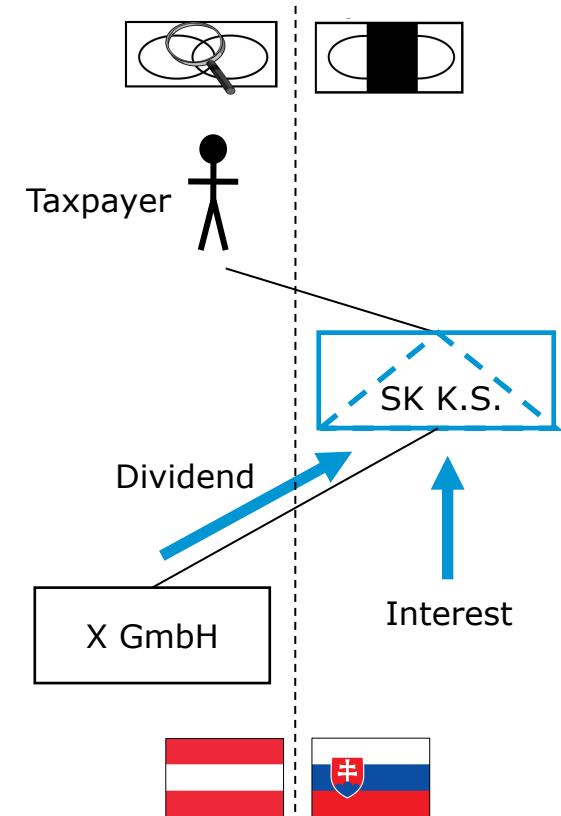
- **Residence-based taxation of the K.S.**

- In the concrete case, the Slovak K.S. had received **interest-bearing securities** as an in-kind distribution from X GmbH (in 2015), but these distributed securities were directly attributed to the Austrian taxpayer from Austria's tax perspective (VwGH, para. 26).
    - However, **K.S. has earned interest income** from the securities (before selling them to the taxpayer in 2016), which was **taxed in the Slovak Republic** at a rate of 23% (VwGH, para. 13), and also taxed in **Austria**.
    - Indeed, the Slovak Republic may tax all the K.S.'s income, including the interest, on a **residence basis** (Art 7(1)) (VwGH, paras 48-49; possibly contra BFG, 10 October 2018, RV/7101777/2015).
  - But: Does **Austria have to give tax-treaty relief for the Slovak corporate-level tax** on the K.S.'s (domestic or foreign) income under Art 23(2) DTC?



# Comments | *Interest Income of K.S.*

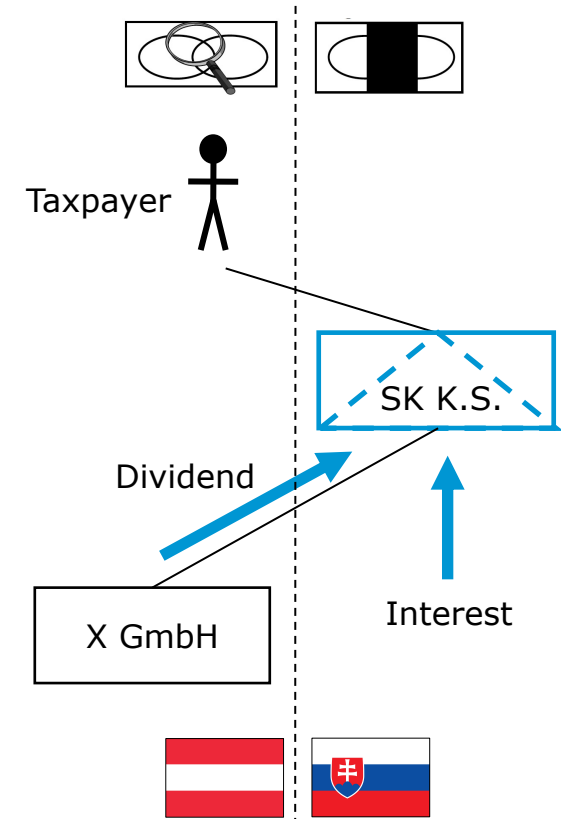
- **An Interesting "Side Topic"**
  - Does **Austria have to give tax-treaty relief for the Slovak corporate-level tax** on the K.S.'s (domestic or foreign) income under Art 23(2) DTC?
    - **Austrian administrative guidance (before 2017)**
      - **Yes**, for **domestic or foreign income** taxed at the level of the Slovak K.S. and for **both exemption and credit** (EAS 3304, concerning interest and royalties from sources within and outside the other Contracting State, referring to an extended reading of Ex 17 and para. 131 PSR) – *See also Ex 18 PSR and Art 23 no. 69.1 OECD MC Comm. before 2017 ("flow through" for purposes of the foreign tax credit).*
      - But only if there is indeed a **double taxation** (EAS 3018).
    - **VwGH**
      - **No**, as the interest from the securities is income of the taxpayer and because the DTC does not regulate the **subjective attribution of income** (VwGH, para. 49) – *Indeed, this is economic double taxation that is not addressed by the DTC (e.g., Lang, SWI 2020, 650-651; Loukota, SWI 2021, 187-188)*



