The chameleon-like features of the foundation in Dutch tax law

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1 INTRODUCTION

The essential feature of a Dutch foundation is that it is of legally autonomous 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; it is without members and its purpose, with the aid of funds intended for such purpose, is to realise the objects set out in its articles of association (Book 2 Article 285 (1) of the Dutch Civil Code).

Accordingly, we term the foundation a 'purpose fund'. To distinguish it from an association there is an added stipulation that the 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. The foundation is an abstract entity of rights and obligations in which a court or public prosecution service may only interfere in exceptional circumstances. In practice, it is not unusual for their form to include some kind of supervisory board to supervise the foundation's governing board. The governance of the foundation can be tailored to its scope.

2 THE APPEARANCE OF THE FOUNDATION IN DUTCH TAX LAW PRACTICE

The Dutch legal system utilises the foundation for various purposes, on the basis of the flexible conditions that Dutch law attributes to foundations. Applications include at least the following[2]:

a. Foundations with a general benefit goal that qualify for tax purposes as foundations with a general benefit purpose ('ANBIs') as defined by Article 6.33 of the Dutch Income Tax Act 2001 (*Wet IB 2001*) and which remain exempt from a number of taxes;

b. Foundations with a social goal that do not qualify for tax purposes as foundations with a general benefit purpose, but that possibly do qualify as institutions promoting the social good ('SSBIs'); on the basis of this attribution acquisitions by these foundations are free of gift and inheritance tax;

c. A '*stichting administratiekantoor*' that for tax purposes is regarded almost as being non-existent because the foundation is not beneficially entitled to the funds entrusted to it;

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[2] I do not include here, for example, foundations whose purpose is to make funds tradable by means of securitization. See in this regard C.P.M. van Houte: 'De stichting als special purpose vehicle in het kader van securitization', Stichting & Vereniging 2001/4, pp. 76-81.

d. Other foundations not included in any of the above three categories. These could include a trading foundation that generates income itself in order to achieve its objects, or a combined foundation that does not qualify / no longer qualifies as an ANBI, or a foundation in possession of 'old' funds or funds that originate from outside the Netherlands.

Until recently, foundations with purely private-purpose funds hardly existed at all within the Dutch legal system due to the prohibitive imposition of gift tax on gifts to, and payments out of, such a foundation at the highest rate, ('*derdentarief*'), a progressive rate varying from 41% to 68% applied up to 1 January 2010. From that date onwards this rate was reduced to a fixed rate of 40%.

From 2010, the introduction of the concept of *afgezonderd particulier vermogen* ('APV' – separate private funds) in tax legislation extended the tax qualification of the various forms of the foundation with a new category. This means that we now have foundations that in legal and economic terms are entitled to funds and the income and outgoings relating thereto that for tax purposes are allocated to parties other than the legal owner of these rights (and obligations).

The introduction of the APV regime was inspired by the wish to disregard foreign purpose funds being used to 'shelter' funds and to impose the tax on the structured funds therein upon the original owners or their beneficiaries. In order, however, for such legislation to remain 'EU-proof', an abstract definition – independent of place of registration and legal form – was introduced: the APV. Foundations registered in the Netherlands may also qualify as an APV.

A foundation under which a 'more than incidental[3] private interest is intended' qualifies as an APV unless (a) in exchange for the separation of these funds there was an issue of shares, bonus shares, membership rights, participation rights or similar rights, or (b) an economic participation right has been created, or (c) the foundation qualifies as an SSBI (Article 2.14a of the Income Tax Act 2001). The consequence of qualifying as an APV is that, the separated funds therein and the income and outgoings generated thereunder are, for the purposes of the Income Tax Act 2001, attributed to the transferor. After the death of the contributor these are attributed to his beneficiaries in proportion to the share of the total estate that each beneficiary is entitled under inheritance law. There is only a liability to income tax if the contributor or his beneficiaries is / are tax subject in the Netherlands in respect of the attributed funds or income derived thereunder.

