The Dutch private foundation in comparison with trusts: for the same purpose but rather different

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Abstract

The Dutch Private Foundation provides an alternative paradigm for sustainable asset protection purposes. Due to its legal autonomy, it is less vulnerable to 'inflammation' and family conflicts if compared to a discretionary trust. A comparison with other continental foundation legislations shows that the Dutch foundation model is rather different in more than one respect.

Introduction

In 2014, I contributed to this *Journal* an article[1] in which I described the use of a Dutch private foundation for solid asset protection purposes and the interesting Dutch (transparent) tax regime if the foundation is structured for private purposes by a foreign family without Dutch resident descendants.

In the International Academy of Estate and Trust Law's annual conference 2015, held in Florence, together with Paolo Panico, Luxembourg I have chaired a panel under the heading 'Private Foundations and Trusts: just the same but different!'.

The panel consisted of speakers from different European continental countries with foundation laws, and speakers with extensive experience on the use of both foundations and trusts in various parts of the world.

Where reference is made to 'private foundations', we refer to foundations that are used more than incidentally or even predominantly for private purposes. The term 'private foundation' therefore in this context does not relate to the US equivalent of a non-public charitable organization.

The Dutch private foundation appears to be a rather unique model in comparison to the foundation laws embedded in the German–Swiss jurisdictions and certainly in comparison to the foundation laws more recently enacted in various common law jurisdictions. In this contribution, I will highlight the features that are typical for Dutch foundation law to the extent these are different from foundation laws in other jurisdictions and in general, different from the way how discretionary trusts are governed in common law systems.

Where the use of Dutch private foundations was not attractive for (gift) tax reasons before 2010, the current Dutch tax transparency approach to purpose funds such as trusts, foundations, and *Anstalts* irrespective of their jurisdiction makes the Dutch private foundation an attractive alternative for non-Dutch families to structure their wealth.[2]

Discretionary trust versus Dutch private foundation

It is impossible to make a legal comparison between discretionary trusts and a Dutch private foundation,

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1. 'The Dutch Private Foundation: A Robust but Flexible Tool in Dynastic Structuring' (2014) 20(6) *Trusts & Trustees*.
2. See (n 1).

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since these have complete different historical backgrounds. Therefore, I restrict myself to practical differences.

Trustees of a discretionary trust have a fiduciary duty towards the settlor while at the same time, the trustee is accountable towards the persons within the class of beneficiaries who also have rights of information in relation to the trust, its funds, and distributions. To a large extent, the discretionary trust is suspected by tax authorities of many jurisdictions due to the fact that properties are 'hovering' between settlor and beneficiaries, without being 'owned' by any of these, while the trustee only has a fiduciary relation to the trust assets and accordingly, cannot be considered an 'owner' for tax purposes either. In jurisdictions like France, the Netherlands, and Belgium tax legislation has been introduced that consider trusts as fully transparent (non-existent) for tax purposes, while in other jurisdictions, like the USA, anti-abuse provisions apply in relation to distributions. The result of different kinds of anti-abuse provisions may be that trust assets end up being *de facto* subject to double or even triple taxation or enhanced reporting requirements, which makes them a nightmare, even to terminate.

The trust, especially in its discretionary form, is said to be an institute of great elasticity. In practice, however, I have seen many discretionary trusts where trustees were caught between the various interests of the settlor, distinct beneficiaries, and their own interest (of not being liable towards any of the interested parties) with the inevitable result of stagnation and inflexibility. In such a situation, which is often backed up by proclaimed interests of tax authorities in relation to the trust assets or income, the result is that the trust appears a highly inflexible and inflammable instrument that not seldom leads to (trust and estate) litigation between the family members. The result is the opposite of the initial promise of the use of a discretionary trust, ie the preservation of wealth and the ability to direct the devolution of that wealth through future generations.

Parallel or perhaps as a reaction to the above, practitioners and clients have pushed the envelope too much in stretching the possibilities of maintaining control by families in relation to trust assets, introducing Private Trust Companies and as a result of which the discretionary trust has become increasingly vulnerable for attacks on legal validity and reality of the structure in a cross border context. Where trustees are in the middle of this all, their position is not enviable.

The Dutch private foundation is to a certain extent the opposite of a discretionary trust, although it is used for the same purpose, ie the preservation of wealth and the ability to direct the devolution of that wealth to different causes during several generations. This is because neither the settlor (founder of the foundation) nor the distinct beneficiaries of a 'discretionary' designed foundation have any entitlements in relation to the foundation's assets or income *per se*.

