New foundation legislation in common law jurisdictions: a 'second generation'?

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Abstract

A new wave of private foundation legislation took place in 2017, with five new statutes in Gibraltar, the Cayman Islands, the Abu Dhabi Global Market, the Dubai International Financial Centre (DIFC), and the state of New Hampshire in the USA. This new legislation appears to embark upon a 'second generation' of common law foundation legislation, which tries untested paths such as the notion of a 'foundation company' in the Cayman Islands, the creation of a '*stichting administratiekantoor*' (or STAK) in the DIFC, and the granting of 'trust functions' in New Hampshire, enabling the use of a foundation as a private trust company.

Introduction

The year 2017 witnessed an almost unprecedented wave of new foundation legislation in common law jurisdictions. Five new statutes were enacted and brought foundations to regions of the world that had previously ignored or disregarded the concept.

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The following legislative acts were enacted in chronological order:

- Gibraltar: the Private Foundations Act 2017 received its royal assent on 11 April 2017;
- Abu Dhabi Global Market: the Foundations Regulations 2017 were published and came into force on 16 August 2017;
- New Hampshire: the Foundations Act came into force on 1 October 2017 along with some amendments to the Trust Code of the state;
- Cayman Islands: the Foundation Companies Law 2017 was enacted on 18 October 2017;
- *Dubai International Financial Centre (DIFC)*: the Foundations Law had concluded its consultation period at the end of the year and was enacted as Law *No* 3 of 2018 on 14 March 2018.

Since the St Kitts Foundations Act 2003, which introduced for the first time a quintessentially civilian notion into a common law environment, no single year has had so much legislative activity in this area. The only close comparison may be 2012, when four new foundation statutes were enacted in Barbados, the Cook Islands, Guernsey, and Mauritius.

The new enactments of 2017 appear to show a development towards a 'second generation' of common law foundation legislation. This is true in two respects. On the one hand, the notion of private foundations made its way to financial centres that are increasing in international importance, such as those in Dubai and

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Abu Dhabi, as well as in the USA, where the New Hampshire legislative initiative is likely to be followed by similar enactments in other states in the coming years. On the other hand, the new legislation is exploring new ways that distance themselves from the 'classic' continental European model and look for a reference framework in local legal notions such as the 'foundation companies' in the Cayman Islands.

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The three models of private foundations

In an earlier article in this journal, I suggested that three models of private foundations may be recognized: (i) the 'classic', (ii) the Dutch, and (iii) the common law one.[1]

Private foundations were first enacted under the *Personen- und Gesellschaftsrecht* (PGR) which came into force in Liechtenstein on 19 February 1926. This was the 'classic' model of private foundations, which was built upon the Germanic tradition and proved to be extremely successful to the point that it was largely imitated in the enactments in Austria[2] and Panama[3] in the mid-1990s and was not significantly amended until a 'total review', which came into force on 1 April 2009.[4]

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These features have traditionally been one of the appealing factors of private foundations in comparison to trusts, especially for founders with no common law background who wished to maintain a 'hands-on' approach and feared that access to

1. P Panico, 'Private Foundations and Trusts: Just the Same but Different?' (2016) 22(1) *Trusts & Trustees* 132–39.
2. Austria, *Privatstiftungsgesetz* (1993).
3. Panama, *Ley de 12 de junio de 1995 por la cual se regulan las fundaciones de interés privado.*
4. Liechenstein, *Gesetz vom 26. Juni 2008 über die Abänderung des Personen- und Gesellschaftsrechts* (PGR), LGBl. 2008 Nr 220 in force as of 1 April 2009.
5. ibid, art 552, s30.
6. ibid ss5–8.
7. Austria (n 2) s5.
8. OGH, 2.7.2009, 6 Ob 101/09 k.
9. OGH, 15.12.2004, 6 Ob 180/04w.
10. Liechtenstein (n 4) art 552, s11(1).

information could encourage feuds within the family. It remains to be seen to what extent they may also protect the confidentiality of beneficiaries in the current framework of automatic exchange of financial information under the Common Reporting Standard (CRS).