For the purposes of gift and inheritance tax liability the separation of funds within an APV is not deemed to be a taxable gain[4] and payments made from an APV foundation are deemed to have

[3] According to parliamentary records this is to be interpreted, depending on individual facts and circumstances, as 10% to 15% with respect to both the activities and the nature and size of the funds. If the funds are only (in minimum terms) used to make payments to family members, then on the basis of the activities test this is deemed to be an APV even if less than 10% of the income is used in this way. Explanatory memorandum, Parliamentary Papers II, 2008-2009, 31930, no. 3, V-N 2009/22.3 and memorandum in response to the report, Parliamentary Papers II, 2008-2009, 31930, no. 9, V-N 2009/41.2.

[4] Art. 17a of the Inheritance Tax Act 1956

been acquired by the person or persons to whom the funds of the APPV are attributed for the purposes of levying income tax ('the taxable party').[5] If as a result of the death of the taxable party enforceable rights are created for (certain) beneficiaries of the APV foundation, inheritance tax is levied as if the taxable party had bequeathed such right to the relevant beneficiary.[6]

In the act, and in the parliamentary records, the term 'separation of funds' has been given a very broad definition. It includes not only disposals; the separation by companies is also deemed to be founded on the private interest served by the APV and accordingly the separation can be followed through to the underlying shareholders of a 'separated' company.

Although tax legislation does not refer to the transparency[7] of the APV, this in fact is the scope of this legislation. By virtue of various fictions, notwithstanding the legal reality, funds and gifts are attributed to persons who are liable to tax under the Income Tax Act 2001. The fact that this method of legislation will result in serious implementation problems and questions has been covered everywhere in the literature.[8] The new legislation already envisages a set of scenarios whereby, for example, liability is also attributed to disinherited next-of-kin who themselves, or whose partners or relatives by blood or marriage, are beneficiaries under the APV.

The introduction of the APV scheme offers opportunities for new applications for the Dutch foundation. Thus the debate held at the start of this century about the introduction of a family foundation[9] has been largely overtaken. If the family foundation is created in such a way that there is no breach of the prohibition on payments contained in Book 2 Article 285 (3) of the Dutch Civil Code, a family foundation may be created in the Netherlands without any tax disadvantages to protect family funds.[10]

The *stichting administratiekantoor* ('STAK') is conceptually excluded from an APV because in exchange for the separation of funds within a STAK there has been an issue of depository

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[5] Art. 17 of the Inheritance Tax Act 1956

[6] Art. 16 (2) of the Inheritance Tax Act 1956

[7] One can assume from tax transparency that the character of a fund or income remains the same despite its attribution to a person other than the legal owner of the rights. In this sense, it is better to say that the APV is entirely ignored and is thus in fact non-existent as far as tax law affects the contributor. However, we have by no means had the last word on this matter, since in practice various attribution problems arise which will have to be dealt with.

[8] See X.C.R. Auerbach; 'Afgezonderd Particulier Vermogen: Constructiefouten', WFR 2010/6874 and the literature he refers to in notes 3 and 5.

[9] For a short overview see 'De warme, de koude en de dode hand; rapport van de werkgroep herziening successiewetgeving (Moltmaker Committee), 13 March 2000; W. Burgerhout and P.F. Veltman, 'De familiestichting', Sdu Fiscale en Financiele Uitgevers, Amersfooort 2004; F. Sonneveldt, 'De familiestichting, Een exposé over existentie en extinctie', (Serie Estate planning, deel 2), Kluwer, Deventer 2002.

[10] See M.U.M.A. Waaijer-Linders, 'Trust in de familiestichting', WPNR 2010/6848.

receipts. Furthermore, the SBBI is excluded from the APV regime in so many words.[11] Although the term SBBI is anything but clearly defined, one would anticipate that foundations that carry out activities for the benefit of social conglomerates, such as businesses, villages or neighbourhoods, would qualify as SBBIs.[12]

According to the legislature, the ANBI is conceptually excluded from the APV regime since an ANBI is virtually exclusively – i.e. at least 90% - intended for general benefit and therefore outside the scope of the concept of the APV because this concept intends a private interest of at least 10%. Borrowing the terminology of the legislature, the APV and the ANBI regimes are therefore 'interconnected vessels'.[13] Whatever one may think of the mathematical abilities of the legislature, an institution intended for the general benefit is not intended to benefit private interests, not even for less than 10%. I will return to this in section 3.

