

# § 165 (5) StGB: Substance for tax purposes



## **Extension of predicate offences for money laundering to include “tax savings”**

As of July 1, 2019 stricter regulations are in place with regard to predicate offences for money laundering. Up to now the sanctions with regard to tax offences (tax fraud or qualified tax evasion) applied when assets “originated” from offences of this kind, i.e. when the submission of incorrect or falsified documents, or documents with untrue content, resulted in an influx of capital (e.g. in the form of a wrongly-received tax refund or tax credit). With this change in legislation, these sanctions now already apply when a pure tax saving is achieved by means of tax fraud. In other words: up to now, an

influx of capital actually had to occur, now no outflow of capital, or only a low level of outflow (to the amount of the tax saving) need ensue.

As a consequence, the challenge for those concerned is to prove that a possible tax saving has not ensued. In particular for legal entities with foreign shareholders, which have little substance in Liechtenstein, the presentation of suitable proof can present difficulties.

## **When does a legal entity have sufficient (fiscal) substance?**

In practice, low-substance legal entities, in particular, will be confronted with increased inquiries, e.g. from banks, as

the suspicion could arise that they are primarily deployed for the purpose of unlawful achievement of tax benefits. Where a legal entity has no own employees, no adequate equity financing, or a general low cost structure (e.g. all-in fee to a professional trustee), it may be questionable whether the substance will suffice to allow functions associated with the business purpose of the entity to be fulfilled by the entity. However, a specific examination on a case-by-case basis is to be undertaken as, in the area of professional trusteeship in particular, a range of business activities occur for which a simple examination of traditional substance criteria is not appropriate. Central to this

are the following questions:

- What is the company's business activity?
- Does the reimbursement received by the company reflect its value creation and the risks and functions involved?
- Does the company have adequate substance from a tax perspective to allow it to perform its business activity independently and generate the envisaged value creation?

In our opinion, if a legal entity receives reimbursement which is reasonable for the above-named criteria, no unlawful tax saving can be gained which could be considered a possible predicate offence regarding money laundering.

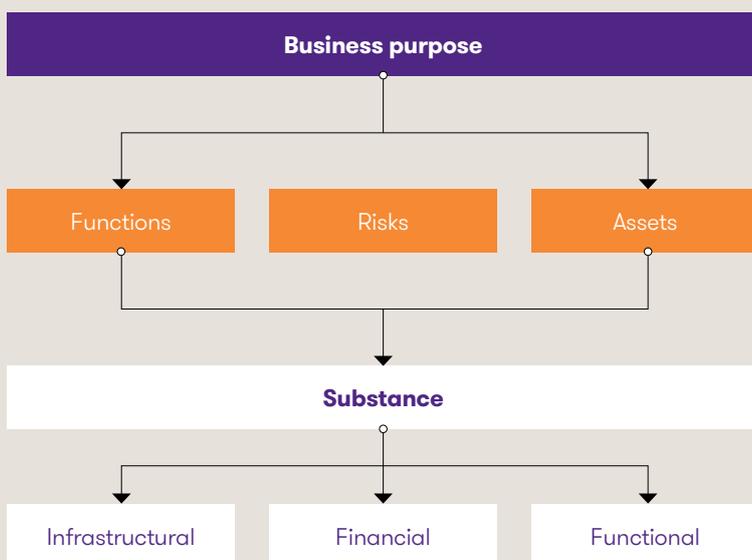
Traditionally, such features as sufficient numbers of qualified staff, rental agreements, electricity and telephone costs have been drawn upon for the assessment of substance for tax purposes. In an increasingly digitalised and globalised economy, however, these conventional parameters no longer seem appropriate for all cases and, on their own, do not suffice to determine the fiscal qualification of a legal entity. This applies in particular to the professional trusteeship sector and the corporate

structures typically associated with it, such as holdings, which do not fall under the concept of the simple substance criteria for companies performing "ordinary" active business operations. In order to determine whether an adequate substance is in place, it is first necessary to analyse what activities and functions the company actually carries out. The scope and complexity of these functions, and the associated risks, affect the substance requirements. In this context, the substance criteria can be divided into three categories as shown in the following illustration:

- Infrastructural substance – employees, office space
- Financial substance –adequate equity for the business risks and
- Functional substance - actual "execution" of the business purpose, decision-making power.

In assessing the substance, special attention should be paid to the business activities being carried out by the entities. The outsourcing or delegation of auxiliary activities such as, for example, administration or secretarial support to third parties should have no adverse implications. On the other hand, an entity cannot claim to have adequate

substance when the operative business decisions are delegated to third parties or foreign group companies in a manner which results in the entity being merely a shell and no longer conducting any business activities of its own.



## Typical structures and possible proof of substance

By way of example, we have listed a number of business activities with low levels of substance. These are intended to demonstrate typical functions and the associated possible evidence.

