

## Article

# Shareholder Foundations of enterprises: the North European style of securing family businesses for the long term—rising up to the global challenge

Ineke A. Koele\* and Rasmus K. Feldthusen†

### Abstract

This article explores how and why the traditional business succession system within family businesses needs to be reconsidered. Holding Foundations are generally overlooked although they provide a purpose-driven ownership structure with a stewardship governance that avoids family conflicts, taxation and dispersed ownership affecting the family business. In this article, the authors combine their experiences and insights from Denmark and the Netherlands with shareholder foundations of enterprises.

## 1. The business case for Shareholder Foundations of family enterprises

From historical research, it appears that long-term successful families are foremost determined by their culture of trust and togetherness.<sup>1</sup> Long-term success is not determined by their assets, since these are divided

between various heirs and over time most often is dissipated since the entrepreneurial spirit is not kept vibrant over the generations.

Successful families provide a culture of abundance, of trust, of inspiration and support.

Where families without a developed strong culture based on this type of values grow rich, however, many lack the resilience to be able to stay generative over the generations which is required to be successful in governing a family-held business over time. They often even enter into a state of entropy where money becomes a divider rather than backing up to a culture of abundance. The result is quite devastating: we all know stories of family feuds, family wars or other exotic stories.

Various research in different parts of the world shows that family businesses are extremely vulnerable in the chain of succession between the generations; only 30% survive the first exchange of generation, whereas 13% of the family businesses survive generally two consecutive transfers to the next generation.<sup>2</sup> Here, it appears not to matter whether a family business is based in a high-tax or

\*Ineke A. Koele, Attorney at law & Tax Lawyer, Koele Tax & Legal Perspecta, Van Twickelostraat 13, 7411 SC Deventer, The Netherlands. Email: ineke@koeletaxlegal.com; Website: www.koeletaxlegal.com

†Rasmus K. Feldthusen, Faculty of Law, University of Copenhagen, Denmark

1. Paul Collier, *The Future of Capitalism*, on Gregory Clark: *The Son Also Rises: Surnames and the History of Social Mobility*; Dennis T. Jaffe, *Resilience of 100-Year Family Enterprises*, Executive Summary of His 100 Year Family Enterprise Research Program, published full in 'Borrowed from Your Grandchildren', John Wiley & Sons, 2020.

2. Recently, Erasmus Centre for Family Business (ECF), P. Heugens (<https://www.rsm.nl/about-rsm/news/detail/5271-two-thirds-of-family-businesses-do-not-survive-a-transfer/>); Roy Williams and Vic Preisser, *Preparing Heirs*, Robert D. Reed 2003, page 17. See also Morten Bennedsen, Kasper Meisner Nielsen, Francisco

low-tax country or in a new or older economy. Although it is common knowledge what the main causes are for these very poor 'success' numbers, it is not so easy in practice to overcome the same. The main reason for the failing generational succession is the lack of communication and trust, or 'cohesion' in general within the family members. In order to create a successful family with sufficient foundation of values and principles to endure the transformation of the generations, there is much more needed than the often proposed 'family constitution' which is in an optimal scenario a fine attempt to start the process of family bonding and in a worse scenario a damaging effort to control the next generation. Most tax lawyers and notaries, who enter into an engagement with the patriarch in a setting of confidence, do not communicate effectively with the other stakeholders in the process and treat the transfer to the next generation as a transaction; issues as tax optimization and control are dominating the discussion. In reality, though, these legal structures do not in themselves ensure the success of the family business and may even induce the already latent risks within the family.

Fortunately, there are examples of excellent and sustainable family businesses. The German Merck family, now in its 11th generation, has developed a €15 billion company in 66 countries. This family has developed over 350 years a strong sense of values and family togetherness. Now over 250 family members, they spend quality time together on a regular basis. Values like transparency, courage, achievement, responsibility and integrity are cultivated. A core theme across generations of the Merck family is their detachment and *caution against material wealth*. The family imprints its younger members with the notion that they are just stewards for the 50,000 employees of the business,

they are seen as custodians of the wealth and the business and see their work as service to mankind.<sup>3</sup>

The paradox here is that where families acknowledge stewardship as an overriding family value and vision for the future, thereby focusing on the long-term interests of all the firm's stakeholders, the business is most likely to flourish over the generations and the notion of the pursuit of a higher purpose that serves the community or even society at large is bonding the family together.<sup>4</sup>

Given the size and impact of family enterprises in Western economies,<sup>5</sup> there is a huge interest of the society at large in the continuity of the enterprises and accordingly, against the 'forced' transfer to the next generation which provides for an insurmountable high risk of discontinuity. All professionals working with family businesses are confronted on a regular basis with heartbreaking stories of family conflict or even family war, family disintegration and entropy, or just lack of planning and governance and the consequential stagnation. Albeit the reasons for the steep risks are known, it is not easy to mitigate the same effectively since these are all found in 'the human condition'.<sup>6</sup> To create a successful Lasting Legacy, a *process of dynastic imaging* should be undertaken. It is sometimes hard and tough work and should never be underestimated.

