The use of Liechtenstein foundations for Swiss founders and/or Swiss assets under the new Switzerland-Liechtenstein double taxation treaty

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Introduction

On 10 July 2015, the long-awaited double taxation treaty (DTT) between the Swiss Confederation and the Principality of Liechtenstein was signed by the negotiating parties. According to the press release of the Swiss State Secretariat for International Financial Matters dated 10 July 2015, the DTT should enter into force from 1 January 2017 and will replace the current treaty between the two countries dated 22 July 1995, which primarily governs the terms of employed individuals who work on a cross-border basis.

The new treaty now follows to a great extent, in terms of structure, the Organisation for Economic Co-operation and Development (OECD) model treaty, particularly with respect to the exchange of information in tax matters, and governs not only the taxation of cross-border commuters and pensions, but also the taxation of cross-border entrepreneurial activities, earnings on assets and licence fees. In the protocol that is an integral part of the treaty, both contracting states have agreed upon further-reaching provisions that relate among other things to the tax residence of Liechtenstein foundations as well as establishments and trust enterprises (trusts reg) that are structured in a similar fashion to foundations.

Concerning the Swiss foundation, which is suited for private use objectives only to a very limited extent, the question often arises as to whether and under which conditions Liechtenstein foundations come into consideration as an alternative for the structuring of cross-border assets and/or company succession solutions for Swiss companies and wealthy individuals. In this regard, it must always be clarified what civil and tax law advantages and, as the case may be, disadvantages are entailed for those users applying Swiss law under the various possible structuring alternatives.

Treatment to date of Liechtenstein foundations in Switzerland

Civil law and tax law principles for family foundations in Switzerland

In Switzerland, the landscape is largely dominated by Swiss charitable foundations that pursue a non-profit objective. Less common are Swiss family foundations that, pursuant to Art 335 para 1 of the Swiss Civil Code (SCC), are only permitted to serve the objectives of covering the costs of education, equipping and aid of family members or similar objectives.[1] Swiss family foundations are not permitted to pursue further-reaching objectives such as, in particular, so-called 'maintenance foundations' that are intended to bring about a higher living standard or

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1 Cf decisions of the Swiss Federal Tribunal (BGE) 108 II 393 consideration 6a, cf Opel, Andrea, Steuerliche Behandlung von Familienstiftungen, Stiftern und Begünstigten – in nationalen und internationalen Verhältnissen, Dissertation, Basel 2009 (Opel, Dissertation 2009), at pp 19ff.

greater prestige for the family.[2] According to Art 52 para 3 SCC, Swiss foundations that are intended impermissibly to benefit the members of a family are void from the very outset, even if they were entered in the Commercial Register. They must, however, be declared void and therefore non-existent in court proceedings. A foundation that is illegal or immoral from the outset leads to the legal entity being non-existent, and therefore to a return of the relevant assets to the founder or, as the case may be, the founder's successors-in-law.

Because there is no independent definition of legal entities in Swiss tax legislation, Swiss tax law is basically tied to the legal personality under civil law. According to the case-law of the Swiss Federal Tribunal, however, an existing legal entity recognised under civil law can be disregarded as a tax subject, on an exceptional basis, in the event that tax evasion or an abuse of the law is in point by 'piercing the veil' of legal personality. Tax evasion is in point if a legal structure chosen by the tax subject appears unusual, improper or peculiar, and it must be assumed that this choice was made in an abusive fashion, with the intent of avoiding taxes that would have been owed, in a proper settling of the circumstances, and the manner of proceeding chosen would lead to considerable tax savings if it were to be accepted by the tax authority.[3]

Already in the 1920s and 1930s, the Swiss Federal Tribunal dealt at an intercantonal level with the question of whether Swiss family foundations are to be recognised as a matter of tax law.[4] At that time, it held that, in the case of various intercantonal double taxation conflicts, the civil law existence of a legal entity can be disregarded from a tax law perspective if the establishment of the foundation:

> 'demonstrably occurred merely for the purpose of avoiding a tax obligation otherwise existing in another canton, and provided further that the establishment is structured in a manner such that, in reality, despite the circumstances, the holder of the assets, through the chosen civil law form, continues to exercise the powers over the relevant assets and income thereon that are decisive with respect to the tailoring of the fiscal sovereignty.'

