

I. Introduction

In the past couple of years, various cross-border hybrid “sandwich structures” have been scrutinized by the tax administration as well as the courts in Austria.² One such structure, the so-called “K.S. model”, involves the interposition of a commercially active Slovak “komanditná spoločnosť” (K.S.), which is viewed as “intransparent” and a resident taxpayer by the Slovak Republic but is considered as comparable with an Austrian limited partnership and hence treated as “tax transparent” from an Austria tax perspective.³ Simplified, under the “K.S. model”, an Austrian individual shareholder of an Austrian corporation (e.g. a “GmbH”) transfers those shares⁴ as an equity contribution to a Slovak K.S. that subsequently receives dividends from that Austrian corporation.⁵ If successful, this structure would effectively transform taxable domestic dividends into exempt foreign business income.⁶ However, it raises a number of questions from the perspective of the Austrian domestic tax system as well as from the perspective of the bilateral tax treaty between Austria and the Slovak Republic.⁷ First, will a dividend paid from the Austrian corporation to the K.S. be exempt from Austrian source taxation under the Austrian implementation of the Parent Subsidiary Directive (PSD)? Second, will the Austrian shareholder be exempt from Austrian residence taxation of the undistributed income of the Slovak K.S. under Articles 7 and 23 of the tax treaty? Third, will the Austrian shareholder be taxed on any subsequent

- 2 For a detailed analysis of the administrative practice on hybrid entities in the Austrian Ministry of Finance’s “Express Answer Service” (EAS), see G. Kofler & H. Moshhammer, *Zurechnungskonflikte bei Personengesellschaften*, 23 *Steuer und Wirtschaft International* 2013, pp. 6-17. See also specifically with regard to a Slovak “komanditná spoločnosť” EAS 2783 (23 Oct. 2006), EAS 3010 (18 Dec. 2008), EAS 3018 (18 Nov. 2008) and EAS 3125 (18 Mar. 2010). Similar hybrid structures involving a Hungarian “betéti társaság” (B.T.) were addressed in EAS 3303 (23 Nov. 2012) and EAS 3304 (23 Nov. 2012), and hybrid Romanian entities were at issue in EAS 3040 (11 Feb. 2009) and EAS 3217 (18 April 2011).
- 3 EAS 2694 (6 Feb. 2006); EAS 2783 (23 Oct. 2006); EAS 3018 (18 Nov. 2008).
- 4 It should be noted in passing that a straightforward transfer of shares would trigger exit taxation under § 27(6) EStG (before 2012: § 31(2) EStG) if Austria lost its right to tax the capital gains (see, e.g., EAS 3125 (18 Mar. 2010)).
- 5 See, e.g. R. Beiser, *KESSt-Ersparnis durch slowakische KS?*, 28 *Recht der Wirtschaft* 2010, p. 426; R. Beiser, *BFH bestätigt Durchgriff durch ausländische Personengesellschaften*, 29 *Recht der Wirtschaft* 2011, p. 691. See also the discussions in T. Stradinger, *SWI-Jahrestagung: Anteilsübergang an (hybride) Ost-Personengesellschaften*, 21 *Steuer und Wirtschaft International* 2011, p. 347, and in D. Auer & A. Miladinovic, *SWI-Jahrestagung: Zuordnung einer Beteiligung zur Betriebsstätte im DBA-Recht*, 29 *Steuer und Wirtschaft International* 2019, p. 234.
- 6 As for the treatment in the Slovak Republic, a qualifying dividend received by the Slovak K.S. is exempt in the Slovak Republic (following the Parent Subsidiary Directive). Moreover, dividends paid by the K.S. to the Austrian taxpayer were exempt from withholding taxation in the Slovak Republic in the past (until 2017) and are now taxed at a rate of 7 % (since 2017).
- 7 In relation to the Slovak Republic, the “old” treaty with the Czechoslovakia (ČSSR) (Federal Gazette 1979/34, as amended) still applies (see the exchange of notes to that effect in Federal Gazette 1994/1046). It largely follows the *OECD Model Tax Convention on Income and Capital* (11 April 1977), Models IBFD. The treaty, though amended by the *OECD Multilateral Convention* (MLI), Models IBFD, does not include provisions similar to Article 1(2), (3) or the new wording of Article 23A(1), 23B(1) *OECD Model Tax Convention on Income and Capital* (21 Nov. 2017), Models IBFD.