In more practical terms, the traditional ownership structures may create continuity problems in the event of any separation or buy-out of family members, since each and every family member is subject to the main forces of life such as love, decease and conflict.

Of course, the complexity of taxation adds to the picture. Traditional property structures already do and will undeniably face increasing gift and inheritance taxes in the future, as the very generous exemptions of

Perez-Gonzalez and Daniel Wolfenson, Inside the Family Firm, The Role of Families in Succession Decisions and Performance, where the authors amongst other things find that family successions have a large negative causal impact on firms' performance: [https://www.cbs.dk/files/cbs.dk/inside\\_the\\_family\\_firm\\_0.pdf](https://www.cbs.dk/files/cbs.dk/inside_the_family_firm_0.pdf).

3. Campden Family Business, <http://www.campdenfb.com/article/institution-building-what-family-businesses-can-learn-merck>.

4. See also Randel S. Carlock and John L. Ward, Strategic Planning for the Family Business, Palgrave Macmillan, 2001, p. 145.

5. In the Netherlands, 70% of all enterprises are family businesses who represent more than 50% of GDP and more than 1/3 of employment in the country. In surrounding countries, similar percentages can be found.

6. For information on how to create a Lasting Legacy rather than a simple legal-technical top down estate plan with a 'quick fix' that leaves its marks on family & business: I. A. Koele, Family Business and Lasting Legacy Planning, Philanthropy Impact Magazine, Winter 2015. Koele, Lecture, University of Oxford on 22 October 2015, <http://podcasts.ox.ac.uk/series/philanthropy>.

gift and inheritance taxation for business assets are increasingly associated with unequal taxation.<sup>7</sup>

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## 2. Features of Shareholder Foundations of family enterprises

The Shareholder Foundation is characterized by the following:

- It is created by a transfer that in civil law countries is referred to as a gift or inheritance.
- The foundation is a separate legal entity and therefore legally independent from the donor and of the underlying enterprise.
- The purpose of the enterprise foundation is typically non-selfish, i.e. not serving the interests of the donor or the family.
- The family, however, may have influence or control in the governance of the foundation (subject to restrictions).
- Thoughtful governance mechanisms exist or are put in place to overlook the operations of the foundation together with its underlying corporations, in order to manage this ‘orphan structure’ responsibly.

A Shareholder Foundation is designed for an indefinite period and may be regarded as a strong ‘commitment device’ better serving nowadays needs in society

than the traditional corporation.<sup>8</sup> Without shareholders’ interests, the foundation can focus on its task to maintain the survival of the business and balance the interests of all stakeholders.

Where the business distributes dividends in excess of a volume that should be maintained as a safety net for the business, normally the foundation has another purpose. This purpose may be charitable in nature, or have a social character not necessarily being charitable. The Shareholder Foundation would often not have a purpose in serving the interests of the original families’ interests or even have a narrowly defined family purpose as well, such as the supporting of family members in need. It could, however, have as a purpose to serve the communal interests of all employees and other stakeholders of the underlying enterprise—in that case, obviously, the foundation would not be charitable in nature, but social. In some jurisdictions, such as, for example, Switzerland, foundations need to have a charitable purpose and accordingly, are supervised accordingly.

In practice, many Shareholder Foundations retain voting majority even where the company is listed on the stock exchange; this is the case with the largest Shareholder Foundations in Denmark: for example, Carlsberg, A.P. Møller-Maersk and Novo Nordisk. In preserving voting control by means of preferential shares, the foundation is able to set the dividend policy which is a distinguished factor in terms of its independence from the underlying business. In other jurisdictions, such as Germany, it is not permitted for a foundation to maintain voting control over the operations of a subsidiary business. In the case of Robert Bosch, the family itself retained voting control over the operations of the underlying business.

