F.L. TRENDING 2004

EU Interest Tax on Savings: Special Rules for Liechtenstein

Successful EU-negotiations guarantee extensive banking secrecy

As of 1st July 2005 the directive on taxation of savings income will be applied within the European Union (EU). From this day on, EU countries will automatically exchange information on interest payments to individuals resident in other EU countries with their state of residence. At the same time, a series of agreements the EU has negotiated with Third Party States, among them Switzerland and Liechtenstein, will come into force. They intend to prevent the evasion of interest tax on savings. Both, Switzerland and Liechtenstein, have succeeded in negotiating a solution with the EU that fully maintains banking secrecy, which is of utmost importance for both countries.

Since 1989 the EU has continually attempted to harmonise the taxation of interest on savings income. The signing of the Maastricht Treaty in 1992 added further importance to the issue: at that time, the EU Member States agreed on the realisation of a Unified Economic and Monetary Union by 1999.

On 1st January 1999 the Stability and Growth Pact came into force. This obliged the EURO-countries to maintain a balanced national budget and to limit new debts to 3% of the Gross National Product (GNP).

Increasing deficits of national budgets quickly forced the finance ministers to open up additional financial sources in order to fulfil the requirements of the Stability and Growth Pact. One possible answer to this problem was to focus on the interest tax on savings income, which had for a long-time remained unrealised due to lack of consensus.

An agreement was reached in June 2003 when the Council of the European Finance Ministers (ECOFIN) finalised a tax package in Luxembourg, which contained the essential directive 2003/48/EC. This includes an automatic exchange of information which allows the state of residence of the EU citizen to levy tax on interest payments paid in other EU Member States.

Belgium, Luxembourg and Austria withdraw

Belgium, Austria and Luxembourg negotiated a special rule because they feared that their financial markets would be disadvantaged when compared to Switzerland. They will not participate in the automatic exchange of information but instead place a withholding tax on interest gained by EU citizens.

Initially 15 %, it increases to 20 % by 1st July 2008 and reaches its upper limit of 35 % by 1st July 2011. 75 % of tax income gained through this withholding tax will be paid to the state of residence of the beneficial owner without obligation to disclose any personal data. The country levying the withholding tax retains the remaining 25 %.

Agreement with Third Party States

Originally, the EU interest tax was to be introduced on 1st January 2005. This was, however, tied to the condition that Switzerland, Andorra, Liechtenstein, Monaco and San Marino as well as the associated territories of the Member States (e.g. the Channel Islands or the Dutch Antilles) would also introduce equivalent measures.

The EU directive aims against eva-

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sion of interest tax through capital transfers to Third Party States.

Switzerland successfully upholds its Banking Secrecy Law

In December 1993 Swiss citizens voted against membership of the European Economic Area (EEA). The Swiss Government then needed to reorganise its relationship to the EU through bilateral agreements. The first package of seven agreements became effective in 1999, the second, which included agreements on taxation of savings income and combating of fraud, was signed in Brussels on 26th October 2004. Switzerland has always emphasised that it had no desire to attract capital intended to evade EU interest tax. It also clearly stated that it would only accept a solution if banking secrecy was unaffected.

Retention instead of information exchange

Therefore Switzerland categorically rejected an automatic exchange of information and instead offered the EU a retention on interest payments in favour of beneficial owners resident in EU countries. The level of this retention corresponds to the withholding tax levied in Belgium, Luxemburg and Austria. The gradual increase to 20 % respectively 35 % will also be introduced parallel with the three afore mentioned EU Member States. 75 % of the revenue gained by retention will be transferred to the EU state of residence of the beneficial owner, 25 % will remain with the Swiss tax authorities.

In addition, the agreement determined that the beneficial owner may choose between paying a retention or authorising national tax authorities to declare interest payments to his state of residence.

Any beneficial owner can authorise the paying agent to present his personal data together with details on the interest payments to the national tax authorities. This authorisation can be withdrawn at any time. Thus this rule will successfully contribute to upholding the Swiss banking secrecy.

Cooperation on combating tax fraud

Finally Switzerland and the EU agreed on providing mutual legal assistance in cases of justified allega-

Competition versus Harmonisation

«Not only from Liechtenstein's point of view but also for the well-being of the EU, competition is obviously preferable to harmonisation. Competition will benefit Liechtenstein because of the attractive framework Liechtenstein provides. For the representative democracies within the EU, competition pressure is important as it limits the expansion of bureaucracy.»