The Swiss Federal Tribunal did not deal with the question of the private law classification of a foundation until later,[5] and declared the foundation to be disregarded in terms of its existence as a tax subject because it ascertained that the foundation was invalid as a matter of civil law.

Civil law and tax law principles for family foundations and similar special-purpose assets in Liechtenstein

In Liechtenstein, several structuring possibilities for special-purpose assets without shareholders have existed since the introduction of the Person and Company Law (PCL) in the mid-1920s. Apart from the foundation (pursuant to Art 552 § 1–41 PCL), such possibilities also include the establishment (pursuant to Arts 534–551 PCL), the trust enterprise (pursuant to Art 932a § 1–170 PCL) and the trust (pursuant to Arts 897–932 PCL). All of the above-named legal institutions can be equipped with objectives that are for private use, charitable or mixed private-charitable objectives. The foundation is always a legal entity. The establishment and the trust enterprise are typically structured as legal entities, but there are also alternatives without legal entity status. The Liechtenstein trust was modelled to a large extent on Anglo-Saxon trust law and continues to date to represent the only German-language country that has received this

2 So-called 'entailed family estates' within the meaning of Art 335 para 2 SCC; cf BGE 108 II 394.
3 BGE 107 Ib 315, p 323; as well as M René, *Der Durchgriff bei den von Inländern beherrschten Auslandsgesellschaften, Berner Beiträge zum Steuer- und Wirtschaftsrecht*, 18 (Stämpfli Verlag, 2003), at p 173.
4 BGE 252 I 372; BGE 53 I 440; BGE 5 I 373; a summary of these decisions as well as others can be found at Opel, Dissertation 2009, op cit n 1, above, at pp 44ff.
5 BGE 71 I 265.

legal institution. Under Liechtenstein civil law, there are no limitations on a private use definition of the objective that are comparable to the Swiss Art 335 SCC.

The choice and structuring possibilities for Liechtenstein legal institutions are attractive because configurations that are optimally suited for various domestic and foreign persons and assets can be found.

Cross-border recognition of Liechtenstein foundations in Switzerland

Under Swiss law, the civil law recognition of a family foundation is basically adjudged under the law of the state of incorporation, ie the legal system of the country in which it was established (Art 154 para 1 of the Swiss Private International Law Act (PILA)).

The incorporation theory, however, can be limited by Art 17 PILA (reservation as to public policy) as well as by Art 18 PILA (law of mandatory application). In the literature there appears to be a consensus that Liechtenstein family foundations do not violate public policy and thus are to be recognised as a matter of civil law regardless of their structure. With respect to the applicability of Art 18 PILA to foreign family foundations, differing opinions existed in the past, and inconsistent decisions have also resulted under case-law. By a decision dated 29 October 2009, however, the Swiss Federal Tribunal decided that the prohibition on the establishment of family foundations pursuant to Art 335 para 2 SCC did not constitute any law of mandatory application within the meaning of Art 18 PILA.

Tax law 'piercing the veil' in the context of tax evasion

Under Swiss Federal Tribunal case-law, however, the existence of tax evasion leads to a 'piercing the veil' under tax law. In this regard, it is hypothetically assumed for tax purposes that the foundation does not exist at all. Consequently, assets and income of the foundation do not belong as a matter of tax law to the foundation itself but are instead attributed to the participating persons domiciled in Switzerland, ie to the founder, on the one hand, or to the beneficiary, on the other hand.

With respect to Liechtenstein foundations, legal doctrine and case-law have to date distinguished between so-called 'controlled' foundations and 'non-controlled' foundations.[6]

Liechtenstein 'controlled' foundations, to which a tax law 'piercing the veil' applies, are characterised by the following:[7]

- the founder, in the deed of foundation, has retained a right to revoke the foundation; or
- the founder, in the deed of foundation, has retained a right to supplement the purpose of the foundation; or
- the founder can continue regularly to appropriate the income on the foundation's assets without contravening the deed of foundation or the purpose of the foundation; or
- the founder in actual fact does as he pleases as if the foundation's assets were still his own personal assets, without regard to the powers under the deed of foundation and the limitations on the same.

