Swiss Foundation Law—Tightrope act between freedom and regulation

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Abstract

While a recently adopted reform of foundation law will bring facilitations for some types of Swiss foundations, other developments draw a less optimistic picture, especially for Swiss family foundations. This article gives an overview of the most recent developments and trends in Swiss foundation law and sheds light on the question, what role the newly presented draft bill for a Swiss trust law can play in this context.

Introduction

Switzerland is recognized worldwide as a hub for foundations. As of 1 January 2021, 17,500 foundations were registered in the public registry.[1] When discussions elaborate further, it often comes as a surprise that it is rather unclear what the thriving Swiss foundation sector actually is. The reason for this is that the renowned liberal Swiss law is in principle neutral towards the purpose of foundations and therefore covers multiple types of foundations. While for the most part, Swiss foundations are charitable (around 13,500 charitable foundations existed at the end of 2020),[2] the foundation sector is composed of a broad variation of other types, such as enterprise foundations, family foundations, ecclesiastic foundations, pension fund foundations, just to name a few.

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Even though these various types of foundations require a differentiated and nuanced regulatory approach, taking into consideration the interests and risks at hand, the core legal basis of Swiss foundation law, ie, Arts 80–89 of the Swiss Civil Code (CC), applies to *all* types of foundations. The neutrality of these provisions towards all (permissible) purposes constitute a cornerstone of Swiss foundation law and stand out as a reason for the success of Switzerland's foundation sector. However, Swiss foundation law is in motion and it must be analysed with care if the right balance between freedom on the one hand and regulation on the other is safeguarded. This article aims to elucidate the most important trends and legal developments and sheds light on their effects on Swiss foundations.

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1. https://ehra.fenceit.ch/wp-content/uploads/sites/54/statistiken/2021_01_01_eingetr_Rechtseinheiten_Rechtsform.pdf.
2. K Guggi/J Jakob/D Jakob/G von Schnurbein (editors), *Der Schweizer Stiftungsreport 2021*, 6.

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Classical foundations: on track for the future

In Switzerland, the term "classical foundation" covers all types of foundations that are not family foundations, ecclesiastic foundations, or foundations acting as pension funds, for which Swiss law stipulates certain specific norms. Most classical foundations are charitable foundations, enterprise foundations, art foundations, or other private foundations including, more recently, foundations that are connected to crypto-assets, blockchains, etc. (so-called "crypto foundations").

Enhancing the flexibility of foundations

On 17 December 2021, a reform of Swiss foundation law was adopted that will bring a further liberalisation.

On 17 December 2021, a reform of Swiss foundation law[3] was adopted that will bring a further liberalisation. The new law[4] was the result of a lengthy political deliberation process which started in 2014 with the report of an expert group (in which the first-mentioned author has participated). The draft included various aspects, the first being to enhance the flexibility of foundations:

- Today, the founder may reserve a right to amend the foundation's purpose. Henceforth, the founder shall also have the right to reserve the power to amend the organisation and the structure of the foundation (new Art 86a para 1 CC). These rights need to be reserved in the foundation deed and can only be exercised ten years after the establishment of the foundation or the last amendment of the foundation's purpose or organisation (for which two independent periods apply). The right can also be exercised by means of a testamentary disposition. The right to amend the purpose or organisation is neither inheritable nor transferrable (new Art 86*a* para 3 CC). If the foundation has been established by more than one founder, the right can only be exercised jointly (new Art 86*a* para 4 CC).
- Currently, the supervisory authority shall enact minor amendments to the foundation deed if this appears necessary for good reasons and no rights of third parties are affected. As of now, the relatively high threshold of "*necessary for good reasons*" shall be replaced and these minor amendments shall be enabled if they "*appear justifiable on reasonable grounds*" (new Art 86*b* CC).
- Amendments of the foundation deed shall lie in the competence of the supervisory authority and no further public certification shall be necessary (new Art 86*c* CC).

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Whereas the liberalisation regarding minor amendments will enhance the flexibility of foundation boards, the right of the founder to amend the organisation will further strengthen the founder's freedom when it comes to the structure of the foundation. Together, they constitute an important step towards a legal environment that takes into consideration the needs of a different generation of founders and board members. Especially younger founders often pursue the vision that a foundation shall adapt to changing circumstances. This often includes an amendment of the foundation's organisation

3. Parliamentary Initiative 14.470 "Strengthening of the foundation hub Switzerland", cf report of the Council of State's commission dated 22 February 2021, BBl 2021 485 and message of the Swiss Federal Council dated 12 May 2021, BBl 2021 1169.
4. BBl 2021 486.

or structure. Another legitimate wish is to update an outdated foundation governance and to re-organise the foundation according to a modern state of the art structure. With the facilitations of the current reform, it will also be easier to convert foundations to so-called "consumption foundations" (*Vebrauchsstiftung*), ie foundations that shall not only use their proceeds but also their capital to fulfil the foundation's purpose. To make use of the foundation's capital (even until it is completely consumed) needs to be seen in light of the broader trend of maximising the impact of the foundation in a given time rather than extending its lifespan *ad infinitum* with constant but little "real impact". The new options to alter the organisation offered by the revised Swiss foundation law may also pave the way to more foundations that actively invest their capital by taking into consideration ESG (environmental, social, governance) criteria or even adopt strategies of impact or mission-based investment, venture philanthropy, etc.

