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EXPERIENCES WITH THE REVISED DUE DILIGENCE LEGISLATION

1. INTRODUCTION

The revised Due Diligence Act ("Sorgfaltspflichtgesetz - SPG")[1] and the Ordinance to the Due Diligence Act ("SPV")[2] entered into force on 1 February 2005. There were various reasons for revising the Principality of Liechtenstein's due diligence legislation again after the last revision as recently as 2001. Given the fact that governments everywhere in the world are imposing more effective methods for combating money laundering, the financing of terrorism and organised crime, various new and stricter guidelines, recommendations and standards[3] have been issued, some of which at least have to be incorporated into national law. Switzerland also reacted to these international trends and changed parameters by revising various laws and regulations. Against this background it does not come as a surprise that the due diligence laws in these two countries have been harmonised in certain areas, although, given the differing backgrounds, there are still important systematic and material changes between them that are likely to survive into the future. Today, i.e. less than two years since the revised law entered into force, we can say that the similarities in the due diligence laws of these two countries have a positive impact on our cooperation with our Swiss business and contracting partners.

We will now take a closer look at the changes to the Law that have a significant impact on the trust business:

2. INCLUSION OF THE FINANCING OF TERRORISM IN THE DUE DILIGENCE ACT

With the revision of the SPG the financing of terrorism was added to the Law, even though various provisions regarding the combating of terrorism[4] were included in the Liechtenstein Penal Code at the end of 2003. The inclusion of these activities in the due diligence law did not pass unnoticed by Liechtenstein trustees, as these days trustees not only have to investigate the origin of assets in detail, but also their use. This had a serious impact on the level of detail which the Liechtenstein trustee must include in the business relationship profile.

3. IDENTIFICATION OF CONTRACTING PARTNERS

It is well-known that trustees, being subject to the SPG, are obliged to identify their contracting partners by way of a document with evidentiary value before entering into a business relationship with this person (Art. 5 SPG). During the revision of the Due Diligence Act, the requirements that must be met by the identification document itself were simplified in several respects, as were some of the requirements regarding form. The enclosed overview relating to the form and treatment of documents with evidentiary value used to identify contracting partners should aid understanding of the difficulties. This article therefore only discusses the requirements in summarised form and does not provide many details.

Under the revised Law, a valid official document with a photograph of the holder is also accepted as a document with evidentiary value, as well as a valid passport or identity document. A more far-reaching change, particularly with regard to business relationships with

Swiss citizens or financial intermediaries resident in the EU, is that under certain circumstances identity documents no longer have to be certified.

Previously, a contracting partner trying to establish a business relationship by correspondence had to submit certified copies of the relevant identification documents. However, with the revision of the Law certain occupational groups, notably foreign financial intermediaries who are subject to Directive 91/308/EEC in the version of Directive 2001/97/EC or a similar directive and appropriate supervision in their home country, were granted the option to submit a confirmation regarding the authenticity of the copy of the evidentiary document **(certificate of authenticity)** instead of the previous official certification (Art. 6 SPV).

With a certificate of authenticity the person obliged to fulfil the due diligence requirements confirms by his or her signature that the copy of the identification document matches with the original of the document submitted to him or her.
The above-mentioned occupational groups include in particular Swiss banks or banks domiciled in the EU in their capacity as institutions obliged to exercise due diligence, lawyers practising in Switzerland or the EU, trustees, chartered accountants and asset managers, provided that they are members of a self-regulatory organisation (SRO). If this is not the case or if the contracting partner himself is not obliged to exercise due diligence and does not belong to an SRO, copies of original documents must still be certified by a notary public or another government authority in charge of certification.

The definition of **politically exposed persons** (known as PEPs) in Art. 1 SPV was taken over more or less exactly from the Swiss Banking Commission's money laundering ordinance. However, in contrast to the Swiss solution where a PEP must be explicitly allocated to a category associated with increased risk, the only requirements under Liechtenstein Law (Art. 33 SPV) are that at least one member of the executive board of the company must approve the establishment of a business relationship with a PEP and that such relationships must be submitted to a member of the executive board for review and a decision whether to continue the relationship at least once every year.

In this regard and in an effort to avoid an unnecessarily prolonged process of establishing business relationships, Liechtenstein financial intermediaries should be informed of the PEP status of a potential client before the business relationship is established.

