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Commercial Property - Austria

Act introduces 25% real estate income tax on sales profits

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Introduction

Parliament recently passed the Fiscal Stability Act 2012, introducing a number of measures intended to consolidate the budget. As these measures, among other things, introduce new taxes or increase existing taxes on real estate transactions, the act has sparked a huge outcry by the industry.

The measures include a 25% income tax on all profits derived from real estate sales and the closure of existing loopholes in taxation of value added tax (VAT) on rent agreements. The corporate tax regime remains unchanged.

The act, which entered into force on April 1 2012, will have a significant impact on the Austrian real estate market.

Real estate income tax

Under the previous income tax regulations, proceeds from the sale of a property were not subject to personal income tax, provided that the seller had owned the property for at least 10 years (subject to certain exceptions).

As of April 1 2012, the sale of a property triggers income tax. The relevant date is the date on which the agreement is executed, irrespective of when the property is handed over or the buyer is registered as a new owner in the Land Register.

The act distinguishes between properties for which the 10-year period had not expired when the act entered into force (ie, 'new' real estate assets - generally, those properties acquired on or after April 1 2002) and other properties (ie, 'old' real estate assets or those acquired before that date).

New real estate assets
If the property was acquired on or after April 1 2002, the tax is based on the revenue derived from the sale less the acquisition cost.

The revenue is decreased by certain costs incidental to the sale of the property, such as the fee for assessing the tax base. Other costs incidental to the sale (eg, advertisement costs or broker fees) do not reduce the tax base.

The revenue is further decreased by a deduction for inflation. This deduction reduces the revenue by 2% for each year during which the seller has owned the property, up to a maximum of 50%. There is no deduction for the first 10 years. Therefore, for example, if the property is sold after 30 years, the revenue will be reduced by 2% for the each of the 20 years following the 10-year exemption period, leading to a total reduction of 40%.

The acquisition cost is increased by certain costs of maintenance and repair. For example, if the owner has invested in the building in order to achieve a better price, the cost of this investment is treated as part of the acquisition cost and the tax base is reduced. Costs incidental to the

acquisition (ie, broker fees or legal fees) also increase the acquisition cost. The acquisition cost is reduced by public subsidies and by depreciation for wear and tear (where the property has been rented out).

Old real estate assets

The basis for taxation of the sale of property acquired before April 1 2002 is the revenue derived from the sale minus the acquisition cost. However, as the sellers could have sold the property tax free under the old regime, they cannot be expected to still hold records of the acquisition, which may have taken place several decades ago. For this reason, the tax is not assessed by referring to the actual acquisition cost. Instead, the acquisition costs are deemed to be a certain percentage of the revenue derived from the sale:

- If the zoning of the property was changed from green land (which cannot be used for building purposes) into building land after January 1 1988, the acquisition cost is deemed to be 40% of the revenue derived from the sale. Thus, 60% of the revenue is deemed to be profit.
- In all other cases the acquisition cost is deemed to be 86% of the revenue derived from the sale. Thus, the tax base is 14% of the revenue.

Tax rate

The profit is taxed at a preferential flat rate of 25%. Any losses incurred in connection with the sale of property can be offset only against profits derived from the sale of other real estate during the same fiscal year. Losses may not be carried forward. Profits do not increase the (progressive) tax rate for income derived from other sources.

The seller may waive the preferential rate of 25% and opt for standard tax treatment; the income will then be assessed at the progressive income tax rate of up to 50%. The seller will choose this option if he or she can make use of losses incurred from other business to compensate the profit.

Exceptions

The new taxation rules are inapplicable in cases where the seller continuously used the property as a principal residence following acquisition for the two years before the sale, or for at least five continuous years within the final 10 years before the sale, provided that the principal residence was abandoned in both cases. Certain other exceptions are in place - for example, if the seller has constructed the building himself or herself, or in the case of forced sales due to public authority interventions (eg, condemnation procedures). The same applies to exchanges of real estate in the wake of reallocation or consolidation proceedings and compensation for losses in real estate value due to measures of public interest.

Profits derived from the sale of property as part of the operation of a business

Under the previous tax regime, the profits derived from the sale of a property were subject to income tax on a progressive scale up to 50%, if the property was held in the course of the operation of a business. In certain cases, the tax applied only to the profits from the sale of the building and not those attributed to the sale of the land.

As of April 1 2012, the new 25% real estate income tax applies in the same manner to the sale of properties held as part of the operation of a business. In particular, the distinction between profits on the sale of the land and those on the sale of the building has been dropped.

However, the tax will be levied on the basis of the regular income tax rate (rather than the preferential rate of 25%) if the property is allocated within the company's current assets, provided that the business mainly covers the sale or lease of real estate and insofar as a current value depreciation was conducted or insofar as unrealised gains disclosed before April 1 2012 have been transferred. Capital gains from real estate assets of corporations remain subject to corporate income tax.

VAT

Under the old VAT regime it was common practice for entities not entitled to input VAT deduction (eg, banks or insurance companies) to outsource the construction of their commercial buildings to special purpose companies in order to then lease the respective premises from the intermediary. Thus, input VAT on the construction was deductible, thereby reducing construction costs. In return, the rents were subject to VAT. Previous regulations allowed for selling and letting such

buildings tax free by way of opting for a tax exemption after 10 years (without adjustment of any earlier input VAT deduction), resulting in an overall input VAT benefit.

Under the new laws (applicable as of September 1 2012, provided that the construction of the respective building was not started before such date), this routine is permitted only if the tenant uses the premises for services not excluding input VAT deduction. However, a use for rendering services excluded from input VAT deduction of up to 5% is tolerated.

Furthermore, previous input VAT rules concerning real estate provided for input tax corrections triggering a pay-back mechanism for originally deducted input VAT applicable in case of subsequent changes in use of a building (eg, an initially taxably leased building is later sold or leased tax free). In this context a 10-year adjustment period was determined. Under the new regime this period was extended to 20 years, affecting real estate used as a fixed asset within a business for the first time after March 31 2012 and rental agreements concerning real estate let for residential purposes concluded after March 31 2012. In addition to these modifications, the new laws state that relevant documentation must be retained for 22 years.

Comment

It is hard to predict the impact of the act on real estate transactions. However, the following presumptions can be made.

The act will have only indirect influence on corporations - whether limited liability companies (GmbH) or joint stock corporations (AG) - as these are subject to corporate tax rather than income tax. The corporate tax regime is unchanged.

As private individuals are typically long-term investors, the act is also likely to have insignificant influence on the demand side. Demand by private individuals has been very high in the past few years, despite soaring prices, as real estate is considered a safe investment in turbulent times.

However, the act will render the sale of real estate by private individuals or companies not subject to corporate tax (eg, limited partnerships) uninteresting in certain scenarios, as the new real estate income tax can melt away a large portion of the profit of the sale, in particular with regard to 'old' real estate where the tax is calculated based not on the actual acquisition cost, but rather on the presumed acquisition cost.

In some cases, the new tax regime will trigger a lower tax than the old regime. In particular, properties that were held as part of a business can now be sold by making use of the preferential tax rate of 25%, as opposed to the progressive tax rate of up to 50% that was in place under the old regime. In these cases, properties that for tax reasons were previously not sold may now appear on the market.

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