

Switzerland: estate planning with foreign family foundations—an assessment of the conflict of law and tax issues arising

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Abstract

The authors discuss the opportunities and potential pitfalls of using foreign family foundations in Switzerland. Do Arts 335 para 2 and 448 para 2 of the Swiss Civil Code have an *ordre public* character or are they *lois d'application immédiate*, preventing the recognition of foreign maintenance foundations in Switzerland? The criteria to establish whether assets transferred to a foreign family foundation and the income there from are being attributable to the foundation, the Swiss resident founder or beneficiaries are identified and the Swiss tax consequences of four typical scenarios in which foreign foundations are established by Swiss resident individuals examined.

Key points

- Article 335 para 2 SCC providing for the prohibition of maintenance foundations is a mandatory provision of Swiss law which has not yet been assessed by the Swiss Supreme Court.
- The Federal Council, however, expressed the view that this provision should not be considered a mandatory provision of Swiss law.
- Until either the law has been amended or the Supreme Court has held that Article 335 SCC does not prevent the recognition of foreign family foundations established by Swiss residents, the risk remains that foundation assets located in Switzerland are attributed to the Swiss resident founder.

Introductory Remarks on the Effect of Forced Heirship Rules on Estate Planning for Swiss Resident Individuals

Individuals resident in Switzerland are not entirely free to whom they bequeath their estate. Swiss residents find themselves constrained by the forced heirship provisions of Article 470 et seq. of the Swiss Civil Code (SCC). Pursuant to these rules, a

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testator leaving descendants, parents, a spouse, or a registered partner may only dispose of his or her assets up to their mandatory portion.¹ The restrictions imposed by the SCC can be quite severe: an unmarried testator leaving one or more descendants may, for example, only freely dispose over one quarter of his or her assets and must leave the remainder to the descendant(s).² Moreover, the forced heirship provisions under Swiss law may yield unexpected results, such as the statutory entitlement of parents, of married couples without descendants to a mandatory share of one eighth of the estate.

Foreigners living in Switzerland may, depending on the inheritance laws of the country of which they are citizens, more freely dispose of their estate. This exception for foreigners, which is particularly attractive for individuals with a common law background, is a result of the Swiss conflict of law rules. Article 90 of the Swiss Private International Law Act (PILA) provides that a foreigner may submit his estate by will or by testamentary contract to the law of the states of which he is a citizen.³ Swiss forced heirship provisions do therefore not affect the estate of a Swiss resident foreigner if the estate, by virtue of his or her choice of applicable law, is governed by a succession law that does not provide for mandatory shares of relatives or spouses.

Swiss succession law provides that the same corrective mechanism that is available to heirs not receiving the amount of their mandatory portion, i.e. the action in abatement, is also available in case of certain dispositions *inter vivos* (such as gifts to a family foundation). Under Article 527 SCC donations that are freely revocable by the disposing person or that have been made in the last 5 years prior to his or

her death are subject to an action in abatement in the same manner as dispositions upon death. Furthermore, if the disposing person transfers assets with the obvious intent to evade the restrictions concerning mandatory portions, then an action in abatement will never become barred by the statute of limitations.

The use of family foundations for the devolution of wealth over generations

Under Swiss law, the legal institution that is most suitable for the devolution of wealth over generations, the Swiss family foundation, may only be validly established if its purpose is limited to cover the costs of education, endowment, support of family members or similar purposes.⁴ The establishment of perpetual trusts (lat. *fideicommissum*) for the benefit of a family is not permitted.⁵ The Swiss Parliament considered them as harmful remnants of aristocratic times, as plutocratic and undemocratic.⁶ It is thus not possible under Swiss law to establish a family foundation as a maintenance foundation⁷ that makes distributions and grants other economic benefits to certain members of a specifically designated family in order to support them outside the narrow scope permitted by Swiss law.

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1. Article 470 SCC.

2. Article 470 in connection with Art 457 SCC.

3. Such choice will, however, be void, if the decedent was no longer a citizen of the chosen state at his death or if he had acquired Swiss citizenship.

