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Tax incentives on Research and Development (R&D)

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Summary and conclusions

Effective 1 January 2011, article 55 of the Law of 23 September 2010 on National and Municipal Taxes (Tax Act) introduced a provision granting a tax deduction of 80 per cent for income from relevant intellectual property (IP) rights, thus reducing the effective tax rate on income derived from such rights.

The Liechtenstein Tax Act explicitly lists the IP rights that qualify for the IP box. Following a wide approach, the list currently includes patents, supplementary protection certificates, utility models, designs, trademarks, software as well as technical and scientific databases. Furthermore, it includes self-developed and acquired IP on the condition that the IP was developed or acquired on or after 1 January 2011.

Relevant IP income can result from sales income, licence fees, proceeds of sale, damages for infringements and other compensation where related to relevant IP rights. To determine the assessment base for the tax deduction, all associated tax-relevant expenses, including write-downs on relevant IP rights, have to be deducted from the relevant IP income.

The election for the IP box can be made on an annual basis with the filing of the corporate income tax return. However, in order to get full transaction security, a taxpayer is supposed to consult with the Liechtenstein tax authorities prior to implementing the box. In large or complex cases, a taxpayer is recommended to ask for a binding tax ruling.

The scope of the Liechtenstein IP box also extends to IP income from permanent establishments and self-employed persons. Being equally applicable by all economic operators and thus treating all persons or groups of persons according to the same legal order, the Liechtenstein IP box is in line with the non-discrimination provision of article 24(3) of the OECD model convention (OECD MC). It does not apply any explicit or implicit territorial restriction; this is why the tax measure is compatible with EU fundamental freedoms. In addition, the EFTA surveillance authority (ESA) qualified the Liechtenstein IP box as a non-selective tax measure in its formal decisions of 1 June 2011 and 12 December 2012.

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It remains to be seen how the Liechtenstein IP box will be affected by present international developments. The Liechtenstein government has set up a base erosion and profit shifting (BEPS) working group that closely monitors international developments and directly reports to the government on a regular basis. Having committed to and closely following the OECD transfer pricing guidelines in practice, Liechtenstein is in favour of the transfer pricing approach.

1. R&D incentives under domestic tax law

1.1. Introduction

Effective 1 January 2011, Liechtenstein introduced the Law of 23 September 2010 on National and Municipal Taxes (Tax Act). This new tax law is the result of a comprehensive reform of the Liechtenstein tax system, which also allowed for the introduction of an output R&D incentive.

1.2. A brief overview of business income taxation[1]

1.2.1. Taxation of incorporated taxpayers

Under the Tax Act, in principle, all corporations, foundations, and establishments are subject to a corporate income tax at a flat rate of 12.5 per cent. Resident companies are subject to unlimited tax liability on their worldwide income. Non-resident companies are subject to limited tax liability on income from properties or branches within Liechtenstein.

All legal entities are subject to an annual minimum tax of CHF 1,200, a tax which can be fully credited against corporate income tax.

As of 1 January 2011, tax privileges for certain legal structures, such as domiciliary and holding companies, have been abolished. For legal entities that benefited from such privileges a transitional period was applicable through 2013, unless they opted for the ordinary taxation scheme.

Broadly speaking, the following tax incentives are applicable as of 1 January 2011:

- profit tax exemption for corporations that have an irrevocable charitable, cultural, or ideal purpose without commercial activity;
- profit tax exemption of dividend income and capital gains on shares/participations;
- notional interest deduction on equity (NID);
- private asset structure (PAS);
- deduction for income from IP rights (IP box).

Capital gains derived from the sale of shares, dividend income and liquidation proceeds are fully tax exempt. Capital gains from the sale of real estate are subject to a separately assessed real estate profit tax.

[1] For further details see: http://www.taxsummaries.pwc.com.

The NID is a standardised deduction for interest on equity based on the multiplication of the modified equity by an interest rate, which is determined on an annual basis in the finance law. Currently, the equity interest rate is 4 per cent. Losses due to the NID are prohibited, which implies that the tax measure cannot generate negative results and thus loss carryforward.

The modified equity, in substance, encompasses:

- nominal capital, capital stock or share capital and the reserves constituting an entity's own assets;
- minus its own shares;
- minus participations in legal persons;
- minus non-operating related assets;
- minus deduction of 6 per cent of all assets other than the assets referred to above;
- equity increases and decreases, based on the capital at the beginning of the business year.

Until 31 December 2010, Liechtenstein levied a coupon tax of 4 per cent on dividend and certain interest payments. The coupon tax has been abolished under the new tax regime with effect from 1 January 2011. The coupon tax, however, still applies with regard to open reserves existing as per 31 December 2010. Regardless of any future distribution, these reserves have to be taxed by 31 December 2015 at the latest with a reduced tax rate of 2.5 per cent.

1.2.2. Taxation of other taxpayers (individuals, partnerships, self-employed)

Generally, all income is subject to income tax. Income tax is an annual tax and is progressive with a maximum tax rate of up to 28 per cent for income above CHF 200,000. For communal tax calculation, a surcharge on the basic of the national income tax is due. Communities levy a surcharge of minimum 150 per cent and maximum 250 per cent. The surcharges are fixed annually by the local municipalities. For illustration, based on a municipal surcharge of 200 per cent a total tax rate of up to 24 per cent can result.

An employee resident in Liechtenstein is principally taxed on any salary and any other monetary benefits (including reimbursements of living expenses) received from the employer, regardless of where the work has been performed or where the payment is made. A self-employed resident in Liechtenstein is taxed on any salary and any other monetary benefits similar to those referred to above.

Movable and immovable assets are subject to net wealth tax. In principle, net wealth tax is levied based upon fair market value. The taxable net wealth tax is multiplied by a standard interest rate of currently 4 per cent in order to determine a notional income. This notional income is subject to income tax together with the other income at the applicable tax rate.

1.3. Tax policy considerations relating to R&D incentives[2]

1.3.1. General tax climate for R&D

The Tax Act generally provides moderate tax rates for individuals (maximum 28 per cent) and corporations (12.5 per cent flat rate). This is why the general tax climate in Liechtenstein for R&D can be considered favourable. Besides the deduction for income from IP rights there are no specific reliefs for R&D.

1.3.2. Reasons for introducing R&D incentives

In the Report and Application No. 48/2010 the government expresses its view that the domestic industrial sector in particular must remain highly innovative in terms of its R&D possibilities.[3]

Especially for small jurisdictions like Liechtenstein, which is poor in natural resources, technological and scientific R&D is a lifeline for economic advantage and growth. To take account of the European trend, the special deduction of 80 per cent set out in article 55 Tax Act (deduction for income from IP rights) creates an output tax incentive intended to keep the business location attractive.[4]

Despite this fact, Liechtenstein needs to follow the example of other countries and not be reluctant to further improve its framework conditions for R&D.[5] Only the additional adoption of input tax incentives supplementing the actual IP box regime is likely to allow Liechtenstein to take up a coherent and sustainable international position.[6]

1.3.3. R&D incentives, equality of treatment and ability to pay

A tax measure violates the legal requirement on equality if it encounters legal distinctions for which reasonable grounds are not apparent in the circumstances being regulated, or if it omits distinctions which intrude due to the circumstances. Legal equality is especially violated if equal entities are not treated equally according to their equality or unequal entities are not treated unequally according to their inequality, provided that the unfounded difference or unfounded equality relates to a basic fact. Accordingly, what is required is not absolute, but only relative equality of treatment. In tax law, relative equality of treatment is mainly achieved through the principles of universality of taxation and ability to pay.[7]

2 This treatise on the Liechtenstein IP box is largely based on the dissertation of Dr Marco Felder, *IP Boxes from a European, Liechtenstein and Swiss Perspective*, Schulthess (ed.) (2013). For detailed reference to the sources, the reporters refer to the list of literature and materials in this dissertation.

