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United States Tax Treatment of Liechtenstein Anstalts: A Comment

I. Introduction

In an excellent article[1] analyzing the hybrid concept of Liechtenstein corporate law, the Anstalt, Professor G. Glos has briefly touched upon the U.S. tax treatment of such entities. Specifically, Professor Glos has discussed those provisions of the U.S. Internal Revenue Code of 1954 (I.R.C.)[2] which might be applied to negate the tax advantages of an Anstalt when utilized by "U.S. shareholders."[3]

This article will analyze a preliminary and perhaps more difficult issue which affects the use of Liechtenstein Anstalts both by U.S. persons and by non-U.S. persons investing in the U.S. — namely how such an entity will itself be classified and treated under U.S. tax law.[4] Professor Glos appears to treat an Anstalt's characterization as a corporation to be a foregone conclusion under U.S. tax law, but this is not the case.

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1. Glos, *The Analysis of a Tax Haven: The Liechtenstein Anstalt*, 18 INT'L LAW. 929 (1984).

2. *Viz.*, Subpart F, which comprises I.R.C. Sections 951–964. *See generally* Liebman, *The Tax Treatment of Joint Venture Income Under Subpart F: Some Issues and Alternatives*, 32 BUS. LAW. 341 (1977); Liebman, *Note on the Tax Treatment of Joint Venture Income Under Subpart F: An Addendum*, 32 BUS. LAW. 1819 (1977).

3. This is a term of art, which includes not only U.S. residents, as Professor Glos seems to imply at one point (Glos, *supra* note 1, at 953), but also U.S. citizens residing abroad. I.R.C. §§ 951(b) & 7701(a)(30). Because "U.S. persons" must hold at least ten percent of the voting stock of a foreign corporation in order to be denominated "U.S. shareholders," a group of more than ten U.S. persons might be able to effectively utilize a Liechtenstein Anstalt. Even fewer than ten U.S. persons may do likewise if together they do not in actual fact control the Anstalt. *See* Liebman, *Taxation of Foreign Source Income: Implications of CCA, Inc:*, 17 HARV. INT'L L.J. 335 (1976); Liebman, *Eliminating Current U.S. Taxation*, 6 TAX PLANNING INT'L 69 (1979).

4. This is a seminal issue under Subpart F as well since the Anstalt must be classified as a "corporation" before Subpart F can ever be brought to bear.

II. Characterization of an Anstalt

An Anstalt is an entity which in commercial practice is unique to Liechtenstein law. It is translated in English as an "establishment" and is an independent legal entity of a corporate type. It is organized by one or more individuals or legal entities acting as the founder(s). Contrary to the norm for corporate bodies, however, an Anstalt may have beneficiaries. In the absence of a stated beneficiary, the founder is treated as the beneficiary. It is perhaps for this reason that the Liechtenstein laws governing "trust undertakings" are applicable to Anstalts.[5]

A. As Trust or Corporation

However, the fact that local law may characterize the entity as a trust is not dispositive for the purposes of U.S. income tax treatment.[6] Pursuant to the Treasury Regulations promulgated under I.R.C. Section 7701,

> The determination of whether a trust which has such characteristics (i.e., continuity of life, centralization of management, a limited liability, and free transferability of interests) is to be treated for tax purposes as a trust or as an association depends on whether there are associates and an objective to carry on business and derive the gains therefrom.[7]

Typically, the Statutes of an Anstalt will provide that it be of unlimited duration, thereby according it the corporate attribute (for U.S. tax purposes) of continuity of life. But this need not always be the case.

It would also appear that most Anstalts will have the corporate attribute of centralized management in the form of a Board of Directors which, under the Anstalt Statutes, will ordinarily have the power to manage the Anstalt and take such other actions as are usual for a Board of Directors of a corporation. But again, this need not necessarily be the case. The founder(s) may have retained a number of significant powers, which may or may not be more akin to those which the shareholders of a corporation would retain (such as the election of the Board of Directors, approval of amendments to the Statutes and decisions on dividend distributions and/or liquidation) or to those of a day-to-day manager.

Finally, Liechtenstein law accords an Anstalt characteristics of limited liability and free transferability of the founder's rights (i.e., shares or, if the capital is not divided into shares, the transferability of the right to such capital). These are requirements which are common to both a corporation and a trust under U.S. tax law.

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5. *See* P. Marxer & A. Goop, The Formation of Undertakings in Liechtenstein: A Guide 19 (June 1968).
6. *See* Rev. Rul. 80-75, 1980-1 C.B. 314. *Cf.* Treas. Regs. § 301.7701-1(c).
7. Treas. Regs. § 301.7701-2(a)(2).

In that event, an Anstalt's status will depend on the presence of associates and the entity's purpose and objectives. Since there is no definition of what is an associate in either the I.R.C. or the Treasury Regulations, the case law has tended to place primary emphasis on the "business objective" factor in distinguishing "ordinary trusts" from so-called "business trusts" taxable as corporations.[8]

In the case of an "ordinary trust," the purpose of

> the arrangement is to vest trustees with responsibility for the protection and conservation of property for beneficiaries who cannot share in the discharge of this responsibility and, therefore, are not associated in a joint enterprise for the conduct of business for profit.[9]

This is in starkest contrast to a "business trust," which is created by the beneficiaries themselves to carry on a profit-making businesss.[10] The case law, beginning with *Morrissey v. Commissioner*,[11] has therefore treated trusts created to enable beneficiaries to carry on a business and divide the gains from such a common undertaking as associations taxable as corporations.[12]

Such a trust may be taxed as a corporation even if the beneficiaries do not control the trustees, there are no formal meetings of trustees nor any Minute Books, records or By-Laws, and even if there is no office, official name or seal, and the business purpose of the trust is limited to one project.[13]

B. Business Purpose

In the final analysis, the taxability of an Anstalt as a trust or a corporation is likely to depend on its business purpose as stated in its Statutes and as carried out in reality. In effect, the beneficiaries or those persons having powers of attorney over all or a part of the Anstalt's assets may appear more akin to associates conducting a business for profit than to passive beneficiaries and/or to trustees.