4. Article 335 para 1 SCC.

5. Article 335 para 2 SCC.

6. Comments of the Parliamentary Expert Commission, cited in:

Zürcher Kommentar zum schweizerischen Zivilgesetzbuch, 2. Band, Das Familienrecht, 2. Abteilung, die Verwandtschaft, Art 252–359, 2nd edition, Zurich 1943, Art 335 N 23.

7. A maintenance foundation (Unterhalts-/Genusstiftung) typically provides economic support to the specified family irrespective of specific needs such as the provision for costs of education or the support in distress.

Such maintenance foundations may, however, be established in various other civil and common law jurisdictions, such as Liechtenstein, Austria, Panama, the Netherlands Antilles, the Bahamas, Malta or Jersey to name just a few. These jurisdictions are not only more lenient towards the concept of maintenance foundations but some of them have also introduced provisions in their legislation preventing the heirs of the founder from using the action in abatement to claim the mandatory shares to which they would be entitled pursuant to the succession laws of their home country. An example of such a provision is Article 14 of the Panamanian law no. 25 of 12 June 1995 on Private Foundations, which states:

The existence of legal provisions in inheritance matters in the domicile of the founder or of its beneficiaries, shall not be opposable to the foundation, nor shall it affect its validity, or prevent the fulfilment of its objectives as provided for in the foundation charter or its regulations.

Due to the flexibility of foreign foundation laws, foreign family foundations are taken into consideration for *domestic* estate planning. The opportunities as well as the potential pitfalls, from a conflict of law and tax point of view, of using *foreign* family foundations in a *domestic* context will be outlined below.

The use of foreign family foundations from a Swiss conflict of law point of view

Jurisdiction of the Swiss courts

Pursuant to Article 1 of the Swiss Private International Law Act ('PILA') the Swiss conflict of law rules govern *in an international context* the jurisdiction of the Swiss judicial and administrative

authorities, the applicable law and the conditions for the recognition, and enforcement of foreign decisions (as well as other topics that are of little relevance in this context). Foreign family foundations qualify as 'organized units of assets' and are thus treated as 'corporations' for purposes of the PILA.⁸ Consequently, the Swiss courts would, in disputes concerning foundation law, have jurisdiction if the foreign family foundation had a registered office in Switzerland.⁹ Considering that a typical foreign family foundation does not have a registered office in Switzerland, the Swiss courts will in practice have jurisdiction if the foundation's assets consist of real estate located in Switzerland¹⁰ or if a claimant seeks to enforce an action to validate an attachment.¹¹

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If, therefore, a Swiss resident individual establishes a foreign family foundation that holds title to real or movable property located abroad, then the validity of this foundation and its interests in the movable property or real estate are not determined pursuant to the Swiss conflict of law rules, but pursuant to the conflict of law rules of the jurisdiction under the laws of which the foundation is organized or where the property is located.

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8. Article 150 para 1 PILA.

9. Article 151 para 1 PILA.

10. Article 97 PILA.

11. Article 4 PILA.

Recognition of a foreign family foundation under the Swiss conflict of law rules

If a foreign family foundation owns movable property or real estate located in Switzerland, then the question arises of whether the family foundation is recognized pursuant to the rules of the Swiss PILA. For purposes of the Swiss conflict of law rules, a foreign family foundation is classified as a 'company' because the term 'company' in the PILA includes both organized associations of persons as well as organized units of assets.¹²

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Pursuant to Article 154 para 1 PILA, companies are governed by the law of the State under which they are organized if they satisfy the publication or registration requirements of that law. Alternatively, if there are no such requirements, then they are organized according to the law of that State. This principle, the so called 'incorporation theory', provides for the recognition of foreign companies (and thus also for the recognition of foreign foundations) in Switzerland if they have been validly incorporated abroad and provided that:

- foreign law does not produce a result which is incompatible with Swiss public policy (*ordre public*)¹³ and
- mandatory provisions of Swiss law which, by reason of their particular purpose, are applicable regardless of the law designated by the PILA

(so called 'loi d'application immédiate') do not apply.¹⁴

The mandatory provisions of Swiss law which could preclude the recognition of a foreign family foundation are Article 335 para 2 SCC, prohibiting the establishment of perpetual trusts (and thereby also prohibiting the establishment of maintenance foundations), and Article 448 para 2 SCC, prohibiting the designation of two or more reversionary heirs. Due to the absence of a clarifying supreme court decision on the scope of the provisions, the question, whether these provisions constitute *loi d'application immédiate* or even form part of the Swiss *ordre public*, is the subject of several contradictory publications.