The reform also brought to the table two other important discussions which proved to be less successful: the need to clarify the legal basis of the right to file a complaint with the supervisory authority (so-called "*Stiftungsaufsichtsbeschwerde*") and to create a legitimization for the remuneration of board members of tax-exempt charitable foundations.

Supervisory complaints as means of internal governance

All classical Swiss foundations are supervised by a (municipal, cantonal, or federal) supervisory authority (Art 84 para 1 CC) and the supervisory authority must ensure that the foundation's assets are used for their declared purpose (Art 84 para 2 CC). It is unanimously recognised that (already today) Art 84 para 2 CC implicitly includes the possibility to file a complaint with the supervisory authority as a remedy *sui generis*. However, due to some controversial decisions by the highest Swiss Courts,[5] not only the procedural prerequisites but also the question who has the right to appeal became the object of debate. While beneficiaries with direct claims against the foundation are entitled to file a complaint, such right of current and former members of the foundation board or other interested persons is yet unclear. The initial text of the reform strove to eliminate this uncertainty while leaving room for appreciation in a specific case at hand.[6] Nevertheless, the competent first chamber of Swiss Parliament in its initial draft did not include any provision on the complaint. The National Assembly as second chamber did not agree with this omission and included in the draft bill a provision to this effect with the following wording (Art 84 para 3 draft CC): "Whoever has a justified control interest in ensuring that the administration of the foundation complies with the law and is in accordance with the foundation deed, can file a complaint with the supervisory authority against acts and omissions of the foundation's bodies".[7]

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The clarification in the law that the right to file a complaint with the supervisory authority is tied to a *justified control interest* would have been of high practical importance. Such clarification ensures both, namely a crucial tool of internal foundation governance for involved persons to control the acts or omissions of the foundation's bodies, and at the same time, that no unjustified claims from parties without a sufficient interest in the foundation's wellbeing are conceivable (avoidance of "popular appeals").[8] Unfortunately, however,

5. Cf, eg, Federal Supreme Court 5A_97/2018 dated 10 September 2018 (= BGE 144 III 433); Federal Administrative Court B-1932/2017 dated 6 November 2018.

6. The wording of the Initiative 14.470 by MP Werner Luginbühl demanded in no. 2 "a clear regulation of the complaint with the supervisory authority for persons with a legitimate control interest".

7. This wording goes back to the research and proposal of the first-mentioned author, see *eg* D Jakob, "Ein Stiftungsbegriff für die Schweiz" Gutachten zum Schweizer Juristentag 2013, ZSR 2013 II 319 et seq.

8. Cf in detail with several references D Jakob, "Reformen im Stiftungsrecht—eine Agenda: Zugleich ein Beitrag des Zentrums für Stiftungsrecht an der Universität Zürich zum Vernehmlassungsverfahren der parlamentarischen Initiative Luginbühl (14.470)", jusletter, 20 April 2020, 14 et seqq.

the Council of States did not follow this argumentation. The two chambers of the Swiss Parliament finally found a (more or less random) compromise with the following wording of a new Art 84 para 3 Civil Code (CC): "Beneficiaries or creditors of the foundation, the founder, the subsequent founder and former and current members of the board of foundation who have an interest in ensuring that the administration of the foundation complies with the law and the foundation deed may file a complaint with the supervisory authority against acts and omissions of the foundation bodies". This formulation is misguiding in two aspects: the enumeration of the involved persons is too narrow and the pure "interest" too broad. It has to be seen how these provisions will be applied in practice. It is yet unclear when these new provisions of the revised law will enter into force.

Remuneration of board members of charitable foundations

The diverging practices can cause legal uncertainty and inequality, especially when tax authorities are prone to a more restrictive approach.

