

V. Location of family charities: the Netherlands and beyond

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Charity regulations can differ significantly from country to country. Multinational families may consider a number of jurisdictions in deciding where to establish a charity. The Netherlands is one of the most liberal jurisdictions in this regard.

1. Introduction

When internationally active families are considering where to base their family charity, the flexibility of the legal framework is paramount. The concept of a charity for tax and legal purposes is always subject to requirements and restrictions which will determine the extent to which an extended family can pursue their philanthropic vision.

In order to create a meaningful structure and take advantage of the legal framework in the optimal jurisdiction for a family's charitable activities, time and effort must be devoted to creating a meaningful nexus with that jurisdiction. Residence and domicile should never be taken for granted, but should be considered carefully. The day-to-day management of the charity should normally be based in the jurisdiction of choice.

If the family is resident elsewhere, or in several countries around the globe, the charity may also take on the function of a family council gathering, by involving representatives of the family in its governance.

The ideal legal framework should allow the family to participate in the governance of a charity, even if they do not have a nexus with the particular jurisdiction in which the charity is established.

The tax deductibility of the transfer of an endowed fund into a family charity is a decisive factor in only a few scenarios. If the family is resident in the Netherlands, the transfer to a foreign-based qualifying charitable entity can benefit from a tax deduction; but that is not the case everywhere in the world. In most jurisdictions, direct or indirect impediments prevent international grants from benefiting from tax deductions on the same basis as transfers to a local charity.¹ However, within the EU legal framework, the principle of non-discrimination should lead to full deductibility.

When examining the legal landscape for charities around the world, a good starting point is the research conducted by the US-based Hudson Institute, referred to as the “Index of Philanthropic Freedom”.²

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Foundations – the most common legal form for charities in the Netherlands – have historically been part of the ‘private domain’ rather than the ‘public domain’, which means that there is limited regulatory oversight. Only in a catastrophic situation and at the request of a close circle of ‘interested persons’ will the local court and prosecutor have supervisory powers.

This is not the case in other continental European jurisdictions. For example, foundations in Switzerland, Germany and Denmark are closely scrutinised by local regulators. In the Netherlands, the concept of a ‘charity’ is relevant only for tax purposes; and a foundation that does not have the tax status of a charity (ANBI) may also pursue philanthropic causes. The traditional but sophisticated charity regimes in the United Kingdom and the United States provide for detailed regulatory oversight of family charities.³ This is not only very expensive, but also unnecessarily restrictive.

There is a cultural resistance to greater regulation of foundations in the Netherlands. Non-profit organisations tend to complain about the administrative burden that they would have to bear if they were obliged to publish accounts, which currently is not compulsory for foundations in general. The Netherlands is also the first country in the world to have completely opened its borders to facilitate tax-efficient cross-border gifts and bequests (if the foreign charity has sought recognition as a charity under Dutch tax laws).

While the scope of regulatory oversight and restrictions for charities is important to consider when determining the optimal location of a family charity, there are also other factors to bear in mind in this respect.

First, the possibility of exiting from the jurisdiction should always be considered. If adverse (tax) legislation would affect the family charity, a mechanism should be put in place to withdraw funds and activities from the jurisdiction without stringent consequences.

Second, it should be considered whether the family charity in fact requires the status of a charity. Certain jurisdictions have a separate legal framework in place to govern charitable organisations, independently from the tax authorities which are responsible for ensuring that charities are tax compliant. In many situations, a charity must have a specific tax status in order to benefit from effective taxation of the income realised from its investments. This leads to situations in which charities have a dual compliance obligation. In practice, it is increasingly apparent that the status of a charity is not in fact required. Under Dutch tax law, a foundation is exempt from tax on investment income regardless of its purposes. ANBI status is not

required if the charity is, for example, an operational charity that organises its own philanthropic activities.

Third, when the tax status of a charity is required, because otherwise transfers of funds would be subject to high gift tax rates, it is important to consider how practical compliance will work in the jurisdiction of choice, and what time and costs will need to be allocated in this regard. These will vary depending on the level of compliance and bureaucracy.

This chapter outlines the features of Dutch charitable foundations and makes some practical comparisons between other jurisdictions and the Netherlands.

2. Dutch charitable foundations

Charities in the Netherlands are primarily structured as foundations and, to a lesser extent, as associations. This chapter focuses on the foundation.

A Dutch foundation is a legally autonomous ('corporate') form, with rights and obligations, but without any owners or persons with an interest therein. A foundation is created through a legal transaction before a notary. It has no members and its purpose is to realise the objects set out in its articles of association, with the aid of funds dedicated for this purpose (Book 2, Article 285(1) of the Civil Code).

