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Trust and foundation after the reforms of the foundation and tax laws

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It has been possible to use a trust or foundation to structure assets in Liechtenstein since 1926. The introduction at that time of the common law trust into Liechtenstein law and the simultaneous codification of foundation law as well as other unique legal forms such as the establishment are regarded today as one of the main impetuses behind Liechtenstein's rise as a financial centre. A great deal has already been written about the differences between trusts and foundations. However, the latest reforms of the Liechtenstein foundation and tax laws make it appropriate to briefly reassess and elaborate on those differences.

Familiar differences and similarities

A short overview of the main differences between a trust and a foundation is set out below:

	Trust	Foundation
Legal form/ asset status	Segregated assets owned by the trustee, no legal personality	Legal entity with its own assets and legal personality
Bodies/functions	Trustee, possibly a protector (who are not bodies in the company-law sense)	Foundation council, possibly protector, other bodies possible
Commercial activities	Permitted to engage in commercial and non-commercial activities	Only permitted to engage in commercial activities to achieve non-commercial goals
Capital/ minimum capital	No minimum capital required, often small initial capital stipulated (e.g. CHF 1'000)	Minimum capital of CHF 30'000 (or EUR or USD 30'000)
Registration	Registration (not necessary for legal validity, minimal information required) or deposit (trust deed)	Deposit of the notification of formation or registration (necessary for legal validity)
Beneficiaries	Defined in the trust deed itself or in attachments	Usually defined in a supplementary foundation deed

Asset structuring and asset protection, family office, succession planning, international tax advice and tax planning, legal advice, trusts, foundations and companies, holding and patent management companies. ***Focus on: Trust and foundation after the reforms of the foundation and tax laws. PVS – practical application and interpretation.*** *Processing of corporate business, bank selection, investment funds and insurance matters, accounting and auditing, change of residency, asset structuring and asset protection, family office, succession planning, international tax advice and tax planning, legal advice, trusts, foundations and companies, holding and patent management companies, processing of corporate business, bank selection, investment funds and insurance*

The fact that trust deeds are usually drafted in greater detail than foundation documents and specify all of the rights and duties of the settlor, trustee and beneficiaries is attributable to their origins in the common law concept of trusts, which is based on the decisions of the courts rather than on statute. Foundations which are rooted in the civil law tradition are always governed by statutory provisions and therefore do not require such detailed private law provisions. Being a civil law jurisdiction, Liechtenstein has codified its trust law. However, Liechtenstein trust deeds are nonetheless still drafted in detail as this leaves open the option of a subsequent transfer of the trust to a common law jurisdiction (this can be achieved easily through the appropriate amendment of the choice of law clause in the trust deed and the corresponding change in the identity of the trustee). Moreover, the adaptation to the Anglo-Saxon style of trust deed helps to increase the recognition of a trust abroad in cases with international aspects. For this reason, Liechtenstein trust deeds often contain elements of Anglo-Saxon trust law although such inclusions would not be necessary under Liechtenstein law (e.g. perpetuity period). In addition, trust deeds are drafted in such detail so that it is possible to adapt Liechtenstein trust law, which is dispositive in many respects, to the needs of the client. Due to the liberal regulation of trust law, this can be done without any difficulty.

Effects of the 2009 reform of foundation law

A significant difference between trusts and foundations is that a foundation is much less flexible with regard to its purpose. One speaks of foundations being subject to the principle of rigidity. This underlying principle requires the founder to stipulate the foundation's purpose (in particular, the rules designating beneficiaries) at the time of its establishment in a manner that is unalterable. The 2009 reform of foundation law clarified this principle and thus codified the existing court decisions. Now the foundation's purpose may only be altered by the founder during his lifetime provided that he has reserved the right to do so in the foundation deed. In addition, this right is restricted to founders who are natural persons. It is possible to grant the settlor of a trust comparable rights. However, in the case of a trust, the additional option exists of granting the trustee a broad and far-reaching discretion to alter the terms of the trust without the settlor's consent although the exercise of such discretion is often contingent upon the protector's consent. The principle of rigidity is not known to Liechtenstein trust law, and trusts are therefore a dynamic instrument for asset structuring.