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Künzle states that Article 335 SCC does not have *ordre public* character at all.¹⁵ Similarly, Grüninger sees neither a clear legal provision nor a convincing reason why foreign maintenance foundations should not be recognized, irrespective of the intensity of the domestic context of founder, beneficiaries, etc.¹⁶ Von Planta/Eberhard, on the other hand, argue that Article 335 para 2 SCC is a provision with a fundamental character, having an educational purpose. Therefore, they conclude that the provision should have an *ordre public* character for persons resident in Switzerland.¹⁷ Vischer distinguishes between

12. Article 150 para. 1 PILA.

13. Article 17 PILA.

14. Article 18 PILA.

15. Künzle Hans Rainer, Konturen des Stiftungsbegriffs aus schweizerischer Sicht, in: Die Liechtensteinische Stiftung, Referate zur Tagung 'Stiftungsnovellierung - wohin geht die Reise?' Zürich 2002, p. 1 et seq., p. 32.

16. Grüninger Harold, in: Honsell Heinrich/Vogt Nedim Peter/Geiser Thomas, Basler Kommentar zum Zivilgesetzbuch I, Art 1 - 456 ZGB, 3rd edition, Basel 2006, Art 335 no. 16.

17. Von Planta Andreas/Eberhard Stefan in: Honsell Heinrich/Vogt Nedim Peter/Schnyder Anton K./Berti Stephen V. (Herausgeber), Basler Kommentar zum Internationalen Privatrecht, 2nd edition, Basel 2007, Art 17 no. 7.

negative and positive functions of *ordre public* provisions. The negative function is expressed by Article 17 PILA that prevents the application of provisions of the foreign law that would otherwise be applicable. Article 18 PILA is an expression of the positive function in that it requires that mandatory provisions of Swiss law with a specific *ordre public* content are applied.¹⁸ The prohibition of family foundations would be an example of the positive function of an *ordre public* clause. *Vischer* states, however, that it is questionable whether the prohibition of maintenance foundations has the character of a *loi d'application immédiate* considering that the Swiss courts have for decades not taken offence at family foundations with business purposes and the character of maintenance foundations. He also argues that the rationale of Article 335 SCC is not an expression of a fundamental principle of law. Should the prohibition nevertheless be treated as a *loi d'application immédiate*, then he demands that such a prohibition be enforced only if the beneficiaries are resident in Switzerland at the time of the incorporation of the foundation. The prohibition of maintenance foundations has, in his opinion, clearly an educational purpose: saving descendants from idleness. To prohibit maintenance foundations for persons resident abroad would mean to impose the Swiss values reflected by this prohibition internationally.¹⁹ *Grüniger* also writes that the prohibition of maintenance foundations does not have the characteristics of a *loi d'application immédiate* in the meaning of Article 18 PILA. He argues that if Swiss law did not provide for or prohibit succession planning tools such as trusts and maintenance foundations, for which there was an international need, then it should at least recognize validly incorporated foreign foundations and trusts.²⁰

The Swiss Federal Council expressed in his 2005 Report on the Ratification of the Hague Trust Convention²¹ the view that Article 335 SCC was based on antiquated moral and ideological considerations (i.e. the prevention of idleness and the removal of feudal structures) so that it should not be considered a mandatory provision of Swiss law. Most scholars have expressed the same view and argued that Article 335 SCC and Article 488 para 2 SCC should not be mandatory.²²

The question, whether Article 335 para 2 SCC constitutes a *loi d'application immédiate*, has not yet been assessed by the Swiss Supreme Court. It was, however, assessed by several cantonal courts in recent years. The administrative court of St. Gallen held in its decision of 29 August 2007 that Article 335 SCC is not a fundamental principle of the Swiss legal system and that the recognition of a Liechtenstein family foundation is therefore not precluded by virtue of Article 17 PILA (*ordre public*). It also stated, with reference to *Vischer*, that it was questionable whether Article 335 SCC has the character of a *loi d'application immédiate*. However, in this particular case, the court was not required to decide this question because the foundation was not recognized as a tax subject for other reasons.

