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The common-benefit foundation

A. Introduction

The Principality of Liechtenstein, situated at the heart of Europe, has had a unique foundation law ever since 1926. On 1st April 2009 the foundation law underwent modernisation in the form of a wide-ranging wholesale overhaul and is henceforth anchored in Art. 552 para. 1 ff. of the Persons and Corporations Act (PGR).

Under Liechtenstein law the foundation is set up by allocation of assets in favour of a specific purpose. Upon its setting-up, the foundation acquires a legal personality of its own, thereby forming a legally independent entity and hence existing independently of the founder's fate. By contrast with a company, the foundation has neither shareholders nor proprietors. However, there is the option of appointing beneficiaries or prospective beneficiaries who may enjoy the foundation's income and/or assets. By being put on an independent legal footing, the foundation assets remain outside the control of the founders, beneficiaries and prospective beneficiaries.

A distinction is made between private-benefit and common-benefit purposes. Whilst in the past the main focus was on private-benefit foundations, the possibility of setting up a common-benefit foundation has, not least because of social developments in recent years, taken on an ever-increasing significance – a tendency which is evident not only in Liechtenstein but internationally. Accordingly, the legislature has, in addition to the wholesale overhaul of the foundation law mentioned above, taken account of these developments in the new Tax Act which entered into force on 1st January 2011. With its legal framework for companies and tax, Liechtenstein now offers ideal conditions for setting-up a common-benefit foundation.

It should be noted that in December 2010 a lobby group was formed to establish the Association of Liechtenstein Common-Benefit Foundations (vlgs) after setting itself the task inter alia of not only generally promoting benevolent causes through the interaction of various common-benefit foundations, but also of finding a way of safeguarding interests when dealing with authorities. The promotion of philanthropy, the general framework and level of awareness of the common-benefit foundation system are given a strong boost by the vlgs.

B. Concept of common benefit

The concept of common benefit is governed by Art. 107 4 a) of the PGR. This means that there is deemed to be a benefit to the general public in particular «if the activity serves the common good in the charitable, religious, humanitarian, scientific, cultural, moral, social, sporting or ecological sense, even if only a specific category of person benefits from the activity».

Although tax law also refers to this concept of common benefit, there is a distinction between company law and tax law in the classification of a foundation as being of common benefit (see Points C and G on this). Nonetheless, tax law's use of the definition in the PGR makes for considerable advantages when applying to the revenue authorities and creates further attractive general conditions for Liechtenstein as a flourishing location for common benefit.

C. The common-benefit foundation from the PGR perspective

A foundation qualifies as being of common benefit within the meaning of the PGR if its activity is entirely or predominantly consistent with common-benefit purposes within the meaning of the definition in Art. 107 para. 4 a PGR. Predominance must be assessed according to the relationship between services provided to serve private-benefit purposes and those serving common-benefit purposes. A foundation is also allowed to carry on a commercial business in order to achieve the common-benefit purpose.

Common-benefit foundations must be entered in the Public Register and, as such, are required to keep books and accounts. They are subject to the Foundation Supervisory Authority (see Point E).

D. Obligation to keep books

In the event of the foundation operating a business run along commercial lines, the special accounting principles and standards under Art. 1,045 ff. PGR will apply. In the case of all other foundations, the foundation council must, for the management and appropriation of the foundation assets in accordance with the principles of orderly book-keeping, maintain appropriate records of the financial circumstances of the foundation showing the course of business and performance of the foundation assets. Also, a statement of assets must be drawn up showing the status and investment of the foundation assets.

E. Foundation Supervisory Authority (Stifa)

Stifa is the Land Registry and Public Registry Office. It has the task of monitoring ex officio that the foundation assets are managed and used appropriately by the executive bodies of the foundation. Should the appointing of an auditor be dispensed with (see Points F1 and 2), Stifa will, as a rule, itself examine the management and appropriation of the foundation assets.