# Comments | *Interest Income of K.S.*

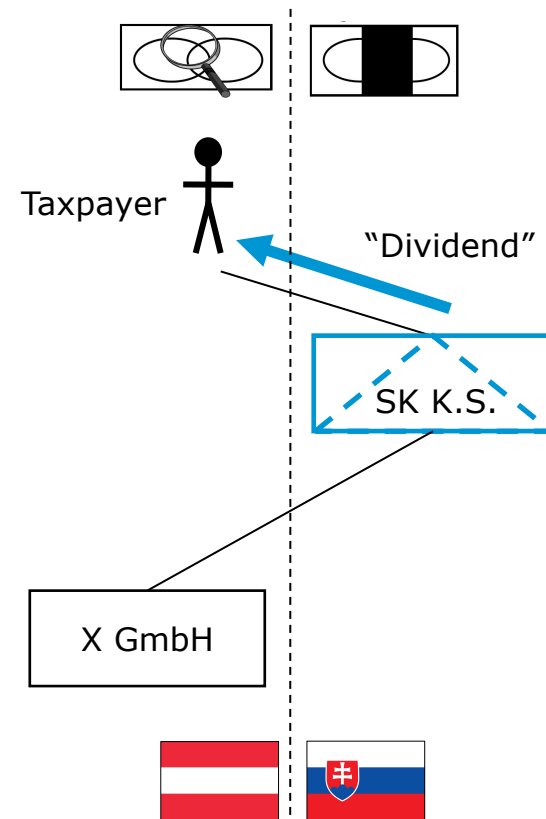
- **An Interesting "Side Topic"**

- Does **Austria have to give tax-treaty relief for the Slovak corporate-level tax** on the K.S.'s (domestic or foreign) income under Art 23(2) DTC?
- **New Art 23 OECD MC (since 2017)**
  - Credit in the taxpayer's residence State for partnership-level taxes only for **that State's source and PE taxation**, up to the maximum source tax under the treaty (Art 23 no. 11.1 with Ex E and F and no. 69.1 OECD MC Comm. after the 2017 Update)
  - No relief for the **residence-based tax** on foreign income or tax that exceeds the maximum source tax (e.g., in excess of 10% under Art 11(2)) in the partnership State (Art 23 OECD MC after the 2017 Update and Art 23 no. 11.1 with Ex C and D OECD MC Comm. after the 2017 Update)
  - The OECD views the **new wording of Art 23** after the 2017 Update as merely clarifying ("result would logically follow from the wording of Articles 23 A and 23 B even in the absence of that phrase"; Art 23 no. 11.1 OECD MC Comm. after the 2017 Update)