The question, whether Article 335 para 2 SCC constitutes a loi d'application immédiate, has not yet been assessed by the Swiss Supreme Court

An earlier decision of the administrative court of Zug²³ does not clarify, which view the court takes on this issue. And while the tax appeals commission (Steuerrekurskommission) of the Canton of Zurich

18. *Vischer Frank*, in: *Girsberger Daniel/Heini Anton/Keller Max/Kren Kostkiewicz Jolanta/Siehr Kurt/Vischer Frank/Volken Paul* (Herausgeber), *Zürcher Kommentar zum IPRG*, 2nd edition, Zürich 2004, Art 154 no. 34.

19. *Vischer Frank*, *op. cit.*, Art 154 no. 34.

20. *Grüniger*, *op. cit.*, Art 335 no. 16.

21. *Botschaft des Bundesrats zur Genehmigung und Umsetzung des Haager Übereinkommens über das auf Trusts anzuwendende Recht und über ihre Anerkennung*, BBl 2006 p. 551 et. seq., Chiffre 1.4.1.7.

22. See also *Robert J. Danon*, 'L'imposition du 'private express trust', *Analyse critique de la Circulaire CSI du 22 août 2007 et proposition de modèle d'imposition de lege ferenda*, ASA 76 (2007/2008) p. 435 et seq. with further references in s III:2 on domestic trusts.

23. Decision of the *Verwaltungsgericht des Kantons Zug*, 12.3.2003, A 2002/6 (StE 2004 B 52.7 No.2).

in its decision of 10 January 2000 held that that based on Article 18 PILA the prohibition of maintenance foundations within the meaning of Article 335 para 2 SCC would preclude the recognition of foreign family foundation, its decisions has been qualified in a recent paper written by *Betschart*²⁴ pursuant to which an infringement of these provisions does no longer automatically lead to a non-recognition of a foundation by the tax administration of the Canton of Zurich.

All of the recent court decisions addressing the recognition of foreign family foundations in Switzerland are decisions in which this question was examined from a *tax* point of view. Consequently, they give only limited guidance on the question, of whether such family foundations, if attacked by aggrieved heirs with an action in abatement, would withstand such attacks.

Personally, we concur with the view expressed by the Federal Council, that Article 335 SCC was based on antiquated moral and ideological considerations that are no longer of relevance today so that it should not be considered a mandatory provision of Swiss law. However, it is questionable whether the view expressed by the Federal Council in connection with the ratification of the Hague Trust Convention and the views expressed in the majority of the legal publications on this topic suffice to eradicate the concerns a diligent estate planner should have about the validity of a family foundation owning assets located in Switzerland. The risk that foundation assets located in Switzerland are attributed to the Swiss resident founder and thereby included in his estate as suggested by *Vischer*²⁵ remains until either the law has been changed/clarified, or until the Supreme Court has held that Article 335 SCC does not prevent the recognition of foreign family foundations established by Swiss residents. Until then, holding assets located in Switzerland

through a foreign family foundation may yield unexpected results if legal heirs challenge the foundation's ownership of these assets with an action in abatement.

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Tax consequences of the use of foreign family foundations by Swiss resident individuals

Basic principles governing the attribution of foundation assets

The Swiss tax administrations and courts have established various criteria on which they determine whether assets transferred to a foreign family foundation and the income resulting from it, are being attributed to the foundation, or to the Swiss resident founder, or to any Swiss resident beneficiaries. In principle, assets held by a legal entity such as a family foundation and the income resulting from it are taxable by the legal entity. However, in many situations courts have disregarded the legal ownership

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24. Philipp Betschart: Die Besteuerung der liechtensteinischen Familienstiftung—dargestellt anhand der Zürcher Praxis, in ZSIS, 2008 Aufsätze N. 2.

