International Fiscal Association

2023
Cancun Congress

cahiers de droit fiscal international

VOLUME 107

A: Sharing and shifting of corporate losses – The new profit shifting?

1938-2023

Liechtenstein

Branch reporter
Patrick Knörzer[1]

Summary and conclusions

The Liechtenstein tax rules on the utilisation of losses have been somewhat extended and liberalised by the big tax reform in 2011. Since then, tax losses of legal entities are to be carried forward indefinitely for corporate income tax purposes. Legal entities that generate a loss are not taxed in the respective year except for the annual minimum corporate income tax of CHF 1,800. The deduction of carried forward losses is by definition limited to 70% of taxable corporate income of the current tax year which results in a minimum tax base of 30% of the current taxable income. Excess tax losses beyond the cap can still be carried forward to future years.

The deduction of losses from foreign permanent establishments is permitted, although income from permanent establishments in Liechtenstein is tax-exempt. However, the deduction is only temporary, and the deducted PE losses must be taxed by the Liechtenstein legal persons after five years at the latest. Thus, the use of foreign losses only results in a tax deferral.

A modern group taxation regime opens up the utilisation of losses between legal entities belonging to the same group also including losses from foreign subsidiaries if they are group members. However, the use of losses of other group members is also limited to a period of maximum five years. Since subsequent taxation takes effect after five years at the latest, group taxation merely results in a deferral of tax.

All tax losses deducted in Liechtenstein must be determined in accordance with the book-tax conformity principle and the provision of the Liechtenstein tax law. It is stipulated that the equity interest deduction by definition cannot lead to any tax loss. If a legal entity subject to corporate income tax in Liechtenstein has incurred a tax loss, this loss has to be calculated without claiming the allowance for corporate equity.

Under the Liechtenstein tax-neutral holding regime, capital gains and capital losses from the sale of domestic and foreign participations and shares do not impact the tax base. Similarly, no tax-effective depreciation is permitted if a value adjustment of the shares is required for accounting purposes.

The Liechtenstein legislator has not found it necessary to introduce special provisions for losses caused by the COVID pandemic; COVID-related losses are treated like all other losses under Liechtenstein tax law. Accounting losses from restructurings are generally not tax deductible if the restructuring is tax neutral, such as a share deal. If a company ceases to exist in the course of such a reorganisation, e.g. in the course of a merger, an existing loss carry-forward is transferred to the fiscal successor.

Liechtenstein resident legal persons are usually not leveraged to a large extent and do not use the debt interest deduction so much to generate a loss. Instead, they are predominantly equity-financed and make greater use of the notional interest deduction,

1 Deputy Head of the International Division, Liechtenstein Fiscal Authority.

which, however, by definition cannot generate a loss. Of course, the interplay of deductible debt interest and the equity interest deduction requires a number of anti-abuse provisions to prevent double claiming of the same financing expenses.

The BEPS project had a big impact on Liechtenstein tax law in general but not so much in the field of losses, as abusive schemes encouraging the shifting of losses have not been common in Liechtenstein. To avoid the result of deduction non-inclusion (D/NI) Liechtenstein has introduced the correspondence principle for dividends from domestic and foreign subsidiaries if the share is at least 25% of the votes or the capital. The existing Liechtenstein GAAR can also be a suitable instrument to prevent the multiple use of losses, but due to the lack of cases and court decisions, its exact effects are not yet foreseeable.

As Liechtenstein has rather moderate tax rates the shifting of foreign losses to Liechtenstein to optimise the tax burden normally does not occur. Overall, Liechtenstein tax law is not the most liberal system with regard to loss deduction. In particular, the deduction of tax losses in Liechtenstein is restricted by the general 70 % limit, the subsequent taxation of foreign PE losses and losses attributed by group taxation and special provisions around the deduction of equity and debt interest.

Part One: General aspects of corporate tax losses

1.1. General overview

Losses are a frequent phenomenon, especially in times of an economic crisis. In the terminology of tax law, losses are described as negative corporate income. In Liechtenstein, the recognition of losses within the framework of corporate income tax is required by the ability-to-pay principle that is stated in the constitution.[2] Loss compensation and loss carry-forward have been expanded by the tax reform 2011.

An offset of profits and losses is made between the different types of income of a legal person within the same tax period according to Liechtenstein tax law. For example, profits from services can be compensated with losses from rentals and vice versa. In the context of corporate income tax, the balancing of profits and losses from different sources within the same taxable period is usually already done through accounting. The Liechtenstein concept of company taxation does not distinguish between different types of profits and losses, but all types of profits and losses are part of the overall income of the legal entity.

The basis for determining tax losses is the profit or loss in the annual financial statements, which is determined on the basis of accounting. In accordance with the authoritative principle governing the tax accounts the commercial profit is the starting point for tax purposes and must be modified by certain additions and deductions in order to calculate the tax base. The Liechtenstein Persons and Companies Act ("PGR") is the sole authoritative accounting standard, whereas individual financial statements prepared in accordance with IFRS or other international accounting standards are not a permissible basis for taxation.

From a systematic point of view, it is important to emphasise that the loss offset is mandatory and not an option of the taxpayer under Liechtenstein tax law unless the

2 Art. 24 para. 1 of the Liechtenstein Constitution.

respective provision explicitly stipulates an option. This principle is particularly important to consider in case of reorganisations. The only option for the taxpayer to either claim or not claim taxable losses is under the Liechtenstein group taxation regime, where there is the option to form a group or not.

Generally, the offsetting of losses within the current tax year applies to all types of taxable losses, irrespective of whether they are current losses or losses on disposal of an asset. This principle is breached in the case of losses from the sale of real estate: Capital gains from the sale of a domestic real estate are exempt from corporate income tax but subject to a special real estate gains tax ('Grundstücksgewinnsteuer') in Liechtenstein. However, losses from the sale of a domestic real estate do not trigger real estate tax. Therefore, these losses are relevant for corporate income tax purposes and can be offset with other positive sources of income.[3]

As regards the real estate gains tax, a capital loss arises if the taxpayer's investment costs exceed the proceeds from the sale. Losses from the sale of immovable property are deductible for purposes of the real estate tax only to the extent that such losses were not compensated by insurance benefits.[4] Capital gains from the sale of a foreign real estate are not taxable in Liechtenstein; they are exempt from corporate income tax and they are not subject to real estate gains tax. Conversely, losses from the disposal of foreign real estate are disregarded for tax purposes.

