



# Newsletter

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## INFORMATION ON THE NEW ACT ON NATIONAL AND MUNICIPAL TAXATION IN THE PRINCIPALITY OF LIECHTENSTEIN (Steuergesetz/SteG, Tax Act)

(Helmuth Ritter, certified trust expert FH)

### WHAT ARE THE CHANGES?

A short overview with the most important points of interest:

#### LEGAL ENTITIES

##### Abolition:

- of the special company taxes for domicile and holding companies (with the option that the current law continues to apply for another five years)

##### Introduction:

- of a minimum corporate income tax of CHF 1,200.00 for „private asset structures“ (Privatvermögensstruktur, PVS). The requirements for this are regulated (among other provisions) in Art. 64 et sqq. of the new Tax Act:
  - no business activities (real estate and/or loans qualify as a business activity)
  - participations in other companies are allowed, provided that the PVS and/or its shareholders or beneficiaries do not exercise any actual control by directly or indirectly influencing the management of such companies
  - the company object is the management and sale of financial instruments pursuant to Art. 4.1 g) of the Vermögensverwaltungsgesetz (Asset Management Act)

##### Abolition:

- of coupon tax as per 01.01.2011 with transition rules for existing reserves
- of the 0.002 % capital tax
- of the distribution surcharge of between 1 and 5 %
- resp. exemption of capital gains from the sale or liquidation of participations in domestic or foreign legal entities
- of participation deduction; profits from participations in domestic or foreign legal entities will be exempt from taxation

##### Introduction:

- of a income tax at a rate of 12.5 % (tax costs can no longer be asserted as business expenditures)
- of an equity capital interest deduction of 4 % of the modified equity capital
- of a minimum income tax of CHF 1,200.00 (exception: Art. 62 (3) SteG)
- of the option to set off losses without any limit as to time
- of a deduction of 80 % of the amount of total positive revenue from intangible property rights
- of the taxation of inland rental income for family foundations

#### INDIVIDUALS

##### Abolition:

- of estate, inheritance and gift tax

##### Exemption:

- of capital gains from income tax

##### Adjustment:

- of deductions and tax-free amounts
- of the maximum tax burden on taxable property from 0.8585 % (old) to 0.84 % (new)
- of the maximum tax burden on taxable income from 17.01 % (old) to up to 21 % (new, with a municipal tax surcharge of 200 %)

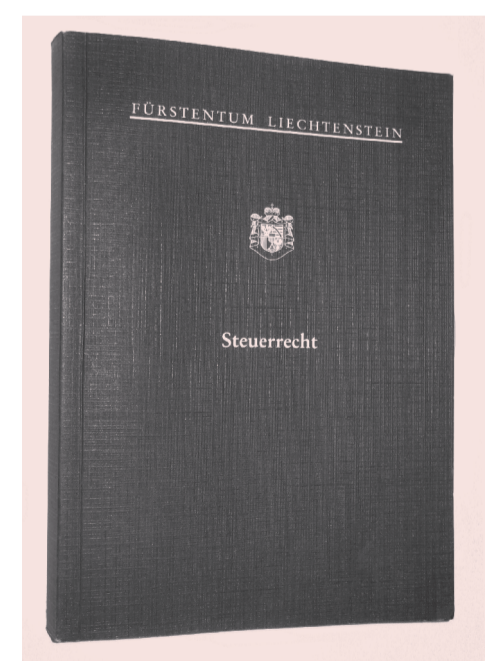
##### Introduction:

- of the integration of capital tax into income tax by transferring property into a special type of income on the basis of the estimated capital gain of 4 %
- of a graduated tax rate for national tax of 1, 3, 4, 5, 6, 6.5, and 7 % (municipal tax will be added for total taxation)
- an endowment tax of 2.5 % (plus municipal tax) if a transfer of assets leads to exemption from ordinary taxation of assets

#### LIMITED SELF-REPORTING

(individuals and legal entities)

Anyone who within one year after the new Tax Act enters into force reports an offence in terms of the Tax Act committed by him without there being in immediate danger of discovery, only has to pay the retroactive tax for the last five years. There will be neither punishment nor a 10 % surcharge on the retroactive tax nor default interest.



## STARTING SITUATION

### Reasons for the reform of the tax law

The Tax Act currently in force was created in 1961. At that time, i.e. almost 50 years ago, a total revision of the Tax Act then in force (which was from 1923) was intended, but was never fully implemented.

Accordingly, the roots of the current Tax Act go back to 1923. Selective adjustments have been made by various part revisions since 1961.