F. Obligation to appoint an auditor

In principle, common-benefit foundations are obliged to have an auditor appointed by the court. As a rule the court will follow the founder's proposals, insofar as the auditor(s) proposed possess(es) the requisite qualifications. The latter is obliged as an executive body of the foundation to verify once a year whether the foundation assets are managed and appropriated in accordance with its purposes. It must submit a report to the foundation council and Stifa on the result of the audit. Stifa may require information from the auditor about all facts which come to its attention in the course of the audit.

In the case of minor-value foundation assets or where this appears expedient on other grounds, Stifa may, at the foundation council's request, refrain from appointing an auditor. In essence, both these exemption scenarios provided for in the Statutory Order on Foundations [Stiftungsrechtsverordnung (StRV)] appear as follows:

1. Exemption from the obligation to appoint an auditor due to minor assets and non-disclosure of the source of funds (Art. 5 StRV)

Preconditions:
- The foundation assets are worth less than CHF 750'000.- and
- The foundation does not make a public invitation for donations or other contributions and does not operate any business run along commercial lines and
- A reliable assessment by Stifa of the foundation's financial situation is possible.

2. Exemption from the obligation to appoint an auditor on other grounds (Art. 6 StRV)

Pursuant to Art. 6 para. 1 StRV, a foundation may also be exempted on other grounds from the obligation to appoint an auditor provided it appears expedient.

Thus, the obligation to appoint an auditor may be waived at the foundation council's request inter alia in the case of common-benefit foundations whose investment policy and way of appropriating funds allow supervision by Stifa.

One of the essential preconditions required for this is an investment policy which must be clearly defined by means of an internal regulation or foundation council resolution and which is governed by the principles of reliability, profitability, liquidity, risk diversification and maintenance of assets.

In principle, investments with banks which meet the additional following preconditions are deemed investment criteria which are compatible with an exemption from appointment of an auditor:
- Top-rated (>50%) fixed-interest investments (fixed-term deposits, bonds, money market securities, etc.);
- The assets are invested on regulated and supervised markets;
- The investment risks are clear-cut (as regards foreign currency ratio, investment dispersal/cluster risks, nature and/or creditworthiness of the investments etc.);
- The account-keeping bank is located in the EU/EEA/EFTA area;
- The absolute limit of the investments is CHF 2 million (maximum limit); valued at market values.

The investment criteria set out below are, in principle, deemed non-compatible with an exemption from the obligation to appoint an auditor. Exceptionally, an exemption may also be made from these investment criteria, provided unimpeded supervision by Stifa is possible.

- Equity holdings, investments with higher risk-aspects (share ratio, derivatives, commodities, loans, etc.);
- Real estate if no market values and/or reliable bases of valuation (such as by means of a statement of income for example) are available;
- External financing (e.g. collateral loans);
- Physical investments in «in-house» safes or vaults;
- Cash transactions (prohibition on distributions in cash to beneficiaries)

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3. Obligation to report and/or keep documentation on exemption from appointment of an auditor

Foundations which are exempt from the obligation to appoint an auditor also, inter alia, have to submit to Stifa on demand, besides the foundation documents, such book-keeping records as are prescribed by law. Stifa is to be advised immediately of amendments to the foundation documents as well as non-compliance with the preconditions for an exemption from the obligation to appoint an auditor. There is an obligation on the foundation to issue an annual report for those cases in which the exemption is based on the scenario in Art. 6 StRV.

As a rule, Stifa itself will perform its supervisory obligation in connection with audits. For these audits, in principle, an interval of 3 years each is set, bar audits relating to individual and special cases.

