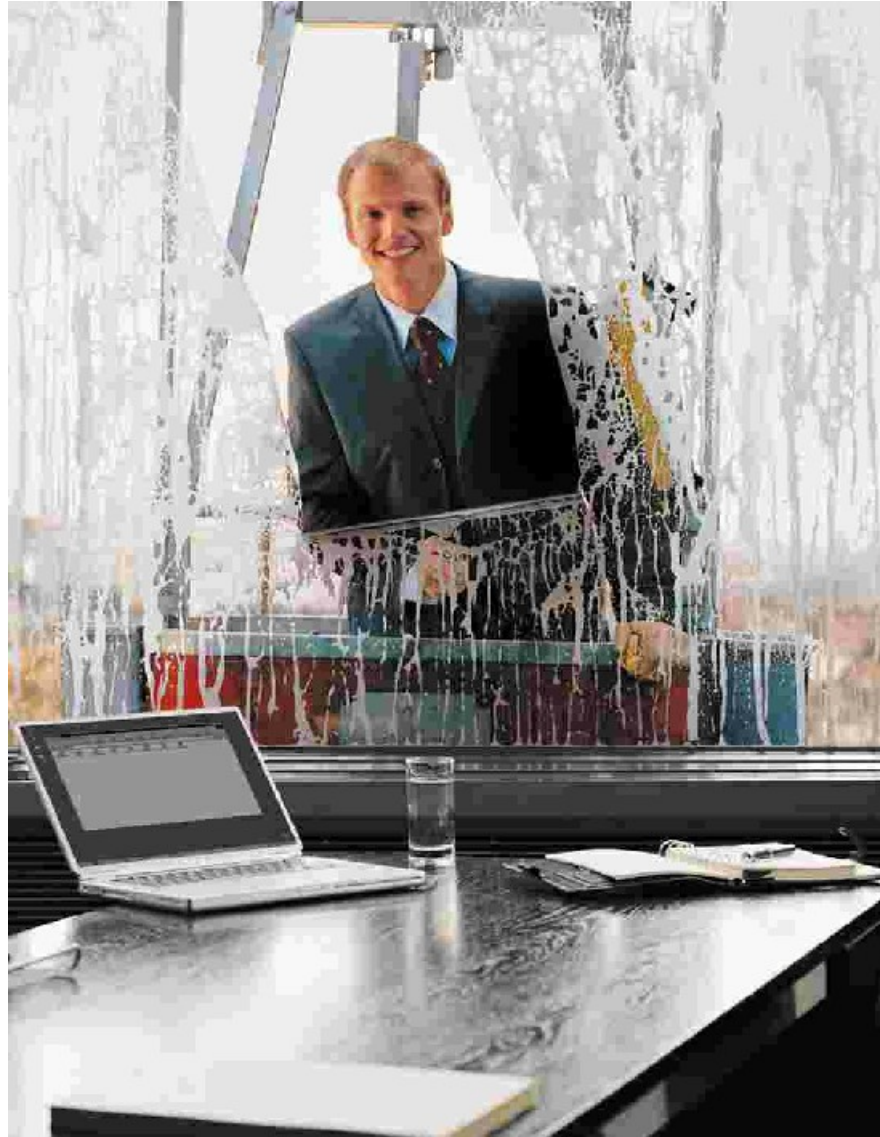


New Severance Pay Rules in Austria (Abfertigung NEU)



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Outline

<i>New Severance Pay Rules in Austria (Abfertigung NEU)</i>	<i>1</i>
1. Basic Information	3
1.1. Employment relationships starting before 31/12/2002 – “Abfertigung ALT”	3
1.1. Employment relationships starting after the 31/12/2002 – “Abfertigung NEU”	4
1.3 Total-Transfer to the new System	5
1.4. Partial-Transfer to the new system	6
2. Terms and Explanations for NEW Severance Pay	6
2.1. Law on Contributions	6
2.2. Choice of MV-Fund by Employer and Employee	7
2.3. Levying of Contributions	7
2.4. Law on Payment	7
2.6. Provision	8
2.7. Regulatory council of the MV-Fund	8
2.8. Investment rules	8
2.9. Organizational framework conditions	9
2.10. The retirement phase	9
3. Accompanying tax measures	10
3.1. Employers’ regular contributions to funds	10
3.2. Contributions paid on transfer to the new system	10
3.3 Taxation of the fund	10
3.4. Pay –outs from the MV-Fund	10
3.5 Taxation in the case of retirement	10
3.6. Collectively agreed and voluntary severance pay	11
3.7.Right to transfer the severance pay reserve	11

1. Basic Information

A new law amending the rules on severance pay¹ and termination indemnities is designed to promote private occupational pensions. The new regulations affect all companies with employment contracts subject to civil law. These new rules apply only to new employment contracts signed after December 31, 2002 but with the addition for contracts signed under the old system to transfer into the new system.