Swiss tax law is generally conceived as liberal and friendly towards philanthropy. This is mainly due to the fact that Swiss federalism is particularly well developed when it comes to taxes. While only few provisions on tax exemption exist on federal level,[9] the cantonal practices vary importantly. This fact often comes as a double-edged sword: On the one side, it is often easy to establish or relocate tax-exempt charitable foundations according to the "best" cantonal practice. On the other side, the diverging practices can cause legal uncertainty and inequality, especially when tax authorities are prone to a more restrictive approach. Particularly, when it comes to the question of whether members of the board of a tax-exempt charitable foundation can be remunerated (and, if so, to what extent), practices diverge. Some cantonal authorities are of the—in our view erroneous—opinion that eventual remunerations are detrimental to a tax exemption since the foundation would no longer act altruistically (with "altruism" being a subjective criterion for tax exemption next to the objective element of a foundation's purpose being of public interest).[10]

The reform project of the Swiss foundation law also included a revised Art 56 para 2 Federal Law on the Direct Federal Tax and Art 23 para 2 Federal Act on the Harmonization of Direct Taxation at Cantonal and Communal Levels holding that a "reasonable" remuneration of board members shall not be detrimental to a tax exemption. In Parliament, however, the opponents argued that these dispositions would eliminate the desirable practical discretion of the cantonal tax authorities, thus leaving less *marge de manoeuvre* for suitable solutions. Furthermore, it was argued that in most cases a tax exemption would be granted anyway (which, however, is not true in many of the important foundation cantons). The new dispositions would have brought an important clarification for charitable foundations. As an expression of the ever-increasing duties of board members due to regulatory requirements, the possibility of an adequate remuneration is necessary to ensure a professional charitable sector in Switzerland and to enable the upcoming generational change in foundation boards. Unfortunately, the chambers in Swiss Parliament were not able to find a compromise. Consequently, the new provisions were not enacted. As a result, the overall development has been detrimental to the sector because the restrictive authorities will now be able to invoke the dismissive decision of the Parliament in their favour.

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9. Cf Art 56 lit g Swiss Act on the direct federal tax SR 642.11 and Art 23 para 1 lit f Swiss Act on the harmonization of the direct taxes of cantons and municipalities SR 642.14.

10. Cf the elements for a tax exemption in Circular No. 12 issued by the Federal Tax Authority dated 8 July 1994 (accessible at http://www.estv.admin.ch).

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Swiss family foundations: a less optimistic saga

These (at least in principle) positive developments for classical foundations stand in stark contrast to the current state of Swiss family foundations. Over the last decades, Swiss family foundations have become increasingly unattractive. For one, Art 335 para 1 CC restricts the purposes of a family foundation to bearing the costs for education, equipment, support, or similar purposes. It is, however, the case law of the Swiss Federal Supreme Court that has restricted the possible use of family foundations, holding that unconditional distributions to family beneficiaries for pure "maintenance" or "enjoyment" is prohibited and such a family foundation therefore is considered void.[11] While doctrine and practice have argued for decades that this approach must be liberalised, the environment became even rougher for family foundations as they were obliged to register with the public registry between 1 January 2016 and 31 December 2020.[12] If family foundations missed registering in time, they maintain their legal personality, but the foundation as well as its bodies can be fined with administrative penalties.

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Yet, the drama of Swiss family foundations has continued over the past few years. This time, the challenger was neither the legislator nor the courts but rather the public registry offices. When the time came for family foundations to submit their documents to the public registry to obtain the required entry, some cantonal registry officers and especially the Federal Office for Public Registers (EHRA) held that many of the ancient purposes of the foundations were not in line with the law and court practice. They therefore refused to enter these family foundations in the public registry, thus creating a state of non-conformity with the legal requirements. At the same time, the registers denied the legality of the statutes or amendments thereof, claiming that the amendments need to be approved by a civil judge. This approach is at odds with the prevailing opinion in doctrine and practice[13] but has, surprisingly, been approved by the Swiss Federal Administrative Court.[14]

The restrictive approach towards family foundations is barely comprehensible. Many Swiss family foundations were established several generations ago, some even before the coming into effect of the CC. They were subsequently confronted with an environment created by court decisions and practice that has over the years restricted their (originally fully compliant) status, with the legal provisions, ie, Art 335 CC, remaining unchanged. Also, a jurisdiction with a liberal foundation law should apply the same principles to all types of foundations, which is, however, currently not the case. The result is that many existing family foundations struggle and many clients are forced to choose foreign law vehicles (such as Liechtenstein foundations or Anglo-American trusts which then will be recognised in Switzerland) for their estate planning projects. This is an unwise development since a foundation hub should offer means for all legitimate planning purposes while binding them to its very own standards of governance and transparency.

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11. Cf, eg, Swiss Federal Supreme Court, decisions 135 III 614; 127 III 337; 93 II 439, recently confirmed by the Swiss Federal Administrative Court in its decision B-510/2020 dated 23 November 2021.
12. Previously, Art 52 para 2 CC exempted family foundations to register with the public registry. This provision was revised with the law on the implementation of the 2012 revised recommendations of the FATF, AS 2015 1389, BBl 2014 605, which entered into force on 1 January 2016.
13. Cf D Jakob, in A Büchler/D Jakob (editors), *Kurzkommentar Schweizerisches Zivilgesetzbuch* (Basel 2018), Art 87 N 8 with further references.
14. Swiss Federal Administrative Court, decision B-951/2020 dated 16 August 2021.

