Bulletin

No. 26 · July 2014

Allgemeines Treuunternehmen

since 1929

Asset structuring in Liechtenstein focusing on selected double taxation agreements

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Introductory remarks

As transparency rules have become more stringent, international tax planning involving asset structures managed from Liechtenstein has become increasingly complex. Since the Liechtenstein Declaration in 2009, there has been a significant increase in the number of double taxation agreements (DTAs) concluded with Liechtenstein (LI). DTAs[1] are currently in effect with the following countries:

- Germany (DE)
- Luxembourg (LU)
- Austria (AT)
- United Kingdom (UK)
- Hong Kong (HK)
- San Marino (SM)
- Switzerland (CH) (partial agreement)
- Uruguay (UY)

UK taxpayers have the option to regularise their past tax affairs by 2016 under the Liechtenstein Disclosure Facility (LDF). A tax agreement with Austria for the regularisation of past liabilities has also been in effect since 1 January 2014. This agreement contains special provisions governing future Liechtenstein asset structures and their (entrance) taxation (taxation of contributions to foundations on formation) (LI-AT TA). Liechtenstein has initialled DTAs with Singapore and Malta, although these have not yet come into force. A number of other DTAs are in the pipeline.

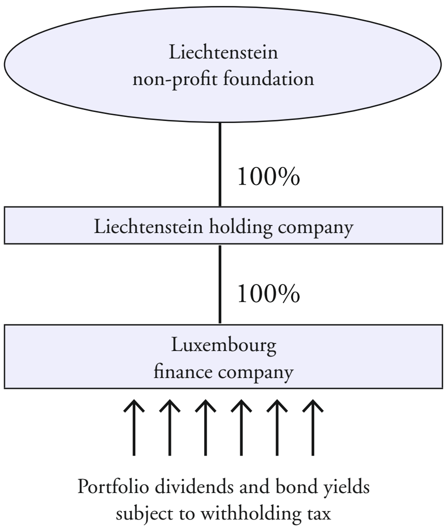
Companies based in Liechtenstein (i.e. legal entities in the form of public limited companies *[Aktiengesellschaft – AG]*, private limited companies [*Gesellschaft mit beschränkter Haftung* – GmbH], foundations, establishments, registered trust companies and cooperatives which are subject to regular taxation) may claim the benefits of a DTA and thus reduce or avoid withholding tax on income such as dividends, interest, royalties, director's fees, etc. DTA protection is particularly significant for asset structures managed in Liechtenstein. Firstly, effective tax optimisation can boost performance considerably. Secondly, DTA protection significantly facilitates recognition of the asset structure for tax purposes.

This bulletin provides specific examples of how to claim the benefits of a DTA and manage assets more tax efficiently.

[1] An overview of all double taxation agreements (DTAs) and tax information exchange agreements (TIEAs) is available on the Liechtenstein Tax Administration website (as at 29 January 2014, http://www.llv.li/#/1953/internationales-steuerrecht). Other DTAs and TIEAs are currently under negotiation.

Private asset structure (PAS) – asset management structure under the LI-LU DTA

A non-profit Liechtenstein foundation manages a high volume of assets. The securities portfolio is actively managed by four external professional asset managers. In accordance with the investment strategy defined by the foundation board, the foundation invests in equities and the dividends earned are suffering from withholding tax. In the course of carrying out its regular asset management controls[2], ATU establishes that the amount of withholding tax that cannot be reclaimed will mean a 3% reduction in annual performance.



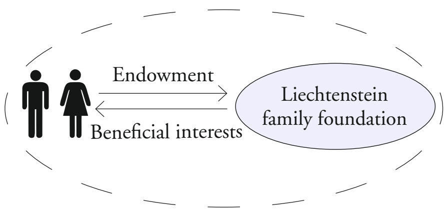
The foundation transfers the entire securities portfolio to a Liechtenstein holding company that is set up and taxed under ordinary rules. The holding company in turn transfers its securities portfolio to a newly established finance subsidiary in Luxembourg. Using the network of DTAs available, the Luxembourg company is able to reduce the withholding tax payable by 30%–50% by claiming tax credits and refunds. Interposing the Liechtenstein holding company ensures that any income generated by the Luxembourg finance company (including savings on withholding tax) can be used for the charitable purposes of the foundation without incurring further tax losses.