A foundation is a 'purpose fund', which may serve purposes that do not necessarily relate to a class of designated beneficiaries.

Dutch law follows the 'incorporation principle', which means in effect that if a foundation is created according to Dutch law but is governed outside the Netherlands (ie, it is staffed by individuals who are resident outside the Netherlands and has no office or activities in the Netherlands), its internal order will still be governed by Dutch law. This is why many international non-governmental organisations choose to use Dutch foundations or associations as their supranational governance body, no matter where in the world they are staffed. If this supranational body is not effectively managed from the Netherlands, there is no tax residence in the Netherlands and the organisation generally need not qualify as a charity under Dutch tax law. However, a foreign-based charity can be recognised as a charity for the purpose of Dutch tax law – for example, to attract Dutch resident donors.

While, as a rule, a family foundation must have an office and an establishment somewhere, it is presumed that it will choose a central hub for its activities, which implies that it will be effectively managed in the place of its establishment. A clear position on the effective place

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of management will avoid disputes over this issue and the corresponding tax and regulatory implications. Regardless of whether a family charity is funding other organisations or is merely operational by nature, the governance of the charity is of paramount importance.

In the Netherlands, the tension between foreign resident family members and the effective local management is typically resolved through the use of a supervisory board with controlling powers. The family staffs the supervisory board, which has month-to-month or quarter-to-quarter controlling power. It also has the power to appoint and dismiss board members, and to approve certain important decisions. The supervisory board can also advise the board of directors on how to pursue the foundation’s objective, without having the authority to act on behalf of the foundation.

In principle, the governance of a Dutch foundation can be as sophisticated as the family wishes. A foundation can have various bodies for different functions and may act as a vehicle for achieving the family’s long-term values and goals, which are reflected by its philanthropic purposes.

Unlike the German-style foundations to be found in Germany, Austria and Switzerland, the Dutch foundation is not merely the embodiment

of the wishes of the founder. The Dutch foundation is a constitutional entity; it can transform and adapt to changing circumstances. It is possible to include certain 'unamendable' provisions in the foundation's articles, whose amendment will require approval by the local court (although these are never strictly unamendable).

To recognise a charity for tax purposes, the following questions must be answered in the affirmative:

- Is the organisation a foundation, an association, a legal person under public law or a church institution?
- Does the organisation, according to both its organisational documents and its operational activities, operate on a non-profit basis?
- Is the organisation, according to both its organisational documents and its operational activities, pursuing a public interest (nearly) exclusively?
- Is it ensured that members of the board of directors or other third parties cannot dispose of the assets of the organisation as if they were their own?
- Do the members of the board of directors, both factually and according to the regulations, conduct their activities without remuneration (except for attendance fees and/or expense allowances)?

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- Does the organisation have a policy plan which provides information on the activities to be carried out, the way in which it raises money and the administration and expenditure of the assets?
- Does the organisation not maintain more property that is reasonably required for the continuity of its public benefit activities?
- Do the organisational documents provide that any surplus in case of the organisation's liquidation is destined for a (similar) public interest?
- Have both the organisation and its board members, supervisory board members, management and other leading persons avoided any claims inciting persons to hatred or violence or the use of violence in the past four years?

In addition, the charity must publish its annual figures and its policy plan on its website. By way of exception, an endowed family charity need not publish its wealth, but merely a declaration of proceeds and expenditures. This is because the transparency requirements are politically motivated and are primarily targeted at fundraising charities.

3. Key comparative notes for family charities

3.1 Possibility of exit

For a charity to qualify as such, it is sometimes required that funds be transferred unconditionally to the charity. This is the case in Switzerland, for example. This makes a Swiss-based family charity vulnerable to legal or other objective changes. In Dutch practice, substantial gifts or endowments to a charity commonly contain conditional elements based on external circumstances such as negative tax developments affecting charities. For an international family, a possible exit should always be considered – especially since democracies generally tend to become more stringent with regard to the practice of charitable organisations.

3.2 Default without special tax status

A family should always consider what the default position would be in a jurisdiction. In fact, this should be the first question they consider. Depending on the purpose and ambitions of the family charity, whether it should apply for special tax status should also be determined. Increasingly, this does not appear to be necessary in the Netherlands. However, in many jurisdictions, a special tax status is required in order to receive gifts or generate investment income without effective taxation. In the Netherlands, there is no need for a special tax status in order to be exempt from corporate income tax with respect to all sorts of investments. The Netherlands' vast international treaty network should in principle apply to all foundations, whether they qualify for ANBI status or not.

