Switching structures

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NICOLAI FISCHLI AND MARTINA BENEDETTER LOOK AT THE IMPLICATIONS OF THE SWITCHOVER RULES FOR CERTAIN DIVIDENDS AND CAPITAL GAINS UNDER LIECHTENSTEIN CORPORATE INCOME TAX LAW

KEY POINTS

What is the issue?
The Liechtenstein tax code has been amended so that income and capital gains from subsidiaries with passive income that are resident in low-tax countries are no longer exempt from corporate income tax.

What does it mean for me?
Multi-layer structures involving Liechtenstein entities must be analysed in regards to potential switchovers and new structures should be set up with potential switchovers in mind.

What can I take away?
Existing structures can be changed in order to safeguard the tax exemption. However, it is important to take measures before the transition period ends at the end of 2021.

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On 7 June 2018, Liechtenstein's parliament *(Landtag)* adopted an amendment to the principality's corporate income tax (CIT) law implementing,[1] among other things, anti-abuse rules concerning dividends and capital gains derived from participations in foreign entities.[2]

LIECHTENSTEIN CIT

Generally speaking, Liechtenstein-resident companies, foundations and registered trust enterprises pay Liechtenstein CIT on their worldwide profits, calculated in accordance with Liechtenstein accounting conventions. The headline rate of CIT in Liechtenstein is 12.5 per cent. However, certain items such as dividends from participations and realised capital gains on the disposal of the same are, subject to certain exceptions, excluded from the tax base, often resulting in low effective rates of CIT for many entities.

Entities that meet the applicable qualifying conditions may choose to register as private asset structures (*Privatvermögensstrukturen*) and pay only the annual minimum CIT of CHF1,800. However, for some types of asset-holding structures, this is not an option due to the nature of the qualifying conditions. As a consequence, a significant number of asset-holding structures that pay conventional Liechtenstein CIT may be affected by the new anti-abuse rules.

NEW ANTI-ABUSE PROVISION REGARDING TAXATION OF DIVIDENDS AND CAPITAL GAINS

The new anti-abuse rules restrict this exemption in the case of participations that are resident in low-tax jurisdictions

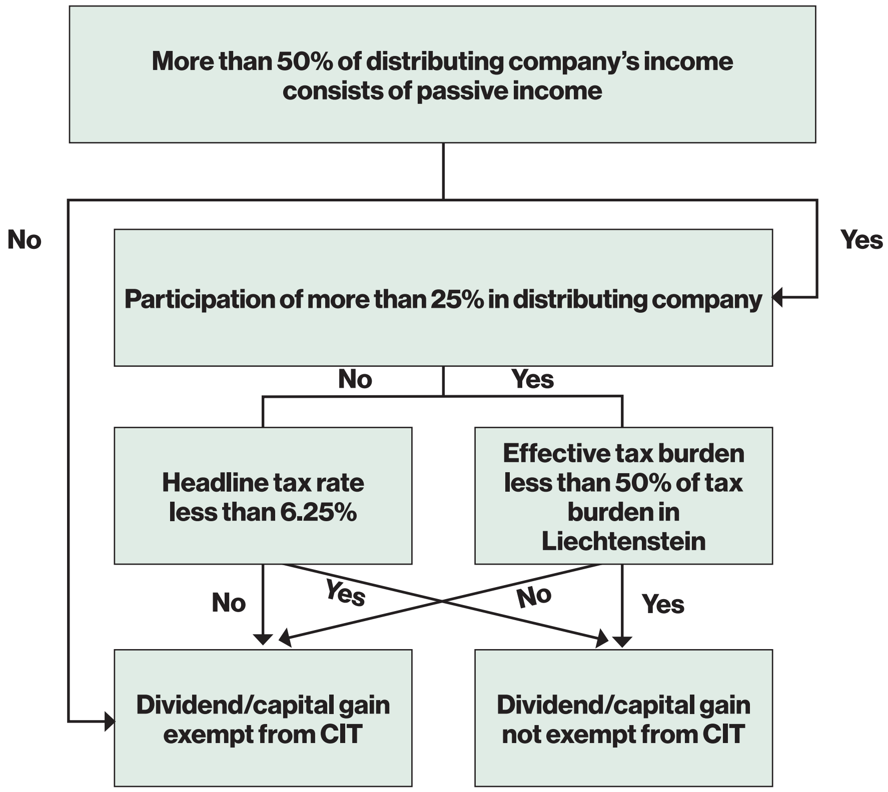

Figure 1: Decision tree (simplified) to determine whether a switchover is possible

and that continuously derive 50 per cent or more of their income from passive sources. Thus, three factors must be tested:

- is the participation resident in a low-tax jurisdiction;
- does the participation derive 50 per cent or more of its income from passive sources; and
- does it do so continuously?

As highlighted in Figure 1 (above), where the restriction applies, dividends received from such participations will be exposed to Liechtenstein CIT, as will capital gains derived from such participations and benefits received from a foreign foundation.

LOW TAXATION OF THE PARTICIPATION

Whether the distributing company's net profit is subject to no or low taxation depends on the level of participation. For participations below 25 per cent, low taxation is assumed if the headline tax rate is less than half of the current Liechtenstein CIT rate, i.e., less than 6.25 per cent. For participations above 25 per cent, the effective tax rate that would result if the company was liable to tax in Liechtenstein has to be computed. This means the entity's tax base, according to Liechtenstein tax law, has to be calculated and then multiplied by the local CIT rate in the company's country of tax residency. The resulting tax burden must not be lower than half of the tax burden that would result in Liechtenstein. When calculating the tax burden, withholding taxes are taken into account.

PASSIVE INCOME

For the purposes of the switchover rule, passive income is defined as:

- interest;
- royalties;
- income from financial leasing; and
- other income from financial assets or intellectual property.

If the distributing company in turn receives dividends/capital gains, this income must again be examined one level lower according to the same criteria (i.e., whether the dividends/capital gains are paid by a company that continuously generates more than 50 per cent of its income from passive sources and is resident in a low-tax country).

Legal entities whose main operating business consists of generating passive income (such as banks) are exempt from the switchover regulation, as it is part of their active business. Depending on the specific circumstances, this exemption may also apply to an intra-group financing entity (in such cases, obtaining a ruling from the tax authority is recommended).

DEFINING 'CONTINUOUS GENERATION'

The generation of passive income is considered 'continuous' if the company intends to do so repeatedly over several years. If an entity uses its resources (e.g., in the form of capital and labour force) over a longer period to generate passive income, this is considered a continuous activity.

Single events, even if big in numbers, may, therefore, not fall under the anti-abuse provision. Such cases have to be analysed based on the individual fact pattern and a discussion with the tax authority and/or applying for a tax ruling is strongly recommended.

ACTION REQUIRED

The window of opportunity to reorganise existing structures before the new anti-abuse rules apply ends on 31 December 2021. Therefore, this is an ideal time to review holding structures that involve Liechtenstein entities in the light of the amended regulations, in order to avoid unwanted additional tax burdens in the future.

A first analysis consists of reviewing the types of income of the Liechtenstein entity's shareholdings regarding their passive or active nature. For all participations of which more than 50 per cent of their income derives from passive activities, the tax burden must be analysed. If the analysis shows that the tax burden is too low, further action will be required.

It is then advisable to review each subsidiary and determine for which of them the restructuring or onshoring measures must be taken before the end of the transition period. Companies that only hold wasting assets (e.g., yachts or other vehicles) might never generate any dividends or capital gains that could lead to taxation in Liechtenstein, whereas typical holding, wealth-management or mixed-financing companies that are resident in low-tax countries can bear a high risk of triggering the switchover regulations in Liechtenstein.

It is advisable to start the analysis well before the end of 2021, to have enough time to analyse and plan adequate tax-risk mitigation measures.

#COMPANIES #COMPLIANCE #LIECHTENSTEIN #TAXATION

1 bit.ly/3s28lio 2 'Participations' are any shareholdings in corporations. There is no minimum holding requirement; i.e., one share of a company is enough to have a 'participation' for tax purposes.