The Shareholder Foundation, as referred to in this article, cannot be compared to an Anglo Saxon discretionary trust. The fundamental difference is that an irrevocable discretionary trust always has a fiduciary

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7. For example, after the German Federal Constitutional Court had ruled that the existing inheritance and gift tax act is unconstitutional, the inheritance and gift tax act was amended in order to comply with the decision. The wide-ranging exemptions for transfer of business assets were reduced, and additional conditions introduced. The new law has been made retroactively applicable since 1 July 2016. In Dutch jurisprudence, due to the lack of a Constitutional Court, the Supreme Court has maintained the current generous exemptions, albeit both friend and foe agree that the legislation is contrary to the principle of equality.

8. See Colin Mayer, *Firm Commitment: Why the Corporation Is Failing Us and How to Restore Trust in It*, OUP, 2013.

obligation toward the beneficiaries and, accordingly, entails a fiduciary form of traditional ownership. Where the beneficiaries of a discretionary trust have an equitable interest in the underlying ownership, nonetheless this type of ownership is far from liquid, for the sake of the communal management of the properties by the trustee. One cannot quickly think too lightly about the delicacy of this balance between legal but fiduciary ownership of the trustee and the equitable ownership of each and individual of the beneficiaries; unless the stakeholders are all aligned, the trust can be a highly inflammable device and is the source of a flourishing litigation practice of many international trust and estate lawyers.

The current debate on inequality between the wealthy and ‘the average workers’ is also a relevant contextual circumstance. The fact that people are considered to be ‘elite’ because they are born or raised in a wealthy family is an identity not everybody embraces wholeheartedly. More often than not, experienced international trust and estate lawyers, knowledgeable of the challenges, express their clients’ preference not being raised as a NextGen in a large family enterprise despite the financial benefits this would also have.

Instead, for board members—whether family related or not—to participate in the values and norms of the business that the family has created, can be highly rewarding to their self-fulfillment and prestige. At the same time, the foundation model may foster social responsibility and ethical behavior by the business that is owned by the foundation since it is lacking an impatient controlling shareholder; the business of a Shareholder Foundation is therefore ideally suited to qualify as an impact or purpose organization. This adds to the legitimacy of the business and the alignment of the stakeholders, therefore increasing the reputation and expression of the business.

There is an existing culture of Shareholder Foundations in Sweden, Denmark, Germany, Switzerland and the Netherlands. It represents a perhaps predominant

North European culture, where strong common social norms exist and there is a relatively high trust in society.<sup>9</sup> In the view of the authors, this culture deserves to be highlighted, deepened and expanded.

Within the topic of Shareholder Foundations, these jurisdictions have at least as much different as similar features. In this contribution, we will focus on the examples of Denmark and the Netherlands.

### 3. Denmark: culture of ‘Commercial foundations’

Denmark sets the example since 70% of stock market capitalization consists of companies held by commercial foundations,<sup>10</sup> including three of the four largest Danish companies—A.P. Møller-Maersk, Novo-Nordisk and Carlsberg. As a consequence of these remarkable facts, there has been substantial research carried out in Denmark on the effectiveness and efficiency of commercial foundations (also sometimes referred to as ‘industrial foundations’) by Steen Thomsen of the Copenhagen Business School and Rasmus K. Feldthusen of the University of Copenhagen. The Danish Shareholder Foundations are responsible for more than 50% of the entire budget for research and innovation and this can be said to be a valid explanation of the strong innovative character of Denmark.

In addition, research on commercial foundations in Denmark has shown that despite the lack of incentive for profit maximization of shareholders and the control of the market, foundation-owned businesses do not underperform. Instead, at least where the larger enterprises are concerned, enterprises held by Shareholding Foundations outperform relative to privately held businesses which are likely to be explained by the typical advantages that foundation-owned corporates have: no short-term pressure of the market and corresponding myopia, no succession issues whilst benefiting from a higher reputation in relation to social responsibility.<sup>11</sup>

9. However, it is certainly not exclusively found in Europe. Many centuries-old enterprises origin from Japan, where a strong culture of responsibility is found, and blood relationships are not decisive in the succession of businesses.

10. Steen Thomsen, *The Danish Industrial Foundations*, Djöf Publishing, Copenhagen 2017, p. 9.

11. *Id.*, chapter 7.

It has also been acknowledged by the research of Steen Thomsen that commercial foundations exert a stabilizing influence on the Danish economy since they emerged from the last financial crisis relatively unscathed<sup>12</sup> and that foundation-owned companies survive much longer than traditionally owned companies.<sup>13</sup>

Commercial foundations have been used in Denmark since at least since 1876 when J. C. Jacobsen established the Carlsberg Foundation, which in 1888 inherited his brewery. Since then numerous significant companies have been transferred by gift or inheritance to commercial foundations.

