037160/EU XXVI. GP
Eingelangt am 04/10/18

Council of the
European Union

Brussels, 4 October 2018
(OR. en)

12773/18

FISC 393
ECOFIN 872

OUTCOME OF PROCEEDINGS

From:	General Secretariat of the Council
To:	Code of Conduct Group (Business Taxation)
Subject:	Liechtenstein's Tax Exempt Corporate Income (LI001) – Final description and assessment

I/ STANDSTILL REVIEW PROCESS (DECEMBER 2017)[1]:

a. Description

Article 44 of the Law concerns personal tax liability and states that legal persons, along with their entire corporate income, shall be subject to unrestricted tax liability if their domicile or effective place of management is in Liechtenstein. Legal persons includes corporate bodies such as associations, companies limited by shares, partnerships limited by shares, cooperative societies and other specified bodies.

The Tax Act allows resident and non-resident taxpayers a complete exemption for dividend income and for capital gains (including liquidation gains) on both domestic and foreign participations without any further conditions or thresholds (Article 48 of the Tax Act).

[1] Endorsed by ECOFIN on 5 December 2017 (doc. 15429/17).

www.parlament.gv.at

i) Full exemption for dividends and capital gains

Article 48 sets out tax-exempt corporate income which in the case of a legal person subject to unrestricted (48.1 e) as well as restricted (48.2 b) taxation includes dividends arising from participations in domestic or foreign legal persons. The legislation provides no switch-over provisions or anti-abuse rules to ensure effective taxation.

ii) Full exemption for capital gains

The exemption for capital gains is combined with a tax-deductible write down/value adjustment for participations decreasing in value (Articles 48.1 f) and 48.2 d) and 53.1 of the Tax Act). However, if a write-down or value adjustment on a participation has been performed and if, in a later business year, it turns out that the grounds for a permanent depreciation no longer apply, then a write-up shall be performed (Article 53.2). To the extent write-downs or value adjustments performed have not yet been recovered capital gains achieved by the taxpayer from the sale of this participation shall not be tax-exempt under article 48 up to the amount of the write-downs or value adjustments that have not yet been recovered (Article 53.3).

The compulsory tax effective write-up required by Article 53.3 upon economic recovery of the subsidiary and the taxation of the amount written down upon a sale ensures that only a final loss gets relieved.

An anti-abuse provision (Article 53.4) prevents taxpayers from claiming a tax-effective write-down after an acquisition from a related party, ensuring that a write-down is only accepted to the extent the value declines below third-party acquisition costs.

b-c. Preferential features and possible concerns under the Code

i) The Code Group has always required that a participation exemption (holding regime) should be combined with appropriate anti-abuse provisions, most recently in the guidance on inbound profit transfers.

The Liechtenstein regime does not appear to include an anti-abuse provision as required under the Code (Paragraph L).

ii) Under previous Code practice, asymmetric provisions that allow the deduction of capital losses whereas capital gains are exempt have been found harmful as measures of this kind risk affecting the location of holding companies in the EU.[2]

In the past regimes have been found not to be harmful when an exemption for capital gains is reduced by any capital losses incurred and accounted for prior to the realisation of the gain meaning that any deduction of capital losses is recovered in case of a subsequent capital gain.[3]

d. Assessment

Criterion	1a	1b	2a	2b	3	4	5	OA
Tax exempt income	X	?	X	?	V	V	X	V

V = harmful

X = not harmful

Explanation

Significantly lower level of taxation: “Within the scope specified in paragraph A, tax measures which provide for a significantly lower effective level of taxation, including zero taxation, than those levels which generally apply in the Member State in question are to be regarded as potentially harmful and therefore covered by this code”

[2] Par. 51 of the 23 November 1999 Report (SN 4901/99): "51. The Group concluded that a positive evaluation should be given to asymmetrical measures where gains are exempt but losses are tax deductible. In relation to measures where both gains and losses are exempt the Group noted Paragraph L of the Code regarding the use of anti-abuse provisions in Member States to counteract tax avoidance and evasion."
This was repeated in the Guidance on Rollback and Standstill (Par 18 of Annex 1 to Report of 20 November 2000 (13563/00) FISC 193: "18. The features that the Group took into account when evaluating whether the measures it assessed in the areas of finance branches, holding companies and headquarter companies were harmful are: (....) Asymmetrical measures where capital gains are exempt but capital losses are tax deductible."

[3] See the 1999 Report (SN 4901/99) AAM108 (L): "*Application of the parent company/subsidiary system to resident companies with share capital (commonly known as SOPARFI)*".

www.parlament.gv.at

The general tax rate in Liechtenstein is 12.5%.