For the Luxembourg finance company to make optimal use of the DTA network, it needs to establish local and financial substance, including the necessary human resources. The independent asset management controlling services provided by ATU enhance the protection available to the structure through the DTA.

Family foundation under the LI-AT TA

A married couple resident in Austria undertakes estate planning under Austrian inheritance law to make arrangements for succession within their family. They endow a portion of the estate to a Liechtenstein family foundation. The couple appoints their descendants as beneficiaries and set out their specific beneficial interests in the by-laws.

Tax transparency

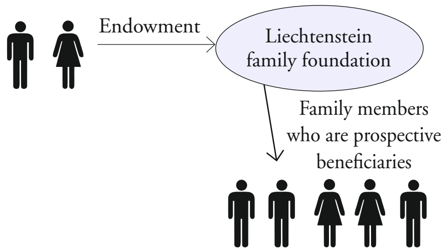


Because the family foundation is not treated as stand-alone tax payer under Austrian law, the income and assets of the family foundation are attributed to the married couple for tax purposes. Neither does the family foundation satisfy the conditions for it to be deemed an Austrian private asset foundation. The investment income generated is subject to Austrian capital gains tax at a rate of 25%. The founders declare the income in their personal tax returns, which does not affect the foundation's legal rights of disposal.

By ensuring tax transparency, no entrance tax liability arises on establishing the foundation. Any distributions to the founders, i.e. the husband and wife, will be tax exempt. Once the founders have passed away, the assets of the foundation are still deemed to form part of their estate. The assets are only transferred on distribution of the estate, with the usual tax implications for foreign heirs/beneficiaries.

Family foundation under the LI-AT DTA

In contrast to the situation described above, the married couple makes a permanent and irrevocable endowment of a proportion of the estate (securities portfolio and a shareholding in an Austrian GmbH), which then satisfies the criteria to be categorised as an Austrian private asset foundation. Potential family members (AT residents) and non-profit organisations may benefit from interests under the by-laws, while the foundation council has full discretion to determine the amount and timing of any distributions to prospective beneficiaries. Neither the founders nor the beneficiaries have any right to issue instructions to the foundation council.



In setting up the foundation, the married couple expresses the wish that the structure should not be disclosed to the Austrian tax authorities.

The foundation qualifies as an undisclosed, non-transparent foundation and

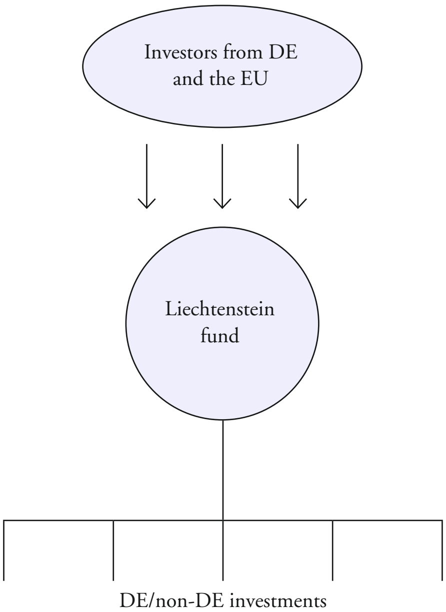
2 Carried out by ATU General Trust (Schweiz) AG

stand-alone taxpayer. Under the LI-AT TA, entrance tax is due on establishing the foundation at a rate of 7.5% (5% entrance tax, 2.5% "discretionary surcharge"). Any dividends, interest payments and other income due to the foundation will not be attributed to the founders and will be exempt from tax in Liechtenstein.

Capital gains tax at a rate of 25% will be deducted at source on any distributions to the beneficiaries. Provided that the family foundation is subject to normal taxation in Liechtenstein, it will be deemed to be resident under the LI-AT DTA. Dividends from the GmbH that are distributed to the family foundation are therefore exempt from withholding tax.

