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PRACTITIONERS' CORNER

Liechtenstein's New Tax Law — The End of Offshore Companies?

by Markus H. Wanger

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Liechtenstein has implemented a modern and highly competitive corporate tax law, replacing one that had been in place for 60 years. The new tax law, which took effect January 1, 2011,[1] abolishes the former domiciliary (offshore) tax for offshore companies, which will no longer be recognized. (For existing offshore companies, a transition period of three years is granted.)

Under the new tax law, published in Liechtenstein Law Gazette No. 340 (2010), the profits of all Liechtenstein legal entities will be subject to a flat tax rate of 12.5 percent. This is one of the lowest corporate tax rates in the world, comparable to the Irish corporate tax rate.

Moreover, this rate may even be further reduced through the use of deductions. Losses can be carried forward against future profits for an unlimited period of time. A 4 percent deduction of modified equity will be allowed for legal entities and for persons or partnerships according to the principle of neutrality of decision. A license fee deduction of 80 percent of the income deriving from immaterial rights will be available. Also, the new tax law permits the following:

- restructuring of legal entities without adverse tax implications;
- group taxation, if a group of entities has a Liechtenstein participant; and
- deduction of losses of foreign participations, if those losses are not deducted in a third country.

The law introduces a new, privileged category of structures: the private investment structure (PIS, or *Privatvermögensstrukturen*), which is a structure (foundation, registered trust company (or trust reg.), or other legal entity) that holds only bankable assets. A PIS must be absolutely independent from any influence of investors and beneficiaries. Qualifying structures will be subject to a minimum ''all in'' tax of CHF 1,200 per year.

Private investment structures are regulated in article 64 SteG. The concept had to be approved by the European Free Trade Association Surveillance Authority, or ESA, and it became effective only after the ESA had accepted this kind of taxation and ruled it as compliant with European Economic Area and EU law.

The text of the new tax law can be found in the appendix to this article.

General

Foundations are subject to either general income taxation at a 12.5 percent rate or taxation as a PIS in accordance with article 64 SteG. They are subject to the minimum income tax of CHF 1,200 only if all of the requirements for qualification as a PIS have been met.

If a PIS is a legal entity, it may also be referred to as a private asset company.

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[1]Gesetz über die Landes- und Gemeindesteuern (Steuergesetz, or SteG); and Verordnung über die Landes- und Gemeindessteuern (Steuerverordnung; SteV).

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PIS

The special PIS regulation was created to better attract asset management structures. These structures include most of the previous domiciliary companies, primarily foundations, institutions, and registered trust companies.

These types of legal entities and special forms of asset dedications may also be classified as private investment structures if they act exclusively for individuals in an asset management capacity and do not conduct any commercial activities.

Not every legal entity that holds assets may be classified as a PIS. Only legal entities that do not conduct commercial activities in the pursuit of their purpose qualify as private investment structures. In this regard, the actual activity conducted (rather than the definition of purpose) is decisive.

Assets

A PIS may only acquire, hold, manage, and sell financial instruments described in article 4, paragraph 1(g) of the Asset Management Act (Vermögensverwaltungsgesetz). In accordance with that statute, the following are considered financial instruments:

- negotiable securities;
- money market instruments;
- equity interests in investment companies (shares in collective investment undertakings (OGA));
- options, futures, swaps, forward rate agreements, and all other derivative contracts related to securities, currencies, interest rates or interest income, or other derivative instruments, financial indices, or benchmarks that may be settled physically or in cash;
- options, futures, swaps, forward rate agreements, and all other derivative contracts related to commodities that must be settled in cash or may be settled in cash at the request of one of the parties (other than because of contractually agreed terms);
- options, futures, swaps, forward rate agreements, and all other derivative contracts related to commodities that may be settled in kind, subject to the condition that they be traded on a regulated market and/or via a multilateral trading facility;
- options, futures, swaps, forward rate agreements, and all other derivative contracts related to commodities that may be delivered in kind that are otherwise not listed in paragraph 6 SteG, do not serve commercial purposes, and that have the characteristics of other derivative financial instruments, for which it is taken into account whether clearing and settlement occurs via recognized clearing facilities or whether there is a regular obligatory margin call;
- derivative financial instruments for the transfer of credit risks;
- financial contracts for difference; and
- options, futures, swaps, forward rate agreements, and all other derivative contracts that relate to climate variables, freight rates, emissions rights, inflation rates, or other official economic statistics that must be settled in cash or that may be settled in cash at the request of one of the parties (other than because of contractually agreed terms); as well as all other derivative contracts related to assets, rights, obligations, indices, and benchmarks that are otherwise not listed in paragraph 1(b) of the Asset Management Act and that have the characteristics of other derivative financial instruments, for which it is taken into account whether trading occurs on a regulated market or a multilateral trading facility, clearing and settlement occurs via recognized clearing facilities, or there is a regular obligatory margin call.