The current system is based on a general property tax with a supplementary income tax for individuals, the property tax rate being between 0.162 % and 0.851 % and the income tax rate being between 3.24 % and 17.01 % (calculated with a tax rate of 54 % of the legal unit and a municipal surcharge of 200 %). Legal entities have to pay capital tax and income tax. The capital tax rate is 0.002 %; the income tax rate varies between 7.5 % and 15 % depending on the ratio of net profits to taxable capital, and if there are distributions (maximum distribution surcharge: 5 %) that rate may increase to 20 %. Divergent to this, certain legal entities (in particular domicile and holding companies) are subject to special company taxes. Additional taxes levied are a real estate gains tax on the sale of domestic land, a coupon tax on distributions and payments of interest, an estate tax on estates payable in Liechtenstein and an inheritance or gift tax on the obtainment of assets in Liechtenstein mortis causa or by way of gift.

Persons who are not gainfully employed in Liechtenstein may be subject to lump sum taxation if they earn their livelihood from profits of their assets or from allowances received from abroad.

### Role model for a modern taxation

In accordance with the findings of international tax sciences, the conception of

the tax reform is oriented by the model principles of taxing citizens in a way that is as transparent and simple as possible, of (if possible) taxing the income acquired on the markets only once during one's lifetime and of treating individuals and legal entities as equally as possible.

### Development of the existing Tax Act

The conception of the tax reform builds on the existing Liechtenstein Tax Act. The Act has been developed in particular under the aspects of international competitiveness and attractiveness, of conformity and international compatibility with European law and the Liechtenstein constitution, of tax justice, of tax tradition and of neutrality concerning the decisions taken by tax subjects and concerning the income obtained by taxation. This is to ensure the future viability and attractiveness of Liechtenstein as a tax location in a fundamental and sustainable way on the basis of the existing Liechtenstein tax tradition, to increase legal certainty and to simplify the Tax Act. Just like any other law, the Tax Act may be examined for compatibility with EEA law by the ESA (EFTA Surveillance Authority) after the law has entered into force.

## TAXATION OF LEGAL ENTITIES

### General

In the future, legal entities taxable in Liechtenstein will only be subject to income tax and real estate gains tax. Neither capital tax nor coupon tax will be levied any longer.

In the field of the newly regulated income tax, a nominal tax rate of 12.5 % will be combined with the comprehensive exemption of participation income and participation profits as well as with an equity capital interest deduction. In addition, modern group taxation will be introduced for affiliated companies, which will allow the setting-off of intra-group losses on a worldwide basis within the same period. As a result, Liechtenstein will have an internationally competitive tax system for enterprises of commerce or trade, finance and other services as well as for holding companies.

However, a reduction of foreign tax deductions at source on dividends, interest and royalties can only be achieved by double taxation treaties and by applying the Parents-Subsidiary Directive and the Interests and Royalties Directive also in relation to Liechtenstein.

### Increase in international compatibility

In the future, the tax liability of legal entities will depend on whether there is a Liechtenstein domicile or place of effective administration (unlimited tax liability) or whether there is a permanent establishment in Liechtenstein (limited tax liability). This increases international compatibility.

What will be abolished are the special company taxes for domicile and holding companies, since these include the concrete danger of a violation of the prohibition of state aid, which has been laid down in the EEA Treaty.

### Modification in the determination of net income

As so far, the taxable net income will be calculated in line with the tax-modified calculation of profit under commercial law pursuant to the provisions of the Liechtenstein Persons and Companies Act. In addition, the internationally recognised principle of dealing at arm's length must be complied with. Net income must be reduced by dividends and capital gains on participations, real estate profits, earnings from foreign permanent establishments and rental profits from foreign real estate. In addition, an equity capital interest deduction of 4 % of the modified equity capital is to be applied. This means that investment and financing decisions can be more or less decoupled from taxation factors. Negative taxable income can be carried forward without limitation as to time and can be set off against positive income. The deduction of taxes as expenditures is no longer permitted.

### The new standard tax rate

Regardless of any distributions of profit, the new tax rate will be a standard proportional tax rate of 12.5 %. Taking into account the equity capital interest deduction of 4 %, the effective tax rate for a 20 % yield on equity capital is therefore exactly 10 %.

The abolition of capital tax avoids the effects of taxing substance. The equity capital interest deduction will - in particular in times of economic difficulties - lead to substantial tax relief. The current progression depending on the amount of revenues is given up. Equity capital interest deduction will however continue to lead to indirect progression.