4. MONITORING OF BUSINESS RELATIONSHIPS

In a special effort to meet the 40 Revised Recommendations of the FATF, Liechtenstein trustees have been obliged by law since 2001 to implement a risk-appropriate system of monitoring their permanent business relationships (the "know-your-customer" principle, Art. 13 par. 1 SPG). To this end they must keep a **risk profile** of every business relationship that must be updated regularly (Art. 14 SPG). The information contained in the **business profile** serves as the basis for the efficient monitoring of the relationship. In addition to keeping the profile updated, trustees are also obliged to investigate the background of the relationship and particular transactions.

With this in mind, trustees should be provided with detailed information as to the origin of the assets, the profession of the beneficial owner or the founder of a company, and the purpose for which the assets will be used to enable them to meet their legal responsibilities and to comply with their due diligence obligations. If the business profile is very detailed and up-to-date, the Liechtenstein trustees will not need to ask their contracting partners for additional information on the background to the relationship and individual transactions. In this regard the trustee is to a large extent dependent on the information and documentation provided by the contracting partner.

As we all know, changes may occur during the term of a business relationship that will necessitate changes to the existing business profile. In this case the Liechtenstein trustee is obliged by law to launch at least a simple investigation if facts come to light or transactions are carried out that deviate from the profile or meet the risk criteria defined by the trustee. If there are doubts or reason to suspect money laundering, preliminary offences to money laundering, organised crime or the financing of terrorism, a special investigation must be launched (Art. 15 SPG in conjunction with Art. 22 SPV).

The contribution of additional assets or new requirements with regard to the purpose for which the assets may be used to serve as examples of reasons for doubt. To enable the trustee to differentiate between normal and abnormal transactions, the business profile must at all times be updated with new information or changes.

The trustee fulfils his or her obligation to monitor the business relationship by checking the correspondence and documents (e.g. contracts) pertaining to transactions involving the company as well as the company's bank account and custody account statements. If these documents recording the events and transactions are not available, it is more or less impossible to monitor a business relationship. To be mentioned in passing is the trustee's obligation to document all transactions (Art. 20 SPG) and to keep all transaction-related documents and vouchers (account and custody account statements and asset statements) for at least 10 years. Experience has shown that it is a good idea upon the opening of a bank account to instruct the bank to send a duplicate copy of all bank statements to the trustee to enable the Liechtenstein financial intermediary to fulfil his or her legal obligation to monitor the business relationship. If the bank is instructed to send duplicate statements to the Liechtenstein financial intermediary, the Swiss contracting partner or person authorised to issue instructions no longer has to take the time to copy the statements and send them to Liechtenstein on a regular basis. In this way the trustee is saved from bothering the contracting partner with at least some of the transaction-related queries, as payment transactions, portfolio restructurings, etc. are self-explanatory.

Finally, as far as transactions and payment instructions are concerned, it should be mentioned once again that the trustee should know the purpose of the transaction in order to comply with his or her legal obligations to monitor and investigate the business relationship. The trustee therefore needs information on the background to the disposition of assets (if possible, the information should be provided directly on the payment instruction form or in a cover letter), **and** should be provided with documentation on all transactions (e.g. copies of contracts, certificates of inheritance or other documents that plausibly explain the transaction or situation).

[1]) Law of 26 November 2004 on Due Diligence Obligations pertaining to Financial Transactions (LGBl. no. 5/2005)

[2]) Ordinance of 11 January 2005 to the Due Diligence Act (LGBl. no. 6/2005)

[3]) such as, among others: Directive 2001/97/EC of the European Parliament and the Council of 4 December 2001 amending Directive 91/308/EEC of the Council on Preventing the Use of the Financial System for Money Laundering (second EU directive on money laundering), the 40 Revised Recommendations and the 8 Special Recommendations of the FATF (Financial Action Task Force on Money Laundering), etc.

[4]) Penal Code § 278b (terrorist association), § 278c (terrorist crimes) and § 278d (financing of terrorism)

FOCUS ON THE LIECHTENSTEIN CHARITABLE FOUNDATION

Social commitment by the state or the private sector takes many different forms, both at national and international level. In times of a shortage of public funds, non-governmental institutions that act in the interests of the public in the social, educational, cultural, research or health arenas gain increasing importance. The following is a short description of such a non-governmental organisation, the Liechtenstein charitable foundation.

A charitable foundation can be set up by an individual (natural person), in particular under a last will and testament, or by an association (legal entity). The foundation can be given any name. The names of countries or places anywhere in the world may not form part of the name. The selected name must be followed by the word "foundation" in unabbreviated form. The foundation assets must be brought into the foundation in Swiss francs (CHF), euros (€) or US dollars (USD) or in kind, and must amount to at least CHF 30'000, € 30'000 or USD 30'000. Once the foundation has been established, the founder or third parties may dedicate additional assets to the foundation.