Equity Investments

A PIS also may hold equity interests in legal entities, liquid funds, and bank account balances.

Private investment structures are not permitted to directly hold real estate, and may only own real property through a subsidiary. As a result, many Liechtenstein institutions and foundations (which, as is well known, are often formed for the purpose of holding foreign real estate) do not qualify as private investment structures but rather are subject to the flat 12.5 percent tax rate.

Figure 1 shows which structure is needed for owning real estate.

Commercial Activity

Private investment structures may not conduct commercial activities. They may only hold and manage ''bankable assets.'' Permissible investment assets are effectively defined via reference to article 4, paragraph 1(g) of the Asset Management Act in conjunction with the definition of financial instruments contained in the Markets in Financial Instruments Directive (MiFID).

Concurrently, a PIS may not be listed on an exchange because it would be incompatible with private asset management rules if ownership interests in the PIS were to be publicly traded.

If an institution wishes to be classified as a PIS, its purpose as set out in its charter may not include a commercial activity. To qualify as a private asset company, the purpose of the institution would need to be amended.

The purpose set out in the charter is not itself determinative but rather the activity actually conducted. In principle, every PIS must expressly state in its charter that it is fully subject to the limitations applicable to a PIS.

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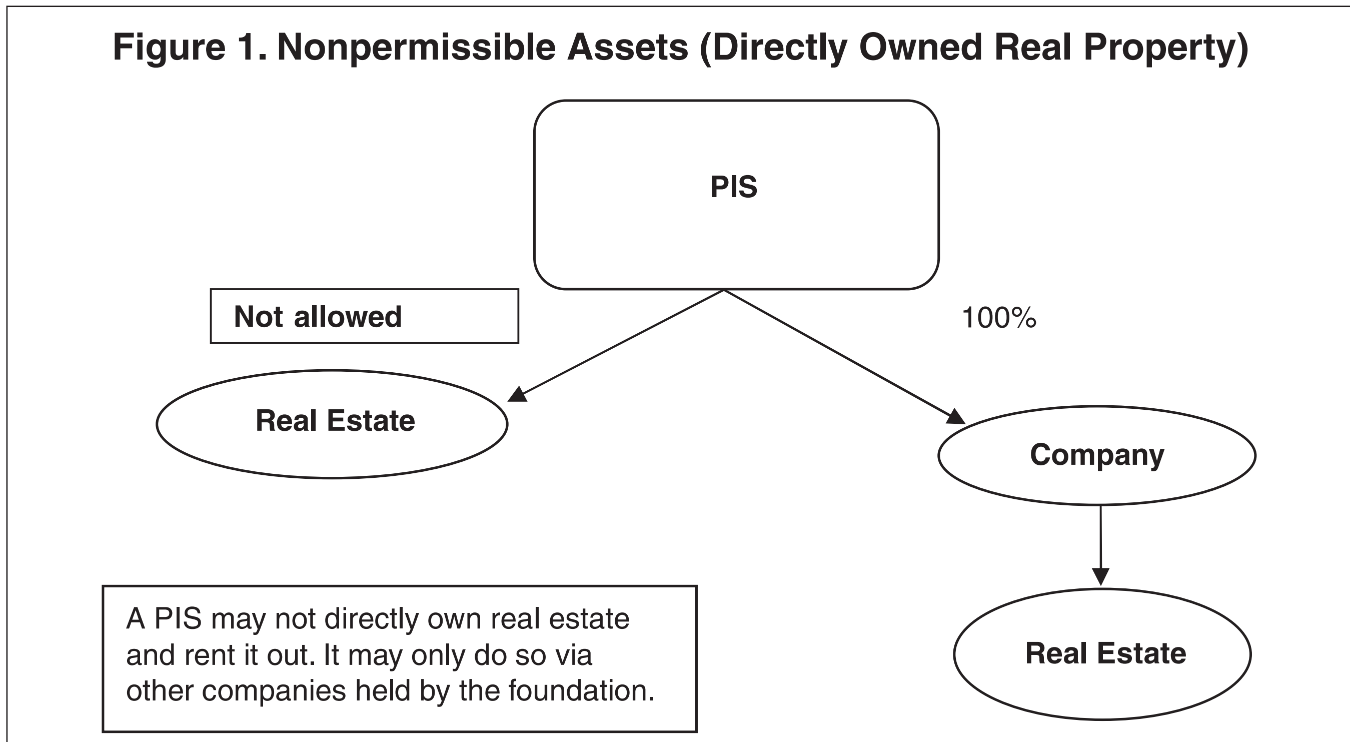