A difficulty may arise, however, if such associates are not conducting the business for joint profit and are therefore not "associates" for purposes of the relevant Treasury Regulations. This may arise when, for example, the Anstalt's assets are divided between several persons acting quite indepen-

8. *See generally* B. Bittker & J. Eustice, Federal Income Taxation of Corporations and Shareholders ¶ 2.03 at 2–9 (4th ed. 1979).
9. Treas. Regs. § 301.7701–4(a).
10. *See* Treas. Regs. § 301.7701–4(b).
11. 296 U.S. 344 (1936).
12. *See also* Mid-Ridge Inv. Co. v. U.S., 214 F.Supp. 8 (D.Wisc. 1963), *aff'd*, 324 F.2d 945 (7th Cir. 1963); John B. Hynes, Jr., 74 T.C. 1266 (1980), *taxpayer's appeal dismissed* (1st Cir. 1981); J. Howard Porter, Trustees, 42 B.T.A. 681 (1940), *acq. and nonacq.*, 1943 C.B. 18, *acq.*, 1940-2 C.B. 6 *withdrawn in part, aff'd*, 130 F.2d 276 (9th Cir. 1942).
13. *See* Joseph E. Swanson, Trustee v. Comm'r, 296 U.S. 362 (1936).

dently of one another as regards their own share of the Anstalt. In *Elm Street Realty Trust*,[14] it was held that to the extent the beneficiaries take no part in establishing a trust, do not participate in the trust's activities and have no power to modify the terms or terminate the trust, and most importantly, to the extent that they do not act together to engage in a common business enterprise, there may not be any "associates" and the trust may escape corporate taxation. The Internal Revenue Service ("IRS") apparently agrees with this position in theory, as evidenced by Revenue Ruling 75–258.[15]

In addition, there is case law to the effect that a "family trust" is not taxable as a corporation (even if it includes a going business) if it is created for the benefit of named family members other than the grantor, and as long as the beneficiaries have no management role nor powers to dispose of or encumber their beneficial interests.[16] The IRS does not necessarily agree with such decisions, however, as its position is that the existence of a profit-seeking activity is of primary importance in characterizing an enterprise.[17]

Hence, the particular facts at issue must be carefully analyzed in order to determine whether an Anstalt would be subject to IRS (and/or judicial) characterization as a "business trust" (i.e., a corporation) or, because of intra-family aspects or the lack of "associates" acting jointly, as a true trust.

C. Proper Attribution

As an aside, it might be noted that only once the characterization can be determined will it be possible to ascertain the proper attribution rules applicable to determine shareholding interests in any companies in which the Anstalt owns stock, since those rules differ as to corporations versus trusts. Under I.R.C. Section 318(a)(2)(C), for example, stock owned by a corporation will be attributed to any person who is a 50-percent or more shareholder. If the latter is an individual, the shareholding interest can be reattributed to that person's immediate family pursuant to I.R.C. Section 318(a)(1)(A)(ii). By contrast, the trust attribution rules of I.R.C. Section 318(a)(2)(B) provide that stock owned by or for a trust is considered owned by the trust's beneficiaries in proportion to their actuarial interest in the trust, except that in the case of a grantor trust under I.R.C. Sections 671 *et seq.*, the ownership is attributed to the grantor.

14. 76 T.C. 803 (1981), *acq.*, 1981–43 I.R.B. 5.

15. 1975–2 C.B. 503, 504.

16. *See* Living Funded Trust of Harry E. Lyman, 36 B.T.A. 161 (1937), *nonacq.*, 1957-2 C.B. 8, *acq.*, 1937–2 C.B. 17 *withdrawn*; Curt Teich Trust No. One, 25 T.C. 884 (1956), *acq.*, 1956–2 C.B. 8.

17. Rev. Rul. 57–534, 1957–2 C.B. 924.

In many instances, the founder may be a bank or trust company. If the Founder remains the holder of the founder's rights and/or the shares and is viewed as merely a nominee for a third person, the result would be a reattribution of the shareholding interests of the Anstalt to the principal. But, if the founder is not merely a nominee, then the family of the principal would presumably remain outside of the chain of ownership, assuming that the family members are not themselves shareholders or are not otherwise related to the founder. On the other hand, if the Anstalt is indeed treated as a trust for U.S. tax purposes, the attribution of ownership and income can be either to the founder or (if the latter is a nominee) to its principal in the case of a grantor trust or to the beneficiaries (whomever they may be deemed to be — perhaps those persons having control over the Anstalt's assets and/or bank accounts) if the grantor trust rules do not apply.

D. Transfers

The characterization issue may also manifest itself in the tax liability of any transfers of U.S. real property interests held by the Anstalt, including shares of stock in U.S. real property companies, since such transfers may constitute tax-free dispositions in the case of a trust or a taxable sale or exchange under the Foreign Investment in Real Property Tax Act of 1980[18] in the case of a corporate Anstalt.

III. Conclusion

The use of a Liechtenstein Anstalt in connection with U.S. persons and/or activities need not necessarily fail in its purpose. Much depends on the purpose itself, as well as how the vehicle is organized and subsequently operated.

18. *See generally* Liebman, *U.S. Tax Consequences of Foreign Investment in U.S. Real Estate: A Reevaluation*, 3 INVESTMENT/USA (Special Supplement) (1981).