A second type of private foundation has evolved in the Netherlands since the 16 century and may be referred to as 'the Dutch model'. It is currently enshrined in the Dutch Civil Code[11] and a modified version of it found its way in that of the Netherlands Antilles, which after their dissolution on 10 October 2010 has remained in force in Curaçao and St Maarten.[12]

The Dutch foundation legislation reserves a limited role to both founders and beneficiaries, which emphasizes the 'orphan', or ownerless, aspect of a Dutch *stichting* which has made it popular in corporate arrangements such as private pension funds, securitization transactions, and syndicated loans. Accurate drafting and contractual arrangements may lead to similar results to those of a 'classic' foundation or a trust.[13] However, a unique feature of the Dutch and Belgian practice of private foundations is the '*stichting administratiekantoor*' (or STAK) under which a foundation issues asset-backed notes which entitle their holders to receive payments from an asset it owns. An arrangement that has been popular since the 19 century is for the foundation to hold a shareholding in an underlying company and to issue notes entitling the holders to receive dividend payments. The resulting arrangement is functionally equivalent to an interest in possession trust where corporate governance is separate from economic enjoyment insofar as the foundation owns the shares and exercises non-economic rights, such as voting at general meetings, but the beneficiaries are directly entitled to any dividend payments which pass through the foundation directly to their hands.

St Kitts enacted its Foundations Act 2003 with a view to expanding the array of arrangements available in its burgeoning financial centre. This legislative initiative was followed by many other common law jurisdictions and now a foundation statute exists in virtually every offshore financial centre.[14] In the same way as offshore trusts, different jurisdictions have taken different approaches in relation to specific aspects of the private foundation, partly trying and recreating the main features of the 'classic' model in their legislation, partly borrowing from local trust and company law.[15]

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The 2017 legislation: selected aspects

A comprehensive overview of the legislation enacted in 2017 is beyond the scope of this article and may be found in the individual articles in this journal which cover each jurisdiction in detail as well as, for the DIFC Foundations Law, in my article in an earlier issue.[16]

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Some specific aspects of the 2017 legislation deserve to be considered in some detail, however, as they show some new paths that

11. Netherlands, *Civil Code*, Bk 2, Pt 6.
12. Netherlands Antilles, *National Ordinance Regarding Foundations* (1998) now Bk 2 of the *Civil Code*.
13. I Koele, 'The Dutch Private Foundation in Comparison with Trusts: for the Same Purpose but Rather Different' (2016) 22(1) *Trusts & Trustees* 140–45.
14. R Pease, 'Foundations in St Kitts: Imitation is the Sincerest Form of Flattery?' (2010) 16(6) *Trusts & Trustees* 517–22.
15. P Panico, *Private Foundations: Law and Practice* (OUP 2014).
16. P Panico, 'The DIFC Foundations Law 2017' (2017) 23(10) *Trusts & Trustees* 1051–065.

common law foundations appear to be going down which have not been attempted in their Continental European models

Three aspects are discussed below: (i) 'foundation companies' in the Cayman Islands, (ii) *stichting administratiekantoor* in the DIFC, and (iii) founder's powers and trust functions in relation to New Hampshire foundations.

'Foundation companies' in the Cayman Islands

Some aspects of the local company law were taken as a reference in the private foundation legislation of all common law financial centres. At the same time, more important borrowings have been taken from the local trust law. An egregious example is the Isle of Man, where the practice of companies limited by guarantee has existed at least since the Company Consolidation Act 1931 as an indigenous alternative to many types of continental-style private foundations[17] but has enacted a Foundations Act 2011 which in some respects follows the example of the Foundations (Jersey) Law 2009.

The Cayman Islands, which had already introduced a special type of trust, the 'STAR trust', under the Special Trust (Alternative Regime) Law, now Part VIII of the Trusts Law (2017 Revision), have introduced foundations in their legal system as a special form of companies, indeed 'foundation companies'.

Section 4 of the Foundation Companies Law 2017 describes the requirements that a company must meet in order to qualify as a 'foundation company':

> For a company to be a foundation company, the requirements (the ''foundation company requirements'') are that-
>
> a. it is limited by shares or by guarantee, with or without share capital;
>
> b. has a memorandum that —
>
> 1. states the company is a foundation company;
> 2. generally or specifically describes its objects (which may, but need not, be beneficial to other persons);
> 3. provides, directly or by reference to its articles, for the disposal of any surplus assets the company may have on winding-up;
> 4. prohibits dividends or other distributions of profits or assets to its members or proposed members as such; and
>
> c. it has adopted its articles; and
> d. its secretary is a qualified person.