3 Liechtenstein Government, Report and Application No. 48/2010, p. 47.

4 Wanger, *Kommentar Steuergesetz*, p. 180; Liechtenstein Government, Report and Application No 48/2010, p. 141.

5 Felder and Harmann, pp. 86, 87; see also Evers, Miller and Spengel, p. 5; SwissHoldings; Hurter, p. 637; Müller, Wenger and Linder, *Tax Incentives*, p. 19 *et seq.*; Schweizer Parliament, Motion Hurter; Müller, Gramigna and Linder, p. 804.

6 Shanahan, *Incentives Group*, p. 5; see also Kachinsky, Medallis and Leibsker, p. 124.

7 Reich, *Verfassungsrechtliche Beurteilung*, p. 695; see also Hangartner, p. 93.

According to the principle of universality of taxation, public expenditure for the accomplishment of public functions should basically be borne by all citizens.[8] The main focus of the principle of universality is the prevention of privileged treatment and discrimination. Everyone has to pay tax regardless of individual characteristics, such as status, religion, origin or race, even though only a symbolic contribution is possibly made to the financing of the public expenditure. The legislator must not favour lesser or greater taxpayers without sufficient justification. The principle does not, however, rule out factually justified exemptions from tax. Tax exemptions are admissible for macroeconomic and social reasons, or on tax systematic grounds.[9] The justification for exemptions of this kind may possibly consist of the fact that the affected persons have already been appropriately burdened by other taxes, such as for example the value-added tax.[10]

The principle of universality of taxation has two characteristics: it can prohibit privileged treatment or discrimination. Privileged treatment prohibition forbids the factually unjustified exemption of persons or group of persons from taxation.[11] On the other hand, the prohibition of discrimination forbids the imposing of substantially larger burdens on a small group of taxpayers – in relation to their economic ability to pay – than on the bulk of remaining taxpayers. With protection against excessive taxation, the principle of universality of taxation also contains a constitutional protection of minorities.[12]

It follows that an IP box regime must be equally applicable by all economic operators and thus treat all persons or groups of persons according to the same legal order. Accordingly, also self-employed persons should fall into the scope of an IP box legislation.[13]

The principle of ability to pay is derived from the principles of uniformity and universality of taxation. It requires that every citizen should contribute to covering the public financial needs in proportion to the funds available to him and the individual circumstances influencing his ability to pay.[14] It cannot entirely be ruled out that the Liechtenstein IP box legislation infringes the principle of ability to pay. However, insofar as there is a violation, it should be stressed that violations of this kind are frequently encountered in the Liechtenstein tax system. For example, individuals who earn dividends or other qualified income, property income, or

8 Hinny, *Lizenzbox des Kantons Nidwalden*, p. 152; Reich, *Verfassungsrechtliche Beurteilung*, p. 699; Hangartner, p. 92; Reich, *Allgemeinheit der Steuer*, p. 172.

9 Hinny, *Lizenzbox des Kantons Nidwalden*, p. 152; Cagianut and Cavelti, p. 152; Reich, *Verfassungsrechtliche Beurteilung*, p. 699; Höhn and Waldburger, p. 108 recital 71; Vallender, *Leitlinien*, p. 689; Hangartner, p. 91; Reich, *Allgemeinheit der Steuer*, pp. 172, 173.

10 Höhn and Waldburger, p. 109 recital 72.

11 Reich, *Steuerrecht*, p. 85 recital 128 *et seq.*; Höhn and Waldburger, p. 108, recital 71; Reich, *Verfassungsrechtliche Beurteilung*, p. 699.

12 Reich, *Steuerrecht* p. 86 recital 133; Hinny, *Lizenzbox des Kantons Nidwalden*, p. 152; BGE 133 I 206 E. 6.1 p. 215; Cagianut and Cavelti, p. 153; Reich, *Verfassungsrechtliche Beurteilung*, p. 699; Reich, *Allgemeinheit der Steuer*, p. 173; Yersin, *Les buts extra-fiscaux*, p. 52; BGE 99 Ia 638 E. 9 p. 653.

13 See also Hinny, *Lizenzbox des Kantons Nidwalden*, p. 152.

14 *Ibid.*, p. 154, 155; Cavelti, *Besteuerung nach dem Aufwand*, p. 149; BGE 133 I 206 E. 7.1 p. 217; Cagianut and Cavelti, p. 154; Reich, *Verfassungsrechtliche Beurteilung*, p. 700, 701; Höhn and Waldburger, p. 112 recital 76; Vallender, *Leitlinien*, p. 689; BGE 122 I 101 E. 2b (aa) p. 103; BGE 114 Ia 221 E. 2c p. 225; BGE 99 Ia 638 E. 9 p. 652 *et seq.*

liquidation gains from activity as a self-employed person, are taxed differently and as a rule lower than persons that do not earn income of this kind, not to mention the many different kinds of tax reliefs, which ultimately achieve the same tax effect. Notwithstanding, it must be pointed out that the principle of ability to pay is often deliberately violated in legislative practice and may thereby *de facto* have lost part of its substance.[15]

Against this backdrop, strategies by which certain groups of persons are granted advantages on special factual grounds at the expense of the fiscal principle of equal treatment are permissible within narrow limits provided there is a clear legal or even constitutional basis and the tax law is suitable for achieving the targeted purpose with the tax measure.[16]

Justification of the reduced taxation of IP income by means of a non-fiscal purpose is obviously only required if there is an actual violation of the constitutional principles of taxation. Creating a legal basis for the introduction of an IP box usually appears consistent with the meaning of non-fiscal purposes and is thus proportionate. In a globalised economy that is knowledge-based and innovation-oriented, IP has become an increasingly important driver of economic growth. This is why international tax competition is highly intensive around mobile income. Modern fiscal policies take the different degree of mobility into account by providing lower tax burdens for mobile factors.[17]

In the Report and Application No. 48/2010 the government held that article 55 Tax Act was in line with constitutional principles.[18] Despite this fact, the Liechtenstein Constitutional Court after the introduction of the IP box regime found it partially unconstitutional and unlawful.[19] For further information see section 1.5.2 of this report.

1.3.4. Subjective scope

Article 16(6) Tax Act stipulates that article 55 Tax Act not only applies to the determination of corporate income, but also to the determination of the agricultural and forestry profit and to the determination of any profit arising from self-employment in areas such as commerce, trade and industry. The IP box thus applies to taxpayers which are either subject to personal or corporate income tax. It furthermore covers persons that are subject to restricted and unrestricted tax liability. This implies that the IP box extends to resident and non-resident individuals, as well as to resident corporate entities and permanent establishments of non-resident companies, carrying on a business in Liechtenstein. Against this backdrop, the IP box also applies to relevant IP income derived both from the exercise of a liberal profession and a partnership. Relevant IP rights belonging to the private wealth of a taxpayer, however, do not fall within the scope of the tax measure.

