The Private Wealth & Private Client Review

Fourth Edition

Editor
John Riches

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The Private Wealth & Private Client Review

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For further information please email
Nick.Barette@lbresearch.com

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John Riches

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Gideon Roberton

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EDITOR'S PREFACE

There is no doubt that the twin recurring themes for 2015 at a global level in private wealth planning are those of transparency and regulation. The zeal of policy makers in imposing ever more complex and potentially confusing sets of rules on disclosure of beneficial ownership information seems unabated.

i Common reporting standard (CRS)

The centrepiece of cross-border automatic information exchange is CRS. This FATCA equivalent for the rest of the developed world is set to come into effect from 1 January 2016. At the last count just over 90 countries had committed to CRS. Its principal effects will be felt in two waves – among the so-called early adopters group the rules will take effect from 1 January 2016 and first information exchanges will apply in September 2017. For the second wave, there will be a year's delay.

What is interesting about CRS is that the OECD has taken a central role in producing coordinated guidance on its interpretation. The draft guidance initially published in July 2014 was somewhat sketchy in nature and we can expect, as we move towards the beginning of next year, revised and more detailed guidance on a number of key issues.

Deep concerns exist about the extent to which information exchange between tax authorities under CRS will remain secure in the hands of the 'home' countries of beneficial owners. While the 'normal' way of signing up to CRS is via the multilateral convention that provides for exchange with other signatory nations, there are indications that some jurisdictions (at this stage the Bahamas, Hong Kong and possibly Switzerland) may seek to adopt a more 'bilateral' approach implementing CRS. If this approach becomes more widespread, then the practical implementation of CRS could be significantly delayed by jurisdictions who negotiate treaties on a one-by-one basis with 90 other countries.

While CRS is often compared to FATCA, there are some material differences that emerge from closer scrutiny. Whatever the shortcomings of FATCA, the ability to issue a global intermediary identification number and to sponsor entities on a cross-border basis somewhat lessens the bureaucratic excesses of its impact. What is distinctly unclear about CRS at this point is whether equivalent mechanics will emerge. As CRS is currently written as a series of bilateral treaties between jurisdictions with no domestic law 'anchor' (as is the case with FATCA) concerns are being expressed about the potential duplication for complex cross-border structures of reporting. In this context, the July 2014 introduction to CRS notes that the rules as to where a financial institution (FI) will be deemed resident differs between jurisdictions – in some cases this will be based on the place of incorporation whilst in others it may be based on the place of effective management.

There are concerns as to how non-financial entities (NFEs) will be dealt with under CRS. There is anecdotal evidence emerging already in the context of FATCA that financial institutions, driven by concerns about fines from regulators for NFEs and the related ownership structure are subjecting bank account applications for NFEs to additional enquiries that generate very significant costs and delay.

It is noteworthy that there has been a significant crossover from the anti-money laundering (AML) or terrorist financing regime coordinated by the Financial Action Task Force (FATF). This is expressly provided in the CRS model treaty that imports into CRS the FATF concept of beneficial ownership. In the CRS world, this is known as 'controlling persons'. By expressly linking the definition of controlling persons to that of beneficial ownership employed for FATF purposes, there is the prospect of the beneficial ownership definition evolving over time in accordance with principles adopted in that domain. It is noteworthy that, as well as looking to ultimate legal and beneficial ownership of an entity, these definitions also look to the capacity to exert influence and control in the absence of any formal legal entitlement. Thus the expanded definition is as follows.

Beneficial owner refers to the natural person who ultimately owns or controls a customer or the natural person on whose behalf a transaction is being conducted. It also includes those persons who exercise ultimate effective control over a legal person or arrangement.[1]

It is completely appreciated that, in a law enforcement context, criminals and terrorists do not typically advertise their involvement in ownership structures where they are liable to be detected by the appropriate agencies. Transporting this definition wholesale, however, into the world of tax information exchange where domestic tax authorities may draw unfair and adverse implications from an attribution of being a 'controlling person' is more questionable. It is not a complete response to this concern to say, in the final analysis, if someone has no ability to enjoy the benefit of assets held within a particular structure that they can demonstrate this – the potential costs and bureaucracy of an unwarranted tax audit that may arise from such a misunderstanding will be more difficult to quantify.

Another area of concern is the capacity for banks who have, in the past, misclassified or misunderstood information about ownership structures. If this information is simply

1 http://www.fatf-gafi.org/pages/glossary/a-c/ – The Recommendations were adopted by FATF on 16 February 2012. (emphasis added).

'copied over' from AML records for CRS purposes then there is scope for false and misleading information to be exchanged in circumstances where the 'beneficial owners' may be completely unaware of such mistakes or misclassifications.

What follows from this is an increased importance for professional advisers to actively engage with clients to discuss the implications of these changes. Taken together, the combined impact of these changes is likely to be seen in years to come as a 'paradigm shift' in international wealth structuring. It is therefore critically important that the advisory community equips itself fully to be able to assist in a pro-active manner.

ii Public registers of beneficial ownership

On 20 May 2015, the EU published the final version of its fourth anti-money laundering directive (4AMLD). This commits the EU Member States to providing a public register of beneficial ownership within the next two years. What is noteworthy about the terms of the regulation is the fundamental distinction that has been drawn between ownership information about 'legal persons' (including companies and foundations) on the one hand, and 'legal arrangements' (including trusts) on the other. There is an obligation for information on legal persons to be placed in the public domain while information relating to trusts and equivalent arrangements will be restricted so that it is only made available to competent authorities.

The acceptance in the drafting of these regulations that there is a legitimate distinction to be drawn between commercial entities that interact with third parties, primarily in the context of business arrangements, and private asset ownership structures that are primarily designed to hold wealth for families is an encouraging one.