The recognition of a charity implies a 'licence to operate', which goes further than mere compliance with the tax framework. In addition, where a charity has obtained ANBI status, it should be considered upfront what consequences and sanctions will arise upon its termination. This is an alternative to the issue of an exit. Currently, in the Netherlands, no direct sanctions apply on the loss of ANBI status.

3.3 Bureaucracy

In many sophisticated jurisdictions, charities must report annually and extensively to the tax authorities (and eventually also to the regulator, such as the Charity Commission in the United Kingdom) on their activities in the broadest sense. The Dutch approach is different and tends to be very practical, with no unnecessary red tape. Accordingly, there is no annual general reporting requirement for charities, but only an obligation to report on any material changes to the activities or intentions that may be relevant for ANBI qualification. As a consequence, ANBI status need not be renewed annually. Checks are carried out randomly and on the basis of risk factors. This is backed up by provisions in the tax law that empower the tax authorities to revoke ANBI status retroactively. This is an efficient system that functions quite well, with only approximately 45 civil servants controlling around 50,000 charities.

3.4 Endowment and requisite expenditures

In the context of tax qualification as a charity, most jurisdictions have specific requirements on the level of expenditure in support of a charitable cause. For example, US law has a 5% compulsory expenditure requirement for family charities, which may prove to be very cumbersome. The Dutch practice recognises that there is no 'one size fits all' and is thus of a more qualitative nature: a charity must make clear that it has a 'reasonable' policy regarding expenditure versus accumulation of assets in the context of the continuation of its public interest activities. In practice, a policy plan verifying the policies maintained in this respect substantiates this policy. If a grant contains specific guidance on the maintenance of the funds for the recipient organisation, the maintenance of the funds in accordance with this guidance is lawfully deemed to be 'reasonable'.

3.5 Restrictions in competing with for-profits

In nearly all jurisdictions, it is considered undesirable if non-profits compete with for-profit entities that are fully subject to tax. There are various ways to handle this 'non-compete' perspective. One way is to strictly forbid charities from owning a majority share in a for-profit entity, which is the case in the United States: the so-called 'excess business holding rules' provide a complex set of restrictions, breach of which will result in the imposition of severe sanctions on the charity and its board members. Increasingly, innovative charitable

organisations that wish to make use of a parallel charitable and for-profit model look to jurisdictions other than the United States. All 'non-related' business income generated by a non-profit is subject to corporate tax in the United States.

In the Netherlands, there is full flexibility for charities to hold shares in for-profit entities. The non-compete issue is resolved in the Dutch context by the fact that for-profit activities are always subject to corporate income tax, even if they take place in a non-profit environment (and therefore, there is no distinction between (un)related business income). No restrictions in terms of the size and type of investments apply in the Dutch context; whereas in jurisdictions with more regulatory oversight, the rules of a 'prudent investor' must be followed, which usually means compulsory diversification of passive interests. For the more venture-type philanthropist, this may result in too serious a restriction.

4. Final thoughts

Increasingly, combinations of several distinct entities are being utilised, whereby a passive charity in a sophisticated regulated jurisdiction is combined with a generic foundation in another jurisdiction that offers more flexibility for venture-type investments. Also, a combination of

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philanthropic and private activities may be structured in an alternate structure such as a 'private foundation' (not to be confused with the family charity in US terminology). The private foundation is very similar to a discretionary trust with mingled private and philanthropic purposes. If structured properly, these Dutch resident foundations are completely transparent for Dutch tax purposes and offer a solid wealth planning structure without adding tax costs for an international family.⁴

There are many variations on this theme, depending on the long-term vision of the family and how it should be governed into the future.

Notes

¹ See IA Koele, *International Taxation of Philanthropy* (International Bureau of Fiscal Documentation, 2007).

² www.hudson.org/research/11363-index-of-philanthropic-freedom-2015.

³ In the United States, charities that are not supported by the public in large, but rather by an extended family or business are referred to as 'private foundations', which presents terminological issues given that the foundation as a legal form does not exist in the United States. The distinction between 'private' and 'public' – which, to the author's knowledge, is only found in the US legislation – is thus avoided.

⁴ Obviously, it should be verified how this structure would be viewed in their own jurisdiction. For more, see IA Koele, "The Dutch Private Foundation: a robust but flexible tool in dynastic structuring" in *Trusts & Trustees* (Oxford University Press, 2014); and IA Koele, "The Dutch Private Foundation in comparison with trusts: for the same purpose but rather different", *Trusts & Trustees* (February 2016), www.koeletaxlegal.com/publications.