1.2. Types of tax policies for domestic losses

Legal persons with their seat or place of effective management in Liechtenstein are subject to unlimited corporate income tax of 12.5%. For ordinarily taxed legal persons, all foreign losses are included in the taxable income of resident companies. Special rules exist for losses incurred by a foreign PE or on foreign immovable property. In a year with taxable losses the legal person still has to pay the minimum corporate income tax of CHF 1,800.[5]

Legal entities subject to ordinary taxation may claim general loss compensation and an unlimited and unrestricted loss carry-forward.[6] Negative net income is offset against positive net income. A taxable loss can also be carried forward to subsequent periods without limitation. The idea of the loss carry-forward is to eliminate taxation if no total profit is made over several tax periods, apart from the minimum tax.

Private Asset Structures (PAS) are only subject to a minimum corporate income tax of CHF 1,800 regardless of their income. The tax status of a PAS is available for non-economically active legal persons and can be claimed annually. For the taxation as a PAS, any losses of the legal entity are irrelevant for tax purposes and are not even determined, since a PAS does not have to file a tax return and is not assessed.[7] However, if a PAS opts for ordinary taxation or changes its activity in such a way that it is compulsorily subject to ordinary taxation, it cannot use losses actually incurred from its time as a PAS - if these were calculated at all. Whether an ordinarily taxed legal entity that is subsequently taxed as a PAS for a number of years continues to retain its previously accumulated loss carry-forwards

3 Art. 48 para. 1 lit d of the Liechtenstein Tax Act.
4 Art. 40 of the Liechtenstein Tax Act.
5 Liechtenstein Government, Report and Application (BuA) no. 2012/139.
6 Art. 57 para. 1 of the Liechtenstein Tax Act.
7 Art. 64 para. 8 of the Liechtenstein Tax Act.

and can use them in the future as soon as it reverts to ordinary taxation is not expressly regulated by law.[8]

For the utilisation of losses, it does not matter whether the taxpayer suffering the loss is resident or not resident in Liechtenstein. If non-resident legal persons file a tax return, either on an obligatory or voluntary basis, there are not any restrictions on either loss offset or loss carry-forward that go beyond the provisions which are applicable to tax residents.

Withholding taxes are levied in Liechtenstein to non-resident companies which generate director`s income.[9] As is the nature of most withholding taxes, the withholding tax applies exclusively to the gross income, so that losses cannot be taken into account in this case. The question of loss recognition does not arise here unless the non-resident company voluntarily files a tax return.

1.2.1. *Pre-operating losses*

In Liechtenstein, there are no restrictions on start-up losses as the carry-forward of losses is allowed without any time limitations. Pre-operating losses are treated just as any other losses for tax purposes.

1.2.2. *Loss carry-back*

The Liechtenstein tax law does not contain loss carry-over provisions that allow taxpayers to deduct current year losses against past profits. so-called loss carry-backs.

1.2.3. *Loss carry-forward*

Liechtenstein tax law provides for a general loss carry forward for legal persons. Taxable losses which originate from previous years, are deductible insofar as they could not be taken into account in the calculation of the taxable income of these years.[10] It does not matter to which activity the loss is attributable. Liechtenstein tax law does not contain any prohibitions on carrying forward losses from certain activities.

There is no time limit for loss carry-forwards. The loss must be determined by proper accounting in order to be able to be carried forward.

The loss carry-forward is capped at 70% of taxable corporate income of the current tax year which results in a minimum tax base of 30% of the current taxable income.[11] The provision ensures that tax is payable on at least 30% of the taxable net income which also reduces the volatility of tax revenues.[12] Excess tax losses beyond the cap can still be carried forward.

8 Knörzer & Stöckl, Verlustverwertung im liechtensteinischen Steuerrecht vor und nach der geplanten Steuerrechtsrevision, liechtenstein-journal 2/2010, p. 49.

9 Art. 25 para. 1 of the Liechtenstein Tax Act.

10 Art. 57 para. 1 of the Liechtenstein Tax Act.

11 Art. 57 para. 1 first sentence of the Liechtenstein Tax Act.

12 Liechtenstein Government, Report and Application (BuA) no. 2012/139.

There are no special rules about the impact of COVID-19 on the treatment of losses in Liechtenstein. A loss that is incurred because of the effects of COVID-19 and related measures is treated the same way as any other loss for tax purposes.

The Liechtenstein tax law provides an exit taxation for legal persons: If the Liechtenstein right of taxation with respect to the gain from the sale or use of an asset is excluded or limited by measures taken by the taxpayer, for instance by moving the asset abroad, the asset shall be deemed to be sold or transferred at the arm's length price.[13] This deemed sale may also result in a capital loss to which the same principles apply as to current losses. It may be offset against other profits and, if necessary, carried forward; here, too, the limit of 70% of the current profits applies.

1.2.4. *Losses after the end of a business*

The Liechtenstein tax law does not contain special provisions about the treatment of losses after winding-up of a business. Upon dissolution, the remaining loss carry-forwards of the dissolved company that could not be set off with profits disappear permanently. They cannot be utilised by the former shareholders either.

1.2.5. *Transfer of losses in reorganisation schemes*

For certain types of reorganisations, the Tax Act provides for universal succession for tax purposes in combination with tax neutrality. In the case of such reorganisations existing loss carry-forwards of the fiscal predecessor are transferred to the fiscal successor.[14] Such reorganisations include mergers of two legal persons and conversions of a legal person into another legal entity or into a company without personality (change of legal form). In the case of a transfer of assets by way of a split or a spin-off to one or more other legal entities, which includes at least one partial business, a loss carried forward of the transferring enterprise shall be transferred in proportion to the transferred parts of the assets.[15]

In the course of a share deal the tax carry-forward of the target company basically stays with the transferred company as a share deal does not affect the fiscal sphere of the transferred company. In an asset deal, however, the loss carry-forward of the seller is not transferred to the buyer even if an entire PE is transferred. Firstly, because in an asset deal the hidden reserves of the transferred assets are taxable with the seller. Besides, an asset deal does not lead to a universal succession under Liechtenstein law. Even if the asset deal is structured as a contribution in kind where the businesses or parts thereof are passed in exchange for shares the loss carry-forward which is adhered to the transferred business cannot be passed on to the buyer.