It should not, however, be assumed that the emphasis on privacy that underpinned this particular distinction will necessarily be a permanent one. There is a very strong constituency within the EU that still argues that a public register of trusts should be introduced at some stage in the future.

Turning to the UK, 2016 will see the introduction of a public register of beneficial ownership for companies in the UK. This legislation, to a large extent, anticipates the impact of 4AMLD although it is not completely symmetrical. The centrepiece of UK domestic legislation is the public identification of persons with influence over UK companies, known as 'persons exercising significant control' (PSCs). There are significant penalties for non-compliance. In particular, in circumstances where a PSC does not respond to the request for information from a company, not only can that refusal generate potentially criminal sanctions, it can also result in any economic benefits deriving from the shares as well as the ability to vote being suspended.

While it is appreciated that there are reasons why sanctions need to be applied to encourage people to comply, the harsh economic penalties may be seen as totally disproportionate to non-compliance. It is interesting to note that the PSC concept analogous to that of the 'controlling persons' in the context of CRS. As with CRS, the most complex area here is the extent to which those being seen to exert 'influence' without formal legal entitlement may be classified as PSCs.

One further interesting issue that needs to be considered as matters move forward is whether the impact of the EU public register for corporate entities will result in a 'back door' trust register in many cases. One of the categories for disclosure of PSCs in the UK register is 'ownership or influence via a trust'. In circumstances therefore where a trust holds a material interest in a company, this can result in not only the trustees and protectors of the trust, but also family members with important powers (such as hire and fire powers) being classified as PSCs and having their information placed on a public register. While this register will not give direct information about beneficiaries as such, in many cases it will provide a significant degree of transparency about family involvement. It seems likely that, over time, the EU will also look to 'export' a requirement for beneficial ownership information on public registered companies to be incorporated in many of the international finance centres. While IFCs have indicated that they are sceptical about the adoption of such registers in circumstances where there is not a common standard applied to all jurisdictions, it remains to be seen how long this stance can be maintained once 4AMLD is in full force.

iii Position of the United States

The United States stands out as having secured a position for itself in the context of cross-border disclosure that many feel is hypocritical. Specifically there is a carve out from CRS on the basis that the US has implemented FATCA. The constitutional position in the US where measures of this nature would tend to be introduced at a state rather than federal level also complicates the picture. In the absence of any comprehensive regime to regulate trustee and corporate service providers, the US appears to have achieved a competitive advantage in administering 'offshore' structures because it has exempted itself, in practical terms, from reciprocation on automatic information exchange. This is already leading to many considering the US as an alternative base from which to administer family structures in a more 'private' setting than is possible in IFCs once CRS take effect.

iv Global legal entity identifier system (GLEIs)[2]

A development flowing from the 2008 financial crisis is the introduction of GLEIs. In December 2014 a regulatory oversight committee relating to GLEIs introduced a task force to develop a proposal for collecting GLEIs information on the direct and ultimate parents of legal entities. The policy is to ensure financial intermediaries can track who they are dealing with as counterparties in investment transactions. The underlying policy that drives the creation of the GLEIs is to create transparency in financial markets. In the current phase 1 of the project, the information required to be collected is limited to 'business card information' about the entities concerned and will therefore be limited to a name, address and contact number. However, the 'level 2' data that is likely to be required will extend the reference data to relationships between entities. This could result in beneficial ownership information being required in due course. This proposal is likely to see some development in the course of the next six months but is yet another illustration of overlapping regimes for collecting beneficial ownership information that are likely to have a substantial effect on the operation of family wealth holding structures in the years ahead.

2 http://www.leiroc.org/.

v Conclusion

The challenges of keeping abreast of changes in the regulatory and transparency arena are significant. These issues look set to be a significant driver in wealth strategy in the next three to five years. Navigating these issues will increasingly become a required skill set for professional advisers.

John Riches
RMW Law LLP
London
September 2015

Chapter 26

LIECHTENSTEIN

Markus Summer and Hasan Inetas[1]

I INTRODUCTION

In recent years, Liechtenstein has made numerous efforts to further improve the legal framework for wealth structuring and succession planning and to adjust to international developments.

On 1 January 2011 the new Liechtenstein Tax Act entered into force. With the new act, Liechtenstein introduced an attractive tax system, which complies with European law. In fact, the EFTA Surveillance Authority (ESA) has confirmed that the rules for private asset structures and the new IP box regime are compliant with the provisions of the European Economic Area agreement.

The specific features of the new tax system have turned Liechtenstein into an attractive jurisdiction for many purposes. With a corporate tax rate of 12.5 per cent and the reduction of the effective tax rate even further through the notional interest deduction, Liechtenstein has joined the league of most tax-efficient jurisdictions by European standards. Furthermore, the taxation of legal entities as private asset structures (PAS) offers an attractive way for individuals to structure their wealth.

Liechtenstein is also an interesting jurisdiction for individuals to take residence. The top income tax rate for a resident of the capital, Vaduz, is 20 per cent. Income from assets that are subject to wealth tax is not taxed directly. Instead, tax is currently levied on a notional income of 4 per cent of the tax value of these assets. Moreover, a favourable lump-sum taxation regime is available for foreigners, and there is no inheritance or gift tax. Residence permits are, however, currently issued on a restrictive basis mostly to ultra-high net worth individuals, but a relaxation of this practice is under discussion.

There were also important changes beyond tax law. On 1 April 2009 a new foundation law was introduced. One focus of the new law was on foundation governance,

1 Markus Summer and Hasan Inetas are partners at Marxer & Partner Rechtsanwälte.

implementing the checks and balances to prevent abuse and balancing the interests of the founder, the beneficiaries and the foundation itself. The favourable opportunities for asset protection have fully been preserved under the new law.