Foundations structured as holding companies and that own subsidiaries qualify as private investment structures according to the law.

Organization

Private investment structures may include foundations, registered trust companies, and institutions organized like foundations (article 64, paragraphs 1(b), (c), and (d) SteG):

- whose shares or units are not publicly listed, are not traded on a stock market and are reserved to be held by the investors referenced in paragraph 3, or that benefit no person other than investors referenced in paragraph 3;
- that neither solicit shareholders or investors nor receive remuneration or reimbursement of expenses from them or from third parties for their activity in accordance with paragraph 1(a); and
- whose foundation deeds (charters) state that they will be bound by the restrictions on private investment structures.

It may be concluded from the foregoing that the charters must be amended accordingly to enjoy PIS benefits. Recognition as a PIS must be denied if the charters do not contain the above restrictions.

Based on the wording of the law, it is understood that all requirements must be met on a cumulative basis.

Equity Interests

A PIS may only hold equity interests within the meaning of article 64, paragraph 1(a) SteG, subject to the condition that it, or its shareholders or beneficiaries, exercise no actual control, by direct or indirect influence, over the management of any type of company.

An equity interest in other companies such as corporations — shares in a GmbH are not considered ''bankable assets'' under article 64, paragraph 1(a) SteG — is generally permissible for a PIS. However, a PIS may only hold equity interests within the context of private asset management. This means that asset management activities may not be performed for third parties.

Indirect and Direct Influence

In the event the PIS holds equity interests, neither the PIS nor its shareholders or beneficiaries may exercise direct or indirect influence on the management of such companies in which it owns an equity interest. In this context, actual exercise is relevant (that is, de facto exercise).

Indirect Exercise of Influence

There is a direct exercise of influence in cases in which the shareholders or beneficiaries may indirectly exercise influence on the basis of experience and such influence is in fact actually exercised.

Influence is also exercised indirectly in cases in which there is a contractual or subordinate relationship

