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**Liechtenstein: Setting the Financial Agenda**

**Article by Roger Frick**

## Double Tax Treaties

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 hopefully pass through the appropriate legislative instances and should enter into force on 1 January 2013.

The signing of this 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 other important industrial partners.

We should emphasise the 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, especially in comparison to Section 50d par. 3 sentence 1 of the German Income Tax Act (EStG) as an example.

Unfortunately, Liechtenstein was unable to assert its wish to have the interpretations of the ECJ judges in the Cadbury Schweppes judgment of 12 September 2006 (C-196/04) embedded openly in the DTT. This will mean a less economically focused DTT for the financial industry. Instead it will be necessary to try and cope with the stricter and more difficult interpretations of the German anti-abuse regulations.

If enterprises move, however, within those limits, the DTT will provide them with sufficient certainty that the Liechtenstein industry will no longer be arbitrarily obstructed in its gainful occupation with Germany.

Another double tax treaty is being negotiated with United Kingdom. The negotiation should be finished by the beginning of 2012 and will be another milestone together with the so-called ‘Liechtenstein Disclosure Facility’.

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A further DTT, in force since 1 January 2011, exists with Luxembourg, which enables the zero rate for taxes at source on dividends and interests as well.

**New Liechtenstein Tax Law**

The foundation for these DTTs was laid by the implementation of the new Liechtenstein Tax Law on the 1 January 2011. The aim of the amendments to Liechtenstein's tax law, was to modernise the present legal order with regard to taxation by taking into account international developments. This should ensure that Liechtenstein continues to have a tax system which is attractive both nationally and internationally in future, while complying with the European requirements (especially fundamental freedoms and the regulations prohibiting state aid, including ringfencing).

In addition the holding and patent regime under this new tax law is fully ,'European Union compatible'.

Under the new legislation, legal persons who are taxable in Liechtenstein and engaged in economic activity are only subject to corporate income tax and the supplementary tax on gains from the transfer of Liechtenstein based real property. No 'capital tax' is levied. From now on, corporate income tax at a uniform rate of 12.5 per cent applies to a company's net income/profit, irrespective of the size of that profit and its distribution. Income and capital gains from participating interests are exempt, and there is no time limit on the use of losses carried forward.

Furthermore, an equity capital interest deduction has been introduced. Income in the form of interest is also reduced by what is known as an 'equity capital interest deduction'. Reasonable interest paid on modified equity capital is treated as a justified business expense, to the level of the target income. The equity capital interest deduction may give rise, or add, to a current loss. This reduces taxable interest income in case of a high level of self-financing. It should therefore not matter if the re-financing is done via a third party loan or equity, unless the third party loan interest (at arm's length) is higher then the maximum equity interest deduction which is four per cent during 2011. For example: If a loan given to a subsidiary in the amount of CHF 100 million gives an interest income of five per cent, and this loan is fully financed by the mother company's equity (capital and reserves), then four per cent equity interest is deductible and only the margin of one per cent is taxed at the rate of 12.5 per cent.

## Treaty Benefits

The DTT and Tax Information Exchange Agreements (TIEA) with different countries should help Liechtenstein that the various entities being used for the international asset protection and commercial activity can benefit from more legal and planning assurance when used in the international field. Quite often, tax cooperation has an impact in the civil law as well, for example, if a foreign country just argues that a structure is set up for tax avoidance and therefore against public interest. Such arguments cannot be maintained, if there are treaties in place. Or in the example of Germany, there is assurance now how paragraph 15 ASTG works.

Liechtenstein wants to ensure that further agreements are completed as fast as possible by further protocols and double taxation arrangements in order that the jurisdiction's international clientele can benefit from such international cooperation.

Liechtenstein as European Economic Area (EEA) country will continue to struggle with different foreign legal systems that try to restrict the freedom of their residents to optimise cross-border economic activity. Structures used in the international field can only be of use if the implementation can be planned and is understood in the international field. There is still a long way to go. It must be ensured that a Liechtenstein structure is not excluded from the use of double tax benefits. In order to have more assurance as to how controlled foreign company or anti-abuse provisions will be interpreted, it is important to negotiate the internal regulations and to clarify how the Liechtenstein structures work in the cross-border activity. The Liechtenstein tax authority has understood this situation and the cooperation with them is fruitful.

## General Developments

The developments and changes in the last two years in the Principality of Liechtenstein underline the attractiveness of the jurisdiction for international clients seeking comprehensive asset protection structures. But these changes have to be fully recognised by the international community and the reputation of Liechtenstein has to be rebuilt for these changing times.

## Enforcement Privilege for the Liechtenstein Family Foundation

The rule on enforcement privilege for a Liechtenstein Family Foundation was valid before the implementation of the revised Foundation Law. The law states that the creditors of beneficiaries (founder included) shall not be permitted to deprive the beneficiaries of their entitlement to a beneficial interest or prospective beneficial interest acquired without valuable consideration, or individual claims arising from such an interest, by way of safeguarding proceedings, compulsory enforcement or bankruptcy (see now in Art. 552 § 36 Persons and Companies Act in the New Foundation Law).

## Forced Heirship Rule

With the implementation of the revised Foundation Law, Article 29 of the International Private Law Act was amended by paragraph 5. The Liechtenstein lawmaker decided that the privacy of a founder has a higher value than the protection of forced heirs by limiting their rights:

- By claiming their rights, it is not only the applicable law of the country with respect to the estate but ADDITIONALLY the applicable law of the country with respect to the transfer of assets – which is Liechtenstein law when establishing a Liechtenstein entity – decisive when judging whether or not such a claim is granted (donation law applicable if foreseen in documents and thus reducing to two years).
- By limiting the claiming period therefore to two years after the death of the founder as such a transfer is treated as a donation based upon Liechtenstein law.

So if an irrevocable transfer into a discretionary irrevocable foundation was carried out two and more years ago, and the transfer was under Liechtenstein law an agreement of gift, then the assets in the structure can no longer be attacked under any forced heirship regulation.

## Charitable Foundations / Philanthropy

With the implementation of the revised Foundation Law a legal definition of charity (see Art. 107 para. 4 Persons and Companies Act attached) can now be found and the Foundation Supervisory Authority was established (see Art. 552 § 27 ff. Persons and Companies Act). Charitable Foundations are very attractive in Liechtenstein, and together with existing DTTs they could became interesting for foreign based clients.

## No Enforcement of Foreign Judgements in Liechtenstein

As Liechtenstein is not member of the Lugano Convention, foreign judgements are not enforced. There are exceptions with Switzerland and Austria.

## European Savings Directive (ESD)

Ordinary taxed and properly established foundations are basically accepted as a separate entity (not treated as disregarded entity) and do not therefore fall within the scope of the ESD which means that no withholding tax of 20 per cent or 35 per cent as of 1 July 2011 in place of exchange of information will be levied on interest payments for accounts in Liechtenstein. There is no room to consider these structures as circumvention.

**Developments**

During 2012, there will be further international agreements which will help the clients in the cross-border activity. The assessments by Moneyval/G20/FATF will help to increase Liechtenstein's reputation.

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