With the introduction of the new foundation law, the rules regarding the enforcement of forced heirship rights were amended and leave considerably more room for estate planning now.

II TAX

i Taxation of trusts

Trusts managed from Liechtenstein are subject to an annual tax of 1,200 Swiss francs. No tax filings are necessary.[2]

ii Regular taxation of legal entities

Corporate tax rate and tax base

Legal entities that are taxable in Liechtenstein are subject to the corporate tax on their net income at a rate of 12.5 per cent under regular taxation rules.[3]

The net income is reduced by income from foreign permanent establishments, rental and lease income of foreign real estate, gains from selling real estate, distributions from foundations or trusts, dividends and capital gains on the sale of shares and unrealised capital gains on shareholding in companies both in Liechtenstein and abroad.[4] Dividend income and capital gains from the sale of shares are tax exempt irrespective of the percentage of the shareholding. As a result, not only income and capital gains from interests in partly or wholly owned subsidiaries, but also income and capital gains from shares held as part of a securities portfolio, are tax-free.

Notional interest deduction

The new tax law introduced a notional interest deduction, which is currently 4 per cent of the modified equity as a deemed expense to ensure equal treatment of debt and equity.

The modified equity is calculated by deducting the following items from the net equity:

a own equity;
b shares in legal entities;
c assets not required for the company's purposes; and
d a deduction of 6 per cent of all assets, under exclusion of the items (a) to (c).[5]

The reason for the first three deductions is that they produce tax-exempt income and capital gains and, therefore, cannot be used to create a notional interest deduction. The

2 Article 65 of the Tax Act.
3 Article 61 of the Tax Act.
4 Article 48 of the Tax Act.
5 Article 54 of the Tax Act; Article 32 of the Tax Ordinance.

term 'all assets' refers to the balance sheet total.[6] In case of 100 per cent equity funding, the effective notional interest deduction is reduced from 4 per cent to 3.76 per cent because of the deduction of 6 per cent of the total of all assets (100 per cent – 6 per cent = 94; 94 x 4 per cent = 3.76 per cent).

The table below shows the effects of the notional interest deduction, assuming 100 per cent equity financing for various return-on-equity (ROE) scenarios and the resulting earnings before interest and taxation (EBIT). It is evident that the notional interest deduction can result in a substantial reduction of the effective tax rate. Obviously, the effect is the higher, the closer the ROE is to the 3.76 per cent effective notional interest deduction. However, even in the case of a highly profitable company yielding a 20 per cent ROE, the notional interest deduction results in a decrease of the effective tax rate from 12.5 per cent to 10.15 per cent.

ROE	3,76%	5%	10%	15%	20%
Equity (prior to deduction of 6 % of all assets)	1,000,000	1,000,000	1,000,000	1,000,000	1,000,000
Equity (after deduction of 6 % of all assets)	940,000	940,000	940,000	940,000	940,000
EBIT	37,600	50,000	100,000	150,000	200,000
Notional interest deduction (3.76 %)	37.600	37.600	37.600	37.600	37.600
Profit before taxes	0	12,400	62,400	112,400	162,400
12.5% corporate tax	0	1,550	7,800	14,050	20,300
Effective tax rate	0	3.10%	7.80%	9.37%	10.15%

Since the revision of the Tax Act in December 2014, in case of non-operating receivables from shareholders, founders, beneficiaries or related persons carrying an interest rate of less than 4 per cent, the interest rate differential must be considered in the calculation of the notional interest deduction. This additional requirement applies to non-operating receivables from related persons exclusively.[7]

IP box

With the new tax law Liechtenstein introduced a notional expense, which may be deducted from any income from intellectual property (IP) rights. The notional expense amounts to 80 per cent of the respective net income. However, the notional expense deduction is only available if the IP rights were created or acquired by the Liechtenstein legal entity in the period starting on 1 January 2011.[8]

It is worth noting that this IP box regime was approved by the EFTA Surveillance Agency (ESA) in its decision of 1 June 2011. In particular, ESA ruled that the notional

6 BuA No. 48/2014, 33.

7 Article 54 para 3 of the Tax Act.

8 Article 55 of the Tax Act; Article 33 of the Tax Ordinance.

expense deduction from income on IP rights was no selective measure because it was available to all companies and it did not, therefore, violate European competition law.

iii Taxation as a private asset structure

As an alternative to regular company taxation and inspired by Luxembourg's private asset management company, the Liechtenstein legislature devised a new tax privilege for legal entities that are only engaged in the management of their own assets and do not perform any commercial activity. Such PAS are only subject to the minimum corporate income tax of 1,200 Swiss francs annually without having to file any tax returns. Taxation as a PAS was approved by the EFTA Surveillance Agency as being compliant with the European competition law on 15 February 2011.

The main feature with regard to the tax privilege is the lack of commercial activity. Article 64, Paragraph 1(a) of the Tax Act exemplifies, by reference to the Asset Management Act, what is not considered a commercial activity. This includes the acquisition, possession, management and sale of transferable securities such as bonds, stocks, money market instruments, shares in investment undertakings and derivatives.

Likewise, buying, holding and selling of precious metals, artwork and similar assets is generally possible. In its decision approving the provisions on the PAS, however, the EFTA Surveillance Authority indicates that transactions in securities when effected 'as part of a commercial share dealing activity' constitute economic activity. Regular and active trading of securities (and other assets) is therefore not considered permissible for a PAS unless decisions are delegated to an independent asset manager. The purchase and sale of securities as part of a long-term investment strategy is, however, allowed in any event.

As the mere exercise of ownership and the granting of benefits by the entity to its shareholders or beneficiaries are not considered commercial activities, the holding of a property does not constitute a commercial activity as long as the property is used by the PAS or its shareholders and beneficiaries and no rent is charged.

