CONFIDA INFO

The New Liechtenstein Tax Act: Effects on Existing Domiciliary and Holding Companies

General

The aim of new Liechtenstein Tax Act that came into effect on 1 January 2011 is a simple, internationally compatible and EEA-compliant tax law.

Transition Period for Domiciliary and Holding Companies

In order to avoid any risk of violating the EEA Agreement regarding the prohibition of state aid, the special company tax for domiciliary and holding companies will be abolished after a transition period of 3 years on 31 December 2013.

Until 31 December 2013 the special company tax is still applicable to legal entities that were subject to this tax before 1 March 2011, but the minimum tax charge rises from CHF 1'000 to CHF 1'200. There will be no other changes for these companies.

Corporate Income Tax and Notional Interest Deduction

Legal entities that are taxable in Liechtenstein because of their domicile or place of actual management are, under normal taxation rules, subject to the ordinary corporate income tax on all their earnings at a standard rate of 12.5 percent. Their tax liability is restricted to the taxable net income. The net income based on the accounting principles of the Commercial Code can be reduced by income from foreign permanent establishments, rental and lease income of foreign real estate, gains from selling real estate, dividends, capital gains and the socalled notional interest deduction. This notional interest deduction of currently 4 percent of the modified equity reduces the tax base and consequently the effective tax rate. The modified equity is calculated as follows:

+ paid-up capital stock
+ reserves
- shares in legal entities
- net assets of foreign properties
- net assets of foreign permanent establishments
- assets not required for business operations

= modified equity

There is no capital tax anymore.

Abolition of the Coupon Tax – Treatment of Old Reserves

The former coupon tax of 4 percent on the distribution of profits by legal entities whose capital is divided into shares has been abolished. Nevertheless, the abolition does not apply to existing old reserves as of 31 December 2010. Cumulative profits not distributed until 31 December 2010 are considered as old reserves. The following transitional provisions apply to them:

In the years of 2011 and 2012, only the coupon tax of 2 percent has to be paid for old reserves; but from 2013 on the tax rate will be 4 percent again. Old reserves have to be identified separately, as long as they are not taxed. Future distributions are always deemed to be taken from old reserves, until they are depleted. Offsetting the losses of the business years from 2011 on against declared old reserves is not allowed.

Upon application, a settlement of the old reserves at 2 percent without distribution is also possible. This creates equivalence to future profits, and the separate identification of old reserves is no longer required. The opportunity of settling the coupon tax on old reserves should be taken into account anyway, as the coupon tax on old reserves will be 4 percent again from 2013 on.

Decisions on distributions depend, on the one hand, on the liquidity of the business and the shareholder, and, on the other hand, on the interest rate for the notional interest deduction. This rate is set annually by Parliament in the Budget Act – for 2011 it is 4 percent. When it comes to opting for an actual distribution or just a settlement, the circumstances in the individual case are crucial.

Private Asset Structures

As an alternative to the special company tax, the legislator has provided for a new tax privilege, following Luxembourg's Société de Gestion de Patrimoine Familial (SPF) for legal entities that are only engaged in asset management and do not perform any commercial activity. Such Private Asset Structures (PAS) are subject only to the minimum corporate income tax of CHF 1'200.

A legal entity qualifies as a PAS, if it meets the following requirements:

- no commercial activity;
- no public issuance of its own stocks or shares and no trading on a stock exchange;
- no advertising to shareholders / investors;
- no receipt of compensations or reimbursements by shareholders / investors or third parties (no asset management fees);
- articles of the company contain the restrictions as a PAS (This criterion is deemed fulfilled if the articles exclude commercial activities);
- ownership of shares in the PAS is restricted to natural persons (intermediate legal entities forming a so-called PAS chain are allowed);

The main feature with regard to the tax privilege is the lack of commercial activity. Article 64, paragraph 1a exemplifies, by reference to the Asset Management Act (safe harbour), what is not considered as a commercial activity. This includes the acquisition, possession, management and sale of transferable securities such as bonds and stocks, money market instruments, shares in investment undertakings, options, futures, derivative contracts, and derivatives that can actually be delivered or settled in cash. Buying, holding and selling of precious metals, artwork and similar material assets is generally possible, as long as no commercial trading takes place. As the mere exercise of ownership by the owner as such is not considered a commercial activity, the legislator does not qualify the holding of a property as a commercial activity as long as the property is used by the owner himself and not rented. When holding shares, it is important to observe that neither the PAS, nor its shareholders or beneficiaries exercise any control through direct or indirect influences on the management of the shares, otherwise commercial activity will be assumed and the company will lose its status as a PAS. We wish to point out that only a single illegal activity may lead to the loss of the PAS status and result in the normal taxation of the entire net income.

