



Universität
Zürich^{UZH}

Rechtswissenschaftliches Institut

Foundations and 'Stiftungen': Structure and U.S. Tax Treatment

- Structure -

12th Annual International Estate Planning Institute
New York, 11 March 2016

Prof. Dr. Dominique Jakob, M.I.L.

University of Zurich
Ordinary Professor of Private Law
Director of the Center for Foundation Law



Universität
Zürich^{UZH}

Rechtswissenschaftliches Institut

Prof. Dr. Dominique Jakob

Agenda

- I. Introduction: The concept of foundations
- II. What is a foundation and how does it function?
- III. How to use a foundation in (international) estate planning
 1. Types and structures: The Swiss foundation models as example
 2. Types and structures: The Liechtenstein private foundation
 3. Recognition abroad
 4. Further challenges
- IV. Conclusion



Foundations and 'Stiftungen'

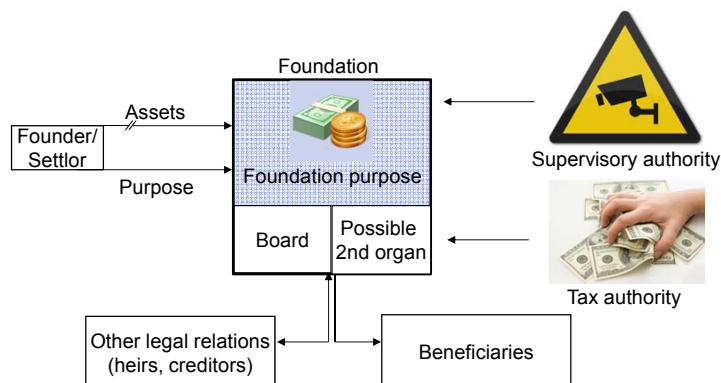
I. Introduction: The concept of foundations

- Foundation has long-standing tradition: From Roman to German law into modern Civil Law Codes
- Neutral institute: Can host *charitable* and *private* purposes
- Change with development of the 'private foundation model': More influence of the founder, more flexibility as a planning tool
- The 'dark side': For quite some time, (international) tax law was not able to discover fraudulent planning
- The 'bright side': If tax compliant, multi-purpose planning tool, more visible (and reliable?) than a trust
- 'Revival of the fittest': Even trust jurisdictions have started to introduce foundations



Foundations and 'Stiftungen'

II. What is a foundation and how does it function?





Foundations and 'Stiftungen'

II. What is a foundation and how does it function?

- The 'classical foundation' concept vs. 'private foundations'
 - Classic model (Germany, France, Italy, etc.):
Complete separation of assets and rigid perpetuation of original will of the founder
 - Private foundations (Liechtenstein, Austria, offshore foundations):
Autonomy of the founder prevails over dogmatic limitations thus providing a more flexible tool for asset and estate planning
 - Private purpose foundation ≠ private foundation
 - Some compromise in Swiss law which contains a few 'functional' elements since 2006 (e.g. a [limited] right of the founder to change the purpose of the foundation)
 - Types of foundations and fields of application vary from jurisdiction to jurisdiction



Foundations and 'Stiftungen'

III. How to use a foundation in (international) estate planning?

1. **Types and structures: The Swiss foundation models as example**
 - Charitable foundation: Vast majority (ca. 95%),
13'000 foundations with assets over CHF 80 Billion
 - Company (Holding) foundations
 - Family foundations
 - Mixed purpose foundations



Foundations and 'Stiftungen'

III. How to use a foundation in (international) estate planning?

1. Types and structures: The Swiss company foundation

- Company/shares constitute essential foundation asset (holding foundation); permitted in principle (decision of Swiss Federal Court of 2001, BGE 127 III 337)
 - Attractive to entrepreneurs as a means to preserve their life's work and to channel estate planning
 - Legal and economic concerns remain
- Combination of company foundation-purposes with family and charitable purposes
 - Permitted, even traditional Swiss foundation model
 - Concern: (Increasingly) diverging interests in second or third generation



Foundations and 'Stiftungen'

III. How to use a foundation in (international) estate planning?

1. Types and structures: The Swiss family foundation

- Family members of founder as beneficiaries, Art. 87, 335 Civil Code
- Prima facie the 'prototypical estate planning foundation'
- In principle some attractive characteristics: No ongoing state supervision, Art. 87 CC; originally no mandatory registration in the commercial register, changed on 1 January 2016!
- But: Art. 335 (1) CC as major impediment
 - Family foundations only permitted: "In order to meet the costs of raising, endowing or supporting family members or for similar purposes"
 - Traditionally narrow reading by courts: No regular, presuppositionless payments permitted, no 'family maintenance foundation'
 - Changing view on family foundations in Switzerland?