When a PAS holds shares in a subsidiary that exercises a commercial activity, neither the PAS nor its shareholders or beneficiaries are allowed to exercise any control over the management of the subsidiary through direct or indirect influence, otherwise, the PAS itself will be regarded as commercially active and lose its status as a PAS.

When comparing regular taxation with PAS taxation, it turns out that in some cases there may be only a small difference in the tax burden because, even in cases of regular taxation, the income from the management of the legal entity's own assets tends to be tax-exempt anyway.

The following table shows where PAS taxation has advantages over regular taxation:

Investment	Revenues	Regular taxation (12.5% corporate tax)	Possible advantage of PAS
Shares	Dividends	Tax-free	–
	Realised capital gains	Tax-free	–

Investment	Revenues	Regular taxation (12.5% corporate tax)	Possible advantage of PAS
Bonds	Interest	Taxable if net profit exceeds the 4% notional interest deduction	Yes
	Realised capital gains	Taxable if net profit exceeds the 4% notional interest deduction	Yes
Commodities (physical, e.g., gold in a safe)	Realised capital gains	Taxable if net profit exceeds the 4% notional interest deduction	Yes
Real estate (non-Liechtenstein)	Rent	Tax-free	–
	Realised capital gains	Tax-free	–
Derivatives	All income	Taxable if net profit exceeds the 4% notional interest deduction	Yes
Investment funds	Treated as transparent; investments of the fund are treated as being held directly by the legal entity		Yes (except pure stock or property funds)

The table shows that a Liechtenstein legal entity that is taxed as a PAS does not have any tax advantage over a regularly taxed company if it only holds shares or real estate outside Liechtenstein. The reason is that even under regular taxation any income or capital gains produced by these asset classes will be tax-free anyway. In the case of the other asset classes, whether taxation as a private asset structure is preferable over regular taxation depends on whether the asset classes yield more than the 4 per cent notional interest deduction applying in case of regular taxation.

iv Taxation of individuals

Income and wealth tax

Personal tax liability

The Liechtenstein tax regime for the taxation of individuals combines income and wealth tax. The wealth tax is based on the notional income of currently 4 per cent on the taxpayer's assets, which is then subject to income tax in lieu of the real income from such assets (which is tax-free). There is an eight-stage scale for determining the income tax.

Individuals having their residence or habitual abode in Liechtenstein are taxable on their entire wealth and income. While residence means the place where a person lives with the intent of staying permanently, habitual abode refers to the place or area in which a person dwells not only temporarily. The Liechtenstein Tax Act considers a temporary continuous abode of more than six months as habitual abode, whereby short-term interruptions are not taken into account.

Limited tax liability applies to individuals whose residence and habitual abode is not in Liechtenstein. Such individuals are taxable in respect of their Liechtenstein wealth and income.

Subject of income tax

All income in money and money's worth is subject to income tax such as:

a any income from self-employment;

b any income from employment relationship under private or public law; and *c* contributions received by the taxpayer as beneficiary, unless this is subject to wealth tax.[9]

Tax-exempt income includes income from wealth for which the taxpayer pays wealth tax, recurring benefits to the taxpayer, which are considered as taxable wealth, and income from permanent establishments abroad.

Subject of wealth tax
The entire moveable and immoveable wealth of the taxpayer is subject to wealth tax. Individuals with limited tax liability are only taxable in respect of their domestic wealth, that is real estate and permanent establishments in Liechtenstein.[10]

The Tax Act provides for certain exemptions from wealth tax. In particular, real estate and permanent establishments abroad are exempted from wealth tax. Taxpayers are also entitled to make certain deductions such as reducing assets by debts and other liabilities provided that the taxpayer is liable as principal debtor.

Trusts or foundations with Liechtenstein-resident settlors or beneficiaries
With regard to trusts, foundations and similar vehicles with Liechtenstein residents as settlors or beneficiaries the following rules apply.

The wealth of revocable foundations, trusts and establishments with a foundation-like structure is attributed to the founder and wealth tax is paid by the founder. However, it is possible to opt for taxation at the level of the trust, foundation or similar structure instead.

In the case of irrevocable trusts, foundations and establishments with a foundation-like structure, a distinction is made between entities with determinable beneficiaries that benefit from a certain quota and entities where this is not the case:

In the case of trusts, foundations or establishments with a foundation-like structure with determinable beneficiaries entitled to a certain quota, wealth tax is levied at the level of the beneficiaries. However, the beneficiaries may apply for taxation at the level of these structures but require the consent of the body responsible for distributions. Such a structure will not become the taxpayer itself but rather must meet the wealth or personal tax liability in lieu of the beneficiaries.[11]

If such structures have no determinable beneficiaries entitled to a certain quota, no wealth tax is payable because the wealth cannot be attributed to any natural persons; however, if such structures are established by Liechtenstein tax residents, the set-up itself triggers a special tax as follows.

Such transfers to a discretionary structure are subject to taxation to the extent that (1) this wealth is no longer subject to wealth tax and (2) benefits or shares do not become

9 Article 14(2)(k) of the Tax Act; see below.

10 Article 6(4) of the Tax Act.

11 Draft Bill (BuA) No. 48/2010, 75.

liable to wealth tax.[12] For example, the first prerequisite is not met if real estate abroad is transferred as this is exempted from wealth tax.

The taxation of transfers to a fiduciary structure also applies in the event of changing circumstances after the establishment of a fiduciary structure that led to a shortfall of the wealth tax liability. As a result, the conversion of a determinable benefit into a discretionary benefit also leads to taxation.[13]

The transferor shall pay a tax in the amount of 3.5 per cent of the wealth tax value of the contribution plus the applicable municipal surcharge. If a tax resident of Vaduz (where the municipal surcharge is 150 per cent) establishes a foundation or trust where no quota can be attributed to the beneficiaries and therefore the assets are no longer subject to wealth tax, the set up is therefore taxed at a rate of 8.75 per cent. The assets will then no longer be subject to wealth tax. However, any distributions from such a foundation or trust to a beneficiary who is a Liechtenstein tax resident will be subject to income tax.