15 Hinny, *Lizenzbox des Kantons Nidwalden*, p. 155; see also Benz, p. 14; BGE 133 I 206 E. 11.1 p. 229; Yersin, *Les buts extra-fiscaux*, pp. 47, 48.

16 Hinny, Lizenzbox des Kantons Nidwalden, p. 157; BGE 133 I 206 E. 11.1 p. 230; Yersin, *Les buts extra-fiscaux*, p. 59.

17 See EFD, Zwischenbericht USTR III, p. 9.

18 Liechtenstein Government, Report and Application No. 48/2010, p. 270.

19 Liechtenstein Constitutional Court, StGH 2011/13.

1.3.5. R&D incentives: multinational eneterprises (MNEs) versus small and medium-sized enterprises (SMEs)?

Liechtenstein applied a wide approach when introducing its IP box. The Tax Act clearly aims at granting MNEs and SMEs an equal amount of R&D tax incentives in relative terms. So far, no detailed analysis has been carried out on whether practical competitive disadvantages between MNEs or SMEs in undertaking and exploiting R&D exist and how the position of SMEs can be improved.

1.3.6. Definition of R&D for tax purposes

The Frascati Manual was originally written by and for the experts in OECD member countries who collect and issue national data on R&D. Over the years, it has become the standard of conduct for R&D surveys and data collection not only in the OECD and the European Union (EU), but also in several non-member economies. By contrast, the Oslo Manual is the foremost international source of guidelines for the collection and use of data on innovation activities in industry.[20]

The definition of R&D for tax purposes in Liechtenstein does not coincide with the interpretation favoured by the Frascati and Oslo Manuals. The reasons are twofold. There is no definition of R&D for tax purposes in Liechtenstein. The IP box legislation is limited to the determination of the tax assessment base and enumerates the qualifying IP rights for this purpose. In addition, the IP box legislation determines the amount of the tax deduction. On the other hand, the Liechtenstein domestic statistical service so far has not had sufficient personnel resources to keep R&D statistics according to the principles of the Frascati and Oslo Manuals.

Since there is no definition of R&D for tax purposes in Liechtenstein, there can be no interference with the interpretation put forward by the Frascati and Oslo Manuals. In addition, from a Liechtenstein perspective no intention exists to diverge from these international standards.

1.4. R&D input incentives

Liechtenstein currently does not provide any R&D input incentives. Various representatives of business and tax experts take the position that Liechtenstein should lose no time in enriching its Tax Act with additional input tax incentives to promote domestic R&D beyond article 55 Tax Act. An internationally attractive and competitive R&D location should combine such input tax incentives with output tax incentives.

1.5. Output R&D fiscal incentives

1.5.1. General overview of output incentives

Effective 1 January 2011, article 55 Tax Act introduced a provision granting a tax deduction of 80 per cent for income from qualifying IP rights, thus reducing the

[20] OECD, available at www.oecd.org (27 September 2014).

effective tax rate on income derived from relevant IP rights. The taxable base for the tax deduction is the income from the use, realisation or sale of the relevant IP rights, less associated tax-relevant expenses, including write-downs on relevant IP rights, even where the expenses arose over several assessment periods.[21] It follows that only 20 per cent of the relevant profit is taxable at the regular income tax rate.

Article 61 Tax Act sets the corporate income tax at 12.5 per cent of the taxable net corporate income. In the case of a corporate taxpayer this implies that the profit in respect of relevant IP rights is subject to an effective tax rate of only 2.5 per cent. Furthermore, the availability of additional tax deductions, such as NID, time unlimited losses carried forward or group taxation, can lower the overall effective tax rate to nil.[22]

1.5.2. Definition of privileged IP rights

Liechtenstein tax law does not include a definition of R&D for tax purposes but rather lists the IP rights which qualify for the IP box. It currently explicitly refers to patents, trademarks and designs, software and technical as well as scientific databases. Furthermore, it implicitly covers supplementary protection certificates and utility models.

Since the elaboration and introduction of the new Tax Law the definition of qualifying R&D has been constantly under discussion. In the original conception of the Liechtenstein IP box, the first idea was merely to allow for patent income deductions.[23] Immediately, business associations and interest groups intervened during consultations and demanded an expansion of the deduction to include all IP rights.[24] After evaluating comparable rules in other European countries, the government decided that, in addition to patent income, other income from IP rights should be covered by the IP box. Additional details, such as in particular the more precise delineation of IP rights benefiting from the regime, were to be governed by an ordinance.[25]

On the basis of understandable considerations, the Constitutional Court in its judgment of 1 July 2011 voided article 33(1) of the Tax Ordinance, finding it unconstitutional and unlawful.[26] The voided provision defined which IP rights should qualify for a deduction under article 55 Tax Act. The Constitutional Court justified its decision essentially with reference to the fact that article 55 Tax Act did not envisage a material restriction of IP rights; such a restriction would have to be

21 Felder, Country Survey, chapter 1, 1.3.3; Hosp and Langer, *Besteuerung von Immaterialgüterrechten*, p. 19; Lehmann and Zanettin, pp. 10, 11; Liechtenstein Government, Report and Application No. 123/2011, p. 7, 23; Hosp and Langer, *Steuerstandort Liechtenstein*, p. 113; Roth, p. 62; Wanger, *Kommentar Steuergesetz*, p. 180; Liechtenstein Government, Report and Application No. 48/2010, p. 75, 134.

22 Lehmann and Zanettin, p. 10; Vils and Bürkler, p. 2; see also Müller, Gramigna and Linder, p. 809.

23 Liechtenstein Government, Report and Application No. 48/2010, p. 141.

24 Liechtenstein Government, Statement No. 83/2010, p. 45.

25 Hosp and Langer, *Besteuerung von Immaterialgüterrechten*, p. 17; Lehmann and Zanettin, p. 10; Liechtenstein Government, Report and Application No. 123/2011, p. 7, 8; Liechtenstein Government, Statement No. 83/2010, p. 45.

26 Liechtenstein Constitutional Court, StGH 2011/13.

undertaken by the legislator itself and not merely by way of a government ordinance.[27] Even if the intent of the legislator had been to delegate to the government the decision regarding which IP rights should be covered by the deduction option, the rule would not be reconcilable with the principle of legality of taxes. According to the Constitutional Court, the question of what income from IP rights should be taxed to what degree is a highly political one that must be decided by the democratic legislator.[28]

After hearing the business associations and interest groups again, Parliament followed the government's proposal on 25 April 2012. The entire content of the rule set out in article 33 of the Tax Ordinance was thus incorporated without any material changes into article 55 Tax Act, effective 1 January 2012.[29] At the same time, the catalogue of relevant IP rights applicable to the IP box was expanded to include software as well as technical and scientific databases created or acquired on or after 1 January 2011.[30] This is why the amended rule governing the IP box, again, required notification to the ESA.[31] On 12 December 2012 the ESA found article 55 Tax Act to be a general measure and thus not to constitute state aid within the meaning of EEA law.[32]

1.5.3. Acquired IP

Liechtenstein does not only apply the IP box incentive to self-developed IP rights. Consequently, a taxpayer for IP box purposes can acquire relevant IP rights from affiliated or non-affiliated parties. It does not matter how such rights are acquired; this can for instance be done by way of sale, contribution in kind or otherwise.[33] Licences in respect of relevant IP rights are not required to be granted for the entire duration of those property rights, nor is it prohibited that licences extend beyond the duration of relevant IP rights. In addition, the IP box benefits are also delivered where a taxpayer acquires relevant IP rights which it licensed formerly.

