Allgemeines Treuunternehmen
since 1929

By Roger Frick, Allgemeines Treuunternehmen (ATU), Vaduz, Principality of Liechtenstein

for IFC Review, 2013 issue

Liechtenstein: Tax Reform brings Attractive Planning Options

The last 12 months have brought interesting legislative and regulatory changes to Liechtenstein's financial industry. This article will examine those changes that continue to make Liechtenstein a very attractive option for international investors.

As a member of the European Economic Area (EEA), Liechtenstein is obligated to implement certain EU regulations into its own law. As a result the country's residency provisions are very flexible, this flexibility stems from the likes of the AIFM Directive or the regulations relating to holding companies and philanthropic endeavors.

I will begin my examination with a consideration of the AIFM Directive and the impact of Double Tax Treaties, and will follow this with a consideration of other new provisions.

Alternative Investment Fund Managers Directive

The term AIFM (Alternative Investment Fund Managers) refers to the supervisory framework for alternative investments (such as hedge funds) and their managers.
Until now, alternative investments have at the most been partially regulated but in most cases not regulated at all. In the wake of the financial crisis, the Group of the 20 most important industrial and emerging economies (the G20) agreed to make alternative investments subject to financial supervision as well. The European Union has responded to this with the AIFM Directive.

As an EEA member, Liechtenstein is required to implement the AIFM Directive.

Liechtenstein's rapid and market-oriented plans for growth include strengthening the competitiveness of the Liechtenstein fund centre, both in the field of securities funds (UCITS) and in the field of alternative investment funds (AIFs).

In a meeting in early 2012, the Liechtenstein Government adopted its consultation report on the creation of an AIFM Act. Parliament considered the report and application for the creation of an AIFM Act in a first reading in June 2012. The Act from 19 December 2012 will enter into force on 22 July 2013.

After entry into force of the Act, the AIFM Act will make it possible to market and – irrespective of the funds' domicile – to manage alternative funds throughout Europe (27+3 countries) with a single license as an AIF manager located in Liechtenstein.

Liechtenstein could also become a very important platform for hedge fund managers who provide their services to EU domiciled clients via funds from the Caribbean. There will be many changes necessary to regularise this business, which will involve either a restructuring of the fund or using the services via a DTT partner from within the EEA. Non-EU and non-EEA countries may be faced with major delays when accessing the AIF-market within the EU.

Double Tax Treaties

DTA with United Kingdom

The DTA between Liechtenstein and the UK, which came into force on 1 January 2013, applies to physical persons and corporations, including foundations. The treaty is a major corner stone in the relationship between the two countries, which enables cross border investments and clarifies the rights and obligations regarding tax.

In the case of withholding taxes, the treaty will apply as from 1 February 2013. On income and revenue from capital, the treaty will apply as from 6 April 2013.

Full discretionary foundations (with a foundation board to whom is allocated the responsibility of choosing beneficiaries from a set of class of beneficiaries and who decides on the timing and extent of any distributions) and ‘Anstalts’/corporations, which are ‘opaque’ and pay ordinary taxes in Liechtenstein of 12.5 per cent, can also benefit from the DTT. It must be clear that the main purpose of the structure is not to benefit from the treaty. Nevertheless, this treaty is one of those which gives planning and legal assurance to the many structures managed by trustees.

Liechtenstein also offers so-called ‘family partnerships’ as used in the United Kingdom. The treaty with the UK, together with the Lichtenstein Disclosure Facility, in force since 11 August 2009, ensures that Liechtenstein family partnerships have the same ability to optimise on inheritance taxation as the UK family partnerships, however, the handling of a Liechtenstein Family Partnerships might prove cheaper.

DTA with Germany

The treaty between the Principality of Liechtenstein and the Federal Republic of Germany for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and fortune (DTT), including the minutes, was signed in Berlin on 17 November 2011. The DTT will also enter into force on 1 January 2013.

The signature of the DTT represents a milestone for Liechtenstein since it is the first time that the small country has succeeded in entering into a treaty with a large industrial nation where the treaty is based on the OECD model convention. This should pave the way for the signature of further DTTs with important industrial partners in addition to the UK and Luxembourg.

It is worth emphasising that the German DTT brings with it zero rate for taxes at source on dividends, interest and royalties in those cases in which the appropriate standards are fulfilled.

The German anti-abuse regulations were made somewhat more transparent by the inclusion of certain articles in the DTT and in the minutes that clarify "the application of the agreement in certain cases" so that the taxpayer can understand whether and how treaty benefits can be used.

A Liechtenstein-based holding company may face various anti-abuse provisions from this treaty, and the wording in the protocol must be carefully studied. This also applies to foundations. It is worth noting that this treaty is really aimed at the large industrial companies in Liechtenstein and not particularly for the financial industry.