Tax calculation

The taxation of individuals is based on a combination of wealth and income tax: the wealth tax is integrated into the income tax by transforming a part of the wealth into an additional category of income. This transformation is based on a notional income.[14] To determine the taxable base, wealth and income are calculated separately and then a notional income from the wealth is assumed. The interest rate for determining the notional income from wealth is determined annually in the Finance Act, being 4 per cent for 2014. This notional income from taxable wealth is then considered income (instead of the real income) and added to the total taxable income.

After basic exemptions up to 15,000 Swiss francs (and up to 22,500 Swiss francs in case of single parents within the meaning of the Family Allowance Act and up to 30,000 Swiss francs for jointly assessed married couples), taxable income (including the notional income resulting from wealth tax) is then taxed at different rates for eight income brackets, with the highest rate for the national income tax being 8 per cent. Additionally, the Liechtenstein communities may levy a municipal surcharge between 150 per cent and 250 per cent on the national tax. Currently, all Liechtenstein communities levy a surcharge between 150 per cent and 200 per cent on the national income tax, with the rate in Vaduz being 150 per cent. The top tax rate for a resident of Vaduz therefore amounts to 20 per cent and applies in the case of a non-married taxpayer without children if his or her annual income exceeds 200,000 Swiss francs.

No inheritance or gift tax

Inheritance tax and gift tax have been abolished in the course of the revision of the Liechtenstein Tax Act. Under the new Liechtenstein tax regime just a disclosure of donations to the fiscal authority is required. Liechtenstein-resident donors and recipients

12 See Article 13(1) of the Tax Act.

13 BuA No. 48/2010, 83.

14 BuA No. 48/2010, 25.

of gifts must therefore include gifts in their tax returns. The purpose of this notification is to enable comprehensibility of declarations of wealth set out in the tax returns of these individuals (i.e., the information is only declaratory).[15] The disclosure requirement applies only to gifts, inheritances and bequests exceeding 10,000 Swiss francs.

Lump-sum taxation

Individuals can apply to the fiscal authority for lump-sum taxation (i.e., apply for taxation on expenditure instead of income and wealth tax). The latter does not apply to real estate in Liechtenstein, which remains subject to wealth tax.

Liechtenstein citizens are not entitled to apply for such lump-sum taxation. Another prerequisite for the application is that the individual takes residence or habitual abode in Liechtenstein for the first time or after an absence of 10 years or more from Liechtenstein. The individual must not be entitled to work in Liechtenstein but shall live on income from his or her wealth or other receipts from abroad.

The discretionary decision regarding the lump-sum taxation is up to the Liechtenstein fiscal authority. The lump-sum taxation considers the total expenditure of the taxpayer, and the tax based on the expenditure amounts to 25 per cent of the expenditure.[16] The tax may be determined for several years depending on the regularity of the amount of the expenditure.

Individuals intending to apply for lump-sum taxation must also take into account the applicable provisions in conjunction with the permission to reside in Liechtenstein. Currently, residence permits are quite restricted, although there is a lottery open to citizens of the EEA. Furthermore, several times in the political process there have been discussions to issue more resident permits to wealthy or highly qualified foreigners but no final conclusion has been reached.

III SUCCESSION

Generally, under the Liechtenstein Private International Law Act all aspects of legal succession are governed by the law of citizenship of the deceased, which will be applied by the Liechtenstein courts. Foreign testators and Liechtenstein nationals living abroad may, however, choose the law of the country of their last residence instead, which offers some planning opportunities.

The enforcement of forced heirship rules against Liechtenstein trusts, foundations and other fiduciary structures has been the subject of several court cases and has consequently led to actions by the Liechtenstein legislator.

Forced heirship rules allocate a part of the assets to the disposition of the testator and another part to certain family members. Generally, contributions of assets to a foundation may be disputed by the heirs in the same way as a donation.[17] If Liechtenstein

15 BuA No. 48/2010, 187.

16 See Article 33 of the Tax Act.

17 Article 552 Section 38(1) of the Persons and Companies Act (PGR). This provision shall refer to Sections 785 and 951 of the Civil Code (ABGB) entitling the heirs to challenge. See BuA

inheritance law applies, upon request of a child, the spouse or the registered partner entitled to a compulsory portion, donations by the testator must be taken into consideration in the computation of the estate. The subject of the donation must be added to the estate.[18] If the estate is insufficient to cover the forced heirship claims because of the transfer of assets by the deceased to a foundation, the subject of a potential challenge is not the foundation itself but the transfer of assets to the foundation.[19]

Donations to persons not entitled to a compulsory portion that have been made more than two years prior to the donator's death are disregarded.[20] This fairly short period[21] also applies to contributions to a foundation, with the caveat that its commencement depends on the structure of the foundation. In particular, the period does not start before the founder's death if the assets have not really been economically transferred to the foundation prior to his or her death. Assets are not deemed entirely separated from the founder if he or she has reserved rights to revoke the foundation and to amend the foundation documents;[22] however, it has been argued that even where the foundation documents provide a revocation right, the statute of limitations starts with the setting up of the foundation if the foundation documents refer to a third party as ultimate beneficiary in the case of a revocation. The founder is also entitled to waive such rights: upon waiver of such rights set out in the foundation documents, the two-year period shall also start.[23] The Liechtenstein Supreme Court recently stated that a revocation right is not the only indication that the assets have not been separated from the founder, and therefore the two-year period has not started to run. Rather, any circumstances indicating the control of the foundation by the founder must be taken into account.[24]

If the founder is not a citizen of Liechtenstein and not resident in Liechtenstein, his or her entire estate is governed by law of the country whose citizen he or she was at the time of his or her death (unless the founder chose the law of the country of his or her last residence instead in a will). That law will also apply to the questions of whether there is a forced share for certain family members and whether such compulsory heirs can challenge transfers to a trust or foundation under certain circumstances. As a result, if a foreign resident has established a Liechtenstein trust or foundation, any challenge of the transfer of assets will generally be based on the law governing his or her estate, not on Liechtenstein compulsory heirship law. Accordingly, the Liechtenstein Supreme

No. 13/2008, 122.