The change of system will lead to as good as no system-related losers apart from companies with a substantial retention of earnings. Compared with the current tax system, all companies that fully distribute their profits will experience tax relief.

### **Abolition of coupon tax**

Coupon tax will no longer be levied. This measure is of great importance in the light of the international compatibility, competitiveness and neutrality as to tax subject decisions of the Liechtenstein tax system.

### **Company procedures (replacement/restructuring)**

Concerning replacement purchases, the new Art. 50 regulates the waiver of the realising of profits in terms of taxation if a replacement item is purchased within a short time period.

Extensive new regulations have been provided for the restructuring of companies. The intended purpose of the reform proposal is that reorganisations making sense in business terms shall not be inhibited by taxation. At the same time, such reorganisations shall not remove any tax base from taxation. The tax neutrality of restructuring may only mean a delay of taxation.

### **Value corrections for participations**

Capital gains from participations in legal entities are now exempt from taxation. This exemption from taxation means that losses from a decrease in value of participations are no longer tax-deductible. At the same time however, in the case of unfavourable economic developments, it is often impossible to set-off losses at the level of the company concerned. In order to ensure that the loss of the invested amounts is taken into account, tax subjects are permitted to assert in terms of taxation permanent and realised reductions in the value of participations. Any tax deduction made must be reverted if the value in question recuperates.

### **Equity capital interest deduction**

All companies - regardless of their legal form - are granted an equity capital interest deduction at a rate of currently 4 % of the balance sheet equity capital corrected by certain factors. In terms of taxation, the equity capital interest de-

duction is a business expenditure that reduces the assessment basis for income tax. By this, financing with equity capital becomes equivalent to financing with outside capital (if taken up at a comparable interest rate) in terms of taxation. The selection of the type of financing can be made exclusively by entrepreneurial criteria without any influence from taxation. In addition, the equity capital interest deduction reduces the effective tax rate (depending on the equity capital yield).

The definition of the assessment base for equity capital interest deduction (modified balance sheet equity capital) ensures that neither is there double benefit nor are companies „overcapitalised“ in order to make use of the equity capital interest deduction by unproductive capital.

### **Group taxation**

Normally, it is the objective of group taxation systems that the formation of groups (associated by undertakings that are legally separate) - normally in various countries - be neutral in terms of taxation. On the one hand, this requires that double taxation in the distribution of group-internal profits (as it is described in the next chapter „distribution neutrality“) be avoided; on the other hand, has to allow set-off of losses of individual group companies against profits of other national and international group companies. Otherwise, the company would be subject to the taxation of profits although, viewed as a whole, it was unable to make profits in such amount.

### **Distribution neutrality**

#### **a) Distributions to individuals**

As in the current tax system, dividends that a shareholder resident in Liechtenstein receives from a legal entity are not subject to income tax. Income from a participation are taxed by way of property tax. Nonetheless, under the old system a distribution led to a higher tax

burden because the corporate income tax of the legal entity was increased by a distribution surcharge and eventually that a coupon tax had to be withheld on the distribution. This made distributions unattractive for legal entities. By abolishing these surcharges, the tax reform ensures that the decision of whether or not profits shall be distributed to the shareholders will no longer be influenced by tax considerations.

#### **b) Distributions to legal entities**

In the future, distributions to legal entities will no longer be indirectly exempt from double tax burden through the participation deduction, but will be exempt from taxation as untaxed income on the assessment base level already.

### **Income from patents**

Due to the great importance of research and development, some European states have recently introduced special tax benefits for research and development activities. In this context, income obtained through the result of research is normally exempt from taxation at a rate of 80 %. Since Liechtenstein industry in particular is and must remain highly innovative, the new Tax Act also includes such a provision.

### **Continued application of current law**

Legal entities that were subject to taxation pursuant to Art. 31.1 c) of the current law before 1 January 2011 as well as their beneficiaries will be taxed in accordance with the current law for the following five years. On request, legal entities will be taxed pursuant to Art. 44 to 65 of the new Act before expiry of that period.

Art. 82 to 88 of current law will remain applicable for a further five years with legal entities and special endowments of assets that met the requirements of Art. 82 to 88 of the current law before Art. 64 of the planned Act entered into force, the minimum amount being

CHF 1,200.00 pursuant to Art. 88 of the current law. On request, these legal entities will be taxed pursuant to Art. 44 to 65 of the new Act before the interim period expires.

