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Acquisition of vatable services from a low-tax country

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Since 1 January 2010, new rules have come into force in the European Union (EU) on the place of supply of services. Under these provisions:

a) the place of supply of services to a taxable person (a person liable to VAT) is the place where that person has established his business;
b) the place of supply of services to a non-taxable person is the place where the supplier has established his business.

The scope of these new provisions is very wide. For example, even a company established in the EU, invoiced by a non-EU undertaking for carriage/packing services in a port outside the EU, must account for that invoice as an acquisition of a service.

The service acquired is recorded in the respective quarterly VAT return and can be offset with other vatable costs on the same form, provided that these acquisitions are used in the context of the activities of the business. In tax law, it is a game of zero-totals, but trade with non-EU companies and services outside the EU still have to be included on VAT returns.

Another consequence of this is that, in fact, all companies established in the EU which procure services from outside the EU have to register such services as part of their taxable acquisitions, as the acquired service is treated as vatable turnover.

This prompts a question: is there a risk that the acquired service will be liable to VAT, while the same VAT will not be eligible for deduction on the form (as a "reverse charge" or recognised business expense), because that service originates, for example, from a "tax haven" outside the EU?

In these circumstances, an undertaking in the EU is not only involved in set-offs against income (corporation) tax, but might suddenly face retrospective claims for VAT, at rates of 20 % or more, on acquired services.

The European Court of Justice (ECJ) recently ruled on this issue on 30 September 2010, in case C-395/09. As Liechtenstein is not in the EU, and undertakings in Liechtenstein often supply services to EU undertakings, this decision is welcome.

The structuring and protection of assets, family office, inheritance and succession planning, international tax advice and planning, legal advice, trusts, foundations and companies, processing of international business transactions, bank selection, ***"A reliable connection – even in times of continuous change", since 1929.*** *Investment funds and insurance, accounting and annual financial statements, change of residence, the structuring and protection of assets, family office, inheritance and succession planning, international tax advice and planning, legal advice, trusts, foundations and companies, processing of international business transactions, bank selection, investment funds and insurance, accounting and annual financial statements, change of residence, the structuring*

According to the ECJ, the right to deduct input tax of Article 17(2) of the Sixth VAT Directive (77/388/EEC) forms part of the overall VAT system and cannot, in principle, be restricted. On the scope of the derogation allowed in Article 17(6) of the Sixth VAT Directive, the ECJ has already ruled that exclusions of input tax deduction, which Member States are allowed to retain under this provision, must have held force of law before entry into force of the Sixth VAT Directive. In principle, goods and services usable for the personal needs of the taxpayer or his staff are not eligible for deduction of input tax.

Thus, if a company in a low-tax country invoices an EU undertaking for management services, marketing, organisational services, etc., the EU Member States cannot in practice exclude all goods and services from the deduction of input tax without limitation. The Member States must be sufficiently specific in their definitions of the exclusions. In the precedents of the ECJ, it is not sufficient to claim that such blanket exclusions prevent tax evasion.

A standstill clause exists in the EU. It allows Member States to derogate from the general principles on the deduction of input tax and retain national elements of exclusion which pertained before entry into force of the Sixth VAT Directive. Clearly, however, the EU Member States are now misusing the standstill clause of Article 176 of the Common VAT System Directive (2006/112/EC). Restrictions of the deduction of input tax are indeed possible, but they must be sufficiently specific. Furthermore, in principle, additions to the elements of exclusion are not allowed after entry into force of the Sixth VAT Directive.

Properties held in France by Liechtenstein companies

The Tax Information Exchange Agreement (TIEA) between Liechtenstein and France has been in force since 19 August 2010. The TIEA applies to tax periods from 1 January 2010 or, where no tax period applies, to all tax claims arising on or since that date.

The information exchange takes place only when specifically requested. It conforms to the OECD standard and the OECD Commentary on such agreements.

In this regard, the question arises of how France is going to treat the holding of real estate by legal persons in Liechtenstein, especially Establishments. In principle France levies the following taxes on properties located in France; furthermore, allowance must be made for the following property-related costs:

One-off costs/taxes

1) Registration fees amount to around 7% of purchase price, including notarial fees (a natural person incurs the same costs on a purchase).