18 See Section 785(1) of the ABGB.

19 See BuA No. 13/2008, 122.

20 Pursuant to Section 785(3) of the ABGB, donations will also be disregarded that the testator made out of current income for charitable purposes in accordance with moral duty or consideration of decorum without diminishing the substance of property.

21 See Jakob, *Die Liechtensteinische Stiftung*, 2009, margin No. 685 with references to Germany and Switzerland.

22 See Jakob, *Die Liechtensteinische Stiftung*, 2009, margin No. 686.

23 See Jakob, *Die Liechtensteinische Stiftung*, 2009, margin No. 687.

24 Supreme Court, 7 December 2012, 03 CG.2011.93.

Court has allowed claims of foreign heirs in several cases based on the applicable foreign heirship law, irrespective of the fact that the Liechtenstein two-year statute of limitations had expired.

However, the newly introduced Article 29 Paragraph 5 of the Liechtenstein Private International Law Act installed another barrier to any challenges,[25] saying that the heirs are entitled to claims for a compulsory portion only if they are entitled in the same way under the laws governing the acquisition of the assets by the foundation or trust. Therefore, disputes by persons entitled to a compulsory portion of contributions to a Liechtenstein foundation made by its foreign founder must be possible both under the applicable inheritance law and under Liechtenstein law if Liechtenstein law had been chosen as the law governing the transfer or if Liechtenstein law is applicable because the funds were transferred to the foundation as part of its stated capital. As a result, if Liechtenstein law applies to the contributions to the foundation, the Liechtenstein rules regarding the statute of limitation will be applicable.[26]

In practice, this means that if a foreigner establishes an irrevocable discretionary trust or a foundation in Liechtenstein (without reserving any revocation rights or equivalent powers) and chooses Liechtenstein law as the law governing the transfer of his or her assets to the foundation or trust, any claims of any compulsory heirs under the applicable inheritance law will become time-barred after the expiry of two years from the transfer of the assets to the trust or foundation.

Alternatively, a potential claim of compulsory portion will generally also be denied, if a founder makes an *inter vivos* donation to a Liechtenstein foundation and agrees that such contributions will be governed by a jurisdiction not having forced heirship rules at all.[27] However, this concept has not yet been contested in court, and it seems possible that under certain circumstances a court could rule that a foundation cannot rely in good faith on such a choice of law for the transfer of assets to the foundation, if it was designed only to frustrate the rights of compulsory heirs under the applicable inheritance law.

IV WEALTH STRUCTURING AND REGULATION

The main Liechtenstein vehicles used for wealth structuring and estate planning are trusts and foundations. The following have recently been the subject of discussions or legislative efforts:

- *a* the checks and balances that can be incorporated in the structure of a Liechtenstein foundation to prevent any abuse (often referred to as foundation governance);
- *b* asset protection and the protection of creditors in connection with Liechtenstein trusts and foundations; and
- *c* the use of a Liechtenstein foundation as a private trust company instead of a trustee company owned by a financial service provider.

25 See BuA No. 13/2008, 140.

26 See BuA No. 13/2008, 140 et seq.

27 See Jakob, *Die Liechtensteinische Stiftung*, 2009, margin No. 692.

i Foundation governance

Foundation types

The Liechtenstein foundation is a legally and economically independent special-purpose fund, which is formed as a legal entity through a unilateral declaration of will by the founder.[28] Assets transferred to a foundation become independent from the personal assets of its founder. The latest reform of the Liechtenstein Foundation Law has led to remarkable amendments. In this chapter we are focusing on the area of foundation governance as one area notably affected by this reform.[29]

For foundation governance purposes, it is necessary to distinguish between common-benefit and private-benefit foundations. For instance, a common-benefit foundation requires a registration in the Commercial Register to acquire legal capacity. In contrast, private-benefit foundations acquire legal capacity by the declaration of establishment. While a common-benefit foundation serves entirely or predominantly common-benefit purposes, a private-benefit foundation serves entirely or predominantly private or personal purposes. If this is unclear, the foundation is treated as a common-benefit foundation.

External foundation governance

Common-benefit foundations are subject to supervision by the foundation supervisory authority (i.e., the Office of Justice).[30] This authority must *ex officio* ensure that the foundation assets are managed in accordance with the purpose of the foundation. The law grants certain information rights to the authority; for example, inspection of the foundation's books and right to information in relation to the foundation. Furthermore, the authority may apply to court to control or remove foundation bodies, to carry out special audits or to cancel resolutions of the foundation council. Such measures are available for all foundation participants,[31] including the founder, the beneficiaries, the foundation bodies and the members of these bodies.

As a rule, private-benefit foundations are not subject to supervision by the foundation supervisory authority. This can be changed if the articles of the foundation (voluntarily) provide for supervision.

Internal foundation governance

All foundations that are subject to supervision by the foundation supervisory authority require an auditor. The auditor that is appointed by the court must be independent from the foundation. As foundation body, the auditor is obliged to annually review the management and the use of the foundation's assets to ascertain that they are in conformity

28 See Article 552, Section 1 of the PGR.

29 For further details see Marxer & Partner, *Liechtensteinisches Wirtschaftsrecht,* 2009, 104 et seq; Jakob, *Die Liechtensteinische Stiftung*, 2009, 195 et seq.