A foundation is according to the Danish Commercial Foundation act considered to be 'commercial' if the foundation:

1. trades goods or intellectual property rights, copyright, provides services or the like, for which it normally receives payment,
2. carries out activities involving the sale or lease of real property or
3. has a connection to a limited liability company mentioned in the Danish Companies Act section 7 (controlling influence).

The nature of the commercial foundation's purpose has no influence on whether the foundation is considered commercial or not. Hence a foundation with a sole charitable purpose is still considered to be commercial if any of the above conditions are met.

It is possible for the family of the founder to also receive and own shares in the business in which the commercial foundation has a controlling stake.

Gifts and bequests to a commercial foundation with a charitable purpose are tax exempt, provided the gift or inheritance adds to the (enlargement of the) core capital of the foundation. The board of directors may not distribute

funds belonging to the core capital of the foundation without prior approval of the supervisory authority.<sup>14</sup>

Since 1999 a commercial foundation may no longer enter into the tax position of the founder (rollover relief) when he or she by gift or bequest transfers shares to the foundation. The consequence is that the founder will be taxed on capital gains at a rate of 42 pct. of all gains exceeding DKK 55.300 (app. €7.418).<sup>15</sup> As this is not ideal to encourage establishing new Shareholding Foundations, a bill has been presented to the Danish Parliament in March 2020 but is not expected to be passed before the Summer due to COVID-19 crisis and legislative priorities following from this.<sup>16</sup> Once enforced this will again enable a founder to transfer his or her shares to a commercial foundation without being taxed on capital gains as a result of the transfer.

However, it is also possible for a holding company to transfer its shares in a subsidiary to a commercial foundation with a predominantly charitable purpose without either the holding company or the foundation incurring any tax. Pursuant to Supreme Court case law, when the foundation's purpose is charitable, it is not considered as an indirect gift of the shareholder(s) of the holding company, hence there is no taxation of the shareholder(s). Broadly speaking a Danish commercial foundation is taxed the same way as a corporation, and at the same tax rate which is currently 22 pct. On the other hand, a commercial foundation may deduct costs and depreciations in its taxable income similarly to corporations.<sup>17</sup> Commercial foundations, for example, may deduct their charitable distributions with a total of 104 pct., and will thus be tax-free if it distributes most of its net income. There is no requirement of minimum annual distributions, which is due to the fact that consolidation of its wealth is important in a commercial foundation, in order for the foundation being able to step in should the underlying business need

12. Id, p. 125.

13. Id, p. 164.

14. See more on Danish foundations, Rasmus K. Feldthusen, *The Danish Law on Foundations, Trusts & Trustees*, Vol. 22, No. 1, February (2016), pp. 146–150.

15. The initial gains of up to €7.418 is taxed at a rate of 27 pct.

16. Prof. Steen Thomsen and Prof. Rasmus K. Feldthusen were amongst the members of the expert group designing the new tax model.

17. A Danish foundation actually has an extended right to deduct costs compared to corporations, as also costs, being noncommercial but necessary to pay for the sake of the foundation's other activities, are deductible.

financial support, or should a competitor perhaps be acquired, etc.

It is possible—and very often used—to state as a purpose of the foundation that it must own the shares in said company and develop the business. This is sometimes referred to as being a ‘commercial purpose’. It is allowed in Denmark for a commercial foundation to have a commercial purpose as the foundation’s sole purpose, just as a commercial foundation can have additional purposes to the commercial purpose, for example, a charitable purpose.

Commercial foundations are subject to supervision by the State, as there are no shareholders or members to control the board of directors. The supervisory authority (Erhvervsstyrelsen) performs a legalistic oversight and may, for example, require that board remuneration is reduced if it exceeds a reasonable level. If the board violates the bylaws of the foundation or does not act in accordance with the law on commercial foundations, the supervisory authority can intervene. In practice, many foundations seek guidance from the supervisory authority on different matters, and the supervisory authority also publishes guides on its website. Complaints about a decision made by the supervisory authority can either be brought before a special administrative tribunal or directly to the courts.

In order to amend a purpose of a commercial foundation, a prior consent of the supervisory authority and an additional public authority is required. The conditions for allowing for an amendment of a foundation’s purpose are strict.

It is a requirement that there is an independent management of the foundation, which pursuant to Danish law implies that at least 1/3 of directors must be independent. The founder and/or the founder’s family may thus be members of the foundation’s board as long as at least 1/3 of the board members are independent from the founders and his family.