If the entire tax loss situation is taken over by the successor company, this also applies to losses from foreign PEs which have been deducted in Liechtenstein in previous years.[16] The

[13] Art. 51 para. 1 of the Liechtenstein Tax Act.
[14] Liechtenstein Government, Report and Application (BuA) no. 48/2010, art. 52, p. 132.
[15] Art. 52 para. 4 of the Liechtenstein Tax Act.
[16] Liechtenstein Government, Report and Application (BuA) no. 48/2010, p. 132.

loss recapture rules and the recapture period of maximum five years for foreign PE losses must also be monitored by the successor company.[17]

1.2.6. Group loss compensation

Since 2011, a group taxation regime is in place in Liechtenstein. On request, associated companies may form a group for tax purposes, whereby the group head must be a legal entity resident in Liechtenstein or a foreign legal entity with a Liechtenstein branch, while group subsidiaries may be domestic or foreign legal entities. A key element of the Liechtenstein group taxation is the attribution of a loss generated by one group member to another group member.[18]

The Liechtenstein group taxation does not lead to a consolidation in the accounting sense. According to the system of the Liechtenstein group taxation, the group head and the group members stay independent tax subjects and have to compute their taxable income or loss in compliance with the ALP.

Loss utilisation by means of group taxation is only possible for legal persons. To apply for group taxation, the parent company must have its legal seat or the place of its effective management in Liechtenstein (group parent) and must hold directly or indirectly more than 50% of the voting rights or the share capital of one or more resident or non-resident companies which are the group members. The holding interest must be in place with no interruption starting at least at the beginning of the tax year.

A non-resident company may be a group parent, provided that it has a branch in Liechtenstein to which the shares are attributable; in such a case, the group regime applies to the domestic branch. Upon the application for the group regime, a group parent must be designated. It is not required that all associated companies become group members.

Within a group, losses of domestic and foreign group members can be utilised by Liechtenstein-resident group members or by the group parent. Under group taxation, losses of group members may be credited against profits of other group members within the same year.

Under the group regime, losses may be set off against profits of other group members, especially against losses of the parent company and/or other subsidiaries. The loss is attributed in proportion to the amount of the direct participation of the parent in the share capital of each group member (participation quota). In the first step, the loss must be allocated to the group parent, and only when its loss has been reduced to zero can the excess losses be passed on to other group members.[19] Losses attributable to a group member are limited to the proportion of the taxable income of that group member corresponding to the participation quota.

The allocation of losses of a group member to the group parent is made pro rata to the respective extent of the participation of the group parent. Losses of group members as well as losses of the group parent can be offset. The company using the losses can either be the group parent or, if the group parent has no income in the corresponding amount, a group member.

[17] Knörzer/Stöckl, Verlustverwertung im liechtensteinischen Steuerrecht vor und nach der geplanten Steuerrechtsrevision, liechtenstein-journal 2/2010, p. 48.

[18] Roth, Grundriss des neuen liechtensteinischen Steuerrechts (Schaan 2011), p. 67.

[19] Langer, Das liechtensteinische Steuerrecht (Wiesbaden, 2019), p. 165.

1.2.7. The role of anti-abuse provisions (GAARs and/or SAARs) in the context of losses

Since 2011, the element of tax abuse has been codified in Liechtenstein in a GAAR according to article 3 of the Liechtenstein Tax Act. Under this general anti-abuse provision, taxes shall be levied in the manner in which they would be levied if the legal structure were appropriate to the economic transactions, facts and circumstances.[20] Any structure or a transaction that is not appropriate for its economic circumstances and that has a sole purpose of attaining tax benefits is considered abusive if by entering into the transaction, the taxpayer violates the object and purpose of the tax legislation; and the taxpayer is unable to present any substantial economic or other reasons for the transaction and the transaction does not generate any economic results.[21] By now, only very few court decisions have been issued on the GAAR so far and none of them deal with an abusive structure to generate, utilise or shift losses.

The Liechtenstein tax law also entails some SAAR provisions. However, these provisions deal with specific situations and do not address the generation, utilisation or shifting of losses.[22]

1.3. Key principles of tax treaty law relevant in case of losses

1.3.1. Profit allocation of PE's (Articles 5 and 7 of the Models)

Generally, income from foreign permanent establishments is not subject to corporate income tax in Liechtenstein on a unilateral basis.[23] Nevertheless, foreign PE income must be declared by resident legal persons even though it is not taxed in Liechtenstein.

When it comes to losses, the Liechtenstein tax law distinguishes between losses from foreign sources in general and losses from foreign permanent establishments. Basically, losses from sources of income that are exempt from corporate income tax in Liechtenstein either on the basis of domestic law or of a tax treaty, are not deductible. This principle applies to income from foreign real estate, i.e. above all rental and lease income from foreign real estate. Since current income from foreign real estate, foreign agriculture and foreign renting and leasing is exempt from corporate income tax,[24] losses arising therefrom are also not deductible in Liechtenstein.[25] This principle is only broken in the case of losses from foreign permanent establishments.

Irrespective of the exemption of any profits from the permanent establishment, losses incurred in a foreign PE can be offset against positive domestic income, provided that

[20] See Felder & Mairhofer, "Liechtenstein", in International Fiscal Association (ed.), Anti-avoidance measures of general nature and scope – GAAR and other rules, Cahiers de Droit Fiscal International Vol. 103A (2018), pp. 480 et seq.; Wenz Knörzer & Busch, "Chapter 19: Liechtenstein" in Lang et al. (eds.), GAAR – A Key Element of Tax Systems in the Post-BEPS Tax World, IBFD Vol. 3 (2016), p. 397 et seq.

[21] Liechtenstein Government, Report and Application (BuA) no. 48/2010, art. 3, pp. 62 et seq.

[22] For details see Wenz Knörzer & Busch, "Chapter 19: Liechtenstein" in Lang et al. (eds.), GAAR – A Key Element of Tax Systems in the Post-BEPS Tax World, IBFD Vol. 3 (2016), p. 401 et seq.