Considering the experience of the last years, it cannot be expected that the highest Swiss courts will adopt a more liberal approach. Rather, any hope for a significant improvement for Swiss family foundations lies with the legislator. Two current reform projects might create such a glimpse of hope as they deal with or at least put a spotlight on family foundations on a political level. The first project is the substantial reform of Swiss inheritance law. This reform is of such importance that the legislator has decided to split it into several parts. The first part, which mainly reduces the portions of forced heirship, has already been enacted.[15] It is possible that the subsequent part of the reform (with the name "technical elements") might also include a reform of Art 335 CC. The second project is the possible enactment of a Swiss substantive Trust law which will be described in the following.

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Swiss Trust Law and family foundations: a new hope?

The concept of a trust is in principle alien to a civil law jurisdiction such as Switzerland. Switzerland is, however, a signatory state of the Hague Trust Convention[16] and, thus, has recognized foreign trusts since 1 July 2007. In recent years, there has been a vocal group in practice and academia that supported the idea of introducing a proper substantive Swiss trust law. These efforts were flanked by several political initiatives in Parliament.[17] The Motion 18.3383 has finally instructed the Swiss Federal Council to provide for the legal basis for the introduction of trusts in Switzerland and, in fact, on 12 January 2022 a draft bill has been presented.[18]

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It is evident that the introduction of a trust in Swiss law will come with certain frictions in tax and civil law, not least because common law concepts such as law and equity (and the resulting dualism of property) are not known in Switzerland. Yet, the efforts and the willingness to open Swiss estate planning and adopt a new tool are remarkable and should, in principle, be supported. Other civil law countries such as Liechtenstein have demonstrated that it is possible to open a jurisdiction to trusts and modern international estate planning. It comes, however, with a certain surprise that the Swiss legislator seems willing to introduce alien concepts into Swiss law before adapting their very own (and over a long time quite successful) tools, such as family foundations. Thus, the legislator should make some fundamental considerations and re-evaluate the attractiveness of Switzerland as an established hub for foundations, also for means of planning in private and family matters. This especially holds true when considering the proximity to Liechtenstein, where family foundations are permissible without restrictions (ie, also for unconditional distributions to family members). The Swiss Federal Supreme Court has held that Liechtenstein family foundations (also with pure maintenance purposes) are to be recognised in Switzerland, as Art 335 CC does not constitute a so-called *lois d'application immédiate.*[19] The same is true *mutatis mutandis* for the recognition of maintenance trusts. The harmful "self-discrimination" of Swiss family foundations is not justifiable and anachronistic in a time of increased mobility and international competing jurisdictions. Most of all: If a new Swiss trust law were to be

15. 18.069, AS 2021 312, published 1 June 2021, entry into force on 1 January 2023.
16. Convention on the law applicable to trusts and on their recognition, concluded 1 July 1985, in force for Switzerland from 1 July 2007, SR 0.221.371.
17. Parliamentary Initiative 16.488 introduced 13 December 2016 or Motion 18.3383 introduced 26 April 2018; further Postulate 15.3098 introduced 11 March 2015.
18. The draft bill is currently in the consultation process, which ended on 30 April 2022.
19. Swiss Federal Supreme Court, decision 135 III 614.

introduced for the same purposes, Art 335 would also have to be liberalised at the same time if one wants to avoid a sharp contradiction of values.

It is therefore desirable that the current project of introducing a genuine Swiss trust law will give impetus also to a reform of the Swiss family foundation. Put differently, a Swiss trust law would be a "nice to have", a reform of the Swiss family foundation, however, is a "must have".[20]

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Conclusion

Switzerland's foundation law is in motion. For classical foundations, a recent reform has brought significant facilitations when it comes to the modification of a foundation's organisation. The reform has, however, not brought suitable clarifications regarding the possibility of filing a complaint with the supervisory authority and the remuneration of board members of charitable foundations without possible loss of the tax exemption. The legislative process has demonstrated the ever-existing struggle between regulation on the one side and freedom on the other. A different story holds true for Swiss family foundations. For family foundations, practice of the courts and, more recently, public registry offices have been a saga of incomprehensible discrimination. Die hard? It remains to be hoped that the recent desire to establish a genuine trust law in Switzerland will also lead the legislator to re-evaluate the law of Swiss family foundations to find a well-balanced result that respects both, the necessity of regulation to prevent abuse and the freedom to provide for liberal estate planning tools.

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20. Cf in further detail D Jakob/M Kalt, "Ein Trustrecht für die Schweiz? Über den Sinn der Einführung eines neuen Rechtsinstituts im Schweizer Recht", Expert Focus 2019/9, 630 et seq.