The EFTA Surveillance Authority (ESA) has qualified the provisions in the new Liechtenstein Tax Act on Private Asset Structures as EEA-compliant and acknowledged them at the European level.

The PAS could play a smaller role than might appear at first sight, since the income from a private asset structure tends to be tax-exempt anyway (foreign real estate income, dividends and capital gains). Interests on time deposits and bonds as well as capital gains from the sale of bonds and derivatives are subject to normal taxation, but, in practice, tax liability only arises from an income of more than 4 percent because of the notional interest deduction.

Commercial Companies

Companies that do not qualify as a PAS have to pay tax on their income at a rate of 12.5 percent. These companies, however, profit from the notional interest deduction, tax exemption of dividends and capital gains from shares, income from foreign permanent establishments and proceeds of properties located abroad.

In particular, the exemption of income earned in a foreign establishment will lead, in practice, to tax-exemption of most income in Liechtenstein.

This is the reason why there will be little changes for the majority of commercial domiciliary companies even after the transition period of 3 years.

Under the old tax regime, domiciliary companies did not receive a VAT number. Now commercial companies that voluntarily submit themselves to normal taxation can apply for a VAT number and reclaim the input VAT billed by Liechtenstein and Swiss service providers.

The application for normal taxation and thus the opportunity of being included in the VAT registry could therefore be useful for commercial companies, if the reclaim of the input VAT outweighs the additional administrative costs.

The application for normal taxation during the transition period of 3 years can, apart from the opportunity of reclaiming the input tax paid, may also be useful for companies with high equity. The reason is that these companies pay a tax of 0.1 percent on their equity under the old tax regime which still applies for the next 3 years without an application to normal taxation.

Provided that such companies earn only income exempted from domestic tax, which, for example, is the case of conducting business exclusively via a foreign permanent establishment, there will be only a minimum corporate income tax of CHF 1'200 under normal taxation rules. Thus, normal taxation on high equity could be lower than the 0.1 percent on equity to be paid during the next 3 years without filing an application to normal taxation.

Taxation of Trusts

For Trusts (specific asset endowments without personality) whose domicile or actual management is located in Liechtenstein, merely the minimum corporate income tax of CHF 1'200 is imposed. A tax assessment does not occur.

Privileged Taxation of Income from Intellectual Property Rights

A special tax privilege was created by the legislator for income from intellectual property rights. The legislator grants a tax exemption of 80 percent of the income from intellectual property rights created or acquired from 1 January 2011 on. The Ordinance specifies what is deemed intellectual property right: It includes patents, trademarks and utility models, if they are protected by inclusion in a domestic, foreign or international registry. Other rights such as copyrights, know-how or commercial relations are not deemed as intellectual property rights and do not qualify for a tax exemption for the time being.

Holding Companies

Holding companies profit from the tax exemptions on dividends and capital gains acquired through the sale of shares. In contrast to other countries, this exemption depends neither on a minimum share nor a minimum holding period. Furthermore, the group taxation introduced with the new tax law and the unrestricted offsetting of losses contributes to Liechtenstein's attractiveness. Thus, upon application, the losses of group companies accumulated in one year, including foreign companies, can be set off proportionally against the income from domestic group companies. Now losses can be set off against future profits without any time restrictions. Losses of foreign permanent establishments can also be set off against the domestic taxable net income.

Liechtenstein's Attractiveness

In sum, the above-mentioned privileges, the conclusion of double taxation agreements and the resulting reduction of foreign withholding taxes on dividends, interests and royalties has turned Liechtenstein into an attractive location for licensing and holding companies.

With a proportional tax rate of 12.5 percent, which can further be reduced to effectively less than 10 percent through the notional interest deduction, Liechtenstein has propelled itself into the top league by European standards and become attractive for the settlement of commercially operating companies, too.

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