[23] Art. 48 para. 1(b) of the Liechtenstein Tax Act.

[24] Art. 48 para. 1(a) and (d) of the Liechtenstein Tax Act.

[25] Knörzer & Stöckl, Verlustverwertung im liechtensteinischen Steuerrecht vor und nach der geplanten Steuerrechtsrevision, liechtenstein-journal 2/2010, p. 49.

these losses have not already been taken into account abroad. In order to avoid a double-deduction of the same loss, deductibility in Liechtenstein is only subsidiary, i.e. if the losses cannot be deducted in the state of the PE.[26]

For the determination of the PE profit or loss the administrative practice provides that the allocation of income is basically carried out on the basis of the object, especially real estate or PE. The pro rata allocation of the corporate income attributable to the foreign PE must be made directly via the permanent establishment accounts under Liechtenstein law. Therefore, separate accounts must be kept for the foreign PE, in which remunerations for services and financing must be recorded in accordance with the OECD arm's length principles.[27]

In relation to Switzerland, due to the traditionally close economic ties with Liechtenstein, a different profit allocation is possible according to the administrative practice as an alternative: For Swiss permanent establishments, also a quota-based elimination can be used. However, an indirect quota-based allocation is a deviation from the OECD standard to which the article on business income in the tax treaty between Liechtenstein and Switzerland corresponds. Therefore, a proportional allocation of PE income must be agreed. The proportionate exemption of Swiss PE income can be based either on employment factors (total assets plus the wages capitalised at 10% or on other earning factors [as a rule the rental expenses capitalised at 6%]), the turnover or other factors suitable for the industry. An advance share (praecipuum) of 20% of the total profit is allocated to the head office of the company in the course of the tax segregation, which is intended to reflect the importance of the head office for the administration and the central management. However, this advance share is not allocated in the event of a loss.[28]

For losses from foreign permanent establishments, Liechtenstein tax law contains an explicit provision according to which losses from PEs are deductible under the condition that the permanent establishment loss must be disregarded in the PE state or in another state.[29] This requirement was introduced to prevent double or multiple utilisation of PE losses. The deductibility of the PE loss in Liechtenstein is thus subsidiary to a deduction of the loss abroad. Deductible PE losses can also be carried forward to future tax periods in Liechtenstein if there is not enough profit in the Liechtenstein head office.

The tax treaties do not change much in these rules, perhaps except for the scope of a PE which is agreed in the tax treaty. Liechtenstein generally has included the exemption method for foreign PE income in its tax treaties. However, the exemption does not impact the deductibility of foreign PE losses in Liechtenstein. So, there is not much difference in treatment of foreign PE losses in a treaty and in a non-treaty situation.

The foreign PE income must be recalculated in accordance with Liechtenstein tax law to arrive at the deductible PE loss. For the deductibility of the loss it is decisive whether a PE loss exists under Liechtenstein tax law whereas it is irrelevant whether there is also a loss under foreign tax law. The deduction of the PE loss in Liechtenstein is also permissible if a positive income is determined under foreign tax law and even taxed in the PE country.

A key protection against a double loss utilisation of foreign PE losses is a recapture rule which must be observed after a deduction of the PE loss has been made in a previous year. If the loss-making foreign PE generates profits in a subsequent year, losses previously offset

26 Art. 57 para. 2 first sentence of the Liechtenstein Tax Act.

27 Liechtenstein Fiscal Authority, Guide to the tax return for legal entities, p. 27.

28 Liechtenstein Fiscal Authority, Guide to the tax return for legal entities, p. 27.

29 Art. 57 para. 2 of the Liechtenstein Tax Act.

against domestic income are subject to subsequent taxation in Liechtenstein.[30] However, it is not a prerequisite for the subsequent taxation that there is actually a loss offset in the PE jurisdiction.

The subsequent taxation aims at avoiding the utilisation of the same loss in two different tax periods, first in Liechtenstein as the residence state and later in the PE state. The documentation of the income of the foreign PE in the following years after the deduction of the loss is the responsibility of the domestic taxpayer; the Liechtenstein resident company must prove annually that the conditions for subsequent taxation are not met. The subsequent taxation also arises if the unlimited corporate income tax liability of the company is terminated either because the company is dissolved or because it is relocated abroad. The latter provision aims to ensure that the taxpayer does not disappear for the purposes of the subsequent taxation.

In any case, the subsequent taxation of the PE losses must take place five years after the attribution of the loss at the latest.[31] After five years the taxable income of the head office must be increased accordingly. For example, in the fiscal year 2021 all losses from foreign PEs of the fiscal year 2016 that have not been taxed before must be recaptured.[32] The subsequent taxation also occurs if the foreign PE has not yet earned any profits and thus has not had the possibility to offset its losses.[33] In the opinion of the Liechtenstein government, a period of five years should be appropriate, on the one hand, to compensate for one-off losses or losses suffered during the set-up phase and to lead the PE into the profit zone and, on the other hand, to prevent abuses.[34] As a result, only a tax deferral can be achieved by utilising foreign PE losses in Liechtenstein.

1.3.2. *Profit/loss recognition in relation to foreign subsidiaries (Articles 7 and 13 of the Models)*

As a consequence of the separation principles losses of foreign subsidiaries generally stay at the level of the subsidiary and are not attributed to the parent company with the exception of the group taxation regime. An indirect deduction for foreign losses in the way of a write-off of the participation at parent level is also not allowed. Losses of subsidiaries can therefore not be taken into account directly by the parent company with the exception of the group taxation regime.

As of 2019, Liechtenstein has introduced a completely symmetrical participation regime for shares in domestic and foreign subsidiaries: Capital gains from participations in companies are tax-exempt at the level of the parent company. Conversely, capital losses from the disposal of shares or from the depreciation of shares are not deductible for tax purposes. Such accounting losses are eliminated for tax purposes and can therefore not be carried forward. Also, unrealised losses on holdings in legal persons, especially by way of a depreciation, are not tax deductible.[35] In return, unrealised gains from appreciations in value are not taxable.

