Bulletin

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Liechtenstein–Switzerland DTA: New opportunities for asset structuring in Liechtenstein

Introductory remarks

Liechtenstein and Switzerland signed a double taxation agreement (DTA) on 10 July 2015. This DTA is scheduled to enter into force on 1 January 2017 and will replace the "rump" DTA signed in 1995. It will create legal certainty, in particular with regard to cross-border tax planning for companies and asset structures.

The aim of the DTA is to avoid double taxation by

- exempting taxable income,
- crediting for taxes paid, and
- reducing withholding taxes.

The DTA is OECD-compliant. Although the exchange of tax-related information is available on request, the DTA does not form the legal basis for the automatic exchange of information (AEoI). The AEoI regime between Liechtenstein and Switzerland requires a separate intergovernmental agreement. Group requests are possible, although "fishing expeditions" are not permitted.

The DTA covers natural persons, legal entities and Liechtenstein asset structures (foundations, *Anstalten* [establishments], registered trust companies [*Trust reg.*]), charitable institutions and pension schemes. If the DTA is abused, no tax relief is granted. The DTA does not cover private asset structures (PASs), trusts and other asset structures without legal personality.

The new DTA opens up opportunities that clients, trustees and advisors might do well to seize. A number of selected examples are given below to indicate what these opportunities might be.

Asset structuring options for natural persons

a. Directors' and trustees' fees

Fees paid to directors, trustees or similar governing officers as private individuals, e.g. by a Liechtenstein limited company or family foundation, are liable to 12% withholding tax (WHT) in Liechtenstein. Until 2017 such fees will be treated as employment income and subject to double taxation in Switzerland. From 2017 they will be governed by Liechtenstein tax law. In Switzerland diretors' and trustees' fees are exempt from Swiss tax, with progression.

Examples:

1) Mr A., a lawyer resident in Geneva, is a trustee of the A. Foundation, domiciled in Vaduz. In 2017 the A. Foundation pays a trustee's fee of CHF 10,000 to Mr A. as a private individual. Liechtenstein has the right to levy tax at source and applies a 12% WHT to the trustee's fee. In Geneva the trustee's fee is exempt from tax with progression.
2) Mr A. invoices for the trustee's fee as part of his independent law practice. In Liechtenstein, no WHT is deducted. Geneva now has the sole right to levy tax on the trustee's fee.
3) The invoice for the trustee's fee is raised by A. AG in Geneva, for which Mr A. works. As before, no WHT is deducted in Liechtenstein. Geneva now has the sole right to levy tax on the trustee's fee.
4) Pursuant to section 2 item b of the Protocol to the DTA, PASs do not count as resident and thus are treated as transparent for DTA purposes. Based on this line of argument, Geneva may claim the right to tax the trustee's fee paid to Mr A. According to the Liechtenstein point of view, governing directors' and trustees' fees are subject to WHT regardless of whether the A. Foundation has PAS status or not. In this scenario, even if the A. Foundation has PAS status the governing fees it pays may be double-taxed under the DTA provided that they are not invoiced via the law firm of Mr A. via AG.

Tip: The method of invoicing determines whether Liechtenstein or Switzerland is entitled to tax directors' and trustees' fees.

b. Dividend distributions from "pre-existing reserves"

Ms B. is resident in Triesen. She holds a 13% participation in the limited company B. AG, domiciled in Basel.

1) *Dividend distribution in 2016:* As things stand, Ms B. cannot reclaim the WHT of 35% on dividends paid out by B. AG. For her, this WHT is a definite cost factor.
2) *Dividend distribution in 2017:* Ms B. can reclaim 20% WHT levied on dividends. The residual 15% WHT is still non-recoverable. The same rate applies to dividends paid out of retained reserves. The Swiss Federal Tax Administration's practice of treating them as paid from "pre-existing reserves" *(Altreserven)* does not apply. Claiming tax benefits under the new DTA once it enters into force is not considered to be DTA abuse.

Tip: It is worth waiting until 1 January 2017 before paying out dividends or dividends out of "pre-existing reserves".

Asset structuring options for legal entities

a. Charitable foundations

Charitable foundations and other not-for-profit organisations will come under the new DTA with effect from 2017. They count as resident, regardless of whether they are fully or partly tax-exempt. This residence qualification will apply even to foundations that are not exclusively charitable but also exist partly for private benefit.

Example:

The G. Charity Foundation, with its domicile and headquarters in Vaduz, holds the part of the foundation's assets that consists of securities (mainly blue chip equities) and generates income subject to Swiss WHT and foreign WHT through G. Finance AG in Zurich. Securities that generate income which is not subject to WHT or subject to only to low amounts of WHT are held directly by the G. Charity Foundation.