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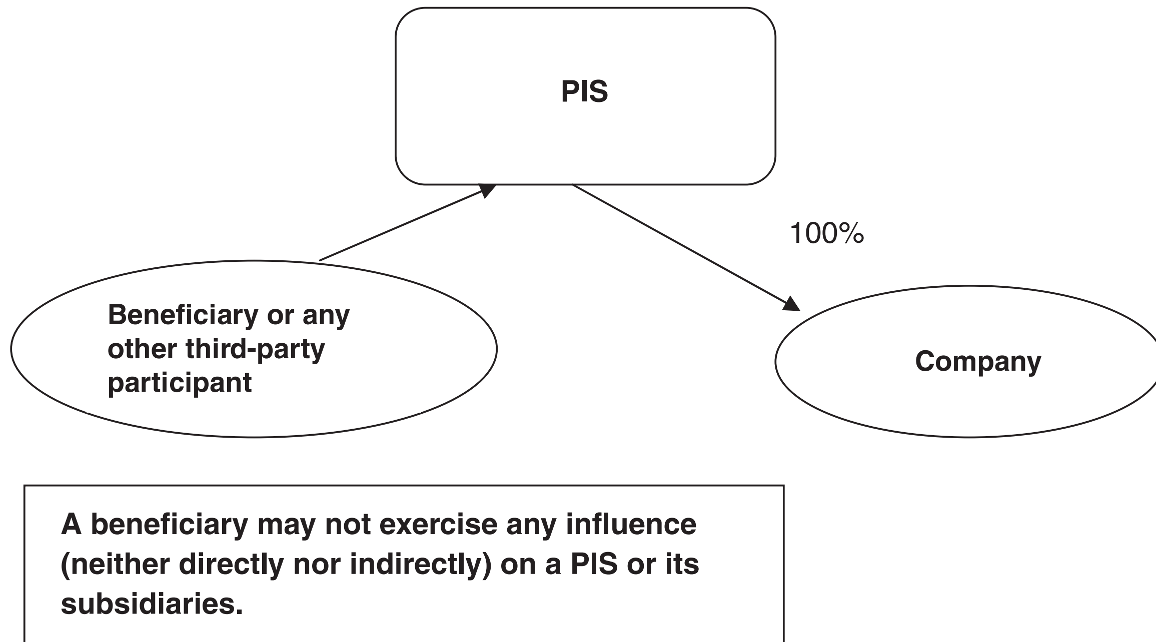
Figure 2. Impermissible Direct or Indirect Influence on the Part of Beneficiaries



(employee or worker). Those cases involve related parties within the meaning of the law.

De Facto Exercise of Influence

The actual exercise of influence is always the case when the private investment structure's executive or supporting bodies are related by kin or marriage or are not in a dependent relationship (such as employment, mandate, power of attorney, best customer, and so forth).

Managing Interests

In the future, no person may be active in the management of a PIS if he has been tasked with ''managing the interests'' owners, beneficiaries, or related third parties if private asset status (in the case of legal entities and private asset companies) is to be maintained.

Representatives of legal entities that are controlled by owners, beneficiaries, or related third parties also may not work in the management of a PIS; based on general life experience, actual influence may be exercised via such a relationship. In practice, this means that for PIS status to be maintained, owners, beneficiaries, or related persons may not exercise influence on the PIS.

Figure 2 shows that the influence of any foundation participant cannot be exercised against the PIS or any subsidiary.

Beneficiary

The term ''beneficiary'' is neither defined nor limited in the law. Accordingly, it is understood to include any arrangement and may therefore include:

- beneficiaries under article 552, section 5 PGR (Personen- und Gesellschaftsrecht, or Persons and Companies Act);
- beneficiaries with a legal right — article 552, section 6 PGR;
- discretionary beneficiaries (beneficiaries without a legal right) — article 552, section 7 PGR; and
- ultimate beneficiaries — article 552, section 8 PGR.

In practice, this means that for PIS status to be maintained, owners and beneficiaries (mostly family members) may not exercise influence on the private investment structure. However, article 64, paragraph 1(b) SteG provides that beneficiaries may not be any persons other than the investors named in paragraph 3.

Investor

An investor within the meaning of article 64 includes the following:

- a natural person acting in the context of the management of his private assets;

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- an asset structure acting solely in the interest of the private assets of one or more natural persons; or
- an intermediary acting on behalf of investors as per either of the above.

Accordingly, only natural persons may be beneficiaries of a PIS. In the event a foundation has even a single beneficiary that is a legal entity, it is no longer classified as a PIS.

Under the third requirement, an intermediary is also deemed an investor if it is acting on behalf of a principal who is an investor under article 64, paragraph 3 SteG. This may be a lawyer, trustee, appointee, representative, or assistant, whereby the representative relationship may be disclosed or undisclosed.

Foundation as PIS?

Can foundations be recognized as private investment structures? If the wording of article 64, paragraph 3(a) SteG is applied literally, hardly any foundation will qualify as a PIS.

