Taxation Rules for Legal Entities and Trusts in Liechtenstein

1. Introduction

Liechtenstein revised its tax laws on 1 January 2011 (the "Tax Reform"). It was one of the aims of the Liechtenstein government to bring its tax rules into line with European law. Further, the Tax Reform facilitates the conclusion of bilateral double taxation treaties.

Any and all withholding taxes on distributions to owners or beneficiaries were abolished.

Liechtenstein legal entities are taxed either under the regular tax regime or as Private Assets Structure ("PAS"; see below).

As of 1 January 2019 anti abuse rules were introduced in relation to taxation of dividends and capital gains as well as liquidation proceeds received by Liechtenstein entities from foreign entities in tax havens. Read more about the Liechtenstein Anti-Abuse Rules here.

2. Regular Taxation

Under regular taxation, legal entities are subject to a corporate income tax of 12.5% on their net profit.

In order to avoid double taxation, important proceeds are not included in the taxable corporate income:

- Dividends from participations in domestic or foreign legal entities;
- Capital gains from the sale or liquidation of domestic or foreign legal entities;
- Proceeds from a foreign place of operation;
- Distributions received from (i) foundations, (ii) establishments being structured like foundations and (iii) trust enterprises;
- Rental and lease income from foreign real estate.

Dividends, capital gains and liquidation proceeds can be deducted irrespective of the percentage of the participation, i.e. even if it is only one share of an entity in a portfolio.

Further, the Liechtenstein Tax Act allows the deduction of a notional (fictitious) interest cost as business expense from the taxable base (notional interest deduction). The notional interest is calculated on the modified (adjusted) equity capital. The modified equity capital consists of the paid-in capital and the reserves constituting own assets minus (i)

own shares held on the balance sheet, (ii) participations in legal entities, (iii) assets not required for producing regular income and (iv) minus 6% of all other assets except those of items (i) to (iii). The notional interest rate is 4%. The notional interest deduction can neither cause nor increase a current loss; it can only reduce the taxable profit to maximum zero but may not lead to losses that can be carried forward. The notional interest deduction takes the incentive for thin capitalization. There are no thin capitalization rules.

Special features:

- *Group taxation*: Domestic and foreign subsidiaries of a Liechtenstein parent entity are allowed to apply for group taxation. Losses of group entities are attributed to the parent company, or, subject to the application of certain criteria, vice versa.
- *Write-downs and value adjustments on participations*: The Tax Act provides for write-downs or value adjustments on participations provided a permanent depreciation is expected or realized. This is subject to recapture rules so that when the depreciation grounds no longer exist, a charge is made on the value of the appreciation. Thus, permanent losses on shares are fully tax deductible although gains are not taxable.
- *Loss carry-forwards*: Loss carry forwards can be used for an unlimited period. They can be deducted from the positive net corporate income in any given year up to 70% of the yearly taxable net income. The remaining loss carry-forward can be deducted in the future years.

3. Private Asset Structure (PAS)

Any Liechtenstein legal entity can qualify as a PAS upon application. Such status will be granted if an entity does not pursue active economic activities, in particular if it only holds "bankable assets" (shares, bonds, other securities etc.). It can also keep other assets, such as gold, art collections, liquid funds or participations. With regard to participations the PAS or its shareholders or beneficiaries must not exert actual control on the management of such entities by means of direct or indirect influence. The mere use of a shareholder's voting rights is not harmful. The shares or ownership interests (if any) of a PAS may not be publicly placed or traded.
A PAS is subject only to the minimum corporate income tax of CHF 1'800.00 per annum. There is no further tax on income, capital or distributions.

The EFTA Surveillance Authority had ruled and approved that the taxation of PAS does not violate European law.

In some cases the PAS status will not save any tax compared to the regular taxation, since the latter already exempts parts of the company's income (dividends, capital gains and liquidation proceeds). A company that restricts its activities to what a PAS may do will save primarily on income from bankable assets which are not shares (bonds, options, funds, alternative investments, structured products), if such income exceeds 4% per year.

However, a PAS does not have to file tax returns and therefore offers enhanced privacy. Depending on the type of legal entity a PAS may also save accounting costs (Foundation and non-commercial Establishment and Registered Trust Enterprise). The downside is the limitation on the entity's permitted activities. One violation will trigger regular taxation for the whole tax year.