Legal persons with unrestricted or restricted tax liability in Liechtenstein are granted a tax exemption for dividends and capital gains (including liquidation gains) on both domestic and foreign participations.

The tax exemption for capital gains is combined with a tax-deductible write down/value adjustment for participations decreasing in value.

The measure therefore provides for a significantly lower level of taxation and should be assessed against all Code of Conduct criteria.

Criterion 1: "whether advantages are accorded only to non-residents or in respect of transactions carried out with non-residents"

Criterion 1 contains two elements. The first element is whether the measure is exclusively available to non-residents or transactions with non-residents (criterion 1a). The second element is whether it is only or mainly used by non-residents or for transactions with non-residents (criterion 1b).

1a) Criterion 1a) concerns the *de jure* application of the measure. The tax exemption is granted to resident and non-resident taxpayers with respect to both domestic and foreign participations.

1b) Criterion 1b) is used to complement the assessment under criterion 1a) which only looks at the literal interpretation of the measure. It takes account of the *de facto* effect of the measure. Where the majority of taxpayers (or counterparties to transactions) benefitting from the measure are in fact non-residents the measure will fall foul of criterion 1b). We do not have information to determine whether the participation exemption is pre-dominantly used by non-residents.

Criterion 2: "whether advantages are ring-fenced from the domestic market, so they do not affect the national tax base"

As regards criterion 2 the division between criteria 2a and 2b is done in the same way as in the case of criterion 1 (i.e. *de jure* interpretation and *de facto* analysis). In general, a measure is caught by criterion 2 if the advantages are ring-fenced from the domestic market so that they do not affect the national tax base. In most cases, the evaluation against criterion 2 follows closely that of criterion 1.

www.parlament.gv.at

2a / 2b We refer to what is mentioned above under criteria 1a) and b).

Criterion 3: "whether advantages are granted even without any real economic activity and substantial economic presence within the Member State offering such tax advantages"

According to the standard practice for the evaluation of the potentially harmful measures against criterion 3, a measure is caught by this criterion if there are no express requirements with regard to real economic activities and notably any requirement with respect to employment obligations.

Such express requirement aims at ensuring that the activities generating the income are undertaken by the taxpayer benefiting from the preferential tax regime.

Holding regimes such as participation exemptions are different from other preferential tax regimes in that they are not based on value creation. Their policy goal is indeed to avoid double taxation, making it difficult to expect a correlation between income-generating activities and benefits.

The situation is different when a holding regime is not properly contained by appropriate anti-abuse measures and allows for the creation of double non-taxation situations.

In the past, the Code of Conduct Group considered a number of measures in various Member States that exempt dividends received from subsidiary companies.

In the 2000 Report, the Group agreed on Guidance on Rollback and Standstill for the evaluation of measures in the areas of finance branches, holding companies and headquarter companies[4]. When evaluating whether a measure in the area of holding companies is harmful, the following features are taken into account:

"(iii) Exemption of foreign source dividends in circumstances in which the profits giving rise to the dividends:

(a) have been taxed at a significantly lower level in the source country than they would have been if they had arisen in the Member States; and

(b) have not been subject to effective anti-abuse or countermeasures which in paragraph L of the code the Council notes play a fundamental role in counteracting tax avoidance and evasion".

---

[4] See COCG compilation of agreed guidance: doc. 5814/3/18 REV 3.

www.parlament.gv.at

In 2010, the Group was able to agree the following guidance on inbound payments[5]:

"Member States may opt to tax inbound profit transfers or to operate a participation exemption. Member States which operate a participation exemption should either ensure that the profits which give rise to foreign source dividends are subject to effective anti-abuse or countermeasures, or apply switch-over provisions targeted at ensuring effective taxation. The first could be achieved through a Member State having CFC-legislation or other anti-abuse provisions which ensure that profits artificially diverted from that Member State which may give rise to foreign source dividends are appropriately taxed".

In the past assessments, the Group considered as harmful measures that allow the exemption of foreign source dividends in circumstances in which the profits giving rise to the dividends have been taxed at a significantly lower level in the source country than they would have been if they had arisen in the Member State. Such measures allow income from tax havens and other harmful regimes to be received tax-free in the Member State. However, in cases where exemptions are combined with appropriate controlled foreign corporation (CFC) legislation, the measures were not given a positive evaluation[6].

In Liechtenstein, the participation exemption is granted to foreign sourced dividends irrespective of the level of foreign (withholding) tax, and no CFC legislation, switch-over provisions or other anti-abuse measures are in force to ensure effective taxation of dividend in abusive cases.

