Liechtenstein Foundation: **opportunities** and **constraints** with regard to **France** and **Switzerland**

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For almost 100 years, Liechtenstein has had a particularly sophisticated legal framework for foundations, whether private (particularly family foundations) or public. In this study, we will analyse the opportunities and constraints associated with this type of entity in relation to Switzerland and France.

The purpose of a family foundation under Liechtenstein law is to hold and preserve assets of any kind (movable property, real estate, financial assets, securities, precious metals, works of art, etc.) in the interests of beneficiaries close to the founder, generally (but not necessarily) members of his or her family, over several generations where applicable. The status of beneficiary cannot under any circumstances be equated with that of an heir or legatee, and the rules governing family foundations are independent of inheritance law.

Under French law, the mechanism of "trust" was established in 2007 and has since been regularly extended, but remains a relatively restrictive system, particularly in that it is not possible to use a trust for the purposes of gratuitous transfer (inheritance or donation). In practical terms, and broadly speaking, French trusts are mainly used in the context of security trusts (allocation of assets for guarantee purposes).

France also has foundations in the charitable sector, whether they are of general interest or public utility, which entail a number of tax exemptions for both entities and contributors. As we shall see later, the fact that Liechtenstein is a party to the Agreement on the European Economic Area (EEA) and has concluded an administrative assistance agreement with France to combat tax fraud and evasion makes it possible to fully consider the use of Liechtenstein public utility foundations. The use of private foundations, which is entirely legal in France, offers clear advantages in certain well-defined cases.

Notes: this study does not aim to provide an exhaustive overview of the issues, but will focus on certain particularly topical questions.

1. Private charitable foundation

Under Liechtenstein law, a foundation is a legally and economically autonomous entity, dedicated to a specific purpose determined by a unilateral declaration of the founder. The founder allocates the assets of a private foundation entirely or mainly to private purposes concerning himself or third parties, within or outside the family.

In a 2011 law, France established a precise and relatively restrictive tax framework for entities similar to trusts, including private foundations. The philosophy behind this law is to consider these foundations as fiscally transpa-

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rent, i.e. the settlors are considered not to have divested themselves of their assets, even in favour of discretionary and irrevocable foundations.

The settlors therefore remain fully taxable on the income and assets of the private foundation and, in the event of death, on its capital.

The advantage of using this type of structure may therefore seem relatively limited, as the foundation is fiscally "neutral". Thus, for individuals with purely French interests, and on a long-term basis, the use of a private foundation does not offer any significant tax advantages, except, as we shall see below, if the private foundation is converted, particularly upon the death of the settlor, into a charitable foundation.

A settlor resident in France will therefore be taxed on the foundation's income (dividends, interest, capital gains), whether this income is distributed or remains in the foundation. However, this problem can be circumvented by capitalising this income in non-distributing funds or investing in assets that do not generate income (such as precious metals).

In terms of wealth, holding assets under the cover of a foundation is a neutral transaction, given that France no longer has a financial wealth tax since 2018.

However, as soon as a foreign element comes into play, the use of a private foundation in Liechtenstein becomes particularly attractive. Three situations can be highlighted:

- **In the event of the settlor's relocation outside France:** upon departure from France, an exit tax must be declared and, where applicable, guarantees provided on unrealised gains on securities. Expectations and/or rights in a foundation do not fall within the scope of the exit tax and therefore do not need to be declared;
- **If the settlor and beneficiaries relocate outside France:** in this case, and provided that the foundation's assets are not of "French origin" (real estate or financial assets), the settlor's estate will be exempt from French transfer duties, regardless of the date of departure from France;
- **If a settlor is outside France and the beneficiaries have become French tax residents:** in this case, and provided that the beneficiaries have not been French residents for more than six years during the last ten years, distributions made to them are completely exempt from all taxation (income tax and transfer duties).

2. Public utility foundation

Unlike a private foundation, a public utility foundation under Liechtenstein law is a foundation whose activities, according to its declaration of establishment, must be entirely devoted to public and charitable purposes strictly defined by law. Thus, the intended activity must benefit the general interest in charitable, religious, humanitarian, scientific, cultural, moral, social, sporting or ecological matters, even if only a defined group of people will benefit from it.