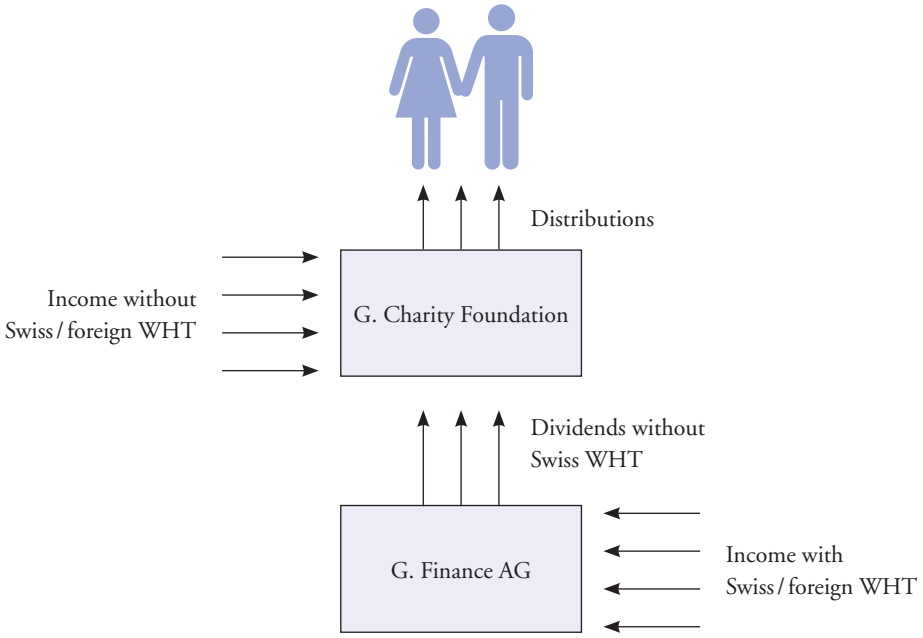
As a Swiss entity, G. Finance AG can reclaim all of the 35% Swiss WHT levied on dividends and interest income. It also reclaims that portion of foreign WHT that is recoverable under other DTAs. The profits of G. Finance AG pass to the G. Charity Foundation free of Swiss WHT.

Tip: From 2017 onwards, by structuring its assets adeptly, a charitable foundation may find it possible to increase its post-tax income considerably to the advantage of its beneficiaries.

b. Family foundations

Examples:

1) *Donor and beneficiaries in Switzerland:* Ms P., who is resident in the Canton of Grisons, establishes the P.

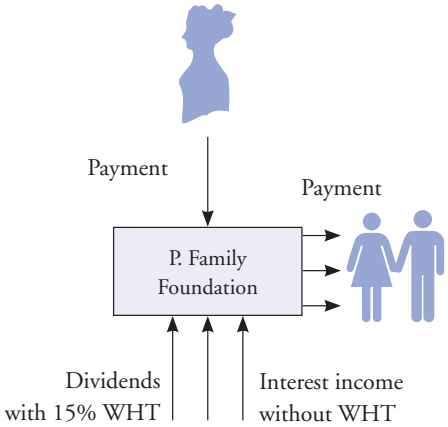


Family Foundation under Liechtenstein law and endows it with a securities portfolio[1]. The donor thereby ensures that the material asset value of the securities is preserved for subsequent generations. At the same time, she wishes her descendants to participate in the income generated by the P. Family Foundation through regular distributions.

The P. Family Foundation has the following features:
- The beneficiaries of the foundation are the donor's descendants.
- The foundation articles are irrevocable and discretionary.
- The donor has no right to instruct the board of trustees.
- The donor may vary the arrangements pertaining to the beneficiaries during her lifetime.
- After the donor's death the arrangements pertaining to the beneficiaries can no longer be altered.
- The beneficiaries do not have a legal entitlement to receive distributions.

Because the P. Family Foundation is subject to the ordinary tax regime and conforms to the above features, it counts as a "resident person" and may claim the benefits offered by the DTA. However, neither the donor, the beneficiaries or their close associates have the right to dispose of the foundation's assets, either *de facto* or *de jure*. Pursuant to section 2 item a iii) of the Protocol to the DTA, each case must be judged on its own merits and with due regard to all the attendant circumstances.

Of the 35% WHT levied on income generated by the securities portfolio, the P. Family Foundation can reclaim all bar the residual 15% of WHT. The WHT



levied on interest income is recoverable in full. The P. Family Foundation also reclaims that portion of foreign WHT that is recoverable under other DTAs. Distributions to the beneficiaries (descendants) are liable to taxation according to the tax rules of the canton in which the recipient of distributions is resident.

2) *Donor and beneficiaries outside Switzerland:* Providing the P. Family Foundation was not set up purely for the purpose of taking advantage of the DTA, it continues to be treated as resident and may benefit from the terms of the DTA. This is especially applicable whenever equivalent DTAs exist between Switzerland and the countries of residence of the donor and beneficiaries. In this case, no DTA abuse can be said to occur.

3) *PAS status:* If it is not resident the P. Family Foundation cannot avail itself of the DTA. For DTA purposes it counts as transparent. This means the donor could try to reclaim all Swiss WHT bar the residual rate of 15%. Her success would depend on whether the Swiss Federal Tax Administration recognises the donor as the beneficial owner of the dividend. There is a strong argument to be made that, because of the tax transparency of the PAS and the attribution of the foundation's assets and income to the donor, beneficial ownership can no longer reside with the P. Family Foundation. However, it remains to be seen how the Swiss Federal Tax Administration will interpret the DTA in this respect.