(Hereditary Prince Alois von Liechtenstein in an interview with the business magazine "AGEFI", Lausanne, 9th August 2004)

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Liechtenstein Categorically Rejects an Automatic Exchange of Information on Interest Payments.

Essential Points of Liechtenstein's Ruling with the EU

- **Retention**

Liechtenstein paying agents will deduct a retention from interest payments made to beneficial owners Resident in an EU country. The level of retention will be 15 % during the first 3 years after the agreement has come into force, will increase to 20 % in the following 3 years and to 35 % in the final 3 years. 75 % of the retention will go to the state of residence, 25 % will remain in Liechtenstein.

- **Voluntary disclosure**

Liechtenstein offers a process which allows the beneficial owner of interest payments to avoid retention. The paying agent in Liechtenstein must be expressly authorised to register the payment with the appropriate authority in Liechtenstein. This authorisation includes all payments by the paying agent to the beneficial owner. The responsible authority in Liechtenstein then presents the information on the beneficial owner to the authorities of the EU Member State in which the beneficial owner is resident.

- **Paying agent**

Paying agencies in Liechtenstein are banks, which underlie Liechtenstein Banking Law, securities dealers, natural and legal persons resident or established in Liechtenstein, including economic operators regulated by the Liechtenstein Persons and Companies Act (PGR), partnerships and permanent establishments of foreign companies, which, even occasionally, accept, hold, invest or transfer assets of third parties or merely pay or secure the payment of interest in the course of their business.

tions on tax fraud. Legal Assistance is however limited to crimes which would be punishable under Swiss Criminal Law. Tax evasion is not included.

The application of the EU directive was postponed from 1st January to 1st July 2005 because the bilateral agreement between the European Union and Switzerland will have to pass enactment by the Swiss Parliament and a referendum by Swiss citizens.

Swiss negotiations as a guideline for Liechtenstein

The Principality of Liechtenstein was explicitly mentioned in the EU Directive 2003/48/EC as a Third Party State with whom negotiations on equivalent measures were to be entered. Thus the Council of the European Union requested entering negotiations in October 2001.

Liechtenstein, with its close economic ties to Switzerland, focussed on achieving a similar solution:

- levying a retention on a level with Switzerland or
- beneficial owner's authorisation for paying agents to present personal data and information about gained interest payments to the national tax authorities.

Liechtenstein furthermore followed Switzerland's position of categorically refusing any automatic exchange of information as set out in the EU Directive. The agreement between the EU and Liechtenstein was initialled on 30th July 2004. The Liechtenstein Government thereby successfully preserved the legally protected banking secrecy.

Liechtenstein Companies exempt from EU interest tax

International investors will be especially interested in the fact that the EU Directive 2003/48/EC will only be applied to natural persons but not to legal entities. Liechtenstein foundations, establishments and stock companies are not subject to EU interest tax on savings income, because their distribution of profits to beneficial owners does not qualify as interest payments.

The Liechtenstein Government is convinced that this solution will contribute to strengthen the Liechtenstein financial services centre.

Liechtenstein keeps its attraction as financial services centre

Thanks to successful negotiations, Liechtenstein remains very attractive for foreign investors.

The exchange of information is voluntary and therefore requires the explicit authorisation of the beneficial owner of the interest payments. This completely ensures the strict banking secrecy which is protected by Liechtenstein law.

The negotiation results confirmed Liechtenstein's reputation as a first class investment location with political and economic stability and highest levels of reliability and discretion. Compared to other European states, it furthermore offers outstandingly low taxes for holding and domicile companies. Therefore it is still an extraordinary attractive location for establishing companies for asset management and commercial activities.

F.L.BULLETIN

On 18th June 2004 the Liechtenstein Parliament unanimously passed a new law on the Financial Market Place Supervision in Liechtenstein. It laid the foundation stone for a new Financial Market Authority (FMA) which will commence its activities on 1st January 2005. The three departments currently operating in this area, Financial Services Authority (FSA), Due Diligence Unit and the Insurance Division at the Office of Economic Affairs will fuse to form the new authority. All financial services which are governed by these departments will fall under the supervision of the FMA.

The FMA safeguards the stability of the financial market place Liechtenstein, the protection of its investors, the reduction of misuse as well as the application of and compliance with recognised international standards. Its core activities comprise the supervision and regulation of the financial market place Liechtenstein.

The FMA is independent of the Government and those operating in the financial market. Its independency, however, does not mean «without any control». The FMA is responsible to the Parliament and has no power to enact laws and to issue regulations.