We therefore consider the measures to fall foul of criterion 3 and have suggested a tick (“V”).

Criterion 4: “whether the rules for profit determination in respect of activities within a multinational group of companies departs from internationally accepted principles, notably the rules agreed upon within the OECD”

Under the Liechtenstein participation exemption, capital gains on the sale of participations in domestic or foreign legal entities are tax exempt. There are no specific rules preventing taxpayers from deducting capital losses. Therefore, the measure creates an asymmetric treatment between capital gains and capital losses.

---

[5] See COCG compilation of agreed guidance: doc. 5814/3/18 REV 3.

[6] See paragraph 48 of the 1999 report to ECOFIN (doc. 14313/99).

www.parlament.gv.at

The tax exemption for capital gains is combined with a tax-deductible write down/value adjustment for participations decreasing in value.

When the participation was not acquired from a related party, the basis for the depreciation test (the "baseline") will be the acquisition cost. If the value of the participation decreases below this baseline, a tax-deductible write-down is allowed.

Due to the general tax exemption of capital gains, it is possible, within a group, to sell participations tax-free. Without an appropriate anti-abuse measure, the acquisition cost between related parties would become the new basis for the depreciation test (the "baseline"). As a result, it would be possible, within a group, to generate a tax-free increased basis for the depreciation test, thus allowing for an artificial tax-deductible write-down.

In order to prevent such abuse, Liechtenstein ensures that a write-down is only tax deducted to the extent the value of the participation declines below a third-party acquisition price. If participation is acquired from a related party, the basis for the depreciation test will not be the acquisition cost between related parties but the acquisition cost of this participation by the related party from a third party.

The law provides for a compulsory tax effective write-up upon economic recovery of the subsidiary, as well as for the taxation of the amount written down upon a disposition of the participation. This ensures that only a final loss gets permanently relieved but it does not eliminate the asymmetric treatment between capital gains and losses existing in the general tax exemption.

In the 2000 Report, the Group agreed on Guidance on Rollback and Standstill for the evaluation of measures in the areas of finance branches, holding companies and headquarter companies[7]. When evaluating whether a measure in the area of holding companies is harmful, the following features are taken into account:

"*Asymmetrical measures where capital gains are exempt but capital losses are tax deductible*".

[7] See COCG compilation of agreed guidance: doc. 5814/3/18 REV 3.

In past assessments, the Code of Conduct Group concluded that a positive evaluation should be given to asymmetrical measures where capital gains are exempt but losses are tax deductible. In relation to measures where both gains and losses are exempt, the Group noted Paragraph L of the Code regarding the use of anti-abuse provisions in Member States to counteract tax avoidance and evasion[8].

Criterion 5: "whether the tax measures lack transparency, including where legal provisions are relaxed at administrative level in a non-transparent way"

All preconditions necessary for the granting of a tax benefit should be clearly laid down in publicly available laws, decrees, regulations etc. before a measure can be considered transparent. Since this is the case with respect to this measure, we have proposed a cross ("X") for criterion 5.

Overall assessment:

Considering the lack of appropriate anti-abuse measures with respect to exemption of dividends and the asymmetric treatment of capital gains and losses, as an overall evaluation of measure LI001– Tax exempt income – exemption for dividends and capital gains, the regime shall be considered harmful.

II/ ROLLBACK REVIEW PROCESS (OCTOBER 2018)[9]:

The Liechtenstein Parliament adopted the legislation to comply with criterion 2.1 on 8 May 2018, no referendum was called and the new legislation thus entered into force on 10 July 2018. Liechtenstein has therefore **fulfilled its commitment**.

The amendments approved by the Liechtenstein Parliament are available (in German) under www.llv.li/files/srk/rd18-079-ref-steg.pdf. An English translation of the relevant provisions (Articles 48, 53, 54 and paragraph 1 of the transitional provisions) can be found in the annex.

---

[8] 23 November 1999 Report to ECOFIN Council, doc. 14313/99, paragraph 51.
[9] Endorsed by the ECOFIN Council on 2 October 2018 (doc. 11763/1/18 REV 1).

www.parlament.gv.at

Article 48 Tax Act

Paragraph 1 (e) to (f), Paragraph 2 (b) to (d) and Paragraphs 3 to 7

1) In the case of persons with unlimited tax liability, the following does not count as taxable net income:

e) dividends arising from holdings in legal persons, notwithstanding Paragraphs 3 to 5;

e^{bis}) distributions by foundations, establishments in a form similar to foundations, and special asset dedications with legal personality, notwithstanding Paragraphs 3 to 5;

f) capital gains from the sale or liquidation as well as unrealised increases in value of holdings in legal persons, notwithstanding Paragraph 6;