There is also a significant residual category, described by the legislature as 'other purpose fund', whereby the foundation serves an interest that, whilst not qualifying as general benefit, does not qualify as a private interest within the framework of the APV legislation either. The parliamentary records[14] give the example of a foundation acting as a shareholder of a company, whereby the foundation reserves and invests the available funds from the business for or within the business and participates in other businesses to benefit business activities and thus employment opportunities. If the facts and circumstances lead one to conclude that foundation's purpose is not to benefit a private interest (of the original shareholders) but on the contrary it creates 'hermetically-sealed divisions' between the original shareholders, their beneficiaries and the foundation then, according to the legislature, such a purpose fund may qualify as 'other purpose fund'. The funds from an other purpose fund are not attributed to anybody and are therefore included in the tax assessment under the normal rules of the Corporate Income Tax Act (no corporate income tax unless the foundation is deemed to be operating a business).

It is up to the tax authorities to prove the existence of an APV. Notwithstanding all statutory definitions and notions, this means that the tax authorities must prove that a foundation 'intends' a private interest purpose for the separated funds to be more than incidental; the wording of the act specifies a 'separated fund with a more than incidental purpose of benefiting a private interest'. Although during the passage of the act through parliament the legislature gave the impression that every foundation embodies the subjective, private intentions of the party that transfer funds to the donor, this however is not a fiction and the burden of proof in any actual case lies with the tax authorities.

[11] Art. 2.14a (2) of the Income Tax Act 2001.

[12] It is further unclear why extended family relationships could not qualify as 'social interest'. Its distinction from businesses and neighbourhoods seems somewhat artificial.

[13] Memorandum in response to the report, Parliamentary Papers II, 2008-2009, 31 930, nr. 9, V-N 2009/41.2.

[14] Memorandum of reply, Parliamentary Papers II, 2009-2010, 31930, nr. D.

For this reason, the group of 'other purpose funds' could in practice be significantly bigger than envisaged by the tax authorities.

3 CHAMELEON-LIKE QUALITIES OF THE FOUNDATION UNDER TAX LAW

3.1 Introduction

Given the introduction of the APV regime, the increasing attention being paid to the ANBI regime and the development of the brand new SBBI regime, one can definitely assert that the qualification of a foundation for tax purposes is facing considerable turbulence. It is not just the demarcation lines between the various qualifications that will give rise to further examination, but the question as to the point at which a foundation qualifies as an APV (or not) is one that in my opinion is grossly underestimated in the legislative process.

The tax qualification of a foundation is not set in stone, but undergoes continuous review. ANBI status may be withdrawn retroactively, and it is also certainly not inconceivable that a qualification as APV or SBBI could be established retroactively by the tax authorities. The tax consequences of these changes in qualification could be substantial and in many situations will raise issues that remain unanswered.

If, for example, the funds of an APV include a substantial interest in a company, the change in qualification may itself result in a tax liability, since the APV loses its qualification as an APV then a point in time will be allocated to such a change and there will have to be a settlement in respect of any increase in value of the substantial interest of the party that had previously transferred the funds to the APV. The APV regime has no transitional provisions regarding the substantial interest so that a temporary APV position can attribute a substantial interest at its historic acquisition price to an individual tax subject.[15] If APV status is lost then – again notionally – a profit from a substantial interest can be taxed pursuant to Article 4.16 (1) (g) since there can no longer be said to a substantial interest in the hands of this tax subject. The parliamentary records show that only pay a little attention was paid to this; it was the view of the legislature that a form of untaxed transfer of sphere does not fit within this regime.[16]

3.2 Chameleon-like response by change of 'intentions'

What strikes one first is that in applying the test of whether an APV exists, the 'intention' is decisive. If it is more than incidentally intended to benefit a private interest through separated funds, there is an APV. We are compelled to consider the comparison with the qualification of a foundation as an ANBI here since the so desirable position of an ANBI depends on the creation of a form that is *intended* to almost exclusively benefit the general good. The intentions of the foundation play the key role in the debate as to whether there exists an ANBI, an APV, an SSBI or other purpose fund. It

[15] Art. 10a.7 (5) of the Income Tax Act 2001.

