037162/EU XXVI. GP
Eingelangt am 04/10/18

Brussels, 4 October 2018
(OR. en)

12774/18

FISC 394
ECOFIN 873

OUTCOME OF PROCEEDINGS

From:	General Secretariat of the Council
To:	Code of Conduct Group (Business Taxation)
Subject:	Liechtenstein's interest deduction on equity / notional interest deduction regime (LI003) – Final description and assessment

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

a. Description

The Notional Interest deduction (Article 54 of the Income Tax Act) allows the deduction of an annually established percentage (the standardized income on wealth) of the modified equity, currently 4%. Modified equity includes share capital and reserves, with a deduction for own shares, participations, the net value of foreign assets (foreign real estate and foreign permanent establishment (PE) assets minus attributable debts) and assets that do not predominantly serve the actual object of the business conducted. For a Liechtenstein PE of a foreign company, only the share of the equity attributable to the assets generating income taxed in Liechtenstein is taken into account.

An anti-abuse provision ensures the disallowance of the interest deduction to the extent any receivables from related parties yield a lower interest rate.

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

www.parlament.gv.at

b-c. Possible concerns/ What is the problem under the Code?

As the group has not discussed this type of regime in the past, there might be a need to analyse the measure in the context of internationally accepted principles for profit determination (criterion 4). As there may be effects on taxation in other Member States (Paragraph G of the Code) in cases where a PE is subject to deduction without inclusion the Liechtenstein measure would need to be further inquired.

d. Assessment

Criterion	1a	1b	2a	2b	3	4	5	OA
Allowance on equity	X	?	X	?	V	X	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"

The general tax rate in Liechtenstein is 12.5%.

The interest deduction on equity (allowance for corporate equity, ACE) is calculated as a percentage of a company's modified equity (article 54 para. 1 of the Tax Act). For the tax year 2016, the rate of interest deduction on equity is 4%.

This reduction of the tax base may lead to a significantly lower level of taxation.

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

www.parlament.gv.at

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 ACE applies and is available to all legal entities based in Liechtenstein without any restriction in terms of shareholding (resident or non-resident shareholders) or in terms of business sector.

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 ACE 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.

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.

www.parlament.gv.at

Notional interest regimes such as the Liechtenstein ACE are different from other preferential tax regimes in that their tax benefits are not based on income generated or the activity performed but on the policy goal to tackle the debt bias, making it difficult to expect a correlation between income-generating activities and benefits.

Such a regime should nonetheless be properly contained by appropriate anti-abuse measures in order to tackle tax planning opportunities, especially when associated with the windfall effect of a regime based on the stock of equity (as compared to an incremental system that rewards only the increase in equity).

Paragraph L of the Code of Conduct states that: "*anti-abuse provisions or countermeasures contained in tax laws and in double taxation conventions play a fundamental role in counteracting tax avoidance and evasion*". In past assessments, the Code Group has taken into account, in the overall assessment of various regimes, the existence of appropriate anti-abuse provisions or countermeasures.

Liechtenstein's ACE includes the following limitations of its scope:

- The application of the allowance may not create nor increase tax losses (article 54 para. 1). Consequently, a negative result due to this deduction does not generate a loss carry forward.

- Exclusion of own shares: this exclusion prevents the possibility for a company to increase its equity and simultaneously subscribe the new shares.

- Exclusion of shares held in other resident and non-resident legal persons: this exclusion tackles the possibility to cascade the ACE through chains of equity injection.

- Assets not necessary for conducting business: this is a classical exclusion in ACE systems to avoid benefiting from ACE on assets that do not generate taxable income (for instance, luxury goods, artwork, etc.).

- The Liechtenstein ACE system does not allow the deduction of ACE with regard to capital which is allocated to a foreign permanent establishment. It the foreign PE was a legal person (a subsidiary), the Liechtenstein company holding its capital would have to exclude those shares from the ACE base.

www.parlament.gv.at

Liechtenstein's ACE includes one specific anti-abuse measure. If a related-party receivable has an interest rate below the level of the ACE rate, the difference has to be deducted from the ACE. However, no deduction has to be made if the receivable arises from the operating activity of the company. This specific anti-abuse measure targets the effect, in Liechtenstein, of cascading the ACE through a chain combining equity and intragroup loans.

- Liechtenstein also has a general anti-abuse rule according to which legal or actual structures that appear inappropriate to the economic circumstances and whose sole economic purpose consists in attaining tax advantages shall be considered abusive if (a) the granting of this tax advantage would violate the object and purpose of this Act; and (b) the taxpayer is unable to present any economic or other substantial reason for the choice of this structure and if the structure does not result in any independent economic consequences.

The Liechtenstein ACE however lacks some anti-abuse rules targeting specifically transactions between related parties that could give rise to abuse especially from[2]:

- Equity contribution in kind or in cash between related parties;
- Double dipping structures combining interests deductibility and the ACE;
- Acquisition of businesses held by associated enterprises;
- Re-categorization of old capital as new capital through liquidation and creation of a new company;
- Intragroup transfer of participations.

We therefore consider the measures to fall foul of criterion 3.

---

[2] The proposal for an EU Directive on a common corporate tax base (CCTB) contains an allowance for growth and investment (AGI). Art. 11(6) of the CCTB reads as follows:
The Commission shall be empowered to adopt delegated acts in accordance with Article 66 to lay down more detailed rules against tax avoidance, and more particularly in the following fields relevant to the AGI:
(a) intra-group loans and loans involving associated enterprises;
(b) cash contributions and contributions in kind;
(c) transfers of participations;
(d) the re-categorisation of old capital as new capital through liquidations and the creation of start-ups;
(e) the creation of subsidiaries;
(f) acquisitions of businesses held by associated enterprises;
(g) double-dipping structures combining interest deductibility and deductions under the AGI;
(h) increases in the amount of loan financing receivables towards associated enterprises as compared to the amount of such receivables at the reference date.

www.parlament.gv.at

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"

The measures do not contain such elements that would be relevant from the point of view of internationally accepted principles as referred to in criterion 4 of paragraph B of the Code.

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.

Overall assessment: "Without prejudice to the respective spheres of competence of the Member States and the Community, this code of conduct, which covers business taxation, concerns those measures which affect, or may affect, in a significant way the location of business activity in the Community"

With respect to the overall evaluation of the Liechtenstein ACE and considering the lack specific anti-abuse measures regarding transactions between related parties, this regime shall be considered harmful.

II/ ROLLBACK REVIEW PROCESS (OCTOBER 2018)[3]:

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.

---

[3] 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