This tax neutral holding regime is applicable to controlling interests as well as to

30 Art. 57 para. 2 of the Liechtenstein Tax Act.
31 Art. 57 para. 2 last sentence of the Liechtenstein Tax Act.
32 Liechtenstein Fiscal Authority, Guide to the tax return for legal entities, p. 29.
33 Langer, Das liechtensteinische Steuerrecht (Wiesbaden, 2019), p. 163.
34 Liechtenstein Government, Report and Application (BuA) no. 2014/15.
35 Art. 47 para. 3 (c^{bis}) of the Liechtenstein Tax Act.

individual shares. It also prevents situations in which a dividend is distributed shortly before an intended sale of the shares so that a tax-deductible capital loss subsequently arises. Since the capital loss is generally not deductible for tax purposes, it is also irrelevant whether the loss arose due to a timely distribution.

However, there is no prohibition of deduction of debt interest expenses which are connected to the shares. Interest on debt capital is generally deductible, even if the purpose of the loan is to acquire a shareholding and earn tax-exempt dividends.

Part Two: Utilisation of losses for tax planning

2.1. General overview

As Liechtenstein has a rather moderate corporate income tax rate the shifting of losses to Liechtenstein as a way of tax planning does not happen very frequently. Besides, there are narrow legal restrictions for shifting losses to related or unrelated parties under Liechtenstein tax law.

The Liechtenstein legislator tries to avoid schemes which utilise losses for aggressive tax planning. Several rules aim to limit the use of losses. In fact, the only possibility to use a tax loss for an unlimited period of time is if the losses are the own losses of the respective legal person and generated domestically. If, on the other hand, foreign PE losses or losses of another group company are attributed, the maximum period of five years for the loss utilisation must always be observed. Besides, foreign PE losses are only deductible if not deductible in another state which prevents double utilisation. These loss rules have not been changed in any way due to the Covid-19 pandemic in Liechtenstein.

2.2. Schemes shifting profits to a loss-making party

a. Utilisation of foreign losses

In the case of income tax, there is no general rule on the treatment of losses from foreign sources. Since tax residents are assessed on their net income earned worldwide - with the exception of income from foreign permanent establishments and from foreign real estate - foreign losses from all other sources of income reduce the taxable net income. It should be noted that the loss figures calculated for tax purposes abroad must be converted in accordance with Liechtenstein tax law.

There is no explicit provision in the Liechtenstein Tax Act on the utilisation of other foreign (non-PE) losses. Since, according to domestic law, taxpayers are always to be assessed on their worldwide income, losses from foreign sources are, in principle, included in the basis of assessment in the same way as losses from domestic sources. The principle applies that the foreign losses are to be determined according to Liechtenstein tax law or converted into Liechtenstein tax law. In the course of this conversion, deviations may occur: If a loss determined according to foreign law results in a profit on the basis of Liechtenstein tax law, this profit is decisive. Conversely, a profit determined according to foreign law may also “convert” into a loss according to Liechtenstein tax law in the course of the conversion. The relevant result is always that which is based on Liechtenstein tax law.

If, on the other hand, not the exemption but the imputation method is agreed in the DTA, the result from the corresponding foreign source of income - i.e. also any loss - must be fully taken into account in Liechtenstein in the assessment and a corresponding foreign tax must be credited in accordance with the agreement, provided such a withholding tax has actually been incurred.

b. Group taxation

The Liechtenstein group taxation regime does not allow shifting profits but – vice versa – shifting losses to a profit-making group company. However, the utilisation of the shifted foreign and domestic losses is subject to tax recapture rules in order to avoid double loss utilisation. Always, the subsequent taxation of the attributed losses is to be made at the level of the loss-utilising group company. A subsequent taxation of the attributed losses takes place in four different situations.[36]

Firstly, subsequent taxation is triggered by a reduction of the participation quota within the group. If the participation quota in a group member is reduced, the attributable net income is to be added to the taxable net income proportionately according to the reduction of the participation quota. This applies accordingly to the reduction of the shareholding in a group member to which losses were attributed.[37]

Secondly, in order to avoid a double-utilisation, a subsequent taxation takes place if the loss-making group member generates a profit in a following year and compensates it with its existing loss carry-forward. This is necessary because in spite of the attribution of the loss to another group company the loss of each group member can still be utilised by the loss-generating group member as a loss carry-forward. The Liechtenstein legislator does not want to reduce the loss carry-forward of any group company in order to avoid putting a company in a worse position due to its membership of a group than without the group membership.[38]

Thirdly, subsequent taxation can be caused by companies leaving the group. If the loss-making group company leaves the group, the subsequent taxation of the losses occurs in the year of the exit.[39] If the loss-receiving group company leaves the group, all its attributed losses from previous years must be recaptured.[40]

Lastly, subsequent taxation always occurs no later than five years after the attribution of the loss.[41]

To sum up, the effect of the attribution of losses under a group taxation regime is reversed after five years, at the latest. Therefore, the group taxation regime in Liechtenstein only consists of a tax deferral and not of a tax deduction.[42] Because of this fact, the shifting of losses by a group taxation regime is rather sparsely used by Liechtenstein companies.

36 For examples see Knörzer, Die neue liechtensteinische Gruppenbesteuerung, Liechtensteinische Juristenzeitung 2010, pp. 98 et seq.

37 Art. 58 para. 5 of the Liechtenstein Tax Act.

38 *Knörzer*, Die neue liechtensteinische Gruppenbesteuerung, Liechtensteinische Juristenzeitung 2010 p. 100.

39 Art. 58 para. 7 first sentence of the Liechtenstein Tax Act.

40 Art. 58 para. 7 second sentence of the Liechtenstein Tax Act.

41 Art. 58 para. 9 second sentence of the Liechtenstein Tax Act.

42 Liechtenstein Administrative Court of 29 April 2021, VGH 2021/009.

2.3. Schemes circumventing time restrictions on the carry-over of losses

Only two kinds of time limitations for the utilisation of losses in Liechtenstein are imposed: one concerning PE losses and the other within the group taxation regime. In all other situations the carry-forward of losses is permitted for an indefinite period. As the number of business restructurings is rather low in Liechtenstein there are no known schemes to circumvent the time limitation of carry-forwards for PE losses.