Where for a tax year a valid relevant IP right has been created or acquired by a relevant taxpayer, the benefits of the IP box for the tax year can be claimed immediately. There is no requirement for a certain period to elapse first.

Liechtenstein does not have any restrictions in order to avoid multiple benefits from IP rights. As a consequence, if IP rights are sold the transferor (profit from the sale of IP rights) and the transferee (future income from IP rights) benefit from the incentive. When granting a sublicence, the licenser and the sublicensee can opt for the IP box.

27 Hosp and Langer, *Besteuerung von Immaterialgüterrechten*, pp. 17, 18; Lehmann and Zanettin, p. 10; Liechtenstein Government, Report and Application No 123/2011, p. 4, 8.

28 Liechtenstein Government, Report and Application No. 123/2011, p. 8.

29 *Landtag des Fürstentums Liechtenstein*, Landtag April 2012; Liechtenstein Government, Statement No. 21/2012, p. 4, 8, 23; Hosp and Langer, *Besteuerung von Immaterialgüterrechten*, p. 18; Liechtenstein Government, Report and Application No. 123/2011, p. 4.

30 Art. 55(1)(b) of Amended Tax Act; Liechtenstein Government, Statement No. 21/2012, p. 10, 14; Hosp and Langer, *Besteuerung von Immaterialgüterrechten*, p. 19.

31 Liechtenstein Government, Report and Application No. 123/2011, p. 4, 23.

32 EFTA Surveillance Authority, State Aid; EFTA Surveillance Authority, 480/12/COL, p. 7 recital 28.

33 See also Müller, Gramigna and Linder, p. 808.

1.5.4. Pre-existing IP

For practical, administrative and budgetary motives, a retroactive effect of the IP box in respect of relevant IP rights before its entry into force has been excluded by the legislator.[34] Accordingly, article 55(1) Tax Act holds that the IP box only applies to relevant IP rights created or acquired from 1 January 2011.[35]

Against this backdrop, the date when an IP right has been created or acquired by a taxpayer is instrumental in determining whether the IP right falls within the scope of article 55 Tax Act. The date of creation of a relevant IP right generally corresponds to the date on which the application for the relevant IP right was filed.[36] The taxpayer must be able to document the existence of the register entry for each relevant IP right.[37] Since neither copyrights nor technical and scientific databases are listed in a register, it is up to the taxpayer to provide evidence of when the relevant IP right was created.[38]

Article 51(3) Tax Act lays down that if the domestic right of taxation with respect to profit arises from the sale or use of an asset, the asset is deemed to be acquired or used at the arm's length price. Where applicable, the date where the relevant IP right has been acquired corresponds to the date when the domestic right of taxation arises.

1.5.5. Development condition

There is no development condition to the Liechtenstein IP box. In practice, a taxpayer is thus not required to be the inventor, creator, developer or the initial applicant of a relevant IP right in order to be an eligible taxpayer under article 55(1) Tax Act.[39]

1.5.6. Privileged IP income

1.5.6.1. Relevant IP income

Relevant IP income may fall within any of the five following categories:[40]

(a) Sales income: to make the IP box competitive for the widest range of undertakings it should have a broad scope. As a result, the regime applies to income of products protected by relevant IP rights which is embedded in the sales income.[41]

34 Liechtenstein Government, Report and Application No. 123/2011, p. 24.

35 Felder, Country Survey, chapter 1, 1.3.3; Liechtenstein Government, Statement No. 21/2012, p. 8, 23; Hosp and Langer, *Besteuerung von Immaterialgüterrechten*, p. 17; Lehmann and Zanettin, p. 10; Liechtenstein Government, Report and Application No. 123/2011, p. 24; Wanger, *Kommentar Steuergesetz*, p. 182.

36 Liechtenstein Government, Report and Application No. 123/2011, p. 24.

37 Hosp and Langer, *Besteuerung von Immaterialgüterrechten*, p. 17.

38 See also OECD Revised Discussion Draft, p. 20 recitals 67, 68; OECD Discussion Draft, p. 13 recitals 31, 32.

39 See also Müller, Gramigna and Linder, p. 808; for a critical opinion, see: Sullivan, p. 11.

40 See also Felder and Harmann, p. 82; Müller, Gramigna and Linder, p. 808.

41 See Sullivan, p. 11; Nicholls and Smith; Krever, p. 756; HM Treasury/HM Revenue & Customs, Consultation, p. 6.

From a conceptual perspective, there is no visible indication why article 55 Tax Act should exclude sales income from the scope of the IP box regime. Accordingly, there should be no difference whether a taxpayer generates a certain amount of profit from granting a licence in respect of a relevant IP right, or an equivalent amount of profit in respect of the relevant IP right embedded in sales income. In the same way there should be no differentiation where a taxpayer uses the relevant IP right for its own purposes, thereby generating an equivalent amount of relevant profit as a notional royalty.

Inclusion of sales income to the IP box increases the difficulty of identifying in a tax year what level of relevant profit should be attributed to the relevant IP rights. Similar to the determination of a notional royalty, the level of relevant profit should correspond to the amount that a relevant taxpayer would pay to an independent third party for the right to use or realise the relevant IP rights in the tax year if the taxpayer were not otherwise able to exploit them.[42] Therefore, relevant taxpayers may be required to perform transfer pricing analyses for each relevant IP right in order to determine the respective share of relevant profit.[43]

Article 55 Tax Act does not contain a requirement whereby worldwide sales income in respect of the legally protected innovation must be protected by a relevant IP right in every jurisdiction of sale. This is why worldwide sales income can be treated as relevant IP income assuming that it is received by a relevant taxpayer.[44] It should be emphasised, however, that the anti-avoidance provision based on article 3 (abuse of structuring options) Tax Act may have to be taken into account. Pseudo-innovations aiming to deliver unjustified IP box benefits therefore risk being considered abusive and must be discouraged for that reason.[45]

(b) Licence fees: this category of relevant IP income includes income from any licence fee or royalty which a relevant taxpayer receives under an agreement granting another person any of the following rights:[46]

– a right in respect of any relevant IP right held by the relevant taxpayer; and
– any other right in respect of a legally protected innovation or process; and
– in the case of an agreement granting any right within the framework referred to above, a right granted to another person for the same purposes as those for which that right was granted to the relevant taxpayer.

Thus, the Liechtenstein IP box specifically includes licence fees or royalties as a category of relevant IP income for the purposes of article 55 Tax Act. In this context it should be emphasised that the definition of licence fees is also deliberately intended to cover the granting of sublicences for IP box purposes.