French residents interested in setting up foundations in Liechtenstein can do so either by establishing a charitable foundation there from the outset or by converting an existing private foundation. Liechtenstein's tax system encourages such initiatives through reduced tax regimes. However, due to the absence of a tax treaty with Liechtenstein covering inheritance and gifts, founders residing in France are subject to French tax rules.

French legislation nevertheless offers specific exemptions from transfer duties for gifts to public interest organisations. Although these exemptions were initially reserved for beneficiaries located in France, they have been extended to countries in the European Union and the European Economic Area (EEA), provided that these

countries have signed a tax assistance agreement with France.

As Liechtenstein is part of the EEA and a signatory to such an agreement, Liechtenstein foundations can benefit from these exemptions.

To be eligible for these exemptions, Liechtenstein foundations must meet certain conditions, in particular that they pursue a non-profit purpose and objectives similar to those of French public interest organisations. An application for approval must also be submitted to the Ministry of Budget, confirming that the foundation meets the required criteria and ensuring that the assets transferred will indeed be allocated to the foundation's non-profit activities.

Approval can be obtained prior to the transfer, which provides legal certainty for the founders, or it can be requested at the time of the inheritance declaration, although this carries a risk of uncertainty.

French law considers foundations located outside France, including in Liechtenstein, to be similar to trusts, even if they are recognised as charitable organisations. As a result, they are subject to reporting requirements when they have links to French residents, whether through beneficiaries, members of the foundation board, or even if the assets include property located in France. These declarations, which must be made annually and at each distribution, enable the tax authorities to monitor movements of assets within the foundation. Failure to comply with these reporting obligations is punishable by a fine of EUR 20,000. Case law is very strict, as it considers that even if members of the foundation board incur disciplinary, civil or criminal penalties in their country of origin by making such declarations to a foreign tax authority, they could only be exempted from their reporting obligations in cases of "force majeure" (a situation not recognised for a Canadian trustee, for example).

Liechtenstein charitable foundations therefore offer French founders significant opportunities, especially for those who wish to support international causes. However, in the absence of a tax treaty with France, these foundations must strictly comply with French conditions in order to qualify for exemptions. By complying with reporting obligations and approval requirements, Liechtenstein foundations can be effective tools for philanthropic wealth management.

Under Swiss law, foundations are entities with legal personality, subject to the same rules regarding their establishment and operation, whether they serve private interests or, on the contrary, public interests, particularly of a charitable nature.

Swiss foundations are very rarely used for the purpose of holding and protecting family assets in the interests of relatives in a transgenerational approach, due to the fact that Swiss law prohibits "maintenance" foundations, i.e. those whose purpose is to provide for the maintenance of family members over several generations.

This prohibition is currently under debate and a bill aimed at abolishing it or at least relaxing it is expected to be drafted and discussed in the near future.

On the other hand, charitable foundations are much more widespread in Switzerland, despite the fact that they only benefit from tax exemptions under certain conditions, which are often stricter and more restrictive than those applicable in Liechtenstein.

There are currently around 14,000 foundations in Switzerland, only a few hundred of which are classified as "family" foundations.

From a tax perspective, foundations are subject to income and capital taxes, although the rates are generally lower than those applied to corporations.

Foundations that are recognised as being of public benefit are exempt from income and capital taxes as well as gift and inheritance taxes, provided that their public benefit status has been recognised by the competent cantonal tax authority. In this regard, it should be noted that, with respect to gift and inheritance taxes, it is the canton of residence of the donor or the deceased that has tax jurisdiction, not the canton in which the foundation has its registered office; thus, sub-

ject to inter-cantonal reciprocal agreements, a canton may levy gift and/or inheritance tax on a contribution made free of charge by one of its taxpayers (during their lifetime or upon their death), even though the foundation benefiting from this "contribution" has been recognised as being of public utility in its own canton of residence...

It should also be noted that several cantons only grant this exemption to foundations pursuing altruistic ("public utility") goals if they carry out their activities or direct their charitable actions mainly in Switzerland.

Regardless of whether or not they are recognised as being of public benefit, natural persons domiciled in Switzerland who receive distributions from foundations (Swiss or foreign) of which they are beneficiaries (or are part of the circle of beneficiaries) are in principle taxed on the income received in the form of sums/benefits; they are therefore not, contrary to what one might think at first glance, taxed on gift tax.

