

Development of the Liechtenstein tax system – Amendment to the Law on National and Municipal Taxes with effect from 1 January 2010¹

The Government of Liechtenstein has launched a consultation process on a total revision of the tax law to be completed by 5 June 2009. Liechtenstein tax law is to be reformed with reference to tax law for private individuals and legal persons including foundations and trusts, and aligned with international specifications. As a result of this, the special company taxes of a flat rate of CHF 1,000.00 for holding and domiciliary companies will be abolished. The differentiation between the terms “onshore” and “offshore” that are used in international finance will cease to exist. This means that the existing tax law, apart from being improved and modernized, will treat domiciled and non-domiciled persons in the same way and bring the tax law into conformity with European Union standards.

The consultation process has just begun (at time of writing in May 2009), and many changes may yet be made before Parliament debates the issue in Autumn 2009.

For the financial market place „Liechtenstein“, the global wealth management must stay attractive to a majority of investors. The concept of the new tax system pays therefore great attention to the taxation of asset management structures including foundations, establishments and trusts which will be taxable within the acceptable frame of the European Economic Area and in an attractive form to be qualified as private asset management companies (PAMC). A foundation, trust, establishment or any other company form qualify as PAMC if it manages private property and does not perform any commercial activity. Under these conditions such an entity is eligible to pay a flat tax on the basis of the minimum legal capital.

Different forms of investment companies will be submitted to an internationally compatible and transparent taxation.

The income taxation of companies, foundations and trusts is based on the concept of the statutory domicile or the place of management (where the company is headed) in Liechtenstein or the existence of a branch in Liechtenstein.

The Government summarises the changes resulting from the tax reform for legal persons as follows:

- Tax on earnings at a rate of 12.5%
- Abolition of the distribution supplement
- Dividends, capital gains and gains from liquidation on shareholdings will be tax-free instead of granting a shareholding deduction
- Introduction of an equity interest deduction of, for example, 3%
- Introduction of an indefinite carry-forward of losses
- Introduction of international group taxation (EU/EEA/CH)
- Allocations to charities defined for tax purposes of up to 10% of the taxable net profit may be made
- Minimum tax on earnings
- Abolition of capital tax
- Abolition of coupon tax with a transitional solution for old reserves

¹ Due to the extensive debates, it is likely to expect that this law will only enter into force in the year 2011.

Natural persons will continue to pay property and income tax, but the calculation will be changed. Income from wealth will continue to be tax-free, and capital gains on movable property will also be taken out of the income tax net. In principle, almost all taxpayers can probably expect a lower tax burden. Estate, inheritance and gift taxes will be abolished.

In future, general and limited partnerships will be treated transparently for tax purposes; only the partners will be taxed.

Legal persons (this includes foundations and trusts) will now only be subject to tax on earnings. A "flat tax" of 12.5% is envisaged. Taxation on capital as well as a supplement for dividend payment (including coupon tax of 4%) will be abolished, although "old tax burdens" (retained reserves) will continue to be subject to coupon tax for public and private limited companies (tax reductions are envisaged during a transitional period).

Taxable earnings will not include income from foreign production sites, income from rents and leases on real estate situated abroad (including real estate gains), shares in profits based on shareholdings in domestic or foreign legal persons, capital gains from the sale or liquidation of shareholdings in domestic or foreign legal persons.

The Government's summary mentions the tax exemption of dividends, capital gains and gains from liquidation in the context of holding companies which have held or hold a certain stake at participations. However, the exemption will be foreseen for any investment vehicle and regardless of the quota of capital or voting participation or of the holding period of the equity investment. The Parliament may have to clarify this matter so that it may not be misinterpreted in the coming tax law.

If the new tax law is to be compatible with the EEA, privileges can only be granted under very limited and clearly defined criteria. These include special provisions relating to private asset management companies. Any company, foundation or trust can fulfil the criteria for such a private asset management company. The exclusive purpose must be to acquire, hold, manage or sell financial instruments (generally bank investments including tradable securities and bonds). This activity may be carried out directly or possibly via an associated company, the activity of which is similarly restricted.

A private asset management company will pay a minimum tax on earnings of 4% of the minimum level of the legal nominal capital according to the law on persons and companies, or CHF 1,200.00, whichever is the greater. Any registered capital in excess of the legal minimum and reserves of any type will be disregarded in the calculation.

Companies, foundations and trusts that are subject to ordinary taxation will pay the ordinary tax on earnings of 12.5% on their profits, or the aforementioned minimum tax on earnings of CHF 1,200.00, whichever is the greater which can be carried forward in the event of a loss.

Foundations that own real estate or that have granted loans (e.g. as the parent company in the group) are not deemed to be private asset management companies and will be taxed normally. The regulations in the EEA do not permit any further privileges.