2) In the case of persons with limited tax liability, the following does not count as taxable net income:

b) dividends arising from holdings in legal persons, notwithstanding Paragraphs 3 to 5;

c) distributions by foundations, establishments in a form similar to foundations, and special asset dedications with legal personality, notwithstanding Paragraphs 3 to 5;

d) capital gains from the sale or liquidation as well as unrealised increases in value of holdings in legal persons, notwithstanding Paragraph 6;

3) Notwithstanding Paragraph 1 (e) and (e^{bis}) and Paragraph 2 (b) and (c), dividends and distributions are not exempt from Corporate Income Tax:

a) in the case of holdings of at least 25 % of the votes or of the capital, or in the case of beneficial interests, if the dividends or distributions can be claimed by the legal person making the payment as an expense for tax purposes; or

b) if the following conditions are all met:

1. more than 50 % of the total earnings of the foreign legal person making the payment sustainably consists of passive income, unless this income is earned as part of a genuine economic activity of the legal person making the payment;

www.parlament.gv.at

2. the net profit of the foreign legal person making the payment is directly or indirectly subject to low taxation. Low taxation is deemed to be:

   i. in the case of holdings of less than 25 % of the votes and of the capital or in the case of beneficial interests, a Corporate Income Tax burden with a tax rate of less than one half of the domestic tax rate as set out in Article 61;

   ii. in the case of holdings of at least 25 % of the votes or of the capital, an effective Corporate Income Tax burden of less than 50 % of the Corporate Income Tax charge in the comparable domestic case as set out in the provisions of this Act.

4) Passive income as set out in Paragraph 3 (b) (1) means:

a) interest or other income from financial assets, royalties or other income from intellectual property and income from financial leasing;

b) dividends arising from holdings in and distributions from foreign legal persons, of which more than 50 % of the total earnings consist of passive income within the meaning of (a) subject to low taxation according to Paragraph 3 (b) (2), insofar as this income was not earned as part of a genuine economic activity;

c) capital gains from the sale or liquidation as well as unrealised increases in value of holdings in foreign legal persons, insofar these meet the conditions set out in (b).

5) Total earnings as set out in Paragraph 3 (b) (1) is understood to include all earnings generated by the foreign legal person without taking account of expenditures and deductions. Net profit as set out in Paragraph 3 (b) (2) is understood to include all income earned directly or indirectly by the legal person after adding the respective foreign Corporate Income Taxes (underlying tax).

6) Notwithstanding Paragraph 1 (f) and Paragraph 2 (d), capital gains are not exempt from Corporate Income Tax if they arise from the sale or liquidation of holdings in foreign legal persons, whose dividends would not be exempt from Corporate Income Tax by reason of holdings as described in Paragraph 3 (b). This also applies to unrealised increases in value.

www.parlament.gv.at

7) When claiming tax-exempt income pursuant to Paragraph 1 (e) to (f) and Paragraph 2 (b) to (d), taxpayers must prove in each case that the requirements of Paragraph 3 to 6 are not fulfilled.

Article 53

repealed

Article 54, Paragraphs 4 to 6

4) If holdings in legal persons which claim an interest deduction on equity in accordance with the provisions of this Act or a deduction with comparable effect to this deduction are financed by debt, there is an offset for tax purposes in the amount of the notional income of this debt finance but not exceeding the amount of the interest deduction on equity claimed by the holding. The relevant debt finance is calculated by the deduction of own shares and holdings in accordance with Sentence 1 from the equity as set out in Sentence 1 of Paragraph 2.

5) In the following transactions the interest deduction on equity is not granted unless the taxpayer proves that the transactions were not made for tax, but for economic or other substantial reasons:

a) contributions in cash and in kind by related persons insofar as they are not already included by Paragraph 2 (c);

b) the acquisition of businesses or parts of businesses held by associated enterprises;

c) the transfer of holdings to related persons or by related persons.

6) The Government will arrange the details by means of a Regulation.

www.parlament.gv.at

Transitional Provisions

§ 1

Transitional provision to Article 48

1) Article 48 Paragraph 3 (b) and Paragraph 4 to 7 of this Act shall apply for the first time from the tax year 2022 to dividends arising from holdings in foreign legal persons, provided that the participations were acquired before 1 January 2019.

2) Article 48 Paragraph 3 (b) and Paragraph 4 to 7 of this Act shall apply for the first time from the tax year 2022 to distributions by foreign foundations, establishments in a form similar to foundations and special asset dedications with legal personality, provided that the benefits existed before 1 January 2019.

---

www.parlament.gv.at