2.4. Schemes circumventing change of ownership/activity restrictions on the carry-over of losses

Basically, there is no special anti-abuse rule in Liechtenstein tax law that imposes restrictions in the area of loss utilisation in relation to the purchase of an inactive company which has a loss carry-forward. Whenever the legal entity is subject to taxation in Liechtenstein, tax losses survive a change of ownership. The domestic tax law does not contain any special shell company provisions that would explicitly provide for the elimination of the loss carry-forward under certain circumstances.

However, the prohibition of so-called trading in losses from empty shell companies can be based on the GAAR and on case law about tax abuse. A shell company is a corporation that has been de facto liquidated but not deleted from the commercial register so that its legal personality still exists. Such companies no longer have any significant assets or the existing assets exist only in liquid form, such as cash, account balances or receivables from the owners. These companies no longer participate in economic life. Only the necessary statutory and legal acts are still performed, such as the filing of a tax return. After the change of ownership, the activity is then typically resumed, which can be shown, for example, by moving the registered office, reappointing the governing bodies or changing the purpose or name.[43]

In such a case, the offsetting of losses incurred prior to the change of ownership is not permitted. The Liechtenstein case law concludes this from the prohibition of abuse of rights, which is derived from the overriding principle of good faith. Based on the GAAR, the Liechtenstein fiscal authority reserves the right to refuse to carry forward losses if the characteristics of the legal entity targeting losses change significantly – this would also include the shell purchase if the company were considered to have lost its identity because of substantial changes in the economic structure, the organisational structure and the ownership structure. Both the company and the holders of the participation rights are treated for tax purposes as if the company had been liquidated and subsequently re-established, not only economically but also under civil law.[44]

2.5. Incorrect application of transfer pricing rules

With regard to transfer prices, the arm's length principle applies in Liechtenstein: If the income or expenses of a taxpayer from a business relationship with related parties or

43 Liechtenstein State Tax Commission (LStEK), Decision of 1 December 2011, 2011/8.

44 Liechtenstein State Tax Commission (LStEK), Decision of 1 December 2011, 2011/8.

with a PE are changed because different conditions were used as a basis than would have been agreed upon by unrelated third parties under otherwise identical circumstances, the income and expenses are to be recognised in the determination of the taxable net income as they would have been incurred in a relationship between unrelated third parties.[45] The Liechtenstein Tax Ordinance refers to the current version of the OECD Transfer Pricing Guidelines for determining the transfer prices of transactions with related parties and PEs.[46] Beyond this, Liechtenstein does not have its own guidelines on transfer pricing. Loss-shifting arrangements are not explicitly addressed in Liechtenstein either.

Transfer pricing practice in Liechtenstein is determined to a great extent by the practice of foreign states. The corporate taxpayers are considerably restricted in the structuring of cross-border transactions by foreign tax laws. Besides, the intention of most taxpayers is not to move foreign losses to Liechtenstein to reduce the Liechtenstein tax base. In the past, amendments of intercompany agreements did not pursue the allocation of losses.

2.6. Schemes planning around rules on the recognition or treatment of losses

In Liechtenstein, no techniques are evident that could fall under the category of schemes planning around rules on the recognition or treatment of losses. Of course, the Liechtenstein group taxation regime allows the shifting and sharing of losses to a certain extent but offers some restrictions as well.

The acquisition of loss-making companies before the end of the tax year does not make the latent losses deductible at the level of the parent company. In the Liechtenstein group taxation regime, the "purchase" of existing loss carry-forwards is not possible. The group with the target company can only be formed from the beginning of the following fiscal year because the majority interest has to exist during the whole fiscal year. Any losses incurred before the group has been formed or before the entry of the company into the group cannot be set off against profits of the other group members. Losses of a company originating from tax years before the commencement of the group regime may only be set off against profits of that company and are not allowed to be included in the group taxation regime.[47]

A non-resident holding company with a domestic PE can apply for group taxation in Liechtenstein if the PE is registered as a branch in Liechtenstein. In such a case, losses of resident subsidiaries can be utilised by another group company but only if the participation is attributed to the domestic branch.[48] However, in the administrative practice this kind of group is not easily formed as there must be an economic reason why the participations are not attributed to the head office but to the PE of the parent company.

2.7. Schemes creating artificial losses

Schemes creating artificial losses are not common in Liechtenstein. Complex financial instruments securities lending, equity swaps, and sale and repurchase agreements ("repos") on shares are generally not used to generate artificial losses which can be utilised for tax

45 Art. 49 para. 1 of the Liechtenstein Tax Act.
46 Art. 31b para. 1 Tax Ordinance.
47 Art. 58 para. 1 last sentence of the Liechtenstein Tax Act.
48 Art. 58 para. 2 second sentence of the Liechtenstein Tax Act.

purposes. The Liechtenstein legislator has not introduced any tax measures in connection with the Covid-19 pandemic which try to ease loss carry-overs.

There have been a few issues with Liechtenstein resident holding companies that tried to profit from a combination of equity and debt interest deductions to optimise their tax debt and even reach to a loss situation. Highly leveraged holding companies founded an actively operating subsidiary company. In this case, the parent company can claim a deduction for debt interest and the subsidiary can claim a notional interest deduction. Although there is (almost) no equity capital in a consolidated view, a notional interest deduction is nevertheless claimed, so that overall excessive interest expenses are deducted. The holding company may even create a loss in such a situation.

The Liechtenstein legislator reacted to those schemes and imposed an anti-abuse provision to avoid this situation. All participations in subsidiaries claiming an equity interest deduction must be financed by equity at the parent company. If this is not the case, the parent company's income is increased by the extent of debt financing multiplied by 4%.[49] This rule ensures that a double deduction of financing costs is corrected at the parent company level.[50]

2.8. Schemes involving the dual/multiple use of the same loss

As a result of the BEPS project, Liechtenstein tackles payments that are deductible under the rules of the payer jurisdiction and are not included in the ordinary income of the payee by the way of a hybrid financial instrument. To avoid these deduction/no inclusion situations Liechtenstein introduced a correspondence principle in its national tax law which is applicable for distributions from outbound investments held by a Liechtenstein legal person. This means that the participation exemption on dividend income may apply in Liechtenstein only if the payment was not classified as tax deductible in the source country.[51]