25. Vischer Frank, op. cit., Art 154 no. 33.

of these assets by the foundation and attributed the assets and the corresponding income to the founder and/or the beneficiaries of the foundation instead. The basis for such an attribution is the application of the abuse of law doctrine as outlined by the decision of the administrative court of St. Gallen.²⁶

An attribution of the assets of a foundation to the founder is namely justified in the following two constellations²⁷:

- The founder has not divested himself permanently of his assets. This would be the case when the founder can revoke the foundation or request its liquidation with the effect that the assets would be transferred back to him.
- Based on the individual facts and circumstances, the founder factually controls the foundation and its assets (so called controlled foundations). Typical examples for such controlled foundations would be foundations in which the founder retains so called founders rights, entitling him to change the statutes and the by-laws at any time or even to liquidate the foundation at his discretion, or foundations, in which the board of foundation is bound to follow instructions issued by the founder by virtue of a mandate agreement between the founder and the board of the foundation. Moreover, it is likely that a court would classify a foreign foundation as a controlled foundation if the founder is simultaneously a member of the board of foundation and also a beneficiary. Similarly, if the founder has been granted broad powers, such as signatory rights on the foundation's bank accounts or a general power of attorney for the foundation, which allow him to dispose of the foundation assets as if he were the legal owner of these assets.²⁸

An attribution of the foundation's assets and its income to the beneficiaries may occur where either the foundation or the foundation's assets are under the control of the beneficiaries.

Swiss tax consequences if a foreign family foundation is controlled by a Swiss resident founder

A foundation controlled by its founder is disregarded for Swiss tax purposes. Its assets are attributed to the founder instead. Consequently, no taxes will be imposed on the transfer of assets from the founder to the foundation as this transfer does not constitute a donation.²⁹ A donation would require the impoverishment of the founder as well as the enrichment of the foundation. Since for tax purposes the assets of the foundation are treated as being owned by the founder, the founder is not impoverished and neither is the foundation enriched.

A foundation controlled by its founder is disregarded for Swiss tax purposes. Its assets are attributed to the founder instead

As a result, the assets of a controlled foundation are attributed to the founder, irrespective of the foundation's legal ownership of these assets and the founder is subject to wealth tax on the assets of the foundation as well as to income tax on any income generated from them.

Distributions from the foundation to beneficiaries, other than the founder, are treated as donations from the founder to these beneficiaries. For gift tax purposes, the applicable tax rate for every distribution is therefore determined by the relationship between the founder and each beneficiary receiving a distribution.

26. Decision of the Verwaltungsgericht des Kantons St. Gallen, 29 August 2007.

27. Philipp Betschart: Die Besteuerung der liechtensteinischen Familienstiftung—dargestellt anhand der Zürcher Praxis, in *successio* 2008, Seite 321.

28. Rainer Hepberger/Wolfgang Maute, Die Besteuerung der liechtensteinischen Familienstiftung aus Sicht der Schweiz, STR 2004, p. 586 et seq. Clause 4.2.

29. Transfer taxes (Handänderungssteuern) might be imposed on the change of ownership of real estate located in Switzerland. The discussion of this local tax is, however outside the scope of this article.

The termination of the foundation has no tax consequences if the assets are transferred back to the founder. The tax consequences resulting from the founder's death depend on the classification of the foundation following the lapse of his control:

- Should the other beneficiaries have fixed interests, then the assets in the foundation will be attributed to these beneficiaries. Estate tax will therefore be imposed as if the founder had transferred these assets to the beneficiaries directly.
- If the lapse of the founder's powers creates an irrevocable discretionary foundation, an estate tax will be imposed as if the assets had been transferred to an unrelated person.

