Tax credit of foreign withholding tax on fund investments for Liechtenstein private Investors

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Liechtenstein is a high-quality investment fund location, which is characterized by modern legislation, a high level of investor protection, an excellent and efficient banking system, and an attractive tax system. In addition to a broad diversification opportunity, investing through investment funds (UCITS, AIF and IU) regularly offers further advantages, such as professional asset management. In order to take full advantage of these benefits, it is essential that there are no tax disadvantages associated with investing via an investment fund compared to direct investments across all levels (investor, fund and investment level).

Taxation of Liechtenstein investment funds

The taxation of Liechtenstein investment funds follows the internationally recognized principle of so-called tax transparency, according to which the investment via investment funds, regardless of their legal form, should not lead to a higher tax burden than the corresponding direct investment.

Investment funds that are not already treated as tax transparently due to their structure as partnerships are considered legal entities and as such are subject to unlimited personal corporate income tax liability, but at the same time all income from the managed assets is exempt from tax. As a result, under Liechtenstein tax law there is basically no additional tax burden at the level of the investment fund. Instead, taxation takes place at the level of the investors.

Foreign withholding taxes

As a rule, investment funds for private investors invest in a broadly diversified portfolio of different investments in accordance with the specified investment strategy. Depending on the type and location of the investment (e.g. foreign shares), the investment fund may be subject to limited tax liability in the respective foreign country. If withholding taxes are levied on the basis of the limited tax liability of the investment fund, these can in many cases be reduced to 15% according to the national law of the source country or on the basis of a double taxation agreement (DTA) concluded with Liechtenstein. This charge is definitive and represents a tax burden on the investment fund. If the investment fund is not entitled to use the DTA or no reduction is requested, the withholding tax burden becomes definitive at the correspondingly higher initial withholding tax rate.

Wealth and income tax

The income of the investment fund is attributed to the investor regardless of whether it is actually distributed or reinvested. For Liechtenstein private Investors the value of the investment fund shares is recognized on the basis of the pro rata value of the investment fund (pro rata NAV) for the purposes of wealth tax and is included in the basis of assessment for the income tax as part of the notional income. Accordingly, the income of the investment fund attributed to the investor is no longer subject to an additional income tax. If withholding taxes are levied abroad (e.g. on dividends), further taxation occurs. This results in a double taxation of the income.

Avoidance of double taxation

According to the latest Liechtenstein jurisprudence, this can be reduced or completely avoided by crediting the foreign withholding taxes against the investor's domestic wealth and income tax, even though the foreign withholding tax is not a tax on the investor.

In many cases, the tax credit can significantly improve the after-tax result.

Here is an example to illustrate:

A Liechtenstein private investor holds shares in a Liechtenstein equity fund. The private investor proportionally holds through the fund, among other things, shares in CH-AG with a value of CHF 100'000 (as of 1.1.). The dividend yield of CH-AG is 4% p.a. The personal tax rate of the private investor is 16%.

Asset value of shares CH-AG as of 1.1.	100'000
Dividend (during the year)	4'000
Foreign withholding tax (15% after DTT)	600
Tax base for income tax (notional income)	4'000
Income tax (Tax rate: 16%)	640
Tax burden without tax credit	1'240
Tax burden after tax credit	(600 + 40) 640 (1'240 ./. 600)

In the example case, double taxation can be avoided completely. The total tax burden is reduced by almost 50%.

According to Art. 22 SteG, a credit of foreign withholding taxes has to be calculated with respect to each individual income (so-called per-item-limitation).

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