The correspondence principle is limited to major shareholdings of at least 25% of the capital and the voting rights of the respective subsidiary. This threshold was chosen by Liechtenstein to cover the same configuration as article 2(4) and (9b) of the EU Anti-Tax Avoidance Directive.[52] In addition, the threshold is also chosen for reasons of practicability, as in other circumstances the non-deductibility of dividend payments at the level of the foreign company is rather difficult to prove. Especially when the Liechtenstein resident company only holds a few shares, the costs and administrative hurdles may exceed the benefit. Moreover, according to the Liechtenstein government, a hybrid structure which is aimed at double non-taxation is extremely unlikely to have a minor shareholding.[53]

The correspondence principle is not limited to special hybrid products or structures, but encompasses all payments that are regarded as dividends under Liechtenstein tax law. According to the wording of the rule, the correspondence principle may also be applied for domestic dividends; however, as dividends are generally not deductible for corporate

49 Art. 54 para. 4 of the Liechtenstein Tax Act.

50 Liechtenstein Government, Report and Application (BuA), no. 2018/35.

51 Art. 48 para. 3 (a) of the Liechtenstein Tax Act.

52 Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market, OJ L 193/1 (2016), EU Law IBFD [hereinafter ATAD].

53 Liechtenstein Government, Report and Application (BuA) no. 91/2016, p. 27.

income tax purposes in Liechtenstein, the correspondence principle is supposed to be applied to dividends from non-resident companies only.

Part Three: Impacts of BEPS on the treatment of losses

3.1. General overview

Liechtenstein committed to the goals of the BEPS project at a very early stage. The elements of the minimum standard were initially implemented, namely the criteria for the privileged taxation of income from intangible assets (IP box regime - Action 5), the spontaneous exchange of information on tax rulings (Action 5), the inclusion of abuse clauses in double taxation agreements (Action 6), the exchange of certain country-related information from companies (Country-by-Country Reporting - Action 13) and dispute resolution under double taxation agreements (Action 14).[54]

In addition to the minimum standard, the correspondence principle for intercompany dividends (Action 2) and a documentation requirement on the determination of transfer prices for transactions with related parties were introduced. Regarding the limitation of interest deduction (Action 4) Liechtenstein has established some special provisions that take into account the special rules of the Liechtenstein corporate income tax about finance expenses (see section 3.5).[55]

3.2. Transfer pricing

The Liechtenstein Tax Act only makes a general reference to the TP Guidelines in the most recent version of the OECD TP Guidelines[56] which also includes the OECD Covid-19 Pandemic Guidance. So, the tax administration or the courts do not rule out the use of loss making comparables as suggested by the OECD Covid-19 Pandemic Guidance. In a comparability analysis comparables that meet the comparability criteria in a particular case are not excluded solely because they have incurred losses in periods affected by the COVID 19 pandemic. However, there are no precedents in the administrative or judicial practice from previous crises. Liechtenstein does not have any domestic rules about the allocation of losses and costs associated with Covid-19. Losses incurred due to the pandemic are treated in the same way as other losses.

3.3. Anti-mismatch recommendations

As a reaction to the BEPS project in order to avoid the result of double-deduction or non-inclusion Liechtenstein has implemented the correspondence principle for dividends into its tax law (see section 2.8). With the implementation of the correspondence principle for

[54] See in detail Wenz/Knörzer/Busch in Lang et al.(eds.), Implementing Key BEPS Actions: Where do we stand? Ch. 21 Liechtenstein (IBFD 2019), pp. 513 et seq.

[55] Liechtenstein Government, Report and Application (BuA) no. 2016/91.

[56] Art. 31b para. 1 Tax Ordinance.

dividends, Liechtenstein meets the BEPS minimum standard concerning hybrid mismatches of Action 2 by avoiding the result of double deduction and non-inclusion.

Branch models are not possible with Liechtenstein-situated branches as a branch cannot be a member in a Liechtenstein group for the purposes of group taxation. In the case of foreign branches, the attribution of foreign permanent establishment losses to the head office is possible, but only on the condition that the losses cannot be offset in another state. For this situation, Liechtenstein tax law wants to avoid that the same loss can be deducted in more than one jurisdiction and to prevent that the cross-border use of losses leads to base erosion.

In the context of group taxation, losses must be taxed as soon as the group company makes profits again and can or could offset the losses with its own income (see section 2.2.b). This provision is intended to prevent a harmful double-dip rule in the sense of BEPS and ATAD.[57]

As far as leasing contracts are concerned, Liechtenstein has not introduced a rule dealing with double-dip leases and double-deduction of depreciation. The administrative practice on the attribution of assets generally follows the Swiss rules. Abusive leasing structures, as described in Action 2, can also be tackled by the general anti-abuse-rule (GAAR) in article 3 of the Liechtenstein Tax Act without having introduced a special provision.

3.4. CFC recommendations

The Liechtenstein tax system does not contain any CFC rules. So, there is no possibility that foreign losses can be attributed to domestic entities via a CFC provision and utilised against domestic profits.

3.5. Limitation of interest deductibility

The issue of interest deductibility must be treated in two parts as the Liechtenstein tax law also contains an allowance for corporate equity (ACE). This notional interest deduction amounts to 4% of the modified equity and might be one of the reasons why Liechtenstein resident legal persons predominantly prefer equity financing to debt financing.

a. Limitation of interest deduction on debt

Liechtenstein tax law does not provide for a limitation of the amount of borrowing costs in the form of an interest barrier or a fixed quote between equity and debt. However, loans between related parties are subject to the arm's length principle.[58]

The Liechtenstein administration has issued a safe-harbour-rule for loans to closely related persons that do not bear interest or do not bear sufficient interest:[59] Interest payments are deductible, if they do not exceed a certain threshold. In the year 2022, the threshold for interest payments to affiliated taxpayers (shareholders, partners) amounts

57 Langer, Das liechtensteinische Steuerrecht (Wiesbaden, 2019), p. 167.

58 Art. 49 para. 1 of the Liechtenstein Tax Act.

59 Liechtenstein Fiscal Authority, Information sheet regarding interest rates 2022 for the calculation of imputed income (´Merkblatt betreffend Zinssätze 2022 für die Berechnung geldwerter Leistungen´), February 2022.

to a maximum of 1.5% if the debt is self-financed and denominated in Swiss francs. On the other hand, the lender must pay tax on interest income of at least 1.5% of the loan amount. For debts in other currencies than Swiss francs there are different maximum interest rates which are significantly higher. If the loan was financed by the lender by means of borrowed capital, an interest rate exceeding the cost price by 0.5% must at least be applied.