Swiss tax consequences if a foreign family foundation is controlled by Swiss resident beneficiaries

If a foundation is controlled by Swiss resident beneficiaries then the assets of the foundation and its income are, for tax purposes, attributed to the Swiss resident beneficiaries. Consequently, the transfer of assets from the founder to the foundation is treated as a donation from the founder to the beneficiaries. The applicable gift tax rate for the taxation of this donation is determined by the relationship between the founder and the controlling beneficiaries.

If a foundation is controlled by Swiss resident beneficiaries then the assets of the foundation and its income are, for tax purposes, attributed to the Swiss resident beneficiaries

Wealth taxes and income taxes are imposed on the beneficiaries' shares in the assets of the foundation and the income resulting from them.

Distributions from the foundation to its beneficiaries have no Swiss tax consequences. Similarly a liquidation of such a controlled foundation is not taxable because the beneficiaries are, for tax purposes, already treated as the beneficial owners of the foundation's assets.

Swiss tax consequences if a foreign family foundation is established by a Swiss resident individual in the form of an irrevocable discretionary foundation

If a foreign family foundation is established by a Swiss resident individual in the form of an irrevocable discretionary foundation, then such a foundation will be recognized as a legal entity (always provided that Article 18 PILA in connection with Article 335 SCC does not prevent its recognition) by the competent tax authorities. Assuming such a foundation is recognized in Switzerland, the endowment of the foundation by the founder will be treated as a donation from the founder to the foundation. Such a donation will be subject to the cantonal gift tax of the canton where the founder is resident or where real estate transferred to the foundation is located. The applicable rate will be determined on the basis of a donation between unrelated parties. No gift tax will be imposed on such a donation, if the founder is resident in a canton that does not impose a gift tax on such transfers (gift taxes are levied in all Cantons with the exception of Schwyz and Luzern³⁰).

If a foreign family foundation is established by a Swiss resident individual in the form of an irrevocable discretionary foundation, then such a foundation will be recognized as a legal entity

30. Documentation published by the Federal Tax Administration on 1 December 2008 on the cantonal gift and estate taxes (www.estv.admin.ch/d/dokumentation/publikationen/dok/steuermaepchen/erbschaft.pdf). In Luzern some municipalities levy an estate tax if the gift was made within a specific amount of years prior to the death of the donor.

The foundation's assets and its income are only subject to taxation in Switzerland if either the foundation is managed in Switzerland or if the foundation owns Swiss real estate.

Distributions to Swiss resident beneficiaries are, in principle, treated as *income* of these beneficiaries.³¹ Such distributions to Swiss resident beneficiaries are not qualified as donations. According to the Swiss Supreme Court, a donation is a gratuitous *inter vivos* grant made with the intention to donate (*animus donandi*). The founder's intention in this respect is irrelevant, because following the transfer of the assets to the foundation he may no longer dispose of these assets. The determination whether there was an intention to donate is solely made on the basis of the foundation's intention. The foundation, however, lacks the intention to donate because its distribution is made according to the statutes and by-laws of the foundation, i.e. in settlement of a legal obligation.³²

Distributions to Swiss resident beneficiaries are, in principle, treated as income of these beneficiaries

Swiss tax consequences if a foreign family foundation is established by a Swiss resident individual in the form of a non-controlled foundation with a specified class of beneficiaries

In 2004 the administrative court of Zug assessed a foreign family foundation established by a Swiss resident founder in the form of a non-controlled foundation with a specified class of beneficiaries.³³ The Liechtenstein family foundation was established

as a maintenance foundation. According to the statutes and by-laws of the foundation, the assets and the income of the foundation were to be distributed for the appropriate support of the descendants of the founder. The decision on whether such distributions would be made was in the sole discretion of the board of foundation. There was no indication of a mandate agreement pursuant to which the board of foundation would have been required to follow instructions of the beneficiaries.

The court held that distributions from the foundation to its Swiss resident beneficiaries were, as outlined in this section, to be treated as income.