Traditionally, holdings and asset management companies have no, or only very limited numbers of own employees and no or very limited own office space. This, however, is attributable to the business model of holdings and asset management companies and is inherent to these structures. In such cases particular attention should be paid to the functional substance. A high level of functional substance might be indicated, among other things, by the decision-making power of the local board of directors, adequate equity and the company's usage authorisation with regard to the revenues achieved (as in no obligation of automatic transfer to the shareholder).

Topics may occur for real estate management companies, in particular, when they have no own employees and the functions are performed by the board of directors or independent agents. In our opinion, the real estate management may also be undertaken by the board of directors, if they are adequately qualified for this activity, appropriately remunerated and dedicate the necessary time.

IP companies encompass a wide range of constellations and activities depending on the intellectual property concerned and the business activity. The development of software or technical patents, for example, is not possible without the company having its own qualified staff. The pure administration and protection of a brand could in some circumstances be rendered by a board of directors in cooperation with external service providers. Where the company has a relatively low number of licences or patents it may not be cost efficient to employ own employees for licence administration purposes. If a company of this kind contracts out part of the activities to external service providers, such as patent lawyers, this fact alone does not per se indicate that the company does not have adequate substance. Here too a case-by-case assessment and analysis must ensue to

## Holding and asset management

Function	Substance requirements	Possible evidence
Portfolio management	Qualified staff or external consultants	Staff or consultancy expenses
Investment management	Qualified staff or external consultants	Staff or consultancy expenses
Management of the company	Qualified staff or professional trustees	Staff or consultancy expenses

## Real estate

Function	Substance requirements	Possible evidence
Real estate management	Qualified staff	<ul style="list-style-type: none"> <li>Staff expenses</li> <li>Proof of staff qualifications</li> <li>Rent payments for suitable premises</li> </ul>
Drawing up of contracts (e.g. purchasing, sales, renting out)	Qualified staff or external legal advisors	Staff or consultancy expenses
Management of the real estate company	Qualified staff or professional trustees	Staff or consultancy expenses
Facility management (maintenance)	Staff or external service providers	Staff or service costs

## Intellectual property (IP)

Function	Substance requirements	Possible evidence
Development of intellectual property	Qualified staff and, in certain circumstances, external partners (e.g. in the case of cost-sharing agreements or contract R&D)	<ul style="list-style-type: none"> <li>Staff or service costs</li> <li>Proof of staff qualifications</li> <li>Rent payments for suitable premises</li> </ul>
Enhancement and maintenance of intellectual property	Qualified staff or external partners	See above
Protection of intellectual property	Qualified staff or external partners	See above
Exploitation of intellectual property	Qualified staff or external partners	See above
Management of the company	Qualified staff or professional trustees	Staff or consultancy expenses



determine the functions performed by the company and how these are remunerated. If a board of directors or professional trustee has the necessary training and assumes significant functions (e.g. initiation of contracts, search for new possible uses/customers), this may be an indicator of the adequate substance of the entity.

In case the provision of services is outsourced by a pure service provider, the entity is “robbed” of its core function and retains only auxiliary functions of an administrative nature (e.g. invoicing, bookkeeping, etc.). In our view, this is a strong indicator of a company lacking adequate substance and thus such company should generate only very limited profits in correspondence to its limited “own” value creation.

### Interface to automatic exchange of information (AEOI)

Within the context of the automatic exchange of information, asset management companies are often classified as passive NFEs, resulting in notification of the controlling persons to their country of residence. It can therefore be assumed that due to the AEOI notification, no tax fraud could be implemented which would lead to a tax saving. Domiciliary companies which have been classified as active NFEs, on the other hand, run a higher risk of being involved in tax offences, which most recently qualify as predicate offences regarding money laundering. In the cases of companies of this kind, closer investigation with regard to substance and special clarification must be anticipated.

## Services

Function	Substance requirements	Possible evidence
Provision of specific services, e.g. in the areas of finance, legal or IT	Qualified staff for the activities	<ul style="list-style-type: none"> <li>Staff expenses</li> <li>Proof of staff qualifications</li> <li>Rent payments for suitable office premises</li> </ul>
Management of service companies	Qualified staff or professional trustees	Staff or consultancy expenses

## Conclusion

The legal provisions on money laundering were extended in Liechtenstein on July 1, 2019 and now also include tax fraud and qualified tax evasion, even if this leads merely to a tax saving and not to an actual inflow of capital. In particular, former domiciliary companies must anticipate that they will have to provide evidence of their fiscal substance. Whether or not an entity has adequate substance should be analysed for the specific case with regard to the activities and functions performed. In particular, the resources required for the core functions of the entity may only be externally obtained to a very limited extent. In our opinion, however, certain tasks can be performed by members of the board of directors provided they are suitably qualified.

**We would be pleased to support you and respond to any questions you may have.**

## Contact



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