Tip: From 2017 onwards, by structuring its assets adeptly, a family foundation (without PAS status) may find it possible to pass on its income to potential descendants without paying WHT, providing there is no DTA abuse, in the best case.

c. Holding structure

A Liechtenstein company which as a legal entity is subject to normal taxation in Liechtenstein is deemed to be resident for the purposes of the DTA. The same is also true for holding companies which, because of the exemption from tax of dividends and capital gains on holdings and the deductibility of taxable equity, are effectively liable only for the minimum corporate income tax.

Examples:

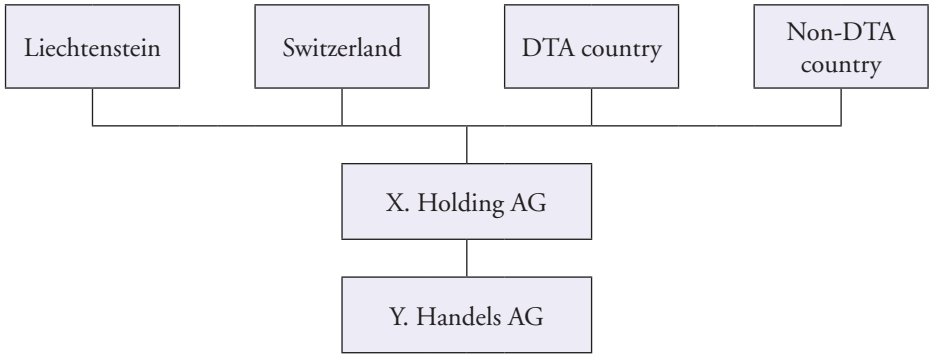
1) *Holding company with shareholders in Liechtenstein:* X. Holding AG, domiciled in Ruggell, was set up 30 years ago as a "domiciliary company". Since 2014 X. Holding AG has been subject to the ordinary tax regime. Since its foundation the company has held a 100% stake in Y. Handels AG, which engages in textile and commodity trading.

   Providing X. Holding AG holds more than 10% of the equity in Y. Handels AG for at least one year, the dividend payments goe WHT free to X. Holding (zero rate). The "zero rate" principle is also applicable for accumulated profits before the DTA has come into force (i.e. pre-existing reserves). It has to be noticed that according to tax practice of the Swiss Federal Tax Administration, full WHT relief implies a certain level of "local substance" corresponding to the actual purpose and function of X. Holding AG.

2) *Holding company with shareholders in Switzerland:* The zero rate applies to dividends paid by Y. Handels AG.

[1] Assumption: in line with the practice of the tax administration of the Canton of Grisons, at its inception the foundation is not subject to gift tax, providing its beneficiaries are spouses, registered civil partners, unregistered partners or direct descendants. Other cantons operate similar arrangements. The Cantons of Schwyz and Lucerne do not have gift tax at all.

Holding company with shareholders in:



WHT relief would be possible even without the intermediation of X. Holding AG. This does not constitute abuse of the DTA.

3) *Holding company with shareholders in a DTA signatory:* The zero rate applies to dividends paid by Y. Handels AG, providing Switzerland and the country of residence of the shareholders have likewise agreed a zero rate for qualifying holdings (cf. provisions of the Swiss-EU agreement on the taxation of interest income). If instead of the zero rate a residual WHT rate of (for example) 5% applies (cf. DTA Switzerland-USA), the Swiss Federal Tax Administration could refuse to reimburse the WHT on dividends paid by Y. Handels AG in the same amount.

4) *Holding company with shareholders in a non-DTA signatory:* If the shareholders of X. Holding AG were resident in a non-DTA signatory, e.g. the BVI, reimbursement of the WHT on dividends paid by Y. Handels AG would constitute DTA abuse. X. Holding AG would not be deemed to be the beneficial owner of dividends paid by Y. Handels AG and, because it is not resident, could not avail itself of the DTA.

Tip: From 2017 a holding company with a "substance" (without PAS status) can pass on dividends free of WHT to shareholders resident in equivalent DTA countries.

Conclusion

The new DTA offers new tax planning opportunities not just for companies and private individuals but also for commercial and asset management structures. The importance of the fact that not-for-profit institutions and discretionary foundations can also avail themselves of the DTA cannot be overstated. In times characterised by FATCA, AEoI and BEPS the issues of privacy and protecting client assets play an even more crucial role. The above examples show that, from 2017, the new DTA will allow for considerable tax relief on Swiss investments. The DTA will also make Liechtenstein more attractive as a location in which to hold existing and new equity participations in Switzerland.

The DTA does not regulate the spontaneous and automatic exchange of information, although this could happen from 2019 onwards if both signatories have introduced the AEoI standard by then. In the light of these developments trustees and advisors have a special duty to take advantage of the asset structuring and tax planning opportunities created by the DTA with Switzerland and other countries in the best interests of the clients and the clients' structures.

For further information, please do not hesitate to contact your client advisor at Allgemeines Treuunternehmen. You may also contact us by email: info@atu.li.

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