PAS

- Pays a lump-sum tax of CHF 1'800.00
- May act as passive investor only
- May not trade or manage other companies
- Is not required to file tax returns
- Foundations and non-commercial Establishments and Registered Trust Enterprises may save accounting costs

4. Trusts

Trusts are exclusively subject to the minimum corporate income tax of CHF 1'800.00, if they are domiciled or actually managed in Liechtenstein or receive earnings in Liechtenstein.

5. Partnerships

Partnerships and limited partnerships are considered as tax transparent and are not taxed separately from their members.

6. Accounting

An entity under the regular taxation rules will have to do a basic accounting in order to be able to properly declare its income.

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New Liechtenstein Anti-Abuse Rules

New Liechtenstein Anti-Abuse Rules in Relation to Taxation of Dividends and Capital Gains and Liquidation Proceeds Received / Made by Liechtenstein Legal Entities.

In order to prevent that Liechtenstein will be blacklisted, it adopted new anti-abuse rules (LGBl. 2018/147). The anti-abuse rules can be summarized as follows:

1.

The principle remains, namely that dividends received and capital gains and liquidation proceeds made on the disposal (liquidation) of participations (or fully owned subsidiaries) are tax-free.

2.

Beginning in the tax year 2022 (for which the tax return will have to be filed in 2023), the anti-abuse legislation will be applied to participations and subsidiaries acquired prior to the 1st of January 2019. For participations and subsidiaries acquired on 1st January 2019 or later, the anti-abuse rules will be applied upon acquisition.

3.

The anti-abuse rules have the following features:

- Dividends and capital gains and liquidation proceeds received from foreign legal entities or gained when disposing or liquidating foreign legal entities are subject to the regular 12.5% taxation if the following prerequisites are fulfilled: (1.) The income of the foreign entity is primarily (more than 50%) passive income (exception: the passive income originates from actual business, for example, from running a bank) **and** (2.) the foreign entity is directly or indirectly taxed on a low level, meaning less than half of what has to be paid in Liechtenstein (less than 6.25%).
- When measuring whether the tax burden of the foreign entity is not (too) low (at least half of the Liechtenstein tax burden), the following count as relevant taxes paid abroad by the foreign entity (paying dividends or being disposed of or

liquidated with a gain): the direct taxation of the foreign entity, any withholding taxes to be paid by the foreign entity, any direct taxation of the foreign entity's participations and subsidiaries, including the withholding taxes they have to pay (underlying taxes).

- When verifying whether the tax burden of the foreign entity (and its underlying entities) is not even half of what it would be in Liechtenstein, there is a short version of calculating if the participation is lower than 25% of the overall capital issued and/or of the overall voting power: Just the tax rates have to be compared; if the tax rate in the country of the participation or subsidiary is less than 6.25% (less than one half of the Liechtenstein tax rate of 12.5%), the dividend income and liquidation and capital gains will be taxed in Liechtenstein. If the foreign tax rate is 6.25% or higher, there will be no further taxation in Liechtenstein.

- If the participation is higher than 25%, one has to do a theoretical Liechtenstein tax return in order to evaluate whether the tax burden in the foreign country where the foreign entity has its seat is at least half of what it would be in Liechtenstein. This requires a full calculation but has the benefit that the Liechtenstein tax rules have other goodies, such as the (net) notional interest deduction of 3.76% on the invested capital, etc. (which brings the actual tax burden frequently down to nothing). If according to such calculation the taxes in the foreign country are still less than one half of what they would be when applying Liechtenstein law, the dividend income and liquidation proceeds and capital gains will be taxed in Liechtenstein; if the tax burden of the foreign participation/subsidiary is one half or more than what it would be when applying Liechtenstein law, the dividends and liquidation and capital gains would not be taxed in Liechtenstein.

4.

As explained earlier, the new legislation is due to pressure from the OECD, which wants to make sure that income is taxed at least once. Other jurisdictions will have to introduce similar taxation in order to prevent black- or grey-listing. Once the new legislation will apply in Liechtenstein (in the year 2022) for existing structures, there might not be many jurisdictions left with a taxation which is less than one half of the taxation in Liechtenstein, or which have a corporate tax rate lower than 6.25% (always considering all taxes, indirect and direct taxes and taxes of the participation/subsidiary as well as its underlying entities).

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