NEW severance pay means a profound transformation of the Austrian system for statutory severance pay, with a **contribution-based system** replacing a performance-related system. Severance pay claims will in future not be made against the employer itself, but against the competent employee provision-fund (Vorsorgekasse – henceforth abbreviated to MV-Fund). The severance pay that this MV-Fund² is to pay out will be financed by contributions made by the employer at the rate of 1.53% of monthly salary.

1.1. Employment relationships starting before 31/12/2002 – “Abfertigung ALT”

The old regulations regarding severance pay apply to all contract signed before December 31, 2002. You have a basic right to the following levels of severance pay:

3 years' service	2 months' pay
5 years' service	3 months' pay
10 years' service	4 months' pay
15 years' service	6 months' pay
20 years' service	9 months' pay
25 years' service	12 months' pay

Furthermore it is a **prerequisite** for a right to severance pay that the employment relationship must last **at least three years** and be terminated in the following ways:

- Dismissal by the employer
- Termination by mutual agreement
- Expiration of the term of a temporary employment contract
- Unjustified or wrongful dismissal without notice by the employer
- Justified early termination at the instigation of the employee

¹ Severance pay stands for the german word „Abfertigung“

² MV-Fund stands for the german word „Vorsorgekasse“ or just „VK“

If the employee resigns he will not receive any severance pay. An exception is made if he has resigned expressly in order to retire and had been working for the company for at least ten years. Female employees who, after the birth of a child, give notice of their resignation at least three months before the end of maternity leave and who have been in service for at least five years are entitled to half the statutory severance pay. In the case of an employee's death 50 % of the severance pay entitlement goes to the heirs.

Severance pay is calculated on the **basis** of the “**salary due for the last month**”. That means all earnings resulting from the **regular monthly payment plus the proportionate special payments**. If the amount earned varies, severance pay is calculated according to the average monthly earnings over the last year. Expense allowances such as parliamentary allowances, expenses, or mileage payments are not included in the calculation.

1.2. Employment relationships starting after the 31/12/2002 – “Abfertigung NEU”

The new regulation of the „NEW severance pay“ applies to all employees with contracts signed after December 31, 2002. 1.53% of gross salary/wage will be paid into the MV-fund (after the first month³).

In cases of **dismissal or termination by mutual agreement** the benefit can be left in the severance fund (where it will continue to earn interest) as capital provision or be paid out as a lump sum. Lump sum payments can only be made after three years⁴.

The money can also be paid as a one-off premium into a private supplementary pension insurance fund (PZV).

In cases of **resignation, rightful dismissal and unfounded early termination** a one-off payment is **not possible**. The accumulated capital will be left in the MV-fund or moved to the MV-fund of the new employer, in accordance with the “Portable principle” (in German the so called “Rucksack-Prinzip”). You can ask for the transfer of the entire severance payment to the MV-fund of the new employer. In the case of an employee's death their MV-fund credit goes to their heirs.

³ In the first month the employment contract can be cancelled by both sides, employee and employer without any reasons or period of cancellation.

The employer contributions do not constitute taxable income to the employee. The benefit is tax free if the payment is made in monthly instalments at retirement. Lump-sum payments are subject to a flat 6% income tax. Both payment forms are exempt from social security contributions.

For employment relationships already in place (and for those commencing before the 01/01/2003) the old severance pay regulations continue to apply. Employee and employer can however come to an individual agreement to transfer to NEW severance pay. The transfer date can be chosen at will in the transfer agreement. In the framework of the transfer it can either be agreed that the (fictitious) entitlement to severance pay accrued against the employer to date will be “frozen”, or that a (freely agreed) contribution with respect to this fictitious severance pay entitlement will be transferred to the MV-Fund.

There are therefore three options for employment relationships already in place on the 01/01/03:

- a) Stay with the old system**
- b) Total-Transfer to the new system (“Transfer” option)**
- c) Partial-Transfer to the new system (“Freezing” option)**

In the following we will discuss the possibilities to part and full-transfer to the new system.

1.3 Total-Transfer to the new System

Within the context of an individual agreement between employer and employee for employment relationships existing at the time the law comes into effect, it can be agreed upon a total transfer to the new system.