## TAXATION OF INDIVIDUALS

### General

Individuals subject to taxation in Liechtenstein will continue to be subject to a combination of property and income tax. By this, the income of an individual is covered evenly and only once, in accordance with the internationally recognised principle that the market income of an individual should be taxed only once.

The provisions on the taxation of individuals have been modified only moderately, taking into account the proven tax tradition of the country. In this, the term „property tax“ has been kept, although in the future, property will be taxed through income tax by a target rate of interest. Specifically, property will be covered on the basis of standardised property income with a target rate of profit of 4 % and also be taxed together with the income.

There will be no taxation of capital gains in the future. In turn however, capital losses will no longer be deductible.

The current, comparatively complex progression surcharge as well as the deduction for single parents or married persons will be replaced by adjusted, partly increased deductions and

tax-free amounts and by a 7-stage tariff. Instead of the household and property deduction, a new tax-free amount of CHF 15,000.00 for singles and CHF 30,000.00 for married persons and single parents will be granted. In the future, household effects and privately used motor vehicles whose value does not exceed CHF 25,000.00 (CHF 50,000.00 with married persons, resp.) will be exempt from taxation.

### The new stage tax tariff

The tariff structure ensures that the changes in the calculation of taxes do not lead to system-related losers, even though it cannot be excluded in a few individual cases that the tax burden will increase after the reform as compared with the old Tax Act.

## ASSET MANAGEMENT

### Asset management structures

#### a) Requirements

Attractiveness for asset management structures is of pivotal importance for Liechtenstein as a financial centre. Therefore, the taxation of such structures demands special attention. Vehicles that do not carry out business activities and serve the management of assets of individuals will in the future be subject to new taxation rules as „private asset structures“ (PVS). The various forms of investment companies where a number of investors may bundle their asset investments will continue to be taxed on the basis of tax transparency and in a way that is internationally compatible.

#### b) Minimum income tax

After the tax reform, PVS shall be liable to a minimum income tax of CHF 1,200.00. These structures are exempt from normal income tax.

#### c) Internationally competitive taxation

Liechtenstein's need as a financial centre for internationally competitive taxation rules for asset management structures are met by the rules applying to the private asset structure. At the same time, however, taxation is put on a new basis that is in conformity with the EEA Treaty, which meets the requirements of investors for legal certainty.

### Investment enterprises

In the field of collective capital investment, the tax reform hardly introduces any changes at all. Collective capital investments with a contractual or corporate fund structure as well as special funds for qualified investors will continue to be handled according to the internationally recognised principle of tax transparency. In this, accumulating as well as distributing funds are not per se subject to taxation. Rather, it are the shareholders who are taxed in their respective countries of residence.

Private equity companies in the form of a private limited partnership are subject to the principle of tax transparency just like all companies lacking a legal personality (partnerships). This means that taxation can only happen on the level of the partners in their respective countries of residence or in the source country. Private equity companies in the form of a legal entity are either subject to income taxation or may be taxed as PVS if they meet the requirements.

Our specialists for tax matters will be glad to assist you with any questions that may arise under the following contact data.



**Robert Schädler**, certified expert in accounting and controlling, auditor  
Telephone: 00423 238 88 88  
E-mail: rst@accurata.li

**Heinz Vogt**, chartered accountant  
Telephone: 00423 238 88 88  
E-mail: voh@accurata.li

**Helmuth Ritter**, certified trust expert FH  
Telephone: 00423 238 88 88  
E-mail: rih@accurata.li

**Klaus Jehle**, accountant  
Telephone: 00423 233 28 56  
E-mail: jek@accurata.li

### The new stage tariff for the taxation of individuals

The national tax depends on the taxable income including the property recalculated as income. The national tax liability for taxable income for spouses to be assessed together is calculated as follows:

Income Range	Rate	Basic tax-free amount	Minus tax-free amount of CHF
up to CHF 30,000			
from CHF 30,001 to CHF 50,000:	1%	minus tax-free amount of CHF	300
from CHF 50,001 to CHF 100,000:	3%	minus tax-free amount of CHF	1,300
from CHF 100,001 to CHF 160,000:	4%	minus tax-free amount of CHF	2,300
from CHF 160,001 to CHF 220,000:	5%	minus tax-free amount of CHF	3,900
from CHF 220,001 to CHF 280,000:	6%	minus tax-free amount of CHF	6,100
from CHF 280,001 to CHF 340,000:	6.5%	minus tax-free amount of CHF	7,500
above CHF 340,000:	7%	minus tax-free amount of CHF	9,200

The total tax burden is the sum of the above national tax calculated as described above plus the respective municipal tax surcharge.