The German treaty together with the TIEA (Tax Exchange Agreement) ensures that the application of anti-abuse provisions to Liechtenstein foundations is clear, and therefore tailor-made irrevocable discretionary foundations no longer face question marks under the German tax law regulating foreign relationships (Aussensteuergesetz – ASTG).

The Liechtenstein Tax Law 2011

The objective of the amendments to Liechtenstein's tax law, which took effect on 1 January 2011, was to modernise the legislation with regard to taxation and take into account international developments.

Liechtenstein tax law has to comply with the European requirements (especially fundamental freedoms and the regulations prohibiting state aid, including ring-fencing).

Legal persons engaged in economic activity are only subject to corporate income tax and the supplementary tax on gains from the transfer of real property. No 'capital tax' is levied. The corporate income tax, set at a uniform rate of 12.5 per cent, applies to a company's net income/profit, irrespective of the size of the profit and its distribution.

Income and capital gains from participating interests (investment into participating shares – no quota required) are exempt, and in addition, an equity capital interest deduction has been introduced.

The Tax Act abolished the special capital contribution duties for holding companies and domicile companies as there was a latent risk of infringement of the prohibition on state aid under the EEA Agreement. The Act does, however, provide for a transitional period in the case of legal entities set up before 1 March 2011. This period ends on 31 December 2013 when all entities will be taxed in the same way. Liechtenstein, therefore, will no longer differentiate between 'onshore' and offshore activity. This move was necessary to enable Liechtenstein to become party to DTTs.

As stated above, income tax amounts to 12.5 per cent of taxable net income. It is important to note that it is possible to claim an equity capital interest deduction as a justified business expense, making the actual income tax payable lower.

A foundation will incur no additional tax liability aside from the minimum income tax if it only holds fixed-term deposits and bonds plus a participating interest, all of which are equity-financed. This is because dividends and capital gains are exempt from tax, and the fixed-interest deposits only yield income of three per cent for example, so less than the four per cent equity capital interest deduction rate for the fiscal years 2011 - 2013.

The equity capital interest deduction makes Liechtenstein a very interesting holding place as income from participations and group financing can be performed in a very attractive tax environment. Liechtenstein does not have a debt/equity ratio because of this regulation.

Alongside this, a holding company or holding foundation can benefit not only from the two DTTs mentioned above, but also from the DTT with Luxembourg, which has been in place since 1 January 2011. As mentioned, the treaty with Germany has many anti-abuse provisions, and without adequate physical presence in Liechtenstein, it might be difficult to benefit from that treaty.

In practice, Liechtenstein applies a control and management principle to establish if an entity is taxable or not for its worldwide income in Liechtenstein. This allows significant flexibility given the circumstances, and the international investor is advised to consider all elements carefully before making a decision.

Bearer Shares

Liechtenstein, as a civil-law country, recognises bearer shares. When the Global Forum on Transparency and Exchange of Information for Tax Purposes' Peer Review Group completed its review in 2011, it stated that the bearer share regime was not meeting the appropriate standards to combat money laundering and terrorism financing. Liechtenstein has therefore had to amend its legislation, and this amendment should be enacted in the next four months. The bearer share regime will not be abolished, but there will be a so-called immobilisation of such shares, together with a shareholder registry where the shareholders are mentioned. This shareholder registry is not public, but will only be available at the office of the director of the company. Foreign regulated persons can also act as a so-called 'immobilisation office'.

Trusts and the Foundation Law

The common law trust has been available in Liechtenstein for over 80 years. This enables the use of either the trust or the foundation in forced heirship, asset protection or succession or IPO planning. There are various factors to consider when deciding whether to use a trust or a foundation, primarily, where the settlor and beneficiaries live and what kind of investments the entity will have.

Following the reform of the foundation law in 2009 and the reform of the tax law in 2011, the differences between the two Liechtenstein legal forms – trust and foundation – have increased. Trusts have an obvious benefit because of the relatively high degree of flexibility and operating freedom they allow (both for the settlor and for the trustee) since they are based on dispositive law. The flexibility and operating freedom are significantly curtailed in the case of foundations since the reform in order to incorporate the developments in civil law countries. It is important to note that foundations remain attractive for founders from Continental Europe and are well positioned within the DTT network. A trust, on the other hand, will not have access to such treaties. The fact that trusts do not have to file tax returns and are only subject to taxation at the minimal rate of currently CHF1,200, irrespective of the nature or amount of the trust property involved, increases their attractiveness when compared with foundations, which are taxable on the income as outlined before.

Roger Frick, BBA
Swiss Certified Public Accountant, TEP
Member of the Board of Trustees and Executive Committee
Allgemeines Treuunternehmen

April 2013