This aspect deserves further consideration in order to better understand the tax consequences for a Swiss taxpayer of being either the founder or beneficiary of a Liechtenstein family foundation (as explained above, the use of a family foundation under Swiss law is not recommended, with some exceptions).

A founder domiciled in Switzerland of a Liechtenstein family foundation (hereinafter "FL Foundation") who transfers part of their assets to it remains taxable in Switzerland on the assets – and the income generated by them – insofar as they retain control of the foundation and/or remain its beneficiary. The FL Foundation is therefore treated as "transparent" for Swiss tax purposes, which means in particular that contributions made by the founder to the foundation are not taxed (gift tax) and that distributions made by the foundation to beneficiaries (other than the founder) are considered as donations made by the founder, taxable where applicable under the tax law of his canton of residence, at a rate depending on the family relationship between him and the beneficiary concerned.

Upon his death – unless the beneficiaries have powers granting them control of the FL Foundation – the canton of residence of the founder will levy inheritance tax (calculated on the value of the foundation's assets), at the rate applied to transfers free of charge between unrelated parties (the highest rate, for example in the canton of Geneva...). even though the beneficiaries of the foundation are relatives, descendants or ascendants.

This particularly unfortunate consequence can be avoided by the founder by requesting (during his lifetime and even before setting up the foundation) an agreement ("ruling") from the tax authorities of his canton of residence, in order to ensure that, upon his death, inheritance tax is calculated in accordance with the rates applicable based on the family relationship between him and the beneficiaries of the foundation; such a ruling is only granted under certain strict conditions, including the establishment of statutory and/or regulatory rules preventing any change in the circle of beneficiaries.

If the FL founder permanently and irrevocably disposes of his or her assets in favour of the FL foundation and is not/no longer a beneficiary, his or her canton of residence will then tax this transaction as a gift at the highest rate (unrelated persons). With the exception of taxpayers taxed in Switzerland under the expenditure-based regime ("lump-sum"), Swiss taxpayers using this structure will not, in principle, be able to obtain a ruling allowing them to benefit from both a gift tax rate determined according to their relationship to the beneficiaries of the foundation (e.g. their descendants) and a "de facto exemption" from wealth tax and income tax on this wealth on the grounds that they have completely divested themselves of it.

Under Liechtenstein tax law, private foundations may, under certain conditions, opt for lump-sum taxation (in the order of a few thousand Swiss francs per year), but they cannot then benefit from the advantages of the tax treaty between Switzerland and Liechtenstein, particularly with regard to withholding tax (for example, dividends paid by a Swiss company to a shareholder that is an FL foundation are subject to a 35% withholding tax in Switzerland; if the FL foundation has not opted for this lump-sum taxation, it may limit this withholding tax to 15%, or even eliminate it altogether if it holds a minimum 10% stake in the Swiss company in question).

Private foundations that are taxed under the "ordinary" regime are subject to a profit tax which – without going into detail about the mechanisms provided for by Liechtenstein tax law – is, in most cases, significantly lower than tax on profit in Switzerland.

Foundations incorporated in Liechtenstein that pursue public interest objectives are exempt from tax.

However, it should be borne in mind that a contribution made by a taxpayer domiciled in Switzerland to a Liechtenstein charitable foundation will trigger – depending on the tax regulations of the canton of domicile of the "contributor" – a gift tax (at the highest rate), even if it were incorporated in Switzerland, it could benefit from an exemption (subject to certain conditions/restrictions).

In view of the above, the main advantage for a Swiss resident of using a Liechtenstein foundation seems to lie in the possibility of placing part of his assets in an entity for the benefit of beneficiaries, in particular to provide them with a certain degree of financial security/protection, possibly over several generations. This objective cannot be achieved through a foundation under Swiss law (prohibition of family "trusts").

From a tax perspective, it is therefore likely to be in the founder's interest to retain control of the foundation during his lifetime – control of this foundation (or to be its beneficiary) during his lifetime and to negotiate a ruling with the tax authorities of his canton of residence so that the inheritance tax rate levied at the time of his death in relation to the assets held in the foundation is calculated on the basis of his family ties with the beneficiaries (particularly if they are descendants). ■