A commercial foundation is obliged to pay an annual fee for the regulatory oversight that it is subjected to.

As mentioned above, it is possible for a foundation to have a family purpose (a foundation may in addition

have, for example, a charitable purpose). For foundations established on or after 1 January 1985, a preferential status for the founder’s family as regards distributions from the foundation is subject to a time limit (rule of perpetuities) and is limited to those family members living at the time of the foundation being established and one unborn generation.

All commercial foundations are obligated to annually report on a set of Recommendations on Foundation Governance. Reporting follows the principle of comply or explain. The reason for this is to enhance transparency and good governance in commercial foundations. The Recommendations on Foundation Governance are drafted by an independent committee appointed by the Minister of Industry, Business and Financial Affairs.<sup>18</sup>

The board composition, by-laws and annual reports of commercial foundations are publicly available.

#### 4. The Netherlands and Shareholders Foundations

The Netherlands is a jurisdiction with highly flexible foundation laws where the historical development of foundation law has concentrated in the private domain rather than in the public domain. As a result, and in contradiction to the Danish example, a regulatory oversight over foundations is restricted to extreme situations where foundation board members are acting in contradiction to the laws or to the constitutional documents of the foundation. The local courts have the power to ask for information, suspend or dismiss board members or appoint new board members, but will only act at the request of the Public Prosecutor or ‘any interested party’, the latter however being interpreted narrowly as somebody whose interests are being damaged by the actions of the foundation. Apart from this protective oversight, there is no regulatory control with respect to investments, important decisions, mergers or changes to the constitutional documents of foundations. Obviously, all formal amendments need to be passed before a notary, who is responsible for the legally rightful application of the law.

18. Prof. Rasmus K. Feldthusen is amongst the members of the Committee, see more <https://godfondsledelse.dk/english>.

Famous examples of Dutch foundations owning corporations are the Van Leer Stichting, a charitable foundation and the IKEA Foundations, which are both noncharitable and charitable in nature. The latter example also shows that Dutch foundations are being used for non-Dutch businesses.

### **Legal requirements of Dutch Shareholding Foundation**

Dutch law on foundations is extremely flexible; it contains only a few mandatory provisions. As a result, foundations may have different purposes at the same time. Likewise, different bodies can be set up in a foundation with different forms of influence and control, remotely or otherwise. Think of a supervisory board or a family council. Detailed arrangements are preferably laid down in Regulations, which are completely discreet and are not published in the official registers of the Chamber of Commerce. The objective of the foundation and the internal organization of the foundation determines its tax qualification.

There is one provision in foundation law that may raise some questions: Article 2: 285 paragraph 3 of the Dutch Civil Code, in which it can be read that the purpose of a foundation may not include making payments to . . . *nor to others, unless the payments are of an idealistic or social nature.*

Based on the legal doctrine of foundations, the many ‘family foundations’ existing in the Netherlands are not conflicting with this benefit prohibition, due to the fact that benefits paid to family members for maintenance, study, health or other meaningful purposes have a social significance. And apart from this, this restriction has to be viewed as to make a distinction between a foundation and a corporate entity divided by shares; that implies that only if the foundation itself can be said to carry on a business, there is a restriction in making distributions to founders or board members (‘quasi-shareholders’).

In practice, Shareholder Foundations have a purpose to maintain and thrive the underlying business of its subsidiary. Apart from that, most Shareholder

Foundations have a societal or a charitable purpose. In addition, the Shareholder Foundation may also have a duty of care to its benefactors, including the family members of the donors. This may in practice have different forms, and the tax consequences are a relevant factor to consider.

### **Alternative tax qualifications of Shareholding Foundation**

An independent foundation acting as a shareholder of active companies may have the following characteristics and qualifications, depending on its purpose and internal organization:

- i. a public benefit purpose institution (ANBI); the essence of this is that the foundation primarily pursues a public benefit purpose;
- ii. a Social Interest Pursuing Institution (SBBI);
- iii. a Segregated Private Capital pursuing private interests (APV);
- iv. a foundation that does not qualify as one of the other foundations: residual category.

Typically, families who would like to create an alternative ownership structure using a Shareholding Foundation opt for the qualification of an ANBI or an SBBI, and in all circumstances would like to avoid the qualification as an APV, and therefore fit with the residual category.