42 See s. 2 (II) (3) (C) (Notional royalty) of this part; see also Müller, Gramigna and Linder, p. 808.
43 See also Hausmann, Roth and Krummenacher, p. 89; Müller, Gramigna and Linder, p. 808.
44 See HM Revenue & Customs, Finance Bill 2012, p. 33 recital 3.27.
45 See Philipps and Danes, p. 8; HM Revenue & Customs, Finance Bill 2012, p. 12 recitals 1.32, 1.33; HM Revenue & Customs, Draft Legislation, p. 7 recital 1.27; HM Treasury/HM Revenue & Customs, Consultation, p. 13 recital 3.4.
46 See Finance (No. 4) Bill, p. 148 at 357CC (6); Consultation draft, p. 9 at 357CB (7); Vanhaute, chapter 5, 5.1.5.1; Hendrickx, p. 18; Müller, Gramigna and Linder, p. 808; Van den Berghe and Kelley, p. 374; Van Stappen, Delanoy and De Groote, p. 291; Onkelinx and Van den Berg, p. 3.

In practice, for sound reasons relevant taxpayers may grant licences in respect of relevant IP rights that further include the right to use other IP rights such as knowhow or technical information. As the case may be, the aggregate income from such licences can qualify as relevant IP income. This is because intangibles can be so closely intertwined that it is difficult to separate them from each other.[47] For instance, in situations where under a licence agreement the performance of services and the exploitation of relevant and non-relevant IP rights are closely intertwined, the IP box benefits should be available on the total income from such agreement, provided that the intangibles are inseparable from each other.[48] With respect to the handling of bundled licences this rationale should thus apply as far as possible. It must be held, however, that the Liechtenstein tax administration does not necessarily follow this interpretation.

Furthermore, licence fees can consist of either variable fees, for instance royalties as a percentage on turnover, or fixed and/or advance fees, for instance milestone or upfront payments.[49]

(c) Proceeds of sale: this category of relevant IP income includes any income arising from the sale or other disposal of relevant IP rights.[50]

In accordance with article 55(2) Tax Act, the basis of assessment for the deduction of 80 per cent includes income from the sale of relevant IP rights.[51] It should be emphasised that proceeds of sale do not include sales or other disposals of non-relevant IP rights, even where they protect innovations that are also protected by relevant IP rights. Similarly, where non-relevant IP rights are sold or disposed of in the same transaction as relevant IP rights, then only the sale proceeds of the relevant IP rights qualify as relevant IP income.[52]

Where not a relevant IP right itself, but the underlying innovation is sold or disposed of by a taxpayer, then by virtue of article 55(1) and (2) Tax Act the corresponding proceeds of sale of the intangible do not qualify as relevant IP income.

(d) Damages for infringement: relevant IP rights are regularly contested. Any damages paid by other persons for infringing or alleged infringement can largely be seen as compensation for lost income, which would otherwise

47 For UK, see: HM Revenue & Customs, Finance Bill 2012, p. 36 recital 3.39; HM Revenue & Customs, Draft Legislation, p. 22 recital 3.29; for Belgium, see: Warson and Glaes, p. 322; Springael and Van de Velden, p. 5; for Luxembourg, see: Muntendam and Chiarella, p. 229; see also OECD Discussion Draft, p. 20 recital 74; Merrill *et al.*, p. 1674; Müller, Gramigna and Linder, p. 808.

48 See OECD Discussion Draft, p. 20 recital 74.

49 See Vanhaute, chapter 5, 5.1.5.3; Bal and Offermanns, p. 171; Warson and Van Ende, p. 2; Hendrickx, p. 18; Scheunemann and Dennisen, p. 410; Warson and Glaes, p. 322; Onkelinx and Rens, p. 3; Cops and Lemaire, p. 13; Van den Berghe and Kelley, p. 377; Warson and Foriers, p. 73; Van Stappen, Delanoy and De Groote, p. 292; Van Stappen, p. 2; Cops and De Haen, p. 2; Onkelinx and Van den Berg, p. 3.

50 See Finance (No. 4) Bill, p. 148 at 357CC (7); Consultation draft, p. 9 at 357CB (8); HM Revenue & Customs, Finance Bill 2012, p. 36 recital 3.40; HM Revenue & Customs, Draft Legislation, p. 22 recital 3.31.

51 See also OECD Discussion Draft, p. 18 recital 62 *et seq.*; Müller, Gramigna and Linder, p. 808.

52 See HM Revenue & Customs, Finance Bill 2012, p. 37 recital 3.44.

have been eligible for the IP box.[53]

Article 55 Tax Act does not expressly refer to the question of whether damages for infringement qualify as relevant IP income. An analysis of the wording of article 55 Tax Act, however, provides no indication why the Tax Act in general and article 55 Tax Act in particular should prevent damages for infringement qualifying as a category of relevant IP income. It can therefore be reasonably concluded that damages for infringement qualify for the IP box on the condition that the taxpayer receiving the income is a relevant taxpayer.

According to the meaning of relevant taxpayer, a taxpayer is supposed to qualify as a relevant taxpayer even if damages for infringement are received after expiry or sale of the relevant IP right, provided that the infringement took place when the right was a relevant IP right and the taxpayer was then entitled to elect for the IP box.[54] If a taxpayer receives an amount falling under the category of damages for infringement, which relates partly to a period when both the taxpayer and the rights were relevant, and partly to a period when one or both of these were not relevant, then a reasonable apportionment of the remuneration should be made.[55]

Due to considerations of criminal law, the damages in certain jurisdictions can sometimes be increased in the event of intentional infringement of IP rights, in particular for patents. Such supplementary penalties are not known in the Liechtenstein legal order. The question therefore arises whether collected supplementary penalties systematically fall within the scope of article 55 Tax Act. It is thus important to note that according to the commentary on article 12 of the OECD MC, the definition of royalties covers both payments made under a licence and compensation which a person would be obliged to pay for fraudulently copying or infringing the right.[56] In addition, the UK IP box legislation clearly refers to "any amount received by the company in respect of an infringement, or alleged infringement" of a relevant IP right held by the company at the time of the infringement or alleged infringement.[57] In those circumstances even if the total award has some punitive element it is likely that the UK tax authorities would regard it as all arising "in respect of" the infringement.

Against this backdrop, it can be reasonably concluded that article 55 Tax Act also extends to supplementary penalties with regard to the damages for infringement collected in proceedings relating to the infringement of relevant IP rights. It should be emphasised, however, that penalties and liquidated damages of differing character and function play a role within each legal

53 See HM Revenue & Customs, Finance Bill 2012, p. 10 recital 1.16 (v), 37 recital 3.46; HM Revenue & Customs, Draft Legislation, p. 5 recital 1.12 (iv), 22 recital 3.35; HM Treasury/HM Revenue & Customs, Consultation, p. 13 recital 3.7.

54 See HM Revenue & Customs, Finance Bill 2012, p. 37 recital 3.47; HM Revenue & Customs, Draft Legislation, p. 22 recital 3.36.

55 See HM Revenue & Customs, Finance Bill 2012, p. 37 recital 3.49; HM Revenue & Customs, Draft Legislation, p. 22 recital 3.37.