This safe-harbour-rule applies to loans between two Liechtenstein resident entities as well as to cross-border loans. The minimum interest rate ensures that no loss is incurred on the loan that could be shifted between related parties by granting a loan.

However, it should be emphasised that these maximum or minimum interest rates only concern the safe-harbour-rule. Higher interest payments are still deductible (and taxable at the level of the lender) if they are in line with a third-party comparison which can be verified by the taxpayer.

b. Limitation of notional interest deduction on equity

A loss also has some effects on the notional interest deduction that is based on the so-called modified equity. As the loss of the current business year as well as the loss carried forward from previous years reduces the modified equity it also reduces the notional interest deduction. If the equity in the balance sheet is negative there is no notional interest deduction at all.

Moreover, Liechtenstein tax law includes a rule that a taxable loss cannot be incurred or increased due to the notional interest deduction. In order to have a notional interest deduction there needs to be a positive income before the allowance from corporate equity is deducted. If the corporate income is negative the notional interest deduction does not apply at all and the negative income leads to a loss carry-forward. In other words, the notional interest deduction must not cause a loss carry-forward.

Therefore, a number of legal persons have a taxable corporate income of zero in Liechtenstein. A loss carry-forward can only be claimed if the income is negative without the notional interest deduction.

The notional interest deduction is negative if the modified equity is negative; this can happen for instance as a result of losses from prior years. But it can also happen because by definition shareholdings reduce the modified equity.[60] This provision was introduced so that the equity interest deduction cannot be claimed from the same equity at two levels, at the level of the parent company and at the level of the subsidiary.

Basically, a negative notional interest deduction does not lead to an increase of the taxable income but the notional interest deduction is deemed to be zero in such a case.[61]

However, there is one exception to this rule which is particularly relevant for holding companies: If participations in legal entities are financed with debt capital, the notional interest deduction on equity is increased by 4% of the debt financing, but not more than the amount of the notional interest deduction claimed by the participation.[62]

[60] Art. 54 para. 2 (b) of the Liechtenstein Tax Act.

[61] Art. 54 para. 2 last sentence of the Liechtenstein Tax Act.

[62] Art. 54 para. 4 of the Liechtenstein Tax Act.

3.6. Patent boxes

There used to be an IP box regime in Liechtenstein until the end of 2016 which consisted of a deemed deduction of qualifying income. As a result of BEPS, the Liechtenstein IP box was completely abolished because it was not in line with the OECD nexus approach. The transition period for pre-existing IP boxes expired at the end of 2021.[63]

3.7. Mandatory disclosure rules and CbCR

The Liechtenstein disclosure rules do not comprise hallmarks involving loss transactions. The CbCR rules only include a reporting requirement for profit or loss before income tax as it is stipulated in the OECD guidelines. In the Liechtenstein government's view, a country-by-country report should only contain the information presented in Annex III of the report on Action 13.[64] The Liechtenstein fiscal authority has not published its own guidelines on CbC-reporting, but the CbC Ordinance only refers to the OECD's final report on BEPS Action 13.[65] It is therefore doubtful that the aggregated data on Liechtenstein can be of much assistance to uncover allegedly existing loss-shifting schemes.

3.8. BEPS Action 6 and Principal Purpose Test (PPT)

Liechtenstein has adopted BEPS Action 6 minimum standard by adopting the treaty preamble and including a principal purpose test in all of its tax treaties either through bilateral treaty amendments or through application of the Multilateral Instrument. The other treaty-anti-abuse rules proposed by the OECD, such as the LOB or the simplified LOB have not been inserted into Liechtenstein tax treaties. In order to meet the requirements of BEPS Action 6, Liechtenstein has also adopted its Model Tax Treaty.[66]

Basically, there might be cases where the creation of a tax loss could be regarded as a principal outcome of the transaction and trigger the PPT. However, no such cases seem to have appeared before Liechtenstein courts so far. In this context, it should be noted that most Liechtenstein treaties contain a notification clause that denotes that the contracting state which applies the PPT to refuse or to exceptionally grant treaty benefits has to notify the other state. This clause was either negotiated in the original treaty text[67] or implemented by article 7 paragraph 4 of the Multilateral Instrument.[68] To date, Liechtenstein has neither been notified about a loss scheme nor has Liechtenstein itself notified a partner state in this context.

Furthermore, in the tax treaty with the Netherlands the existence of losses is explicitly

[63] Liechtenstein Government, Report and Application (BuA) no. 2016/91.

[64] Liechtenstein Government, Report and Application (BuA) no. 2016/99.

[65] Art. 3 of CbC Ordinance.

[66] Wenz/Knörzer/Busch in Lang et al.(eds.), Implementing Key BEPS Actions: Where do we stand? Chapter 21 Liechtenstein (IBFD 2019), p. 533.

[67] Art. 28(2) Liechtenstein-Iceland (2016), art. 27(2) Liechtenstein-Monaco (2017), art. 27(2) Liechtenstein-Jersey (2018), art. 29(2) Liechtenstein-Lithuania (2019) and art. 28(5) Liechtenstein-Netherlands (2020).

[68] Tax Treaties with Andorra, Guernsey, Luxembourg, Malta, San Marino, Singapore, Czech Republic, Hungary, Uruguay, United Arab Emirates and the United Kingdom.

mentioned as an example why the granting of treaty benefits could still be justified although the taxpayer did not satisfy the requirements of the PPT.[69] This provision follows the first sentence of article 29 paragraph 8 of the 2017 OECD Model. If a third-country permanent establishment has been denied treaty benefits, the competent authority may nevertheless grant the treaty benefits at the taxpayer's request if the taxpayer would have obtained them even without the "abusive" arrangement or transaction, for example if the taxpayer does not reach the agreed minimum taxation level due to the existence of losses.[70]

[69] Art. 28 (5) Treaty Liechtenstein-Netherlands.
[70] Liechtenstein Government, Report and Application (BuA) no. 2020/87.

International Fiscal Association

9 789083 087467