Families would like to avoid the qualification of an APV since that would, at least for tax purposes, mean that the divestment of the ownership in the underlying entity would not be recognized. The consequence of qualifying as an APV is that, for the purposes of the Income Tax Act, the assets segregated within the foundation and the resulting income and expenditure are allocated to the transferring family member(s) during their lives and thereafter to their heirs, per heir in the same proportion as the legal entitlement following from the applicable inheritance laws. In other words, a foundation that qualifies as an APV is not recognized for tax purposes, and is in fact regarded as a ‘transparent’ foundation. This counts both income tax, gift and

inheritance tax and as a result, upon the decease of the transferring family member(s), the assets of the foundation are still deemed to be inherited by the legitimate heirs, whilst ongoing distributions by the foundation are deemed to originate from these heirs for tax purposes (rather than from the foundation). In order to avoid the APV status, the foundation should not be qualified as serving the private (in the sense of 'non-societal') interests of, for example, a family.

Obviously, the choice for a charitable ANBI has a designed tax framework of conditions that the foundation would have to meet, whereas there are ample tax advantages with respect to the transfer of the assets to the ANBI foundation and any consecutive distributions by the ANBI in accordance with its charitable objective. Special attention should be paid to the balance between the value of the corporate entity and the distribution of funds for the public interest.

The qualification of an SBBI is a less stringent alternative, whilst safeguarding exemption of Dutch gift tax with respect to the transfer of the ownership of the underlying business to the Shareholding Foundation. In fact, we do argue that many Shareholding Foundations qualify as a Social Interest Pursuing Organization, since they have a combination of (mostly) three purposes: (a) continuation of the enterprise and all its stakeholders, (b) a societal purpose that aligns with the values of the family business and (c) the social interest of keeping the family in its broadest sense in a 'generative' shape and order, without conflicts, as vital citizens with a culture of abundance, trust and support.

As a result, the transfer of the shares to the Shareholding Foundation would be exempt from gift tax, whilst the family would be freed from income tax and future inheritance tax. Nonetheless, and different from the Shareholder Foundation qualifying as a charitable organization, the donor would in effect face capital gains tax upon the transfer of shares to the foundation which would mean in effect that at least for a certain percentage the shares would have to be sold to the foundation.

Similar to Denmark, the Netherlands has not yet embraced the Shareholding Foundation structure as an important succession strategy to benefit society as a whole with the accompanying exemption of capital gains tax. That is why the charitable foundation is still the popular choice for a Shareholding Foundation, since the deductibility of the value of gifted shares (more than) offsets any income tax on an eventual capital gain for income tax purposes.

## Conclusion

Faced with how our traditional business succession system within family businesses can often lead to conflicts and suffering between family members, we need to rethink ownership structures of family businesses. The ownership in a family business is not just an investment, but a responsibility to many stakeholders and in fact is 'borrowed from the living generation's grandchildren'.<sup>19</sup> The Shareholder Foundation structure is a useful alternative structure, which has proven successful in Denmark and has also useful examples in other North European countries. The Dutch example seems to provide highly flexible opportunities in many instances, even without a specific incentive for these specific structures.

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However, a Shareholder Foundation is not a panacea. It should have a well-balanced and elaborated

19. See (n 1).



governance, including, for example, a certain minimal duty of care to the founders and other stakeholders in the underlying company, who have divested themselves of their ownership and self-interest in the business. If the right balance can be reached in this governance, the Shareholding Foundation may prove itself as a genuine alternative for many family businesses which is not

prone to short-termism that often permeates subsequent generations. The legislator, as always, needs to follow with accompanying tax legislation. For the legislator, finally, it can also serve as a way to centralize the effective seat of management of the business within its borders.

***Rasmus Kristian Feldthusen** is a full professor in Commercial Law at the Faculty of Law, University of Copenhagen. Feldthusen specializes in foundations, tax law and corporate governance. Feldthusen is a member of several editorial committees and frequently participates in conferences and seminars. Feldthusen is a member of the Danish Committee on Foundation Governance and TIAETL. Email: [rasmus.kristian.feldthusen@jur.ku.dk](mailto:rasmus.kristian.feldthusen@jur.ku.dk).*

***Dr. Ineke A. Koele**, is a Dutch attorney at law and tax lawyer with three decades' experience in private clients and non-profit matters encompassing tax, estate, succession, charity, social enterprise, trust and foundation law in the Netherlands and abroad. Koele is a Fellow of the IAETL and International Fellow of ACTEC. She is founder of *Koele Tax & Legal Perspecta*, the Netherlands. Email: [ineke@koeletaxlegal.com](mailto:ineke@koeletaxlegal.com).*