6 H Rainer, M Wolfgang, 'Die Besteuerung der liechtensteinischen Familienstiftung aus Sicht der Schweiz', StR (2004), at pp 592ff; N Peter, 'Die liechtensteinische Stiftung und der Trust im Schweizer Steuerrecht', IFF Forum für Steuerrecht 2003, vol 1, at pp 164ff.

7 Among others, BGE 131 II 627 E. 5.2; BGE 107 Ib 315 or Federal Tribunal decision dated 18 June 2010, 2C_43/2010.

In the past, the foundation council was frequently bound to accept instructions of the founder by means of a so-called 'mandate agreement'. As a result, the assets did not actually acquire an independent existence for tax purposes, as is required in connection with the establishment of a Swiss foundation.[8]

Therefore, tax evasion exists in general in the case of family foundations if the founder, first, has retained factual powers within the meaning of the 'controlled' foundation outlined above and, secondly, the foundation was merely established for the purpose of avoiding a tax obligation that would otherwise exist. If a 'controlled' foundation remains hidden for years from the Swiss tax authorities, with the knowledge and consent of the founder, the intent to evade taxes on the part of the founder always exists.

Based on the 'controlled' structure of Liechtenstein foundations that was frequently encountered in the past, the Swiss administrative practice disregarded the tax existence of many Liechtenstein foundations, making reference to the case-law of the Swiss Federal Tribunal relating to tax evasion.[9] Consequently, these foundations were and are treated from a tax perspective as being 'transparent' within the meaning of a 'piercing the veil', which means that:[10]

- the founder has not transferred any assets yet;
- the assets and the income thereon will continue to be attributed in full to the founder, unless the attribution is switched to the beneficiaries;
- no gift tax will be imposed in connection with the establishment or dedication of assets, other than in the case of an attribution to the beneficiaries, who are not exempted from the gift tax;
- based on the tax attribution of the assets, the founder who is domiciled in Switzerland (or the beneficiaries, as the case may be) can reclaim the withholding tax paid by the foundation;
- capital gains on the disposition of foundation assets are tax exempt, as in the case of a disposition of private assets of the founder; and
- the beneficiaries, in the event of distributions, are enriched from a tax law perspective out of the assets of the founder; therefore, the donation may be subject as the case may be to gift tax, but not to income tax.

Only upon the death of the founder does the question arise as to whether the foundation, as from this point in time, receives its own qualification as a tax subject or whether the foundation will continue to be treated as transparent, and therefore, the foundation assets as well as the income thereon will now be attributed to the beneficiaries. In practice, transparent taxation may continue to take place in situations in which the beneficiaries have similar rights of influence over the foundation or the foundation assets as was already the case on the part of the founder.[11] If the rights of the founder, however, are extinguished upon his death, the foundation will be respected from a tax perspective, which in many Swiss cantons triggers the application of inheritance tax at its highest rate. In order to avoid running the risk of a considerable inheritance tax burden at a point in time that is unplanned, it is highly recommended that the

8 Cf Opel, Dissertation 2009, op cit n 1, above, at pp 61ff; A Opel, 'Familienstiftung und Trust – Postulat für eine kohärente Besteuerung', ASA 78 (2009/2010) (Opel, ASA 78), at p 271.

9 Cf Locher Peter, Kommentar zum DBG, II Teil, Einführung zu Art 49 N 23 ff; with further notes, Opel, Dissertation 2009, ibid, at pp 39ff.

10 Cf, eg, Definition of the Practice of the Tax Administration of Graubünden, 15 April, at pp 3ff.

11 Opel, however, precludes transparent treatment because the beneficiaries never participated themselves in the establishment and structuring of the foundation. Opel, Dissertation 2009, op cit n 1, above, at pp 78ff.

issues be clarified early on with the competent cantonal tax authorities, and that a tax ruling be obtained for the purpose of continuing the transparent taxation at the level of the beneficiaries, provided that the prerequisites therefore are met.

In order to prevent tax evasion and thus avert a 'piercing the veil', the founder is also not permitted to grant himself free access to the foundation's principal, in particular any possibility to use foundation assets freely for his own purposes. Moreover, he may not benefit at any time and unconditionally from the foundation. In connection with the 'non-controlled' foundations in this sense, a complete separation of the foundation from the founder occurs as a matter of tax law as well, and the foundation will from then on have its own tax law existence.