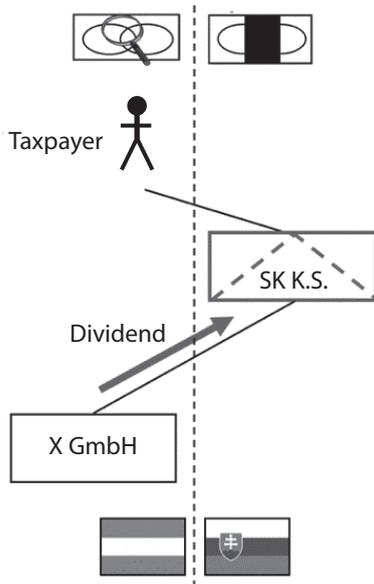
profit distribution by the Slovak K.S., or will it be treated as a tax-free withdrawal? Some of those issues have been addressed in a recent line of case law by the Federal Fiscal Court (BFG) as well as the Austrian Supreme Administrative Court (VwGH), specifically regarding the allocation of a holding in an Austrian corporation to a Slovak K.S.⁸

II. Facts of the Case

The facts in the 2020 decision⁹ by the Austrian Supreme Administrative Court can easily be summarized and simplified. The Austrian individual taxpayer was (effectively) the only shareholder in the Austrian X GmbH and the Slovak K.S. The Slovak K.S.'s business was in the real estate sector (letting and trading real estate) whereas X GmbH's business consisted of its holding and asset management functions. X GmbH held a 25 % share in Swiss Y Holding AG that it sold in 2014 and subsequently purchased securities. In 2007, the taxpayer transferred her stake in X GmbH (as an equity contribution) to the Slovak K.S. (declaring income based on the Austrian exit tax rules and applying for deferred taxation). Subsequently, X GmbH made several profit distributions to the 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, the Slovak K.S. sold the securities to the taxpayer, clearing the purchase price with the taxpayer's rights to profits.

8 The focus of this note is the 2019/13/0007 (15 Oct. 2020) decision (for taxable years 2007-2016, appeal from AT: BFG [Federal Tax Court], 10 Oct. 2018, RV/7101777/2015, unpublished). A previous decision by the Austrian Supreme Administrative Court (VwGH) on a hybrid sandwich structure was VwGH, 18 Oct. 2017, Ro 2016/13/0015 (appeal from AT: BFG [Federal Tax Court], 28 Jan. 2016, RV/7102307/2010), with a continued procedure at the level of the Federal Fiscal Court (BFG) (for taxable year 2007: BFG, 15 July 2018, RV/7105347/2017, not appealed) and a subsequent decision by the same court (for taxable years 2009-2011: AT: BFG [Federal Tax Court], 6 July 2020, RV/7101779/2017, not appealed). For detailed analyses of these decisions, see N. Zorn, *VwGH: Zuordnung einer Beteiligung zur Betriebsstätte im DBA-Recht*, 36 *Recht der Wirtschaft* 2018, p. 254; D. Auer & A. Miladinovic, *supra* n. 4, at 234; N. Zorn, *VwGH: Einkünfte aus Beteiligung an slowakischer k.s.*, 38 *Recht der Wirtschaft* 2020, p. 949; K. Dziurdz, *Zurechnung von Beteiligungen und der funktionale Zusammenhang*, 30 *Steuer und Wirtschaft International* 2020, p. 521; M. Lang, *Neue VwGH-Rechtsprechung zur abkommensrechtlichen Behandlung hybrider ausländischer Gesellschaften*, 31 *Steuer und Wirtschaft International* 2020, p. 642; M. Deichsel, *Steuerliche Behandlung der von einer österreichischen GmbH an eine slowakische k.s. erfolgten Gewinnausschüttungen*, 19 *Zeitschrift für Gesellschaftsrecht und angrenzendes Steuerrecht* 2020, p. 400; M. Hummer & J. Höhfürtnner, *Aktuelles BFG-Erkenntnis zur slowakischen Komanditná Spoločnosť*, 31 *Steuer und Wirtschaft International* 2021, p. 133; H. Loukota, *Aktuelle BEPS-konforme VwGH-Judikatur zu hybriden Personengesellschaften*, 31 *Steuer und Wirtschaft International* 2021, p. 181.