A beneficiary may only be a person that acts in the context of managing his personal assets. In the case of a foundation, the foundation acts not only for private persons and their personal assets, but also is a separate legal entity independent of the assets of the founder or of a beneficiary. Therefore, the investor (beneficiary) cannot act at all within the context of managing personal assets.

Similarly, article 64, paragraph 3(b) SteG is not helpful. A foundation does not act in the interest of the personal assets of one or more natural persons. If this were the case, the foundation would not be independent, the beneficiaries would have an influence on the foundation, the foundation would not have its own interests, and only the interests of the beneficiary's personal assets would be asserted.

This conflicts with article 552, section 2 PGR, which, for example, defines a family foundation as a foundation whose assets serve exclusively to cover the costs of education, development, equipping, or support of family members of one or more families or similar familial interests. Not mentioned, and therefore precluded, is acting solely regarding the personal assets of one or more natural persons.

Similarly, article 64, paragraph 3(c) SteG is not applicable. This provision governs the inclusion of intermediaries that act on the account of the investors or beneficiaries under paragraphs 3(a) or 3(b).

In the event a foundation has even a single legal entity as a beneficiary, classification as a PIS is entirely precluded. Accordingly, this precludes all foundations that have as potential beneficiaries (even if only as ultimate beneficiaries) a charitable organization such as the WWF, the Red Cross, the Red Crescent, a hospital, and so forth.

It is doubtful whether the legislators desired this rule. A simple formulation could have excluded all doubt, such as the following:

> An investor within the meaning of this Article is:
>
> . . . .
>
> *a) a natural person who is a discretionary beneficiary of a legal entity.*

Without such a supplemental rule, most beneficiaries are not included within the term ''investor'' within the meaning of article 64 SteG. This has serious consequences: The foundation is thereby subject to income tax.

Confirmation and Significant Changes

Upon establishing a PIS, the taxpayer must confirm compliance with the requirements under article 64, paragraphs 1-3 SteG to the tax administration.

A new confirmation must be submitted to the tax administration in the following cases:

- there is a significant change in circumstances on the part of the taxpayer;
- there are changes to the foundation's charters;
- there is an actual change in activity; or
- there is a new group of investors in accordance with paragraph 3.

An auditor may issue this confirmation in the case of private investment structures that are required to have their annual financial statements audited under the provisions of the Persons and Companies Act.

If a taxpayer issues a false or incorrect confirmation under article 64, paragraph 4, thereby hindering income taxation, that meets the definition of tax evasion under article 137 SteG. In rare cases, a false confirmation would meet the requirements of article 136 SteG (tax endangerment). This would be the case, for example, when lower taxes are not sought by means of fraud.

Tax Administration's Decision

After the necessary confirmations are submitted under article 64, paragraph 4 SteG, the tax administration makes a decision regarding PIS status. An application, ''Recognition of Status as Private Investment Structure,'' must be submitted to the tax administration along with the confirmations. The tax administration then issues a notice, and the taxpayer may file an appeal under article 117 SteG within 30 days of this decision.

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Monitoring

Under article 38, paragraph 6 SteV, the Fiscal Authority reviews[2] whether the requirements under article 64 SteG have been met. It also reviews in particular:

- charters;
- the annual financial statement under article 21, paragraph 1 SteV or the asset statement under article 182b, paragraph 1 PGR;
- information on the type of income and assets as well as a description of the applicant's specific activities; and
- written confirmation on the part of the applicant that:
  - — it does not conduct a commercial activity;
  - — the applicant's shares or ownership interests have not been publicly listed and are not traded on a stock market, and that such shares or ownership interests are only held by investors within the meaning of article 64, paragraph 3 SteG referenced in paragraph 3, or benefit no person other than such investors;
  - — it solicits neither shareholders nor investors, nor does it receive from such persons or third parties remuneration or reimbursements for its activities; and
  - — neither the applicant, nor its shareholders or beneficiaries, exercise control over companies in which it owns an interest by means of the exercise of influence either indirectly or directly.