Future treatment of Liechtenstein foundations in Switzerland based on treaty residence

Advantages of the DTT for resident legal entities

The Switzerland-Liechtenstein DTT that is now signed (hereinafter simply referred to as the 'DTT CH-FL') sets out comprehensive provisions for the avoidance of double taxation and double non-taxation, as well as for tax cooperation and the exchange of information in tax matters. The treaty partners are in agreement that Liechtenstein will in the future aid Switzerland, among other things, through an exchange of information, in effectively preventing potential tax reductions and tax abuses, including in the context of the use of Liechtenstein foundations and other special-purpose assets without shareholders. In return, certain Liechtenstein foundations and similar legal institutions should be able, in the future, to enjoy treaty benefits that they have not to date been entitled to under the current 1995 treaty.

In the past, Liechtenstein foundations were often established as 'controlled' foundations because structuring them in a non-transparent fashion entailed tax disadvantages. Among such disadvantages is, in particular, the fact that, in many cantons, the establishment of a 'non-controlled' Liechtenstein foundation triggers high gift tax costs at the unattractive rate applicable to non-relatives, and that the foundation itself could not reclaim the 35% withholding tax charged on dividends of Swiss stock corporations.

In the new DTT CH-FL, Liechtenstein foundations and similar legal institutions that qualify as 'residents' within the meaning of Art 4 DTT CH-FL will be entitled to a series of attractive treaty benefits. Among other things, the 35% Swiss withholding tax can in the future be reduced to zero (in the case of interest and stock corporation holdings of 10% or more) or be reduced in part (to 15% in the case of stock corporation holdings of less than 10%) (Art 11 para 1 DTT CH-FL, Art 10 paras 1 and 3(a) DTT CH-FL in conjunction with protocol points 3 and 4 DTT CH-FL).

The DTT legal definition of 'resident' therefore takes on a special significance in the context being examined here of tax planning for the future cross-border establishment of Liechtenstein special-purpose assets without shareholders.

'Non-controlled' private use and mixed charitable foundations

Article 1 DTT CH-FL states that the treaty applies to persons who are resident in one or both treaty states. The terms 'person' and 'resident' are then defined in Art 3 para 1(c) and (d) and Art 4 para 1 DTT CH-FL.

According to Art 3 para 1(c) DTT CH-FL, the term 'person' includes not only natural persons but also companies and other associations of persons. The treaty definition of the term 'company' under Art 3 para 1(d) DTT CH-FL is comprehensive and includes each legal entity and each legal body, provided that it is treated like a legal entity for taxation purposes.

Conversely, all other associations of persons (such as, for example, partnerships) that are not taxed as legal entities do not qualify as 'companies' within the meaning of the treaty.

Pursuant to Art 4 para 1 DTT CH-FL, 'persons' qualify as being 'resident' in a treaty state if the personal characteristics that trigger an unlimited duty of taxation in Liechtenstein (for example, registered office, residence, place of customary abode, place of the actual administration pursuant to Arts 2, 6 and 44 of the Liechtenstein Tax Act) are met in the individual case.

Under Liechtenstein law, private use foundations that are not required to be entered in the public register achieve the status of legal entity already through the establishment of the foundation by the founder, without entry in the public register. Based on unilateral law, therefore, the Liechtenstein foundation is always a legal entity, regardless of its charitable nature, and is subject to an unlimited duty of taxation pursuant to Art 44 para 1(a) of the Liechtenstein Tax Act based solely on place of registered office that is required to be laid down in the foundation deed[12] and is therefore basically a resident company within the meaning of the treaty.

Therefore, pursuant to Art 4 para 1 DTT CH-FL in conjunction with Art 44 of the Liechtenstein Tax Act, all foundations that are subject to an unlimited duty of taxation in Liechtenstein due to their registered office or the place of their actual administration are deemed to be 'resident' persons. The contracting states have, however, agreed in protocol point 2 to Art 4(b) DTT CH-FL that a foundation that takes advantage of its right of election under Liechtenstein law and subjects itself to the special taxation regime for private asset structures ('PVS' according to Art 64 of the Liechtenstein Tax Act) is not deemed to be 'resident' in Liechtenstein and cannot therefore lay claim to the benefits of the DTT CH-FL. Because the taxation of Liechtenstein legal entities, in terms of an international comparison, is competitive and this taxation is hardly distinguishable in many cases on a substantive basis from the special tax regime of the PVS, this limitation in terms of residence does not often represent any significant restriction.