A 'foundation company' is a company limited by shares or by guarantee and as such all the provisions of the Cayman Islands company law apply, unless they are specifically modified or repealed under the Foundation Companies Law.[18] In a way, a 'foundation company' in the Cayman Islands is not a 'new legislative animal' brought in from an alien legal tradition but is a company with some special features. This adds certainty to its foreseeable treatment by the local courts.

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Paragraph 4(b)(iv) contains a salient feature of 'foundation companies': the prohibition of dividends or other distributions to their members 'as such'. Members, be they shareholders or guarantee members, are an essential body in a company. Their presence is not compulsory for a Cayman Islands foundation company, the memorandum of which may provide that it ceases to have them on condition that it continues to have one or more supervisors.[19] Unlike an ordinary company, however, a foundation company

17. C Cain, *Guarantee and Hybrid Companies in the Isle of Man* (Jordans 2003).
18. Cayman Islands, *Foundation Companies Law* (2017) s3(2).
19. ibid s8(5).

cannot distribute its profits to its members 'as such'. This implies that if the members are also named beneficiaries, they may receive distributions in the latter capacity but not because they are members.

The creation of a special type of company with limited intersections with trust law is intended to reduce the potential for litigation which many practitioners identify as a major problem with trusts, especially after the settlor's death. At the same time, an important advantage of trusts is the trustee's ability to approach the court and seek its advice or directions in relation to certain matters. In order to make it possible in relation to foundations, a relatively active role was reserved to the court in the legislation of many financial centres, where the difference with trusts appears to be very tiny.[20] The Cayman Islands foundation company legislation allows a similar situation in a specific case, which founders are free to select if they wish. The memorandum of a foundation company may provide that the foundation company has a duty to carry out its objects and designate persons with standing to enforce such duty.[21] In such case, under section 20 of the statute:

> Subject to any contrary provision in its constitution, a foundation company with enforceable duties under section 7(5) has a right to apply to the Court for an opinion or advice or for directions.

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DIFC foundations: STAK in the desert

The practice of STAK is not mentioned anywhere under Dutch legislation but has developed as a consolidated practice for at least two centuries and is perhaps the most popular application of Dutch foundations.

An attempt to legislate this arrangement was contained in the unsuccessful Bill No 6595, which was lodged with the Luxembourg Parliament on 22 July 2013 with a view to creating 'patrimonial foundations' but has never been enacted.

The Luxembourg bill was expressly recognized as the model for the introduction of a 'STAK mechanism' under the Foundations Law of the DIFC, Article 30 of which provides that:

1. A Foundation may issue securities, including depository receipts, representing specific rights to payment quantified by reference to specific parts of the property owned by the Foundation or relating to other rights or interests, whether present or future, to which the Foundation is or might be entitled.
2. Any such securities issued by a Foundation may be subscribed for or issued in favour of any individual or legal entity.
3. The Foundation retains full ownership of the properties and full entitlement to the rights or interest in any property in respect of which it issued securities under Article 30(1).

Accordingly, a DIFC foundation that owns a certain asset (such as a shareholding in a company) may issue securities giving their holders the right to receive payments out of it (such as dividends).

An interesting and unique feature of DIFC foundations is that the statute does not use the word 'beneficiaries' in order to mark a difference with trusts. A DIFC foundation may have 'qualified recipients', a phrase that includes persons with an entitlement to receive a payment from the foundation but also the holder of a depository receipt in a STAK-like arrangement.[22]

20. Foundations (Jersey) Law 2009, Part 5 Foundations (Guernsey) Law (2012) ss36–45.
21. Cayman Islands (n 19) s 7(5).
22. DIFC, Foundations Law, art 32(b).