56 See OECD MTC, p. 222 recital 8.

57 Finance (No. 4) Bill, p. 148 at 357CC (8); Consultation draft, p. 9 at 357CB (9).

order, so that a differentiated consideration should be the subject of additional research in this regard. This conclusion therefore is without prejudice to cases in which the damages can literally be multiplied on considerations of criminal law when the infringement of the property right was intentional.[58]

(e) Other compensation: this category of relevant IP income includes any amount of damages, proceeds of insurance or other compensation, other than an amount in respect of an infringement or alleged infringement of a relevant IP right, which is received by a taxpayer in respect of an event and is:[59]
   – sales income (see section 1 above); or
   – loss of income which would, if received by the taxpayer at the time of that event, have been relevant IP income.

   Similarly to the category of damages for infringement, article 55 Tax Act does not expressly refer to the question of whether other compensation qualifies as relevant IP income. Again, an analysis of the wording of article 55 Tax Act provides no indication why the Tax Act in general and article 55 Tax Act in particular should prevent other compensation qualifying as a category of relevant IP income. It can therefore be reasonably concluded that other compensation qualifies for the IP box on the condition that the taxpayer receiving the income is a relevant taxpayer.[60]

The calculation of the relevant IP profits encompasses elements, which are further described below:

(a) Determination of assessment basis: by virtue of article 55(1) Tax Act, 80 per cent of the sum of positive income from relevant IP rights is also considered a commercially justified expense. Article 55(2) Tax Act specifies that the basis of assessment for the deduction of 80 perr cent is the income from the use, realisation or sale of the IP rights, minus the associated tax-relevant expenses, including write-downs on IP rights, even if the expenses arose over several assessment periods. Thus, for the purposes of the Liechtenstein IP box it is not sufficient to identify relevant IP profits based on a mere allocation of profits according to the proportion of total income that is relevant IP income. The application of article 55 Tax Act entails the relevant profit matching precisely with each relevant IP right and calls for the determination of relevant profit based on a sophisticated cost accounting approach (*Spartenrechnung*).[61]

   An illustration on how to determine the basis of assessment for the tax deduction by virtue of article 55(2) Tax Act is set out below:[62]

58 See Lowensohn; United States District Court, Northern District of California, San José Division, 24 August 2012, Case No. 11-CV-01846-LHK, Verdict Form, *Apple Inc* v. *Samsung Electronics Co Ltd.*

59 See also Finance (No. 4) Bill, p. 148 at 357CC (9).

60 See also HM Revenue & Customs, Finance Bill 2012, p. 37 recital 3.50, 38 recital 3.53.

61 *Ibid.*

62 Hosp and Langer, *Besteuerung von Immaterialgüterrechten*, p. 19; Lehmann and Zanettin, p. 11; Hosp and Langer, *Steuerstandort Liechtenstein*, p. 114.

Determination of the basis of assessment for the tax deduction under the IP box

Income from the use, realisation or sale or relevant IP rights (including notional royalties, mixed sources of income or income before grant of a right)

– Associated tax-relevant expenses, including write-downs on relevant IP rights

= Basis of assessment for the deduction of 80%

The tax deduction of 80 per cent under the IP box must be calculated for each relevant IP right separately.[63] This is important where the associated tax-relevant expenses for a relevant IP right exceed the corresponding income of the right. Should the tax deduction be calculated for the aggregate of relevant IP rights, any excess expense of a relevant IP right would evidently reduce any excess income of other relevant IP rights. From the perspective of a relevant taxpayer this may negatively affect the potential tax performance of the IP box, since any excess expense in respect of a relevant IP right, in principle, would reduce the basis of assessment for the deduction of 80 per cent.

(b) Associated tax-relevant expenses: all expenses that arise in generating the relevant IP income and are recognised in statutory accounts or deemed a commercially justified expense under domestic tax law are to be precisely attributed against relevant IP income based on a cost accounting approach.[64]

Associated tax-relevant expenses include, but are not limited to the costs set out below:[65]

– R&D costs;
– licence costs;
– damages for infringement costs;
– personnel costs;
– material and supplies costs;
– premises costs;
– plant and machinery costs;
– professional services costs;
– administration costs;
– registration costs;
– write-down costs;
– finance costs; or
– equity costs.

1.5.7. Anti-avoidance provisions

Article 55 Tax Act does not contain any targeted anti-avoidance provision in order to maintain the intended scope of the IP box regime. It should, however, be noted

63 *Steuerverwaltung des Fürstentums Liechtenstein, Wegleitung juristische Personen*, p. 18.

64 See HM Revenue & Customs, Finance Bill 2012, p. 60 recital 4.13, 4.13; HM Revenue & Customs, Draft Legislation, p. 35 recitals 4.11, 4.12.

65 See *Steuerverwaltung des Fürstentums Liechtenstein, Wegleitung juristische Personen*, p. 18; see also HM Revenue & Customs, Finance Bill 2012, p. 46 recital 3.105; HM Revenue & Customs, Draft Legislation, p. 28 recital 3.77; Müller, Gramigna and Linder, p. 806.

that any non-taxable income may artificially boost the basis for assessment for the tax deduction of 80 per cent. This might result in excessive tax deduction for the purposes of the IP box. Any non-taxable income thus cannot be relevant IP income and is excluded from the scope of article 55 Tax Act.

Apart from that, article 3 Tax Act (abuse of structuring options) contains a general anti-avoidance rule aiming to counteract abuse of structuring options, which extends to the IP box regime as well. Thereafter, legal or actual structures that appear inappropriate to the economic circumstances and whose sole economic purpose consists in attaining tax advantages are considered abusive if:

- the granting of this tax advantage would violate the object and purpose of the Tax Act; and
- the taxpayer is unable to present any economic or other substantial reasons for the choice of this structure and if the structure does not yield any independent economic consequences.

Where an abuse within the meaning exists, the taxes are levied in the way they would be if the legal structure were appropriate to the economic processes, facts, and circumstances.

The anti-avoidance provision by virtue of article 3 Tax Act, however, does not affect any reasonable commercial choice.[66] The provision further does not relate to the choice of whether to apply for a relevant IP right or which relevant IP rights to apply for. For instance, where a taxpayer previously chose to rely on secrecy to protect its innovative technology, but now decides otherwise and is able to obtain a relevant IP right in order to benefit from the IP box, anti-avoidance measures do not apply.[67]

1.5.8. Credit for foreign withholding taxes

Article 63 (avoidance of double taxation) Tax Act stipulates that article 22 Tax Act applies *mutatis mutandis* for the purposes of corporate income tax. Thereafter:

- if the income has been generated in a country with which an agreement for the avoidance of double taxation (DTA) has been concluded, where the agreement provides for tax exemption with respect to that income, or in cases where reciprocity is granted, that income is exempted; and
- if the income has been generated in a country with which a DTA has been concluded, where the agreement provides that a foreign tax applicable to that income is allowable against domestic taxes, or in cases where reciprocity is granted, then the tax of that country corresponding to the corporate income tax is allowed against the domestic tax levied on a national and municipal level applicable to that income.

Against this backdrop, the credit method by virtue of articles 22 and 63 Tax Act implies that a taxpayer can credit the foreign tax against its income tax, up to an amount equivalent to the domestic income tax calculated on the foreign gross

[66] See Liechtenstein Government, Report and Application No. 48/2010, p. 62; see also HM Revenue & Customs, Finance Bill 2012, p. 72 recitals 6.6, 6.7; HM Revenue & Customs, Draft Legislation, p. 41 recital 6.3.