These means a transfer of the severance pay entitlement already accrued to the MV-Fund by agreement between employer and employee and agreement on a transfer to the new severance pay system. The amount of payments that can be transferred into the MV-found depends on negotiations between employer and employee and can vary between 50 – 100 %

⁴ Three years of receiving payments (also from different employers) are necessary for lump sum payment.

⁵of the severance pay entitlement already accrued. Payment of contributions starts from the agreed date, the new severance pay law also applies to transferred claims, i.e. they are retained even in the case of the employee's dismissal.

1.4. Partial-Transfer to the new system

The partial transfer to the new system implements the freezing of the severance pay entitlement already accrued (outstanding claim against the employer; for the 'frozen' part the old severance pay law still applies) and the agreement on a transfer to the new severance pay system (Payment of contributions starts from the date agreed upon for the transfer). The employer and employee have to face two different systems – the old system for all severance pay entitlement already accrued and frozen and the new system for the payments of contributions from the date agreed upon. In case of termination of the employment relationship both law systems have to be considered.

2. Terms and Explanations for NEW Severance Pay

2.1. Law on Contributions

The employer starts paying contributions from the beginning of the second month of service. Contributions are at the rate of 1.53% of the monthly salary. Obligation to contribute during periods when salary is not paid in continued employment relationships:

According to the General Social Insurance Law (Allgemeines Sozialversicherungsgesetz) the employer must pay contributions during military service and training, civilian service and foreign national service as well as when maternity pay and sick pay are being received.

For periods when Child Raising Benefit is drawn (during a continued employment relationship, as well as for the unemployed) and during Family Care Leave (Familienhospizkarenz) as well as training leave contributions are paid by the Families' Compensation Fund⁶.

⁵ To transfer less than 50% of the severance pay entitlement which has been already accrued by the employee would violate the Austrian law (lesio enormis).

⁶ Familienlastenausgleichsfonds - FLAF

2.2. Choice of MV-Fund by Employer and Employee

The employer has to pay contributions for all employees into an Employee Provision Fund (MV-Fund). In businesses with a workers' council the choice of MV-Fund is determined by a (forceful) internal agreement.

In businesses without workers' council employees have a qualified right to object to the employer's proposal. If the employer and employees do not reach an agreement, at the employees' request a voluntary group representing their interests, authorized to reach a collective agreement, is to be called in for further discussions. If agreement still cannot be reached, the arbitration board may be called in.

2.3. Levying of Contributions

Contributions are to be paid by the employer on the date that the regular salary is paid via the appropriate health insurance provider to the chosen MV-Fund.

2.4. Law on Payment

An entitlement to severance pay arises whenever an employment relationship is terminated according to the reasons for it. An entitlement to a severance payout arises in the case of the previous conditions justifying a claim after three years of contributions Exception: a pay-out when an employment relationship is terminated at the same time as a pension is claimed from a statutory pension insurance, or if there has been no employment relationship requiring severance pay contributions for five years.

The amount of the severance pay entitlement equals the sum of the accumulated capital less administrative costs under consideration of the capital guarantee and the investment-returns.

In the case of an employee's death the employee's beneficiaries entitled to maintenance have a direct entitlement to severance pay. If there are no such beneficiaries, the severance pay goes to the heirs.

2.5. The employee's right to choose between a payout and the continued investment of the capital i.e. until retirement

In the case of an employment relationship being terminated and there being an entitlement to a severance pay-out, employees have the right to choose between a lump sum payment, continued investment in the MV-Fund until at the latest retirement, the transfer of the severance entitlement to the MV-Fund of a new employer or investment of the entitlement as a one-off premium into a pension scheme i.e. for the purchase of shares in a Pension Investment Fund (tax free).

2.6. Provision

MV-Funds will be set up to administer the contributions by the establishment of its own licensing condition in the Banking Act (Bankwesengesetz – BWG) for the saving phase (single-licence principle).

MV-Funds are subject to the supervision of the financial market regulatory authorities⁷, examination by bank auditors and specialist minimum obligations to the responsible bodies. For MV-Funds the minimum capital provided for is 1.5 million Euros.

2.7. Regulatory council of the MV-Fund

The Regulatory Council of the MV-Fund comprises four capital representatives and two employee representatives. If there is a workers' council within the MV-Fund itself, it may send a further employee representative.