Exclusively charitable foundations

Liechtenstein charitable foundations are required to be entered in a register and acquire in this manner the status of legal entity pursuant to Art 106 para 1 PCL. Furthermore, they are subject to supervision by the Liechtenstein Foundation Supervisory Authority. Based on Art 44 of the Liechtenstein Tax Act, a Liechtenstein charitable foundation is subject to an unlimited taxation based on its registered office or place of its actual administration and therefore qualifies as a 'resident' under the DTT CH-FL.

In addition, according to protocol point 2 to Art 4(a)(ii) DTT CH-FL, the term 'person resident in a contracting State' includes foundations that are resident in Liechtenstein that have been established and pursue exclusively public or charitable purposes. The Liechtenstein 'catalogue of charitable purposes' can be found in Art 107 para 4a PCL and seems to be identical to the charitable terminology used in protocol point 2 to Art 4(a)(ii) DTT CH-FL.

According to Art 552 § 2 para 2 PCL, a Liechtenstein foundation is already 'charitable' from a civil law perspective if the deed of foundation at least foresees the pursuit of objectives that are predominantly charitable in nature. The rule under protocol point 2 to Art 4(a)(ii) DTT CH-FL, however, based on its wording, only covers charitable Liechtenstein foundations that exclusively fulfil charitable objectives.

12 Article 552 § 16 para 1 no 2 PCL.

Under Art 4 para 2 of the Liechtenstein Tax Act, a tax exemption in Liechtenstein is tied to the pursuit of an exclusively charitable objective, and such pursuit must be irrevocable in nature. Because the local tax exemption, based on the explicit wording in protocol point 2 to Art 4(a)(ii) DTT CH-FL, is irrelevant with respect to the residence of the legal entity, tax exempt Liechtenstein foundations are therefore always 'residents' within the meaning of the DTT CH-FL.

'Controlled' foundations

The protocol to the DTT sets out further rules relating to the place of residence as a matter of treaty law of certain Liechtenstein foundations with Swiss connections. Because foundations and similar legal institutions that are exclusively charitable in nature are already covered by protocol point 2 to Art 4(a)(ii) DTT CH-FL, sub-point (iii) only applies to certain mixed charitable foundations or private use foundations and similar legal institutions.

No limitation on the place of residence in the case of controlled foundations without Swiss participants

First, it must be noted that foundations or similar legal institutions are not covered by the further-reaching protocol point 2 to Art 4(a)(iii) DTT CH-FL to the extent that neither the founder nor a beneficiary is resident in Switzerland. This includes, in particular, all types of Liechtenstein foundations or similar legal institutions that hold real estate in Switzerland or hold equity participations in Switzerland, provided that the legal institution was established by natural persons who were not resident in Switzerland and there are no beneficiaries who are persons resident in Switzerland. In these cases, the protocol does not set out any special requirements in terms of residency. Therefore, these foundations are to be viewed as 'residents' based on the general qualification regardless of the question of whether they would be viewed under Swiss case-law as 'controlled' or 'non-controlled', and may directly claim under the DTT CH-FL, apart from certain restrictions concerning abuse scenarios.

In light of the background of the treatment to date of 'controlled' foundations, it is understandable that protocol point 2 to Art 4(a)(iii) DTT CH-FL does not include foundations with foreign founders and beneficiaries. Neither the foreign founder nor the foreign beneficiaries are subject in this situation to an unlimited liability of taxation in Switzerland, such that a transparent treatment would be pointless from an income and wealth tax perspective.

In abuse scenarios, however, it is possible that the reclaiming of Swiss withholding tax that has been withheld will be refused by the Swiss Federal Tax Administration, making reference to protocol point 4 to Arts 10, 11, 12 and 21(a) DTT FL-CH. This possibility to reject treaty benefits is intended to apply in abuse scenarios with respect to 'income' that:

> 'is collected . . . by a legal entity if the primary objective . . . of the establishment of the legal entity consists of laying claim to the benefits of Articles 10, 11, 12 and 21, and if the exclusion . . . of the legal entity means that this income would be attributed to a person who is not resident in either of the two treaty States.'