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The 'qualified recipient' of a DIFC foundation has no rights that may be comparable to the 'equitable interests' of the beneficiary of a trust. Article 29(3) of the Foundations Law provides that a 'qualified recipient' may at the most have a claim similar to that of a creditor if the foundation constitutional documents or a contractual agreement (such as the terms of the issue of depository receipts in a STAK-like arrangement) so provide:

> A Qualified Recipient has no right to or interest in the property of the Foundation other than a right to payment of amounts which arises by virtue of the terms of the By-laws or pursuant to the By-laws, or a contract with the Foundation, including a contract in relation to a depository receipt.

Founders and trust functions in relation to New Hampshire foundations

New Hampshire was the first state in the USA to introduce private foundations into its statute book.[23] Curiously, the legislation permits a New Hampshire foundation to use the Dutch term '*stichting*', or even '*stak*',[24] but in fact no provisions in the statute allow the creation of a 'STAK-like arrangement', as under the DIFC law.

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The foundation model which was followed in New Hampshire was the 'classic' one, which allows founders to reserve very wide powers. An extreme approach was followed in this respect, to the extent that certain powers automatically vest in the founder of a New Hampshire foundation if they are not expressly excluded under the constitutional documents. More precisely, section 564-E: 7-702 (b) provides that:

> Unless the governing documents provide otherwise, the founder retains the following powers, rights, and interests:
>
> 1. The power to amend or restate the foundation's certificate of formation
> 2. The power to amend, restate, or revoke the foundation's bylaws
> 3. The power to direct the directors concerning distributions of the foundation's property
> 4. The right to receive distributions from the foundation; or
> 5. The power to dissolve the foundation

Other provisions in the statute indicate that the founder may exercise his power to amend or to dissolve the foundation by filing the corresponding certificates with the New Hampshire secretary of state.[25]

Careful drafting is advisable because in many cross-border arrangements a founder may not want to

23. It may be worth noting that the phrase 'private company foundation' in the USA usually describes a charitable trust.
24. New Hampshire, Foundations Act, s546-E:4-401.
25. ibid sNH 564-E:3-305: (a) Unless the governing documents provide otherwise, the founder or the directors may amend a foundation's certificate of formation by filing with the secretary of state a certificate of amendment. New Hampshire, Foundations Act, s564-E:20-2002: Except as otherwise provided in the governing documents, a founder may dissolve a foundation by filing with the secretary of state a certificate of dissolution.

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The close connection between foundations and trusts is evidenced by the express provisions under New Hampshire law which allows 'trust powers' to be conferred on a local foundation. More precisely, section 564-E: 8-802 provides that:

a. A foundation shall have trust powers to the extent that it:

    1. Does not transact business with the general public
    2. Is a family trust company as defined in RSA 383-A: 2-201(a)(26)
    3. Is a foreign family trust company that is authorized to engage in trust business in this *state* under RSA 383-d: 13-1301

b. Trust powers include the power to act as a trustee or other fiduciary, a trust advisor as defined in RSA 564-B: 1-103(27), or a trust protector as defined in RSA 564-B: 1-103(28).

The 'orphan' nature of foundations has allowed them to be used as structures of choice, as an alternative to purpose trusts, to hold the shares of private trust companies. Some practitioners have short-circuited the process by allowing foundations to act as trustees in selected arrangements for one particular client or family, 'private trust foundations'.

The New Hampshire legislative provisions are intended to allow such arrangements, on condition that they are restricted to the trust or trusts of a particular family. In other words, a New Hampshire foundation may act as an unregulated 'family trust company' but cannot offer its services to the general public, whom would require it to be licensed by the state's Banking Department.

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Conclusion

The new legislation enacted in 2017 shows that the interest for private foundations is still very high in the common law financial centres.

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These legislative developments appear to show that a 'second generation' of foundation legislation is being attempted both in terms of geographical extension, with foundations entering the major financial hubs of the Middle East and the USA, and new arrangements such as 'foundation companies' in the Cayman Islands, STAK in the DIFC, and foundations being granted 'trust powers' in New Hampshire.

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Sadly, no such developments are witnessed in Continental Europe, where private foundations were the original and visionary creation of Wilhelm and Emil Beck, the draftsmen of the Liechtenstein PGR

in the mid-1920s. The current political environment, which is dominated by an all-encompassing obsession with transparency, is unfortunately stifling most efforts towards legitimate privacy and judicious estate planning.

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