The charitable foundation basically only comes into existence when it is registered with the Public Register in Liechtenstein. Only a foundation with appointed or identifiable beneficiaries attains legal personality without being registered with the Public Register (a non-registered or deposited foundation; cf. Art. 557 PGR (Liechtenstein Company Law).

Foundations are as a rule subject to supervision by the government, but ecclesiastical foundations, pure and mixed family foundations and foundations with appointed or identifiable beneficiaries are exempt from these provisions (cf. Art. 564 par. 1 PGR). The Department of Justice carries out this government supervision. However, charitable foundations with appointed or identifiable beneficiaries can voluntarily submit themselves to government supervision.

In general, foundations, regardless of whether they are registered or deposited foundations, must pay the following tax on the endowment fund (capital plus reserves): 0.1 % but at least CHF 1'000 per year up to an endowment fund of CHF 2 million, 0.075 % up to an endowment fund of CHF 10 million, and 0.05 % for an endowment fund of more than CHF 10 million.

Charitable foundations can apply for tax-exempt status to the Liechtenstein Tax Administration. Pursuant to Art. 32 par. 1 (e) of the Liechtenstein Tax Law (SteG), the Tax Administration is authorised to reduce the tax burden or grant tax-exempt status to private institutions set up for charitable purposes only. Tax exemption is granted if the following formal and material conditions are met (cf. the circular of the Liechtenstein Tax Administration of April 2000 on the conditions for tax exemption of charitable institutions, in particular foundations):

- A written application for tax exemption must be submitted to the Liechtenstein Tax Administration. The application for tax exemption must be accompanied by the foundation's charter, by-laws and regulations.

- The foundation must be registered with the Public Register.

- The foundation must pursue only charitable aims during the entire tax-exempt period.

- The charitable purpose must be non-commercial, i.e. the foundation must be a non-profit organisation. However, the foundation may engage in commercial activities if they serve its non-commercial purpose, e.g. providing a nursing service or setting up and operating a children's home.

- The charitable nature of the foundation must be irrevocable. The Liechtenstein Tax Administration must be informed of every change in its purpose and the notification must be accompanied by an excerpt from the Public Register.

- Charitable activities are deemed to be social (e.g. welfare services to the poor and sick) or religious (generally accepted religious communities) activities or activities that promote science, the arts or education. The

purpose given in the charter must be substantiated in such a manner that compliance with the purpose can be monitored by the Liechtenstein Tax Administration. It is not sufficient in a legal sense for the charter to define the purpose as "charitable" without further details.

- The charter must make it clear that funds may only be distributed to charitable institutions and projects that pursue the aims given in the purpose clause.

- The foundation is obliged to be active in the area defined in its purpose clause. The Liechtenstein Tax Administration does not recognise foundations that simply manage their assets and make hardly any distributions to charitable institutions and projects as charitable foundations, and does not grant tax exemption to such foundations or revokes any previous tax exemptions.

- The charter must specify that the assets of the foundation may only be used for the charitable activities mentioned in the purpose clause if the foundation should be liquidated. The charter must also exclude the possibility of returning these assets to the persons who dedicated assets to the foundation (e.g. the founder).

- The foundation is obliged to draw up a balance sheet. It must therefore submit annual accounts prepared in accordance with accepted business principles that set out the assets and all income and expenses of the foundation. The annual accounts must be accompanied by a list of donations to the foundation as well as details on all distributions, including the names of the beneficiaries.

The following applies to charitable foundations that are subject to government supervision:

- The charter, by-laws, regulations and all and any amendments to these documents must be submitted to the Department of Justice for approval.

- The annual accounts, auditors' report and a list of the distributions made by the foundation must be submitted to the Department of Justice within six months of the end of every financial year.

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Exemption from the obligation to pay tax is always granted subject to revocation if the funds are not used in accordance with the foundation's charitable purpose if the foundation focuses on asset management and does not distribute sufficient funds to charitable institutions and projects. If the tax-exempt status is revoked, the foundation must pay tax retroactively for the entire period for which no charitable activities can be shown.

If you require additional information, please do not hesitate to contact the authors of the articles, Dr. Beat Graf (Experiences with the Revised Due Diligence Legislation) and lic.iur. Oliver Schmidt (Focus on the Liechtenstein Charitable Foundation).

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