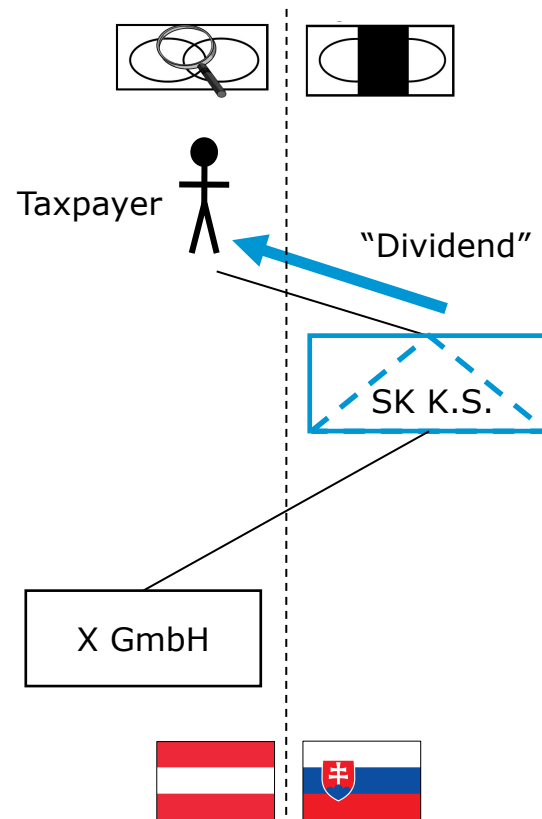
# Comments | *Dividends from K.S.*

- **What About Subsequent Profit Distributions from the Slovak K.S. to the Taxpayer?**
  - **Art 10(2) DTC** applies to such distribution, i.e., the Slovak Republic could levy a maximum **10% withholding tax**, as its qualification is decisive under Art 10(3) (EAS 2683, EAS 2375, EAS 3018, EAS 3040, EAS 3303; Art 23 no. 69.1 OECD MC Comm.)
  - **Will there be a tax treaty credit for the Slovak dividend withholding tax in Austria?**

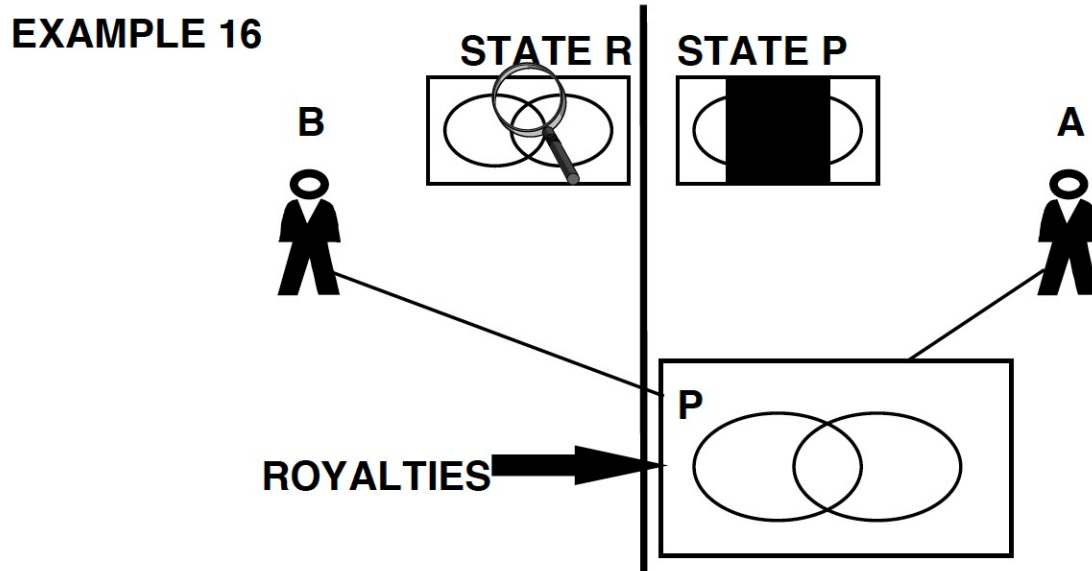


# Comments | *Dividends from K.S.*

- **What About Subsequent Profit Distributions from the Slovak K.S. to the Taxpayer?**
  - **Will there be a tax treaty credit for the Slovak dividend withholding tax in Austria?**
  - **No.** Tax treaties do not create domestic taxing rights.
    - From a treaty perspective, Austria **could tax the dividend** (Art 10(1)) and would then be required to grant a **tax credit** (Art 23(2)(b); para. 135 PSR)
    - However, from Austria's domestic tax perspective the "dividend" is a **tax-neutral withdrawal** (e.g., EAS 2683, EAS 3018, EAS 3040, EAS 3303; see also para. 136 PSR, Art 23 no. 69.3 OECD MC Comm.)
    - As the withdrawal is tax neutral, there will be **no credit** for any Slovak withholding tax on the dividend (EAS 3040, EAS 3303: dividend is "excluded from the treaty credit system"; Art 23 no. 69.3 OECD MC Comm.: no credit "as there is simply no tax" in the residence State against which to credit)
    - Also, the withdrawal is not "income" for purposes of calculating the **"per-country limitation"** (EAS 3303)



- *Partnership Report ("PSR") and the 2017 OECD MC Update (Art 1(2), (3))*



# Thank you!



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