According to the by-laws, the assets that generated this income could not be freely distributed to the beneficiaries but were reserved for the support of subsequent generations instead. Nevertheless, the court held that this qualification did not exempt these assets from being subject to the Swiss wealth tax. Moreover, it held that the position of the beneficiaries of the foundation was comparable to the position of usufructuaries. Since under cantonal tax law assets that are encumbered with a usufruct are attributed for wealth tax purposes to the usufructuaries³⁴, the beneficiaries were not just taxed on actual distributions which they received but were also subject to wealth tax on their share of the foundation assets. Moreover, the court held that not just the actual distribution made to a Swiss resident beneficiary was subject to income tax but all income generated by the share of the foundation assets attributed to this beneficiary, irrespective of whether the beneficiary actually received a distribution or not.

The court also held that the failure of a Swiss resident beneficiary to disclose the accounts of the foundation (in this case because the board of foundation did not release this information to the

31. Article 16 para 1 Federal Income Tax Act ('FITA') and Art 7 para 1 Federal Tax Harmonization Act Excluded are, however, distributions that are classified as support from private sources according to Art 24 lit. d FITA or as payments in settlement of legal obligations arising out of family relations according to Art 24 lit. e FITA.

32. Decision of the Swiss Supreme Court of 22 April 2005 (2A.688/2004).

33. Decision of the administrative court of Zug of 12 March 2003 (StE 2004 B 52.7).

34. See for example s 38 para 2 of the Tax Act of the Canton of Zurich.

beneficiaries) justified the imposition of taxes in the discretion of the tax authorities. It specifically approved the appraisal of the tax authorities, which assumed that not all of the income generated by the beneficiary's share had been distributed and also increased the income tax accordingly.

Conclusions

Unless a Swiss resident founder lives in a Canton that does not impose gift tax on gratuitous *inter vivos* transfers (such as the Canton of Luzern or Schwyz) the establishment of a non-controlled foreign family foundation, that is recognized as an independent taxpayer, is not without tax consequences. Gratuitous transfers to such foundations trigger gift taxes at the tax rates applying to transfers between unrelated persons, i.e. typically at the highest possible tax rates.

Unless a Swiss resident founder lives in a Canton that does not impose gift tax on gratuitous inter vivos transfers (such as the Canton of Luzern or Schwyz) the establishment of a non-controlled foreign family foundation, that is recognized as an independent taxpayer, is not without tax consequences

Instead of setting up a foreign family foundation that is recognized as an independent taxpayer (such as an irrevocable discretionary foundation), it is in most situations an alternative to establish a foreign family foundation that is controlled either by its Swiss resident founder or its Swiss resident beneficiaries. The assets legally owned by such a foundation are attributed for tax purposes either to its founder or its beneficiaries. Consequently, assets transferred to, and distributions made by, the foundation, are for tax purposes treated as being transferred directly from the founder to the beneficiaries. Because gratuitous transfers between parents and descendants are in

most cantons exempt from gift and estate tax, such controlled foreign family foundations are particularly effective from a tax point of view.

It is in most situations an alternative to establish a foreign family foundation that is controlled either by its Swiss resident founder or its Swiss resident beneficiaries

Foreign family foundations may thus be structured in such a way that their establishment and their endowment with assets from a Swiss resident founder does not increase the overall tax burden of the founder and the beneficiaries compared with more traditional forms of succession planning such as last wills and succession contracts. Furthermore, by obtaining a tax ruling from the competent tax authorities, the tax consequences of a particular structure can be ascertained in advance.

Foreign family foundations may thus be structured in such a way that their establishment and their endowment with assets from a Swiss resident founder does not increase the overall tax burden of the founder and the beneficiaries

The taxation of foreign family foundations is generally in line with the principles of the circular letter no. 20 of the Federal Tax Administration on the taxation of trust.³⁵ However, the principles governing the taxation of family foundations outlined above have not been formally agreed upon in an official circular letter but are, instead, derived from court decisions of different cantons. In our experience, economically identical succession planning structures in which the assets are held by trusts will thus receive the same treatment in the various cantons, whereas foreign family foundations might obtain a different treatment, as the cantonal tax authorities are not bound by a circular letter.

35. Actually, the circular no. 20 on the taxation of trusts, originally issued by the SSK (Swiss tax conference) as circular letter no. 30, is based on principles developed by the tax administrations and courts in the assessment of foundations.