In the event the documents that have been submitted are insufficient, the tax administration may have access to some designated records and thereby review[3] the statutory requirements for private investment structures. These records include the following documents:

- minutes of meetings of the administrative board, foundation board, or other administrative bodies of the applicant;
- excerpts from the public register or corresponding registers of subsidiaries as well as of shareholders or beneficiaries;
- confirmation of the shareholder or beneficiary that it is an investor within the meaning of article 64, paragraph 3 SteG, as well as additional information regarding its activities; and
- other appropriate documents that substantiate compliance with the statutory requirements, including powers of attorney and contracts, but also documents that may substantiate the degree of relationship on the part of the shareholders or beneficiaries to the governing bodies.

Regarding the documents mentioned above, the tax administration has unlimited access to the taxpayer's records and determines at its own discretion the documents it believes to be relevant. The taxpayer cannot refuse such access on the occasion of the initial granting of PIS status.

Authority to Issue Regulations

The tax administration was granted the authority to provide further detail by means of regulation. This applies in particular to the deadlines and the form of the submission under article 64, paragraph 4 SteG. Likewise, the administration may establish by regulation the means of conducting monitoring under article 64, paragraph 6 SteG as well as the imposition of fees.

Monitoring (Article 38 SteV)

The tax administration is required to periodically review compliance with the requirements for PIS status. This is performed annually on the occasion of the review of the annual financial statement under article 21, paragraph 1 SteV of this regulation or the asset statement under article 182b, paragraph 1 PGR.

If the taxpayer wishes to avoid this periodic review, it may submit a well-founded application for exemption to the tax administration. The application says:

> The tax administration is requested to assign the review of compliance with the requirements under Art. 64 para. 1-3 SteG to a neutral auditor at the taxpayer's expense.

This application could be made more precise and suggest a specific auditor. However, three auditors would need to be suggested from which the tax administration may select, and the independence of the suggested auditors must be substantiated.

To comply with the regulations that require a neutral auditor, three suggestions are necessary:

- The application would be worded as follows:

  > The tax administration is requested to assign the review of compliance with the requirements under Art. 64 para. 1-3 SteG to Auditor A, B or C at the taxpayer's expense.

- The applicant must bear the expense of the auditor.
- The tax administration must justify the rejection of the application or the rejection of the suggested auditor.

Application Due Dates

The application for the grant of PIS status must be submitted upon formation of the legal entity, according to article 37, paragraph 4 SteV. It may also be submitted three months before the start of the tax year.

[2]Article 37, para. 2 SteV.

[3]Article 37, para. 3 SteV.

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Minimum Income Tax

Qualified private investment structures — that is, private investment structures that have been recognized by the tax administration by means of a decision — are only subject to the minimum income tax under article 62 SteG. No additional taxes are to be paid.

The minimum income tax is currently CHF 1,200. An exemption from the minimum income tax in cases of low total assets is not granted to a PIS. In accordance with article 61, paragraph 2 (last sentence) SteG, such tax is to be paid in advance.

In practice, only a small number of structures will be capable of being recognized by the tax administration as private investment structures. The majority of existing foundations will likely not qualify, so they will be subject to the general income tax.

In the event a legal entity is recognized as a PIS, it will not be subject to assessment. However, it is required to submit a detailed annual financial statement (electronic balance sheet and income statement) to the tax administration so that the compliance with the requirements for PIS status may be reviewed.

Mandatory Provisions

The purpose of the strict provisions is to ensure the following:

- a PIS does not conduct a commercial activity itself;
- the commercial activity of a business is not attributed to it; and
- entities conducting commercial activities do not own an interest in a PIS.

The legislators deemed this to be necessary as the prohibition on state aid in the EEA prohibits preferential treatment, even regarding taxation, of some entities conducting commercial activities (businesses).

Only private investments by natural persons who limit their involvement in the case of equity investments in other companies to the exercise of regular shareholder rights and who exercise no influence over such other companies have been recognized by the European Court of Justice as noncommercial activities.

Only the restrictions described above may eliminate any danger in relation to PIS qualification that the intended rules would lead to prohibited preferential treatment of entities conducting commercial activities and be subject to sanctions.