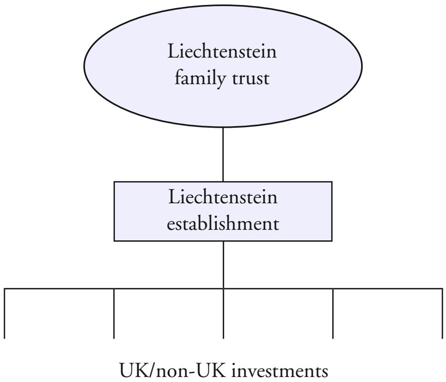
Fund structure under the LI-DE DTA

Investors from Germany and within the EU invest in a Liechtenstein collective investment fund in contract form. The fund qualifies as an Undertaking for Collective Investment in Transferable Securities (UCITS) and invests in alternative energy technologies across the globe, including investments in German companies.



Provided at least 90% of the investors in the fund are based in Germany and/or the EU, or 75% of the investors are based in Germany, the fund is deemed to be resident under the LI-DE DTA and may claim the treaty benefits. The fund is entitled to a full refund on distributions from German investments that are subject to German capital gains tax at a rate of 26.375%. The fund as such does not need to have any actual substance.

Family trust under the LI-UK DTA



A high net worth client based in London, who qualifies as a resident non-domiciled (RND) individual, sets up an irrevocable discretionary trust, in the capacity of settlor, in order to protect his assets and for the purposes of estate planning in relation to all UK resident and non-UK resident family members. An establishment is set up, with the founder's rights vested in the family trust, with a view to investing in a range of asset classes both within and outside the UK.

The Liechtenstein trustee can make decisions autonomously and independently with regard to investment policy and the amount and timing of any distributions to prospective beneficiaries (open class of beneficiaries). Insofar as is practicable, the trustee will take account of the settlor's preferences, as set out in the "letter of wishes".

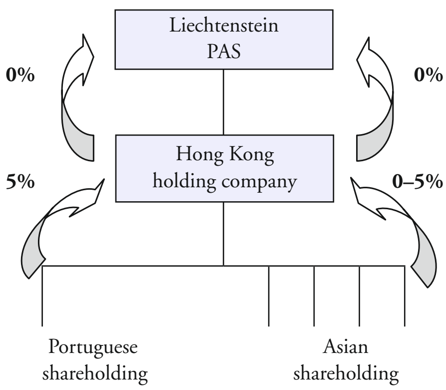
As a legal entity with unlimited tax liability, the establishment is deemed to be resident for the purposes of the LI-UK DTA and may fully avail itself of the benefits thereunder. Any distributions to the beneficiaries will be made through the trust.

From a UK perspective, family trusts have the potential to achieve positive long-term tax effects for RND clients in particular, such as deferring capital gains tax and protecting non-UK assets from inheritance tax.

PAS holding structure under the LI-HK DTA

Liechtenstein trusts and asset structures with PAS status may also avail themselves of the benefits of the DTA with Hong Kong. For example, clients may exploit these benefits by using a Hong Kong holding company to hold Asian and Portuguese investments.

Hong Kong has concluded attractive DTAs with various countries. A Hong Kong holding company can achieve a withholding tax reduction of up to 5% on qualifying dividends in relation to Portugal. For Asia, it is possible to claim full relief from withholding tax or a 5% reduction, depending on the country concerned.



Summary

Even if tax transparency rules proliferate in future, it is still essential for international clients to create structures to safeguard their assets and for estate planning purposes. Tax optimisation and asset management control will always remain key concerns. Depending on their place of residence and particular situation, clients will need to invest more in the substance of the vehicle concerned in order to secure recognition of that vehicle for tax purposes. However, the above examples have shown that Liechtenstein asset structures can still be protected under a DTA even if they lack actual substance.

In addition to giving advice on and managing a range of asset structures, ATU can assist clients by providing any local substance that may be necessary as well as providing asset management control and other advisory services as required.

The author of this article, Ralph Thiede, Allgemeines Treuunternehmen, will be pleased to provide you with further information.

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