[67] See Liechtenstein Government, Report and Application No. 48/2010, p. 62; HM Revenue & Customs, Finance Bill 2012, p. 72 recital 6.8.

income reduced by the associated tax-relevant expenses, including write-downs, on relevant IP rights.[68]

Any excess of foreign tax credit cannot be carried forward or deducted as an expense from taxable income either. It will therefore be lost. In addition, the allowance of foreign tax credits can only be available in respect of foreign taxes that have been assessed and paid.[69]

1.6. Procedural requirements

Where the relevant taxpayer is subject to corporate income tax, the election for the application of the IP box is made annually with the filing of the corporate income tax return. In this regard, the tax deduction under article 55 Tax Act is calculated by using form G, which is considered being an integral part of the corporate income tax return.[70] Similarly, where a relevant taxpayer is subject to personal income tax, the election for the application of the IP box by way of article 16 (determination of taxable income) paragraph 6 Tax Act is made annually with the filing of the personal income tax return. The personal income tax return so far does not contain a specific form for IP box purposes.

Beyond these submission requirements and the use of form G, a relevant taxpayer is supposed to consult the competent tax authorities with respect to the necessary documentation when first applying the IP box in respect of a relevant IP right.[71] In order to obtain transaction security, it is possible to file for an advance tax ruling with the Liechtenstein tax authorities.

2. R&D incentives in an international context

2.1. Subjective and territorial scope of R&D incentives

2.1.1. Non-discrimination provision of article 24(3) OECD MC

As outlined in section 1.3.4, Liechtenstein extends the benefit of R&D incentives to permanent establishments of foreign establishments of foreign enterprises. By the same token, such permanent establishments are able to take advantage of a tax credit with respect to residual withholding tax levied by a third state on royalties to the same extent as individuals and/or corporations domiciled in Liechtenstein. Thus, the taxation of permanent establishments in Liechtenstein is in line with article 24(3) OECD MC.

68 See also Müller, Gramigna and Linder, p. 810; Felder, *Perspektiven*, p. 148.
69 See Eynatten and Brauns, p. 4; Muntendam and Chiarella, p. 228.
70 See *Steuerverwaltung des Fürstentums Liechtenstein, Wegleitung juristische Personen*, p. 18.
71 *Ibid.*

2.1.2. Compatibility with EU fundamental freedoms (territorial scope)

The Liechtenstein IP box is not subject to any explicit or implicit territorial restriction. As an example, relevant IP income is not restricted to patents stemming from R&D activity conducted in Liechtenstein.

2.1.3. Compatibility with EU state aid rules

As outlined in section 1.3.4, the Liechtenstein IP box not only applies to the determination of corporate income, but also to the determination of the agricultural and forestry profit and to the determination of any income arising from self-employment in areas such as commerce, trade and industry. The IP box thus applies to taxpayers, which are either subject to personal or corporate income tax. The Liechtenstein Tax Act thus complies with the conditions of the EU state aid rules and applies the R&D incentives without distinction to all firms and to the production of all goods without any distinction regarding their legal form, size, location or sector.

2.2. Liechtenstein IP box regimes and harmful tax competition

2.2.1. ESA qualifies Liechtenstein IP box as non-selective

Although the new Liechtenstein Tax Act was strictly drafted with the purpose of avoiding any selective measure,[72] Liechtenstein transmitted the notification of its IP box legislation as a non-aid measure to the ESA for reasons of legal certainty on 23 December 2010.[73] The reasons why the competent authorities in Liechtenstein were considering that the measure did not constitute state aid within the meaning of article 61(1) of the EEA Agreement was that article 55 Tax Act provided for a special tax relief to an amount of 80 per cent of the sum of the positive income from IP rights as a commercially justified and deductible expense aiming to promote R&D.

The assessment taken by the ESA in its decision of 1 June 2011 can be considered as straightforward and in line with its guidelines regarding the application of state aid rules to measures relating to direct business taxation aiming to uniformly apply the same state aid principles throughout the EEA.[74] As set out in the following, one of the four cumulative conditions for a measure to constitute state aid within the meaning of article 61(1) of the EEA Agreement was not met:

(a) Economic advantage: a measure must confer on an undertaking an advantage that relieves it of a charge that is normally borne from its budget.[75] The ESA rightly asserted that article 55 Tax Act allows for a deduction in income derived from IP rights. Undertakings that benefit from the deduction thus pay less income tax. It follows that these undertakings receive an economic advantage.[76]

72 Wenz and Linn, p. 457.
73 ESA, OJ C 278, p. 2.
74 ESA, OJ L 137/20.
75 ESA, OJ C 278, p. 3 recital 1.2.
76 *Ibid.*

(b) Presence of state resources: in order for a measure to be subject to state aid, it must be granted by the state or through state resources.[77] Article 55 Tax Act stipulates that undertakings may claim a relief of 80 per cent of their income from IP rights as a deductible expense for income tax purposes. By allowing for such a deduction prior to the imposition of personal or corporate income tax, the state clearly sacrifices tax revenue. A loss of tax revenue equals the consumption of state resources in the form of a fiscal expenditure.[78] The ESA thus rightly asserted that with respect to the Liechtenstein IP box there is presence of state resources involved.

(c) Selectivity: the presence of state aid further requires that a measure is selective in that it favours certain undertakings or the production of goods.[79] The ESA finds that the tax deduction based on article 55 Tax Act is available to any undertaking subject to personal or corporate income tax. It thus applies without distinction to all economically active persons, irrespective of their size, legal structure or sector.[80] In addition, the ESA declares that the measure does not confer discretionary powers on the tax administration. The competent Liechtenstein authorities confirmed that to their knowledge no particular group of undertakings should benefit more from the measure than others.[81]

Against this backdrop, the ESA considered article 55 Tax Act not to strengthen the position of any particular class of undertakings. The IP box was thus confirmed as not being selective.[82] In its reasoning the ESA further elaborates that a measure open to all economic agents operating within an EFTA state, in principle, is a general measure. The central fact that not every undertaking benefits from the measure in the same way is seen as a mere reflection of economic reality.[83] Because one of the cumulative conditions of article 61(1) of the EEA Agreement is not fulfilled, which must be met in order for aid to be involved, the Liechtenstein IP box was confirmed to be in line with European state aid principles.[84]

As outlined in section 1.5.2, by a resolution of the Liechtenstein Parliament on 25 April 2012, article 55 of the Tax Act has been amended. Article 33 of the Tax Ordinance has basically been absorbed by article 55 of the Tax Act. Furthermore, the catalogue of relevant IP rights has been expanded by software and medical, technical and scientific databases. Again, the government decided to formally notify the modified provision in order to obtain legal certainty.[85]

On 12 December 2012 the ESA confirmed article 55 of the Tax Act to be a general measure and thus not to constitute state aid within the meaning of the EEA