Commencement Delay for Article 64 SteG

Mere asset management is not deemed a commercial activity and is not subject to the state aid provisions.[4]

[4]ECJ, *Cassa di Risparmio di Firenze* (C-222/04).

Accordingly, the tax administration of Liechtenstein believes the proposed tax regime for private investment structures performing solely asset management activities to be compatible with the prohibition on state aid contained in the EEA Agreement. However, it was not entirely certain because the provisions under article 64 SteG will enter[5] into effect as soon as the ESA qualifies them as conforming with the state aid rules under article 61 of the EEA Agreement.

In the meantime, the ESA reached a decision (Feb. 15, 2011)[6] and has designated them as conforming; however, it tightened the requirements even further.

Extremely strict criteria are applicable. The authorities are required to strictly interpret and apply the new tax rules. In particular, as part of the required administrative process, they will conduct a detailed evaluation of each case to ensure that there is no commercial activity.

Outlook

The new tax law eliminates the special corporate tax that was applicable to date and thereby the prior domiciliary corporations.

The PIS does not really represent a substitute, as only a negligible number of the previous domiciliary corporations will qualify as private investment structures — likely less than 20 percent. It has been presumed that out of the remaining 50,000 legal entities (40,000 have already been dissolved), an additional 20,000-30,000 will be dissolved.

This represents a radical change in the structure of Liechtenstein's economy. One would be inclined to say that the new tax law does not represent evolution but rather revolution. However, the new tax law is one of the most advanced worldwide and its 12.5 percent flat rate is one of the lowest tax rates in the world.

Liechtenstein's new tax law will attract a completely new clientele. Primarily this will include holding companies, multinational firms, banks and other financial institutions, insurance companies, and investment funds.

Appendix. Article 64 SteG

Requirements and Taxation

1) The following legal entities are deemed to be Private Investment Structures:

a) Those which exercise no commercial activities in the pursuit of their purposes, in particular if they exclusively acquire, own, administer and sell financial instruments under Art. 4 para. 1 part g

[5]Article 160, para. 3 SteG.

[6]*See* Appendix.

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of the Asset Management Act as well as equity interests in legal entities, liquid funds and bank account balances;

b) Whose shares or units are not publicly listed, not traded on a stock market and which are reserved to be held by the investors referenced in para. 3, or which benefit no person other than investors referenced in para. 3;

c) Those which neither solicit shareholders or investors nor receive remuneration or reimbursement of expenses from them or from third parties for their activity in accordance with a); and

d) Whose foundation deed (statutes) state that they shall be bound by the restrictions on Private Investment Structures.

2) A Private Investment Structure may only hold equity interests within the meaning of paragraph 1 a) subject to the condition that it, or its shareholders or beneficiaries, exercise no actual control, by direct or indirect influence, over the management of such companies.

3) An investor within the meaning of this Article is:

a) A natural person acting in the context of the management of his private assets;

b) An asset structure acting solely in the interest of the private assets of one or more natural persons; or

c) An intermediary acting on behalf of investors as per a) or b) above.

4) The taxpayer shall notify the tax administration in cases where the requirements of para. 1 to 3 have been met both on their initial satisfaction and thereafter in case of major changes. An auditor may issue this confirmation in the case of Private Investment Structures which are required to have their annual financial statements audited under the provisions of the Persons and Companies Act.

5) Following the submission of the necessary confirmations under para. 4, the tax administration makes a decision as to Private Investment Structure status. Within 30 days of this decision, the taxpayer may file an appeal within the meaning of Art. 117.

6) The tax administration is responsible for monitoring Private Investment Structure status. In particular, it is authorised and obligated to monitor compliance with the requirements set out in para. 1 to 3. The tax administration may delegate the review of the requirements under para. 1 to 3 to third parties.

7) The administration will regulate the details, in particular the deadlines and form of submission for the confirmation under para. 4, the means of performing monitoring under para. 6 as well as the imposition of fees, by means of regulation.

8) Private Investment Structures are exclusively subject to the minimum income tax under the provisions of Art. 62 para. 1 and 2 and are not subject to assessment. ◆

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