9 See 2019/13/0007 (15 Oct. 2020) (for taxable years 2007-2016, appeal from RV/7101777/2015 (10 Oct. 2018), unpublished).



III. The Court’s Decision

The main issue addressed by the BFG as well as the VwGH was whether the shares in the Austrian X GmbH were “effectively connected” with K.S.’s active business in the Slovak Republic. Both courts concluded that this was not the case, so neither Articles 7 and 23(2) nor any other provision would restrict Austria’s domestic right to tax the dividends paid by X GmbH in the hands of the Austrian taxpayer.

Before addressing the VwGH’s decision, two (more or less) implicit assumptions should be brought to light. First, 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 comparable with an Austrian limited partnership and hence as tax transparent from an Austrian perspective.¹⁰ This determination is neither influenced by the list of qualified entities in the Parent-Subsidiary-Directive¹¹ nor by the qualification under foreign (tax) law.¹² Second, the fact that the Slovak K.S. is treated as non-transparent and as a resident taxpayer by the Slovak Republic does not mean, for purposes of the tax treaty, that Article 7(1) would

10 See also, e.g., EAS 2694 (6 Feb. 2006); EAS 2783 (23 Oct. 2006); EAS 3018 (18 Nov. 2008).

11 See also EAS 2683 (21 Dec. 2005), EAS 3018 (18 Nov. 2008) and, although in a different context, 2019/13/0007 (15 Oct. 2020), paras. 44, 45.

12 See, e.g., EAS 2248 (3 Mar. 2003); EAS 2375 (21 Nov. 2003); EAS 3018 (18 Nov. 2008); EAS 3040 (11 Feb. 2009); EAS 3217 (18 April 2011); EAS 3304 (23 Nov. 2012).

prevent taxation of the respective income share in the partner's state, i.e. Austria.¹³ This reflects the VwGH's view that a tax treaty does not generally contain rules that determine the subjective attribution of income to a taxpayer and that this attribution is rather a matter to be determined under the domestic law of the source state.¹⁴ Third, the VwGH implicitly confirmed that the Slovak K.S., though non-transparent from a Slovak perspective, is treated as merely conveying a "regular" permanent establishment to the Austrian partner and that the K.S., which is a single entity under the tax law of the Slovak Republic, can hence be "compartmentalized" into several spheres from that perspective. This latter view makes it therefore decisive if a certain asset can be attributed to the permanent establishment conveyed to the Austrian taxpayer by the Slovak K.S. (or if, conversely, that asset must be treated as being held by the Austrian taxpayer directly¹⁵).

Moreover, and although not disputed in the case, the VwGH implicitly acknowledged that Austria has a dual position in this hybrid "sandwich structure". It is the source state of the dividend as well as the residence state of the taxpayer. Regarding Austria's position as a source state, the VwGH, in passing, confirmed that Austria is barred from levying a withholding tax on the dividend based on Austria's implementation of the EU's Parent Subsidiary Directive (PSD). This is because the Slovak K.S. is a listed legal form in the PSD¹⁶ and hence exempt from withholding taxation in Austria¹⁷ if the other relevant conditions are met (e.g. a 10% equity stake).¹⁸ Switching the perspective back to Austria's position as the taxpayer's residence state, however, the VwGH confirmed that the PSD does not prohibit taxation (via assessment) of the dividend income on the level of the individual shareholder on a residence basis.¹⁹