Foundations and 'Stiftungen'

III. How to use a foundation in (international) estate planning?

2. Types and structures: The Liechtenstein private foundation

- Important differences to Swiss Law
- (Pure) maintenance/enjoyment foundations permissible
- Further 'special features'
 - Founder as beneficiary
 - Founder enjoys considerable latitude in retaining control over the foundation; can reserve right to revoke foundation or to change its purpose
 - Foundation can be established by fiduciary → Privacy



Foundations and 'Stiftungen'

III. How to use a foundation in (international) estate planning?

2. Types and structures: The Liechtenstein private foundation

- Stronger protection against interference by succession rules
 - 2-year period for 'inclusion' in forced share, § 785 (3) Civil Code
 - No enforcement of foreign forced shares that differ from Liechtenstein regime, Art. 29 (5) Code on Private International Law
- Total revision of foundation law (2009): New governance regime and new emphasis on charitable foundations; yet special features remain

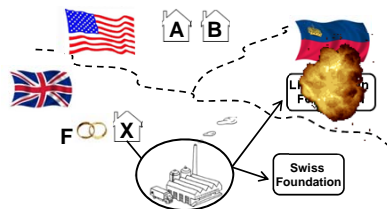


Foundations and 'Stiftungen'

III. How to use a foundation in (international) estate planning?

3. Recognition abroad

- Liechtenstein private foundations highly flexible and attractive; many new offshore foundations go beyond the (new) Liechtenstein law
- Danger: Other relevant jurisdictions may consider them as violation of mandatory law and refuse to recognize them or certain planning effects



Foundations and 'Stiftungen'

III. How to use a foundation in (international) estate planning?

3. Recognition abroad

- Foreign law foundations usually recognized, if lawfully established under that foreign law ('incorporation principle' - details depending on conflict of law rules of recognizing state)
- The *law of establishment* also decides of its validity in potentially abusive cases (most common examples: tax evasion purpose; too far-reaching control of the founder = bank account in disguise)
 - Sham (lack of intent: foundation is void)
 - (Reverse) piercing the veil (foundation is regarded as formally existing, but founder cannot claim separation of assets because of an abuse of law: assets will be regarded as founder's assets for creditors'/inheritance purposes)
- Even if foundation is valid according to the law of establishment (no 'sham' or 'piercing' case): State of recognition could invoke its *domestic* 'public policy' (or similar institutes) to disregard foundation



Foundations and 'Stiftungen'

III. How to use a foundation in (international) estate planning?

4. Further Challenges

- Even if foundation is valid and recognized, some typical implications/challenges
- Inheritance law: Applicable inheritance law (depending on forum and case) decides on the treatment of assets transferred to foundations
 - Surviving spouse's elective share/forced heirship rights
 - Periods for 'inclusion' might not start running if founder retains too strong control and thus has not separated himself from the assets
- Matrimonial property law: Assets might be calculated into spouse's share according to applicable law
 - Cf. famous divorce case 'Rybolovlev vs Rybolovleva' in Switzerland (which could also happen to a foundation)



Foundations and 'Stiftungen'

III. How to use a foundation in (international) estate planning?

4. Further Challenges

- Tax law: treatment differs according to system
 - Civil law countries 'know' foundations and tax them accordingly; however: if founder retains too strong control, assets have – from an economic perspective – not left the founder and are taxed as *founder's* assets!
 - US: depending on classification (which might depend on structure: business activities – conservation of property; discretionary – non discretionary; revocable – non revocable); see also IRS Memo of 2009
- Important lesson: The more flexibility and control a founder retains, the weaker the asset protection (and tax effect) may be; so *individual prioritization* is imperative for prudent estate planning



Foundations and 'Stiftungen'

IV. Conclusion

- Foundations are no perfidious invention of tax evaders, but long-established and respectable civil law instruments
- Just treat them as they 'deserve' it:
 - A Swiss charitable Foundation is as honourable as a US-charity
 - A Liechtenstein asset protection foundation might be comparable to an asset protection trust (with the respective consequences according to its individual structure)
- Crucial to have a profound understanding of possible structures
- Important would be clear rules, so that clients and advisors can reliably foresee planning consequences (also within U.S.) and prioritize respectively
- This would improve the international planning environment for all parties involved



Thank you for your attention

Prof. Dr. Dominique Jakob, M.I.L.

Chair of Private Law, Center for Foundation Law
University of Zurich

www.rwi.uzh.ch/jakob

Legal advice

dominique.jakob@rwi.uzh.ch

Jakob Studen Partner, www.jsp-law.com



JSP-LAW.COM