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**Austria – Shift from Legal Employer to Economic Employer Approach**

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After years of applying the “legal employer” approach in Austria, a recent decision by the Austrian Higher Administrative Court seems to shift to an “economic employer” approach for outbound international assignments in a case where “cost allocation” was deemed an important factor.

### Why This Matters

Until recently, Austrian national tax law has typically defined the “employer” based on the legal employment contract and the resulting rights and obligations. In comparison with its neighbors, few countries in fact utilize the legal employer approach. More and more countries are using the economic employer approach. The two different approaches, in many cases, have led to confusion and disagreements between tax authorities and employers. The switch to an economic employer approach should lead to greater clarity around taxing authority and from the employers' perspective, how they are to be taxed.

### Background

For years, Austria has emphasized the so-called legal employer approach for determining taxation rights for employment income according to Article 15 OECD Model Convention (OECD-MC). This has caused numerous cases of double taxation as well as many discussions with the tax authorities.

### Article 15 OECD Model Convention – Taxation of Income from Employment

Article 15 OECD-MC deals with the taxation of income from employment. It states that such income is generally taxable in the country where the work is physically performed. In the event that three requirements are met cumulatively (we discuss these further below), the right of taxation falls back to the residence state of the individual. In practice, with short-term assignments – which often implies a physical presence in the host country of less than 183 days in the corresponding period – it is essential to determine where the individual's “employer” is resident.

A main question is: Who is qualified as the “employer” – the sending or the receiving entity? Neither in the OECD-MC itself nor in its commentary is there a legal definition of this term. In such cases it is expected that the national definition is applicable.

### Austria's “Stand-Alone” Position and its Implications for Assignments

Austrian national tax law defines the “employer” based on the legal employment contract and the resulting rights and obligations. Hence, the Austrian interpretation stressed the importance of the “original” authority to give directives to the employee. Generally, this authority arises from the originally concluded employment contract with the sending company. The receiving company usually is only given a “derived” authority. The position taken by Austrian authorities is called “legal employer approach.”

In an international comparison, especially compared with its neighboring countries, the Austrian position is only shared by a few other states. The overwhelming majority applies the economic employer approach which is determined by the following factors<sup>1</sup>:

- Who has the authority to instruct the individual regarding the manner in which the work has to be performed?
- Who controls and has responsibility for the place at which the work is performed?
- Is the remuneration of the individual directly charged by the formal employer to the enterprise to which the services are provided?
- Who puts the tools and materials necessary for the work at the individual's disposal?
- Who determines the number and qualification of the individuals performing the work?
- Who has the right to select the individual who will perform the work and to terminate the contractual arrangements entered into with that individual for that purpose?
- Who has the right to impose disciplinary sanctions related to the work of that individual?
- Who determines the holidays and work schedule of that individual?

In cases where an Austrian company is sending employees to an entity abroad to perform work there ("outbound assignments"), this has often led to a situation in which Austria considered the employer to be resident in Austria as the individual's original employment contract is concluded with the Austrian sending company. The other state determined that the employer was resident of that other state as the individual is integrated in the organization of the receiving company, salary costs are recharged, etc. Consequently, in case of short-term assignments, the other state claims the right to tax the work performed there whereas Austria would insist on its taxation right as the resident state of the employee. In order to resolve this situation of double taxation it was necessary to apply for a mutual agreement between the contracting states.

### Recent "U-Turn" and Future Developments

After long years of challenging and often unsatisfactory situations, the Austrian Higher Administrative Court made this ground-breaking decision<sup>2</sup> and applied the economic employer approach in the case of a short-term outbound assignment. It was confirmed by the Higher Administrative Court that while the term "employer" has to be determined according to national tax law, the relevant double taxation treaty's terms must also be considered. In this context, the Higher Administrative Court especially mentioned cost allocation as a decisive factor. The idea behind this is that taxation of the employee occurs in the same state where the taxable profits of the employer are reduced by the personal costs it bears relative to the employee.

It is important to note that this decision was specific to the particular facts and circumstances of the parties involved and, so, not generally binding for the tax authorities in other cases. Any future matters will need to be determined on a case-by-case-basis. However, the Austrian Ministry of Finance has indicated in an informal comment<sup>3</sup> that it intends to revise its opinion and follow the new approach.

### KPMG Note

It remains to be seen how Austria will deal with inbound cases and KPMG will endeavor to keep readers of *Flash International Executive Alert* and clients of KPMG updated as developments occur.

*Footnotes:*

- 1 OECD Model Tax Convention on Income and on Capital, Article 15 para. 8.14 gives objective criteria to determine who is de facto employer.
- 2 VwGH vom 22.5.2013, 2009/13/0031.
- 3 Schreiben an den Fachsenat für Steuerrecht der Kammer der Wirtschaftstreuhänder über eine Besprechung mit dem Bundesministerium für Finanzen.

The information contained in this newsletter was submitted by the KPMG International member firm in Austria. The information contained herein is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser.

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