77 *Ibid*, p. 3 recital 1.3.
78 *Ibid.*
79 *Ibid.*, p. 4 recital 1.4.
80 *Ibid.*
81 ESA OJ C 278, p. 4 recital 1.4; see also Cavelti, *Besteuerung nach dem Aufwand*, p. 153.
82 *Ibid.*
83 *Ibid.*
84 *Ibid.*, p. 4 recital 2.
85 Felder and Harmann, pp. 75, 76; ESA, State Aid; ESA, 480/12/COL, p. 1 recital 1; Liechtenstein Government, Report and Application No. 139/2012, p. 29, 50; Liechtenstein Government, Statement No. 21/2012, p. 8, 9, 23; Liechtenstein Government, Report and Application No. 123/2011, p. 23; Liechtenstein Constitutional Court, StGH 2011/13; see also s. 3 (II) (1) (Rights to which the IP box applies) of Part 3.

law.[86] The notified measure, however, covered income from medical databases. In order to eliminate a potentially selective element, the Liechtenstein authorities decided to amend article 55 of the Tax Act during the notification process by taking out the reference to medical databases with effect from 1 January 2012.[87] With respect to discretionary practices it should be emphasised that further than in its decision of 1 June 2011 the ESA expressly held that the Liechtenstein tax authorities are bound to accept the tax deduction where the conditions set out in article 55 Tax Act are met.[88]

2.2.2. Code of conduct

The code of conduct was designed to detect measures which excessively affect the location of business activity in the Community by being targeted only at non-residents and by providing them with a more favourable tax treatment than that which is generally available in the Member State concerned.

The Liechtenstein IP box regime charges relevant IP profit with an effective tax rate of only 2.5 per cent. Other European IP box regimes generally offer similar rates.[89] It should be emphasised that real economic activity and proper economic presence is a decisive component in the commercialisation of relevant IP rights on the basis of any IP box system, which is incidentally presumed to be in place. In the light of the above it can be concluded that the Liechtenstein IP box is not a potentially harmful measure. Even though one might not agree on this conclusion, according to the opinion of the reporters the Liechtenstein IP box is unlikely to be classified as harmful measure under the code of conduct.

2.2.3. Transfer of intangibles to low-tax jurisdictions

According to article 49 Liechtenstein Tax Act, if the corporate income or expenses of a taxpayer arising from a business relationship with persons with a close relationship are constructed in such a way that other conditions are taken as a basis than those which mutually independent third parties would have agreed to under otherwise identical circumstances, the determination of taxable net corporate income shall assume the corporate income and expenses that would have applied in a relationship between independent parties. For the assessment whether a transaction is in line with a third party comparison, Liechtenstein applies the OECD transfer pricing guidelines.

Liechtenstein does not have CFC legislation. However, article 3 Tax Act (abuse of structuring options) contains a general anti-avoidance rule aiming to counteract abuse of structuring options. For further details see section 1.5.7.

86 ESA, State Aid; ESA, 480/12/COL, p. 7 recital 28; see also Maute, Senn and König, p. 419.

87 Art. 55(1)(b) of the Amended Tax Act; s. II (*Inkrafttreten*), art. 2 of the Amended Tax Act; ESA, 480/12/COL, p. 3 recital 11; Liechtenstein Government, Report and Application No. 139/2012, p. 29, 50; see also Maute, Senn and König, p. 419.

88 ESA, 480/12/COL, p. 4 recital 17, 7 recital 26; ESA, OJ C 278.

89 See Merrill *et al.*, p. 1667.

2.2.4. Royalty payments to intermediary IP companies

Liechtenstein does not have any specific regulations in any of its relevant international agreements. Again, all structuring activities are scrutinised under the general anti-avoidance rule of article 3 Tax Act. For further details see section 1.5.7.

2.3. Current developments/OECD BEPS initiative

Currently the EU's code of conduct group is reviewing the IP regimes in the EU Member States from a harmful tax practices viewpoint, particularly on the point of substantial economic activity in the Member State that grants the relief. At the request of the 20 June 2014 ECOFIN Council, the code of conduct group will assess all existing patent boxes in the EU, including those already assessed or considered before, by the end of 2014, also against the background of international developments, including the OECD BEPS initiative.

Action item 5 of the OECD BEPS initiative mandates that a preferential regime requires substantial activities before a taxpayer can receive benefits under that regime. The purpose of the approaches is to align the taxation of profits with the economic activities that give rise to them. There are two leading options for tighter substance rules: "nexus" and "transfer pricing".

- The nexus approach would limit the benefit of an IP regime to IP which has been developed through research and development expenditure of the IP owner, or an external organisation to which the R&D has been contracted out. The more activity that is undertaken by the IP company itself or provided by a third party to the IP company, domestically or elsewhere, the higher the proportion of IP income that would benefit from the incentive regime. However, group internal sub-contracted R&D and the acquisition of IP may not qualify.
- The transfer pricing approach would focus on requiring a minimum level of substance in the IP owner modelled on the OECD's revised discussion draft on the transfer pricing of intangibles. The claimant company must be the legal owner, and be performing functions, using assets and assuming risk related to developing, enhancing, maintaining and protecting the intangibles. Once a certain substance threshold is reached, all the relevant income would be subject to a preferential taxation.

While a majority of Member States favour the nexus approach, Liechtenstein together with *inter alia* the Benelux states and Switzerland prefers the traditional transfer pricing approach for several reasons:

- The proposed nexus approach benefits large countries with available intellectual resources. Small countries, which are dependent on insourcing a significant amount of resources, would be discriminated against since doing so (for example via contract R&D) may prove not to be equally tax efficient and thus potentially disadvantageous in comparison to larger countries.
- The nexus approach focuses on patents. However, in today's competitive landscape, countries may wish not to limit their support to companies performing technical R&D activities, but to extend their support to all companies with innovative activities. This is also supported by the Europe 2020 strategy (formally known as the Lisbon Strategy). A pure focus on technical

innovation should at least raise critical questions since limitation to technical innovation may exclude certain industries, such as for example the fashion industry, finance industry or software industry, from an R&D tax measure.

- The nexus approach only focuses on costs and thus ignores the fact that the main limiting constraint to successful R&D is access to funds and the assumption of risks.
- The nexus approach is a fiction that R&D has a direct link to income. This is not the case in practice. Companies may invest in R&D without creating revenues directly. Thus, any costs related to R&D have, also considering a time-lag between costs of R&D and the successful launch of any product or service which may result out of these efforts, absolutely nothing in common with the income receiving benefit.
- Finally, it remains to be seen whether the nexus approach complies with legal EU principles, either on the basis of the fundamental freedoms by possibly excluding R&D activity with its nexus in other EU/EEA Member States or on the basis of state aid by possibly granting selective advantages to R&D intensive undertakings and excluding internal subcontracting.

To address the concerns expressed by some Member States with respect to the nexus approach as proposed by the OECD, Germany and the UK in a joint statement of November 2014 suggest a modified nexus approach to advance the negotiations on new rules for preferential IP regimes within the BEPS initiative. In particular, the modified nexus approach foresees an uplift of qualifying expenditure by taking into account outsourcing costs to related parties and acquisition costs within certain limits.[90]

It remains to be seen how the Liechtenstein IP box will be affected by current international developments and how it may be amended. This is why the Liechtenstein government has set up a BEPS working group that closely monitors the international developments and directly reports to the government on a regular basis.

[90] HM Treasury, HM Revenue & Customs, available at www.gov.uk (13 November 2014).

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