The founder has no special reserved rights in relation to the constitution or the board of the foundation; the foundation in Dutch law is not considered to be the 'institutionalisation' of the founder's wishes. The foundation is owner of its own right, it can be a pure purpose or 'orphan' structure which has the obvious advantage of autonomy and independence from the distinct family members. Board members are accountable to the stated purpose of the foundation. Unless beneficiaries have been designated or assigned specific rights or entitlements in the governing documents of a foundation, they do not have any interest in the foundations' assets. Beneficiaries as such do not have recourse against the foundation and do not have a right of information on the foundations assets nor does the board of the foundation have to account towards the class of beneficiaries in general. Where accountability towards the beneficiaries is a core feature of a trust, the Dutch private foundation can be said to be a complete different legal construct.

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Dutch private foundation law: autonomy

The origins of Dutch foundation law stem from medieval times, but current Dutch foundation law is incorporated in 1956. The essential feature of a Dutch foundation is that it is a legally autonomous ('corporate') form with rights and obligations but without any owner or persons with an interest therein. A foundation is a legal entity created by a legal transaction before a notary; it is without members and its purpose, with the aid of funds intended for such purpose, is to realize the objects set out in its articles of association (Book 2 Article 285 (1) of the Dutch Civil Code).

Accordingly, a foundation is a 'purpose fund' that may perfectly serve purposes that do not (specifically) relate to a class of designated beneficiaries. Where Private Foundations are structured, the purpose therefore is not primarily linked to distributions to designated beneficiaries, but to the maintenance of wealth for certain purposes, one of the purpose evidently being maintenance of family members or other persons who will need support.

A foundation does not need to be endowed at its incorporation, but can solicit gifts, endowments, legacies, or start an enterprise.

Very different from a discretionary trust is that a founder of a foundation (compared to a settlor) has no rights whatsoever in relation to the creation or validity of the trust. There is no default power to revoke or amend the foundation and no fiduciary relationship with the trustee.

Needless to say, it is important that the power of the board of this autonomous private foundation in practice is counterbalanced by a supervisory board, which is an organ of the foundation with controlling powers, including the power to appoint and dismiss board members of the foundation. This two-tier structure is standard corporate practice and although it provides the members of the supervisory board with influential control, it is always a detached control. Where new board members are appointed, they still need to make their own autonomous decisions. Members of the supervisory board do not have the authority to act on behalf of the foundation. The powers that are attributed to the Supervisory Board are flexible: it may be appointed powers to provide prior consent in relation to listed important decisions, but also it may be appointed powers to initiate decisions, regulations and proposals. A Supervisory board should not be compared with a protector in trust law, since the duties of a protector are said to be fiduciary in nature which is a completely different perspective than the corporate 'hierarchic' perspective. For hands on control, the supervisory board can be formed by family members whereas the family can also directly be represented in the board. As always, the balance is sought between 'control' (eventually in hands of trusted persons) and 'asset protection'.

Unlike common law, the transfer of assets by a transferor to a foundation is a gift *agreement*. In continental civil law, a gift is a bilateral agreement, a species of a contract and accordingly, contract law applies to the gift. The gift may be accompanied with conditions, stipulations, reservations, and even the power to revoke the gift. The foundation is the contracting party in the gift agreement and in accepting the gift, it accepts the conditions of the gift. Where stipulations or conditions are included for the benefit of third parties (such as family members or descendants), normally these conditions are formulated as an *encumbrance* to the gift. The consequence is that the transferor is able to withdraw the whole gift if those conditions are not met by the foundation as contracting party; however, the third parties involved do not have an autonomous right vis-à-vis the foundation if the foundation does not meet the conditions. The heirs of the transferor or a Family Council appointed by the transferor

step in the contractual rights stipulated by the transferor.

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Dutch private foundation versus other foundation models

Very different also from the classical Germanistic foundation concept as found in Switzerland, Germany, and Austria, a Dutch foundation may very well be created to perpetuate its own assets and therefore does not need to have beneficiaries (*Selbstzweckstiftung*) to be legally valid. The self-serving purposes of administering the foundations' assets has been since long the driving force behind the popular use of the Dutch foundation as a *Stichting Administratiekantoor*. Foundations traditionally are perfectly suitable for holding the shares of enterprises as a 'patient shareholder' without the family generational turmoil's involvement.[3] Consequently, there are no Dutch rules in play that a foundation should diversify its assets or should have a certain minimum pay out.

The Dutch foundation is foremost a corporate entity without shareholders and unlike the German view on foundations, the foundation should not be viewed as the 'frozen' incorporation of the Will of the founder. The statutory law of the foundation may constitute that the board (default) or the supervisory board, or any other person (eventually also the Founder or Transferor) or organ (a Family Council) has the power to amend (or approval to amendment of) the statutory law and bylaws of the foundation or (approve) to dissolve the foundation. Accordingly, the endowment of the foundation is not a constitutive element of a foundation. We therefore distinguish between the founder of a foundation and the transferor of assets to a foundation, which should be formulated as a bilateral gift between the transferor and the foundation. The relationship between the two is governed by the gift agreement and the law pertaining to this.