Effects of the 2010 tax reform

The report and proposal for the new Tax Act, No. 48/2010, contain the following wording: "Special dedications of assets which do not have legal personality (e.g. trusts) are not subject to corporate income tax since they are not legal persons; however, they have to pay the minimum corporate income tax pursuant to Art. 65." Art. 65(1) of the Tax Act thus affords trusts a clear advantage over foundations and other asset structures with legal personality as far as taxation is concerned. While it is necessary to structure and establish legal persons (foundations, establishments, etc.) as what are known as private asset structures (PVS, see ATU Bulletin No. 22) in order to obtain exemption from the duty to submit a tax return and limit taxation to the minimum amount of corporate income tax, the same is not necessary in respect of trusts. In the case of a trust, the trustee simply pays the minimum corporate income tax of CHF 1,200 annually, irrespective of the type of trust property or its value, and does not have to satisfy the requirements of a PVS.

Conclusions

Following the reform of foundation law in 2009 and the reform of tax law in 2010, the differences between the two Liechtenstein legal forms – trust and foundation – have increased. Trusts have acquired clear advantages. An obvious benefit is the relatively high degree of flexibility and operating freedom they allow (both for the settlor and for the trustee) since they are based on dispositive law. These have been significantly curtailed in the case of foundations since the reform. In addition, trusts now have clear tax advantages. The fact that trusts do not have to file tax returns and are only subject to taxation at the minimal rate of currently CHF 1'200, irrespective of the nature or amount of the trust property involved, increases their attractiveness in comparison with foundations.

Private asset structures (PVS) – practical application and interpretation

The practical application of private asset structures (PVS) has regularly led to problems of interpretation since the enactment of the new Tax Act. This has been caused by the very broad construction of the term "economic activity". The tax administration's guidelines on PVS of 12 May 2012 do indeed offer welcome practical assistance; however, issues such as

- what qualifies as a permissible "economic activity" of the PVS,
- how commercial asset management, which is impermissible, can be distinguished from private asset management, which is permissible, or
- when a simple "exercise of property rights" turns into "commercial share dealing/speculative trading",

have caused uncertainty among market participants. In the meantime, rules of thumb and criteria for categorising an entity as a PVS have developed in practice. However, when applying these rules it is still necessary to look at each case separately.

Bankable assets

- If an external asset manager is responsible for asset management, no difficulties will be encountered in classifying the entity as a PVS.
- If the entity's administrative body (foundation council, administrative board, etc.) itself manages the assets, what is known as the "50% rule" will apply: where no more than 50% of the portfolio is restructured each year, the entity will qualify as a PVS. The replacement of expiring securities (bonds, etc.) does not fall into the category of restructuring. Distressed sales are possible. However, evidence to justify them must be produced if requested by the tax administration.
- The administrative body is entitled to a reasonable flat fee for its work, which includes but is not limited to managing foundation assets.
- "Commercial share dealing/speculative trading" presupposes that income is being generated continually. As a rule, this criterion will not be satisfied if the foundation council takes over the administration of assets itself.
- If a foundation council equips its business premises professionally (e.g. with a typical IT infrastructure, including an e-trade platform such as Bloomberg or Reuters, etc.), this will prevent PVS status and be considered a form of commercial activity.

Loans

Interest-free loans to beneficiaries or to persons close to them in the interests of the beneficiaries are permissible (e.g. in order to finance such persons' education). On the other hand, a grant of a loan with interest will prevent PVS status.

Participations

The holding of participations in other entities will not prevent PVS status if the participations are managed independently of the PVS. The PVS may, however, exercise its ownership rights at any time. Evidence of the fact that the participations are managed independently must be provided in the specific case.

Real assets

Whether structures that hold real assets such as objects of art, motor vehicles, musical instruments, etc., are eligible for PVS status must be decided on a case-by-case basis.

Real estate

It is permissible for a PVS to make real estate available to a beneficiary as long as no rent is charged. However, if rent is charged, the entity will lose its PVS status.

These rules of thumb give market participants concrete criteria which make it easier for them to plan and use PVS. Whether this will increase the attractiveness of PVS in practice remains to be seen. After all, in the case of careful tax planning and asset management, a PVS and a non-PVS foundation, which is subject to ordinary taxation, will in the end often only pay the minimum corporate income tax. This supposed advantage of a PVS is evened out by the fact that PVS are subject to stricter control and monitor provisions than non-PVS foundations.

For further information, please do not hesitate to contact your client advisor at Allgemeines Treuunternehmen. You may also contact us by email: info@atu.li.

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