The VwGH's decision then focused on the bilateral tax treaty between Austria and the Slovak Republic. Here it was decisive for the court to determine whether the holding in X GmbH had an "effective connection" ("tatsächliche Zugehörigkeit") with the business activities of the Slovak K.S.²⁰ Already in 2017 and without even mentioning the Authorized OECD Approach, the VwGH came to this approach based on the systematic context of Articles 7, 10(4), and 13(2) which

13 This assumption is also in line with OECD guidance. See, e.g. paras 125-129 and Example 16 in OECD, *The Application of the OECD Model Tax Convention to Partnerships*, Issues in International Taxation No. 6 (Paris: OECD, 1999) (the "OECD Partnership Report"), Art. 1(6.1) OECD Model Conventions before the 2017 Update, and the "saving clause" in Art. 1(3) of the *OECD Model* (2017).

14 See 2019/13/0007 (15 Oct. 2020), para. 49.

15 See Zorn, (2018), *supra* n. 7, at 256).

16 Annex I Part A lit y of Council Directive 2011/96/EU of 30 November 2011 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States, [2011] OJ L 345, p. 8, as amended.

17 I.e., § 94(2) EStG (before April 2012: § 94a EStG).

18 2019/13/0007 (15 Oct. 2020), paras 43, 47,

19 *Id.*, paras. 44-45.

20 *Id.*, paras. 35-36, referring to AT: VwGH [Supreme Administrative Court], 18 Oct. 2017, Ro 2016/13/0015.

demonstrates that only if a holding has such “effective connection” (“tatsächliche Zugehörigkeit”) to a permanent establishment could the respective dividends be taxed under Article 7 of the treaty.²¹ Moreover, the VwGH clearly viewed this question of attribution of assets and income to a permanent establishment as one of autonomous treaty interpretation so that no recourse to domestic law under Article 3(2) of the tax treaty is warranted. That also means that the domestic law criteria for the attribution of assets to a business, such as the categorization as “necessary” or “voluntary” business property, are not dispositive.²² In the concrete case, the VwGH (just as the BFG before) found that no such “effective connection” between the holding in X GmbH and K.S.’s business existed and that the mere strengthening of credit-worthiness is not sufficient to establish one.²³ Hence, implicitly viewing the dividend paid by the Austrian GmbH as having been received directly by the Austrian shareholder, Austria is not restricted (by Article 23(2) of the tax treaty) in taxing the dividend income K.S. receives from X GmbH.²⁴ This taxation on a residence-basis is also not a prohibited withholding taxation within the meaning of the PSD.²⁵

There are also some interesting further “takeaways” from the VwGH’s analysis. First, the court already confirmed in its 2017 decision that the domestic deeming provision of § 2(4) EStG, which deems all income from a commercial partnership (“Mitunternehmerschaft”) as income from a “business”, is not relevant for the tax treaty analysis.²⁶ Hence, § 2(4) EStG can certainly not be read as meaning that any asset owned by the K.S. would automatically have to be considered a business asset attributable to a permanent establishment under tax treaty law.²⁷ Second, the taxpayer had argued that the “effectively connected requirement” was only developed by the court in 2017²⁸ and that, previously, the tax administration’s general guidance had accepted the domestic law qualification as “necessary” business property²⁹ and even as “voluntary” business property.^{30, 31} The court did not enter into the substance of that challenge but merely noted that general administrative guidance does not trigger good faith protection of the taxpayer.³² Third, the court held that

21 See 2016/13/0015 (18 Oct. 2017).

22 2019/13/0007 (15 Oct. 2020), paras. 36-37 and 39, referring to 2016/13/0015 (18 Oct. 2017).

23 2019/13/0007 (15 Oct. 2020), paras. 37, 38.

24 Id., para. 35.

25 Id., paras. 44-45.

26 See 2016/13/0015 (18 Oct. 2017), referring to German case law; possibly *contra* EAS 2248 (3 March 2003) (“all-or-nothing” for purposes of Article 7).