A foundation with the following simplified structure, for example, will pay the taxes shown below:

All financed with equity	CHF	As a private asset management company (4%)	12.5% tax on earnings
		CHF	CHF
Bonds	2,000,000.00		
Shares (= shareholdings in the traditional sense, but also portfolio investments for cash management)	1,000,000.00		- 1,000,000.00
Nominal capital (statutory)	30,000.00	30,000.00	30,000.00
Reserves	2,970,000.00		2,970,000.00
<i>TOTAL for equity interest</i>			<i>2,000,000.00</i>
Dividends	50,000.00		- 50,000.00
Interest revenue	100,000.00		
Capital gains on shares	150,000.00		- 150,000.00
Fees, administration costs, expenses	- 20,000.00		
<i>TOTAL earnings</i>	<i>280,000.00</i>		<i>280,000.00</i>
Equity interest 3% (defined annually)			- 60,000.00
<i>TOTAL for tax on earnings</i>			<i>20,000.00</i>
Taxes from 2010		1,200.00	2,500.00

The chart shows that the structure holds bonds and shares totalling to CHF 3 million, this is financed by the minimum legal capital of CHF 0.03 million and reserves of CHF 2.97 million. The overall income is CHF 280,000.00 out of which CHF 50,000.00 come from dividends and CHF 150,000.00 from capital gains on shares.

The taxation as a PAMC is foreseen with CHF 1'200.00 (4 % X CHF 30'000.00), the ordinary taxation runs into a taxation of 12.5 % of CHF 20'000.00. The income of CHF 280'000.00 is reduced by the results on shares and the 3 % equity interest on the equity, to be reduced by tax free investments financed from equity. The interest rate is fixed annually.

	CHF	As a private asset manage- ent company (4%) CHF	12.5% tax on earnings CHF
Bonds	2,000,000.00		
Shares (= shareholdings in the traditional sense, but also portfolio investments for cash management)	1,000,000.00		- 1,000,000.00
Nominal capital (statutory)	30,000.00	30,000.00	30,000.00
Borrowed capital, interest payable at 4%	800,000.00		
Reserves	2,170,000.00		2,170,000.00
<i>TOTAL for equity interest</i>			<i>1,200,000.00</i>
Dividends	50,000.00		- 50,000.00
Interest revenue	100,000.00		
Capital gains on shares	150,000.00		- 150,000.00
Fees, administration costs, expenses	- 20,000.00		
Interest on borrowed capital	- 32,000.00		
<i>TOTAL earnings</i>	<i>248,000.00</i>		<i>248,000.00</i>
Equity interest 3% (defined annually)			- 36,000.00
<i>TOTAL for tax on earnings</i>			<i>12,000.00</i>
Taxes from 2010		1,200.00	1,500.00

The chart shows that the structure holds bonds and shares totalling to CHF 3 million, this is financed by the minimum legal capital of CHF 0.03 million and reserves of CHF 2.17 million and loans of CHF 0.8 million. The overall income is CHF 248,000.00 after deduction of the passive interests out of which CHF 50,000.00 come from dividends and CHF 150,000.00 from capital gains on shares.

The taxation as a PAMC is foreseen with CHF 1,200.00 (4 % X CHF 30'000), the ordinary taxation runs into a taxation of 12.5 % of CHF 12,000.00. The income of CHF 248,000.00 is reduced by the results on shares and the 3 % equity interest on the equity, to be reduced by tax free investments financed from equity. The interest rate is fixed annually.

Both calculations have been simplified. It should be assumed that, depending on the situation, only part of the administration costs will be deductible and also that the interest paid will be deductible weighted proportionally to the earnings generated with it.

Companies, foundations and trusts that have previously enjoyed tax privileges and that were subject to special taxation prior to 1 January 2010 (holding and domiciliary companies) will continue to be subject to the previous tax regime for a further five years unless they apply for a change.

The European Union's Savings Directive (paying agent tax) is in upheaval. The European Union (EU) is planning to tighten it up with the goal of treating structures that pay no tax as intermediate structures and to crack down on the effective beneficial owners. From this point of view, the present legislation which provides for foundations and trusts to be ordinarily taxed on interest income, is the appropriate measure to ensure that the tax law and, ultimately, Liechtenstein structures are recognised internationally.

As a result, Liechtenstein will continue to have an attractive, competitive and performance-oriented tax system which accommodates the country's tax tradition whilst being internationally compatible.

About the Author:

Roger Frick, BBA
Swiss Certified Public Accountant,
Member of the Board of Trustees,
Member of the Board of Management,
Allgemeines Treuunternehmen,
Vaduz, Principality of Liechtenstein

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