30 See Article 552, Section 29 of the PGR.

31 See Article 552, Section 3 of the PGR.

with the purpose of the foundation, and must report to the foundation council, as well as to the foundation supervisory authority.[32]

External foundation governance of private-benefit foundations is constrained because they are not subject to supervision by the foundation supervisory authority. For this reason mechanisms of internal foundation governance, particularly the rights granted to the beneficiaries, are of paramount importance. Beneficiaries of the foundation are entitled to inspect the foundation documents as far as their rights are concerned. Beneficiaries are also entitled to information, to reporting and accounts. Again, such rights are only available if the beneficiary's rights are affected. The law restricts the rights of the beneficiaries, for instance, in the event of abuse of such rights.[33] Moreover, the rights may not be exercised in a manner conflicting with the interests of the foundation or other beneficiaries. In this respect, carefully balancing different interests is necessary. The above-mentioned rights are also restricted insofar as they can be denied for important reasons to protect the beneficiary.[34]

To some extent, the interests of the founder can also be considered within the internal foundation governance: if the right of revocation has been reserved by the founder and if the founder is the ultimate beneficiary, the beneficiaries are not entitled to the information rights above.[35]

Adjustments of the internal foundation governance can also result from the founder's right to provide for other supervisory bodies. This will have the consequence that beneficiaries may only demand disclosure of information about the purpose and organisation of the foundation and with regard to their own rights in relation to the foundation, and may verify the accuracy of this information by inspecting the foundation deed, the supplementary foundation deed and the regulations.[36] Obviously, this leads to restrictions for the beneficiary to get information about the foundation. In practice, the beneficiary will not be able to get the names of other beneficiaries, for example. The beneficiary will therefore also not know what distributions other beneficiaries received.[37]

In summary, it can be stated that the Liechtenstein legislator has implemented various checks and balances. Because of a lack of mandatory supervision of private-benefit foundations by the foundation supervisory authority, information rights particularly granted to the beneficiaries are necessary to guarantee a control mechanism. On the other hand, the interests of the founder are also safeguarded by allowing several ways to exclude or limit the information rights of beneficiaries in certain cases.

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32 Upon application, the foundation supervisory authority exempts a common-benefit foundation from the obligation to have an auditor in case of low asset value.

33 See Article 552, Section 9(2) of the PGR.

34 See BuA No. 13/2008, 65; Jakob, *Die Liechtensteinische Stiftung*, 2009, margin No. 490; Article 552, Section 9(2) of the PGR.

35 Article 552, Section 10(1) of the PGR.

36 The founder can also be a controlling body pursuant to Article 552, Section 11(2) No. 3 of the PGR.

37 See BuA No. 13/2008, 68.

ii Asset protection and protection of creditors

Asset protection and protection of creditors obviously reflect opposing interests. Needless to say, the settlor of a Liechtenstein trust or foundation seeks to protect the trust or foundation assets against third parties, but the interests of the founder or settlor are generally in conflict with the demands of third parties.

Creditors of the founder or settlor

Creditors may consider different options to enforce their claims towards the founder of a foundation or trust. First, creditors may dispute contributions of assets to the foundation in the same way as they would a gift.[38] As a rule, every creditor having an enforceable claim is entitled to do so if full compensation could not be achieved by enforcement of the claim against the founder or settlor, or this could be assumed at the time of approval of the enforcement.

Under Article 75 of the Legal Remedy Code, the challenge of a transfer of assets to a foundation or trust by a creditor must be possible under both the laws of the country of residence of the debtor and the law governing the transfer. As a result, if the transfer of assets to a Liechtenstein foundation or trust is made subject to Liechtenstein law, the challenge must be permissible not only under the laws of the country of residence of a foreign settlor or founder, but also under Liechtenstein law.

Under Liechtenstein law, the dispute of the transfer of assets must refer to actions made within a period of one year before approval of the enforcement.[39] The one-year period will not be required if the creditor is able to prove that the debtor's (in the case of foundations the founder's) actions are based on intent to defraud creditors, in which case a five-year limitation period from the transfer of the assets applies.[40]

Under exceptional circumstances creditors may refer to the general principle of the ban on abuse of legal right enshrined in Liechtenstein company law.[41]

Furthermore, in the case of rights of revocation and amendment of the purpose reserved by the founder or settlor, creditors may attempt to attach such rights.[42]

Creditors of the beneficiaries

Another instrument for asset protection is stipulated in Article 552, Section 36 Paragraph 1 of the PGR, which contains an enforcement privilege for family foundations providing that creditors of beneficiaries will not be permitted to deprive the beneficiaries of their

38 Article 552, Section 38(1) of the PGR. Reference is particularly made to Article 65 of the Liechtenstein Legal Remedy Code (RSO); see BuA No. 13/2008, 121.

39 The burden of proof will be carried by the creditor (see Article 65(2) of the RSO).

40 See Article 74(1) of the RSO.

41 See Article 2 of the PGR; in a case of misuse of a foundation by the founder. Also see Constitutional Court, 16 September 2002, LES 2005, 128 et seq; Marxer & Partner, Liechtensteinisches Wirtschaftsrecht, 2009, 107; Jakob, *Die Liechtensteinische Stiftung*, 2009, margin No. 708.