27 See also Lang, *supra* n. 7, at 648-649.

28 See 2016/13/0015 (18 Oct. 2017).

29 EAS 2931 (7 Feb. 2008); EAS 3010 (18 Dec. 2008); EAS 3018 (18 Nov. 2008).

30 See also AT: BFG [Federal Tax Court], 28 Jan. 2016, RV/7102307/2010; but *contra* already EAS 3010 (18 Dec. 2008), EAS 3018 (18 Nov. 2008) and EAS 3317 (8 April 2013).

31 Note that the current administrative guidance is in line with the new case law (e.g., EAS 3403 (8 June 2018); EAS 3421 (25 März 2020); para. 433 of the Austrian Corporate Tax Guidelines (“KStR 2013”), as amended in 2019).

32 See 2019/13/0007 (15 Oct. 2020), paras 39-40.

the Austrian exit tax was not triggered by the transfer of shares by the Austrian individual, non-business shareholder since the holding in X GmbH did not become “effectively connected” with the Slovak K.S. (under Article 13(2)) and, therefore, Austria did not lose its right to tax the capital gains (Article 13(4)).³³

IV. Comments on the Court’s reasoning

A. Austrian Source Taxation of X GmbH’s Distributions?

As for the Austrian source taxation of X GmbH’s distributions, the VwGH clearly found that the withholding tax exemption for cross-border intercompany dividends under domestic law, which is based on the EU’s Parent Subsidiary Directive (PSD), applies because the Slovak K.S. has a legal form listed in the PSD³⁴ (and the other conditions, such as a sufficient equity holding, were fulfilled).³⁵ This confirms that the exemption from Austrian withholding taxation applies irrespective of the hybridity of the recipient³⁶ and irrespective of whether the holding is “effectively connected” with a permanent establishment of the K.S. in the Slovak Republic.³⁷

Given that the withholding tax exemption for cross-border intercompany dividends applied, the VwGH did not have to address the questions if and how a tax treaty would potentially modify Austrian source taxation in a hybrid “sandwich structure”. Generally, Article 10 (and any limit to source taxation) would not have applied in the present case since, from an Austrian perspective, the distribution is not cross-border but rather from an Austrian GmbH to an Austrian shareholder.³⁸ Absent a specific clause along Article 1(2), (3) OECD MC 2017, this view

33 Id., para. 50.

34 See Annex I Part A lit y of Council Directive 2011/96/EU of 30 November 2011 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States, [2011] OJ L 345, p. 8, as amended.

35 As for hybrid entities, that view was generally shared with regard to Article 5 of the Parent Subsidiary Directive (see, e.g. para. 3.3.5.2., of the Report from the Commission to the Council in accordance with Article 8 of Council Directive 2003/49/EC on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States, COM(2009)179) as well as the “old” § 94a EStG (which referred to a recipient “company”; see, e.g. EAS 2783 (23 October 2006)) and the “new” § 94 Z 2 EStG (although doubts might have existed as that provision now refers to a recipient “corporation” and could have been read as requiring comparability under the so-called “Typenvergleich” with a corporation under Austrian law). See, for that discussion and further references, D. Aigner, G. Kofler, H. Kofler and M. Tumpel, *Grenzüberschreitende Gewinnausschüttungen und hybride Gesellschaften in § 10 Abs 2 KStG und § 94 Z 2 EStG*, in: Kammer der Wirtschaftstreuhänder (ed.), *Personengesellschaften und andere Mitunternehmerschaften sowie ihre Gesellschafter*, GedS Bruckner (Vienna: Linde Verlag, 2013), p. 355.

36 See 2019/13/0007 (15 Oct. 2020), paras. 43, 47; for critical perspectives see, however, Beiser, (2010), *supra* n. 4, at 426-427, and the comments by H. Jirousek in Stradinger, *supra* n. 4, at 347-348.

37 See 2019/13/0007 (15 Oct. 2020), paras. 43, 47; RV/7101779/2017 (6 July 2020).

38 RV/7101779/2017 (6 July 2020); see also Example 16 in the *OECD Partnership Report* (majority opinion), *supra* n. 12.