4. Remark on the exemption from appointment of an auditor

It is in keeping with the legislature's intention that the appointment of an auditor should give the founder (in addition to Stifa's pre-existing supervision) an additional assurance that the management and appropriation of the foundation assets are conducted in accordance with the intended purpose and are scrutinised every year by an independent review body. Through the above-mentioned right of proposal, the legislature has even granted the founder the opportunity of taking part in the appointment of an auditor who is independent of the foundation. (The founder may submit two proposals for the appointment of an auditor, indicating his preference. Should the founder not have exercised this right, the foundation council will be able to make such a proposal before the court). It is true that, in the case of an exemption from appointment of an auditor, there will be a review by Stifa itself - through inspection of the foundation's books and records - of the management and appropriation of the foundation assets. However, in principle, there will be an audit only every 3 years. At any rate, should Stifa come to the view that it is unable to conduct a review itself, it will also be authorised to appoint a third party to carry out the inspection (without the founder having the right of proposal). The foundation is to pay the costs thereby incurred as well as the fees accruing in the course of an audit by Stifa. As a result, there is no guaranteed saving of costs as the result of an exemption from the appointment of an auditor. On the other hand, having an independent auditor in place to ensure annual audit of the management and appropriation of the foundation assets provides an additional safeguard in upholding and implementing the founder's intention as articulated in the foundation's stated purpose. This is likely to outweigh the anticipated extra costs. We therefore strongly recommend distancing yourself from exempting to appoint an auditor.

G. A common-benefit foundation's tax exemption

On application, the revenue authorities may exempt from direct taxes such as income tax, property gains tax, foundations which exclusively and irrevocably pursue common-benefit purposes within the meaning of Art. 107 para. 4a PGR without any profit-making intention.

Be that as it may, this tax exemption does not apply to net income from economic business operations they maintain so far as income totalling more than CHF 300'000.- is achieved by these latter.

The following are further substantive preconditions for tax exemption:
- The Articles must stipulate that the common-benefit purpose is pursued exclusively and irrevocably;
- Every alteration of the purpose – which is allowed only in accordance with the common benefit – must be reported to the revenue authorities;
- The foundation is also obliged to act de facto in accordance with the objects. Mere asset-management with no or minor-value contributions in relation to the equity capital for common-benefit purposes is not sufficient;
- The asset management expenses as well as the fees and emoluments paid to the executive bodies of the foundation and/or agents must range within a reasonable scale, having due regard to tasks, function and time spent etc.;
- In the event of dissolution of the foundation, the remaining assets must be used exclusively for such common-benefit activities as are stated in the objects. A reversion of the remaining assets to persons who have made contributions to the foundation and/or allocation to non-charitable third parties is not allowed.

Formal prerequisites for tax exemption

The application for tax exemption, which must enclose the Articles and, if any, the Bye-laws and Regulations, may be lodged both with the revenue authorities directly and, in the course of applying for registration as a common-benefit foundation, to the Land Registry and Public Registry Office. The latter will transmit the documents onwards to the revenue authorities.

If the corresponding substantive preconditions are satisfied, the registration as a common-benefit foundation will be made with the revenue authorities.

Supervision

The revenue authorities will examine every year whether the funds are appropriated in conformity with the objects. The tax

exemption will be revoked where the appropriation of funds is not in conformity.

Value-Added Tax

Pursuant to Art. 10 para 2 c Value Added Tax Act, common-benefit foundations in Liechtenstein which earn less than CHF 150'000.- turnover are exempt from value-added tax liability where the latter do not waive the exemption from tax liability. The turnover is measured according to the agreed charges.

H. Final Consideration

In recent years, a host of States have discovered for themselves the construct of a «Stiftung»(Foundation). However, the Principality of Liechtenstein can, with the Foundation Act which entered into force back in 1926, look back on an 85 year-old tradition and experience. This also guarantees a prerequisite which is so essential specifically for the setting-up of a common-benefit foundation, namely one of legal certainty and constancy in preserving and implementing the founder's intention. In addition, there has been success in bringing, by suitable statutory reform, the general framework for common-benefit foundations into line with the requirements of a modern society in civil- and tax-law respects alike. The Principality of Liechtenstein therefore offers the best foundations for sustainably accomplishing the common-benefit foundation purpose which had been laid down according to the founder's individual stipulations.