'Controlled' foundations with Swiss persons as participants

According to protocol point 2 to Art 4(a)(iii) DTT CH-FL, the contracting states agree that the expression 'a person resident in a treaty State' also includes Liechtenstein foundations that are subject in Liechtenstein to ordinary income tax, 'provided that neither the founder nor a beneficiary' who is 'resident in Switzerland' nor 'any person who is close to the founder or a beneficiary' is able factually or legally to influence the foundation assets or the income thereon. Protocol point 2 to Art 4(a)(iii) DTT CH-FL is therefore limited to foundations and similar

legal entities that were designated in the past as 'non-controlled'. Within the meaning of this protocol point, therefore, 'non-controlled' foundations should now qualify as 'resident' persons within the meaning of the DTT CH-FL.

This rule can be traced back to the case-law and practice to date in Switzerland, pursuant to which 'controlled' foundations are treated as a rule as transparent for tax purposes, such that the foundation assets and the earnings thereon will be attributed to either the founder or, as the case may be, the beneficiary with his place of residence in Switzerland.

The assessment as to whether a foundation is 'non-controlled' is determined by the rules as set out in the protocol, on a case-by-case basis, taking into account all circumstances. In order for a private use foundation with Swiss persons participating in the foundation to be deemed to be resident in Liechtenstein, the following elements must, at a minimum, be satisfied:

- the founder did not retain any right of revocation in the documents establishing the foundation (the foundation is irrevocable);
- in the documents establishing the foundation, the founder did not retain any right to amend the foundation documents (for example, deed of foundation and/or by-laws, the founder does not have any right to amend the foundation documents);
- neither the founder nor any person close to him has a right to issue instructions within the meaning of exerting a certain influence in or towards the Foundation Council;
- the beneficiaries do not have any legal right to donations from the foundation (the legal relationship between the beneficiaries and the foundation is not similar in character to a usufruct).

These requirements are more or less identical to the prerequisites that the Swiss Federal Tribunal has determined in its case-law over many years with respect to a 'piercing the veil' concerning tax evasion. If these minimum requirements under the protocol points were met in the past, Liechtenstein foundations would also have been recognised in the past as being non-transparent from a tax law perspective.

The protocol points specify, however, that Liechtenstein foundations with Swiss participants should qualify as resident within the meaning of the DTT CH-FL if they are 'non-controlled'. In order for them to qualify as 'non-controlled', the minimum requirements that are explicitly listed must be fulfilled on a cumulative basis. If, therefore, one of the requirements is not met, one would assume within the meaning of the protocol point that the Swiss resident founder, beneficiary or person close to him oversees the foundation from a factual or legal perspective. Thus, it would constitute a 'controlled' foundation that should not qualify as a resident person within the meaning of the DTT CH-FL. The last sentence of protocol point 2 to Art 4(a)(iii) DTT CH-FL explicitly states that this protocol point is also intended to apply by analogy to Liechtenstein establishments and trust enterprises (Trust reg) that are structured in similar fashion to foundations.

Potential use scenarios

Swiss law currently only permits family foundations to have a very narrowly defined objective (Art 335 para 1 SCC), and altogether precludes the union of family assets over several generations (entailed family estates within the meaning of Art 335 para 2 SCC). By no later than the effective date of the DTT, Liechtenstein foundations and similar special-purpose assets without shareholders, such as establishments and trust enterprises, will enable users applying Swiss law to avail themselves of a series of structuring alternatives for the purposes of company and asset succession planning. Through a Liechtenstein foundation, the founder preserves the foundation assets over several generations, without any time restriction, by his:

- defining charitable and/or private use foundation objectives;
- determining the foundation assets to be administered, usually in the form of company shares, real estate or bank investments; and
- defining the set of beneficiaries and the type of beneficiary distributions in accordance with his wishes.

The Foundation Council that is appointed will be bound by these arrangements and must implement them.

The founder is completely unrestricted in his choice as to the foundation objective, foundation assets and the set of future beneficiaries. In particular, he is able to determine the type, amount, timing and conditions for potential distributions to beneficiaries and to either grant beneficiaries legal claims to distributions or alternatively to leave the decision as to the making of distributions to the foundation bodies within the scope of their discretion as laid down in the foundation documents.