2) Capital gains tax amounts to 33 1/3% on the gain from the sale. This tax is significantly higher than if the property is held by a natural person or SCI (Société Civile Immobilière).

Annual taxation

3) Taxe Foncière (real estate tax) and Taxe d'Habitation (habitation tax) are payable annually. They are a kind of taxation of rental value, and should approximate to the same amount for natural persons. The tax rate for legal persons is 33 1/3% and up to 40% for natural persons.

4) The annual solidarity tax on wealth (ISF), ranging from 0.55 to 1.8%, is not payable below a certain threshold. Though it applies to both legal and natural persons, the methods of calculation are not identical. However, these differences would not be decisive factors in a purchase decision.

5) The annual tax return, on forms 2072/2746, relates to the beneficial owner of the legal person. If the legal person is not established in a convention state, a 3% tax is payable annually on the market value.

6) Under Article 164 C of the General Tax Code, an annual tax of three times the rental value applies if the property is held by a legal person based in a low-tax-country.

Under the TIEA now concluded, the annual taxes mentioned in 5 and 6 above cease to apply from the 2010 assessment period. Hence the taxation becomes similar to the case of holding by an SCI (Société Civile Immobilière) or by a natural person abroad.

TIEA with Germany

The Tax Information Exchange Agreement between Liechtenstein and Germany applies to tax periods since 1 January 2010. Germany has been insistent that §15, especially paragraphs 1 and 6, of the German Foreign Tax Act, now applies to Liechtenstein. This means that income from discretionary foundations can no longer be imputed to the founder and/or beneficiaries. Foundation income arises at the foundation. However, contributions and distributions remain liable to German gift tax, or possibly to income tax in the case of distributions. It is not yet clear whether both taxes apply to distributions.

A foundation with tax transparency allows the right of revocation and the right to amend the by-laws (de facto or otherwise), and mandate agreements. In these cases, income is imputed to the founder or beneficiaries. The foundation is non-existent for tax purposes: hence the problems of gift tax do not arise.

It should be noted that the statute of limitations applies to gift tax only 10 years from the death of the settlor.

Cases of discretionary foundations with 50 % or more of fixed beneficiaries should be avoided, because they meet all the elements both for gift taxes and imputation of income. Thus the by-laws should be drafted to leave the foundation board responsible for determining benefits to the founder, his or her spouse or children who are minors.

A “transparent” foundation could also solve these tax problems by investing its entire assets in gold. In this case, no taxable income arises.

“Transparent” foundations are currently less attractive from the viewpoint of asset protection, because creditors and family members might also, where applicable, gain access to the foundation assets. In cases other than these, it has become clear that access is no longer possible after two years, provided that the gift is demonstrably subject by contract to the law of Liechtenstein.

In relation to Germany (and later also Austria), it remains to be seen how Switzerland will negotiate further on final withholding tax. One realistically feasible option might be to settle “past” undeclared assets by payment of 25 % to 35 % of the existing German assets to the treasury by the banks, even if the German clients wish to sever their relations with the bank from a given cut-off date. A valid question then is whether the banks will still allow such clients to withdraw.

Both Germany and Austria have promulgated new tax laws as of 1 January 2011, to make the use of foundations even less attractive. Thus a trustee will be well advised to be ready with some response in terms of tax compliance.

Double Taxation Agreement with Luxembourg

The Double Taxation Agreement between Luxembourg and Liechtenstein entered into force on 1 January 2011. It conforms to the current international standards, and significant parts of it are based on the OECD Model Tax Convention.

It is pleasing that every duly taxed entity based in Liechtenstein and investing via Luxembourg can now invoke this Double Taxation Agreement. Thus interest and dividend payments to Liechtenstein on significant holdings are free of taxation at source.

Obviously the new Liechtenstein Tax Act requires duly taxed entities, including foundations, to pay income tax at 12.5 %. In this case capital gains and dividends are not taxed. In case of holding activities, management services, group services and interest income do therefore attract tax.

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