Also, it should be emphasized that the autonomy of the Dutch private foundation vis à vis beneficiaries, the lack of accountability, and the lack of a general duty of information towards beneficiaries is not universally found in jurisdictions with foundation law. In countries like eg Austria and Liechtenstein, beneficiaries of foundations do have a right of information in respect of the trust assets.

Since foundations are part of the private domain in the Netherlands, there is very little regulatory oversight. In neighbouring countries like Germany and Denmark, there exists a very strict regulatory oversight in respect of foundations.

Where a Dutch foundation would be incorporated without proper governance and 'balance checks' and a well-formulated gift agreement (while a Letter of Wishes bears no meaning in a Dutch legal context), there is certainly a risk of a 'black hole' since the default in present Dutch law, a regulatory oversight by the Public Prosecutor and the Court, is not effective in practice. Although the law provides for the possibility of an infringed action initiated by any interested party by the Public Prosecutor before the Court if there are reasonable grounds that a foundation is not acting in good faith in accordance with the law and its articles of incorporation, or where individual board members are acting or lacking action in

3. In this sense, the Netherlands is at least one exception to the rule as expressed in the contribution of Paolo Panico, 'Private Purpose Foundations: From a Classic ''Beneficiary Principle'' to Modern Legislative Creativity?' (2013) 6 *Trusts & Trustees*. p. 542 ff.

contradiction to the law or the articles of incorporation, there is no current legal mechanism that requires the Public Prosecutor to *require* follow-up; in practice, the Public Prosecutor is rarely using its powers to effectively control foundations.

In Denmark and the Netherlands, foundations are seen as typical vehicles for dynastic structuring, keeping enterprises together during many generations without the typical risks of estate devolution and conflicts between family members in respect of the underlying value. Where Danish legislation effectively creates heavy oversight by the State, Dutch legislation provides for flexibility to craft and model the statutory law of foundations as it is deemed fit. Foundation law in the Netherlands provides for only a few compulsory provisions and can be modelled according to one's specific wishes and intentions.

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To distinguish a foundation from an association there is the prohibition in Dutch law that the statutory objects of the foundation may not include making payments to its founders, who constitute its organs, or to any other parties, unless in the latter case the payments have an altruistic or social character. This prohibitive condition, the 'prohibition on payments', is aimed at preventing the foundation from duplicating its founders or those with control over its functions. In 1956, the prohibition is originally included in the law to prevent that profits of commercial activities of a foundation be distributed, and it is not intended to apply to foundations that do not carry on an active enterprise. The distribution prohibition does not prevent a foundation to be effectively designed as a Private Foundation that seeks to preserve wealth long term for private and other, social purposes by the combination of tailor made drafting of its constitutional documents and contractual agreements. Alternatively, it is permitted under Dutch law for a foundation to have a commercial purpose, but the profits could only be distributed for restricted causes.

Conclusion

The Dutch foundation model is different in several aspects from the classic Germanistic foundation models, in that it has not developed as the frozen Will of a founder (similar to a trust), but as an autonomous legal entity without accountability to founders or beneficiaries. It shares with the Danish model that it is seen as a *universitatis rerum*, a corporate entity that may have a perpetuating purpose. It is therefore perfectly suitable for asset-protecting purposes.

The Dutch foundation model seems to be exceptional on the European continent in the sense that it is not subject to public supervision by a state authority but is entirely part of the private domain. Dutch foundations are therefore a solid solution for maintaining wealth for long-term purposes in general. More specifically, private foundations are suitable for family enterprises with expanding families to create a dynastic, long-term structure thereby eliminating the issues relating to transferring to the next generation.

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The foundation is a corporate entity and its constitutional documents may be modelled according to the wishes of it users, including apportioning functions to founders or a family council and a supervisory board. A family is able to determine the level of control they wish to pursue in relation to the foundation in the constitution of the foundation. Dutch foundation law, with only a few compulsory provisions to obey, provides an institute of great elasticity however

without the 'inflammable' mingling of interests that is core to the fiduciary notion of a discretionary trust.

Accountability is key for both trusts and foundations, if professional trustees or foundation's officers take the role of administering the assets. Different from trust law, the balance between control and autonomy of Dutch foundations is determined in the constitutional framework of the foundation on one side and in the gift agreements between the transferor of assets and the foundation on the other side. This provides an alternative model to discretionary trusts, that is less vulnerable to 'inflammation' and may provide a clear demarcated picture towards all other interested parties, including tax authorities.

Having spoken on private purposes alone so far, the ideal setting for a Dutch private foundation is the combination of private with public purposes. Depending on the domestic treatment of the same, the use of a Dutch private foundation for mixed charitable and private purposes may have the advantage of not being subject to the requirements of a 'charity' and still be exempt from Dutch gift tax due to the transparency regime in the Netherlands.

Finally, it might be worthwhile to consider the combination of existing trust structures with more solid foundation applications. Hybrid structures making use of different legal frameworks may be an interesting area to explore for global families embedded in different legal cultures.

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