The transfer of assets to irrevocable foundations, however, can be restricted by the claims to legal shares under Swiss law. The founder cannot circumvent these legal shares, even if he replicates them in the foundation. The heirs who are protected by means of such legal shares have an unrestricted claim to their legal share. This limitation can be overcome if the heirs waive their legal share claims, for example, within the scope of an inheritance agreement. This can make sense, particularly regarding the transfer of shares to a company. The foundation can hold the company together over many generations within the meaning of the founder and ensure the unity of the company management. The set of beneficiaries to the foundation will, depending on the circumstances, increase from generation to generation, but the set of shareholders will not. The sole shareholder is and continues to be in this case the foundation.

To the extent that a founder resident in Switzerland establishes a Liechtenstein foundation that he does not control within the meaning of protocol points 2 to Art 4(a) (iii) DTT CH-FL, this foundation will be recognised in Switzerland both from a civil law as well as a tax law perspective.

As before, the same maxim applies: the greater the potential influence held by the founder, the more likely it is that, from a Swiss perspective, a 'controlled' foundation is created that will be subject to transparent tax treatment during the lifetime of the founder.

Should tax law transparency be desired, the Liechtenstein deed of foundation, the by-laws and the foundation regulations can be structured accordingly. However, due to an absence of residence, these foundations will not be entitled to claim DTT benefits. The same applies if Liechtenstein foundations are established, as was frequently the case in the past, through the use of the PVS taxation regime.

The ongoing taxation of the foundation in this case takes place in a parallel 'two-pronged' fashion at the level of the Liechtenstein foundation and by attribution of the foundation earnings at the level of the Swiss founder and/or the Swiss beneficiaries. In these situations, it continues to be important to keep an eye on potential tax consequences upon the death of the founder. In the worst case, the lapse of the founder rights 'threatens' to lead to a very high cantonal inheritance tax at the rate applicable to non-relatives through the tax law transfer of the foundation assets to the foreign foundation. A prior agreement with the tax office in the canton of residence of the founder (ruling) can bring about cross-generational legal certainty with respect to this topic.

Conversely, non-transparency as a matter of tax law can also be achieved through suitable structuring. The foundation would then be resident in Liechtenstein within the meaning of the

DTT CH-FL and could then itself lay claim to certain treaty benefits that are customary on an international basis such as, for example, reclaiming the Swiss withholding tax. For these purposes, the founder must from the very outset, among other things, waive revocation provisos with respect to the establishment of the foundation, comprehensive founder rights, mandate agreements and the taxation regime of the PVS.

If earnings are accumulated at the level of the Liechtenstein foundation that is subject to taxation, tax advantages might result in Switzerland, as opposed to the taxation of natural persons resident in Switzerland, but also as opposed to Swiss stock corporations, with respect to the ongoing income and gain taxation at the federal level (Art 71 of the Direct Federal Tax Act) and in part also at cantonal and community levels (cf, for example, § 76 of the Zurich Tax Act). Accumulated investment income is not subject in the future to any inheritance tax in Switzerland. It must be noted, however, that all capital gains earned in the foundation that initially remain largely tax exempt in Switzerland and at the level of the foundation will be subject to income taxation upon a later distribution to a Swiss beneficiary. The same applies with respect to the distribution of assets contributed to the foundation. These are likewise basically subject to income taxation upon distribution to the Swiss beneficiary.

It is also possible, however, to define here various rights on the part of the founder to influence foundation matters that are irrelevant with respect to non-transparent treatment under tax law. These rights include, among other things, the determination of the foundation's objective, the determination of the initial foundation documents, potentially the founder's serving on the supervisory body of the foundation, the (non-controlling) dispatch of family members to serve on the Foundation Council, the acceptance of management mandates in Swiss subsidiaries of the foundation and many more.

A specific weighing up of the relevant advantages and disadvantages of the establishment of a 'controlled' foundation (with no DTT residence) as compared to the establishment of a 'non-controlled' foundation (with DTT residence) appears to be a matter for a case by case assessment.

Conclusion

Although the protocol refers to foundations with a Swiss settlor and/or beneficiary(ies) only, there seems to be uncertainty about whether or not these rules will in analogy be applicable to foundations with no Swiss participants, as is the case currently in Switzerland. In practice it is in any event welcome that certain rules are set-out in the DTT.

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