42 See Jakob, *Die Liechtensteinische Stiftung*, 2009, margin No. 710, providing conclusive arguments against such potential enforceability.

entitlement to a beneficial interest acquired without valuable consideration by way of enforcement or bankruptcy proceedings. Such an enforcement privilege must be included in the foundation articles.[43] In the case of mixed family foundations, such a privilege can only be implemented to the extent it serves the purpose of the foundation. It is, however, questionable whether a beneficiary who simultaneously is also the founder will be entitled to such a privilege because in the case of the founder, the beneficial interest was arguably not acquired 'without valuable consideration' since the founder contributed the assets.[44]

In practice, however, the meaning of the aforementioned enforcement restriction is limited. The reason is that it applies only if the beneficiaries have a sufficiently specified claim at all that could potentially be attached by the beneficiaries' creditors. In the event that discretionary beneficiaries of a foundation or trust are merely members of a class of several beneficiaries without any rights to a certain share in the trust or foundation fund, there are no enforceable claims and therefore the beneficiaries' creditors cannot attach their rights, a fact that has been confirmed by the Liechtenstein Supreme Court.[45]

V A LIECHTENSTEIN FOUNDATION AS A PRIVATE TRUST COMPANY

Many families use trusts as an estate planning vehicle and for wealth preservation. Increasingly, instead of using a trustee company owned by a financial service provider, a private trust company (PTC) is appointed as a trustee. The use of a Liechtenstein foundation as such a PTC offers several key advantages.

i A common set-up of a private trust company structure

While using a PTC has several benefits, it begs the question who should act as the shareholder of the privately held trustee company. In most cases, the shareholder cannot be the settlor of the trust because then the shares of the PTC would be part of his or her estate, which would frustrate the estate planning purpose of the trusts. A common set-up to solve this problem has been to establish a separate purpose trust whose only purpose it is to hold the shares of the PTC.

The main drawback of this approach is that again a trustee is needed for the purpose trust holding the shares of the PTC. In most cases, a trustee company owned by a financial service company is used for this purpose. This means that the reasons for not using such a company as a trustee of the family trust are still present. However, they are moved to a remoter level and are mitigated because the only assets held by the trustee company of the purpose trust are the shares in the PTC.

43 See Article 552 Section 16(2) No. 6 of the PGR.

44 See Jakob, *Die Liechtensteinische Stiftung*, 2009, margin No. 713.

45 Supreme Court, 5 February 2009, 2R EX.2008.5850-17.

ii Using a Liechtenstein foundation as a PTC

Using a Liechtenstein foundation removes entirely the need for a trustee company owned by a financial service provider and at the same time reduces complexity. The structure then simply consists of a Liechtenstein foundation acting as trustee of one or more family trust.

A Liechtenstein foundation essentially is a fund endowed for a specific purpose that becomes autonomous and acquires the status of a legal person. It has no shareholders and therefore the question who holds the foundation does not arise. Such a foundation can be established with the sole purpose to act as the trustee of one or more trusts for the benefit of a certain family.

When a Liechtenstein foundation acts as a private trust company, generally no special business licence is necessary in Liechtenstein. This was clarified recently by a submission of the Liechtenstein government to the parliament dealing with an amendment of the Trustee Act. The Liechtenstein Trustee Act deals with the regulatory framework for professional trustees and trust companies. In this submission[46], the Liechtenstein government clarified that a PTC does not qualify as a professional trust company and does not require a licence under the Trustee Act.

The government noted that a Liechtenstein PTC, like all other Liechtenstein companies without a special business licence, requires a member of the board who is licensed as a professional trustee or in an employment relationship with such a professional trustee. According to the Liechtenstein government, no separate regulation of the entity acting as a PTC is necessary. The government pointed out that the licensing requirement only applies to 'professional' trustees and that a privately held trustee company typically does not meet this criterion because it is not used with the goal of creating profits. The government also mentioned that the fact of directors charging a fee to the PTC is not harmful either. Furthermore, the government stated that even if the Liechtenstein entity charges a trustee fee to the trusts, it still does not need to be regulated because the PTC offers its services only to a closed circle of persons. The government also specifically confirmed that a Liechtenstein foundation can act as a PTC.

VI CONCLUSIONS AND OUTLOOK

With the adoption of a new tax law, which is in compliance with European rules, and the revised foundation law, Liechtenstein has strengthened its position as an attractive jurisdiction for wealth structuring and estate planning.

In spite of a demanding environment, Liechtenstein maintained its high degree of stability and the financial system has proven to be very reliable during the last crisis. Reputation, healthy government finances and market access are the key factors for ongoing success.

46 See BuA 42/2013, 40 et seq.

Over the past years, Liechtenstein has made significant progress in fulfilling international reporting standards, which was also recognised by the European Union who stressed that Liechtenstein is one of the leading countries in the Global Forum on Transparency and Information Exchange for Tax Purposes of the OECD.[47]

47 Declaration of the Delegation of the European Union in Switzerland and Liechtenstein from 19 June 2015.

Appendix 1

ABOUT THE AUTHORS

MARKUS SUMMER
Marxer & Partner Rechtsanwälte
Markus Summer is a partner at Marxer & Partner Rechtsanwälte, Liechtenstein's oldest and largest law firm. He has obtained legal degrees from the University of Innsbruck, King's College London and the University of Texas at Austin, and an MBA from Edinburgh Business School. His areas of special interest include tax law, trust and foundations, corporate law, finance law and investments. He is a member of the Society of Trust and Estate Practitioners and of the International Fiscal Association.

HASAN INETAS
Marxer & Partner Rechtsanwälte
Hasan Inetas is a partner at Marxer & Partner Rechtsanwälte. He attended the University of Innsbruck, the University of Cologne and the Harvard Business School. His main areas of practice include family businesses, corporate law, trust and foundation law.

MARXER & PARTNER RECHTSANWÄLTE
Heiligkreuz 6
PO Box 484
9490 Vaduz
Liechtenstein
Tel: +423 235 81 81
Fax: +423 235 82 82
markus.summer@marxerpartner.com
hasan.inetas@marxerpartner.com
www.marxerpartner.com