2.8. Investment rules

The MV-Funds invest the contributions they receive on behalf of the employee like a savings bank. The rules for investment are based on the Pension fund Law (Pensionskassengesetz – PKG) regulations, Insurance Supervisory Law (Versicherungsaufsichtsgesetz -VAG) and Investment Fund Law (Investment Fund Act - InvFG). The maximum proportion of shares is limited to 40% and valuation is according to the daily value principle.

⁷ Finanzmarktraufsichtsbehörde

The MV-Funds are in the initial phase allowed to form an investment group for the administration of the claims. A future expansion to include several investment groups is envisaged.

2.9. Organizational framework conditions

The MV-Fund has to ensure a 100% capital guarantee on the contributions paid into it, which has to be protected by reserves. Moreover, voluntary guarantees of interest rates can be given for the building up of those reserves.

Written information on the severance pay entitlement accrued as well as on the principles of the investment policy are to be sent to those with an entitlement annually.

The MV-Fund may levy administrative charges on the contributions within the permitted band of between 1 and 3.5% established by law⁸. The MV-Fund may retain a maximum of 1% of investment returns until the 31/12/2004 and a maximum of 0.8% from the 01/01/2005. Transfers or payouts of severance pay contribution assets may not be subject to administrative costs.

2.10. The retirement phase

The MV-fund will have an obligation to enter into a service provision contract with at least one insurance and/or a capital investment group, which administers at least one Pension Investment Fund. In this way those entitled to a claim should receive the appropriate detailed information about the option of a pension in plenty of time before a severance payout. The anonymity of the claimants in front of the MV-fund's insurance or capital investment group is protected, as the MV-fund may only pass on personal data indirectly. The claimants right to choose remains unaffected.

⁸ The BAWAG-Allianz Vorsorgekasse AG offers staggered conditions regulated by durability of payments for each member. Longer membership includes more favourable conditions. For further information about conditions please switch to our homepage www.bawag-allianz-vk.at or contact our specialised staff.

3. Accompanying tax measures

3.1. Employers' regular contributions to funds

The employer's regular contributions to funds count as business expenses. Up to a level determined by tax law (1.53%) contributions do not constitute taxable income for the employee. Above that, contributions paid are subject to the same taxes as normal wages.

3.2. Contributions paid on transfer to the new system

Contributions paid by the employer when an employee transfers to the new system also count as business expenses. For the part of the contributions (then) exceeding the severance pay reserve there is to be equal tax distribution over five years. For the employer these contributions are exempt from tax, as long as they do not exceed the fictitious severance pay entitlement established by law and/or by collective agreement on the basis of collective agreements that existed prior to 01/01/2002. Contributions in excess of this are taxed at the normal rate for wages.

3.3 Taxation of the fund

Payments to the fund are exempt from insurance tax. The returns on the capital paid in are exempt from profit tax in the fund. The fund's payments are exempt from sales tax.

3.4. Pay –outs from the MV-Fund

Payouts in the form a capital sum (lump sum) are taxed at the rate of 6%.

3.5 Taxation in the case of retirement

When transferred to a pension insurance scheme or used to buy shares in a Pension Investment Fund the capital sum is tax-free. There is also no insurance tax to pay on the transfer into a pension insurance scheme itself. Capital returns remain exempt from Investment Income Tax (KESt) during the retirement period. Contributions are also not subject to minimum tax. Payouts in the form of a monthly income are tax-free.

3.6. Collectively agreed and voluntary severance pay

Collectively agreed or voluntary severance pay will be subject to normal taxation. An exception is made for collectively agreed and voluntary severance pay for periods that are subject to the old severance pay system. If there is no transfer, new entitlements accruing on voluntary or collectively agreed severance pay will continue to enjoy tax concessions.

3.7. Right to transfer the severance pay reserve

Irrespective of whether there is a transfer to the new system, the existing severance pay reserve could be transferred to a reserve tax-free equity account or an after-tax book reserve in the financial years 2002 and 2003. In the latter case further endowments of the reserve are not possible. Future severance payouts are to be calculated on an individual basis with the contributions transferred to the personal capital or reserve. Further severance pay contributions are deductible as a business expense.

The option of building a reserve for tax law purposes will be reduced in two phases from the current maximum of 50%, to 47.5% from 2003 and to 45% from 2004. The reserve percentage for employees over 50 years of age remains at a maximum of 60%. The requirement of protecting the reserve with bonds does not apply. Bonds already held can be reduced over a period of five years.

In the case of a transfer to the new system with the fictitious old-style severance pay entitlement being frozen, the severance pay reserve in relation to the frozen periods can be extended appropriately.