[16] Memorandum in response to the report, Parliamentary Papers II, 2008-2009, 31 930, nr. 9, V-N 2009/41.2.

is not appropriate here to also make calculations according to the activities of the organisation or the (application of) the funds of the foundation, as I argued in more detail recently in the *Weekblad voor Fiscaal Recht* (Weekly Tax Law Magazine).[17] Practice is more complicated than the simplistic examples outlined by the legislature during the parliamentary process; one may expect in practice that many issues of interpretation will arise concerning the intentions of a foundation and the relevance of such intentions to APV legislation. A clear distinction will also need to be made between 'motive' and 'intention'. In the same way that underlying motive is irrelevant to the – legally relevant – liberality of a gift, so the motive for the separation of funds will not be relevant to an assessment as to whether a foundation intends to more than incidentally benefit a private interest. In other words, a private motive for separating funds by the party effecting such separation is not a decisive factor in determining whether a foundation qualifies as an APV.

A foundation may therefore 'change complexion' if the foundation's board changes its intentions or if its intentions are interpreted differently by the tax authorities or the tax courts on final appeal. An APV registered in the Netherlands created by people resident in the Netherlands may decide, for example, to direct its goals and activities towards the general good. This is entirely in line with the call in 2010 by Warren Buffett to families with funds to dedicate half of those funds for philanthropic purposes under the motto 'Every saint has a past, every sinner has a future'. Of course, the question arises here as to whether the funds of the foundation could not be applied to the general good in the form of a periodic gift.

An APV can amend its articles of association and hermetically seal itself off from the family of its benefactor so that it changes into an other purpose fund. Equally, an other purpose fund may change complexion and become an APV, by virtue of the board of such foundation deciding at a point in time to enable the making of payments (without conferring any concrete rights) to a family member of the person who contributed the family funds to the foundation who is in need. The foundation's funds can thus be freed from the tax burden of gift tax at the highest rate (*derdentarief*) which until 2010 often made payments in such situations prohibitive.

3.3 Chameleon-like response by conferring concrete, enforceable rights

The attribution of fund elements is stopped as soon as someone other than the contributor acquired a concrete, legally-enforceable right to this fund. The Explanatory Memorandum[18] describes it in this way:

"If the separated private fund is discretionary, then the proposed attribution is appropriate. If the separated private fund is non-discretionary, then it is attributed to the party with legal entitlement rather than to the contributor or his beneficiaries. If the legal form is part discretionary and part non-discretionary, then Art. 2.14a of the Income Tax Act applies only to the discretionary part. The non-discretionary - 'fixed' - part is directly attributed to the party entitled to this non-discretionary part, pursuant to Art. 5.3 (2) (f) of the Income Tax Act 2001."

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[17] I.A. Koele: 'De kwaliteiten van algemeen nut beogende instellingen gewogen', WFR 2010/6876

[18] Parliamentary Papers II, 2008)2009, 31930, nr. 3, V-N 2009/22.3.

This is briefly set out in the implementation regulation[19]: The person who as beneficiary has a legally-enforceable right with respect to a separated private fund will, to this extent, have a tax liability.

The inevitable confusion arises in the literature with regard to the application of these rules to the various types of trusts (the basic forms being 'fixed trusts' and 'discretionary trusts').[20] The scope of the APV legislation with respect to trusts is, however, easy to clarify: if one or more persons enjoy a legally-enforceable right to the trust fund, this fund does not to this extent qualify as an APV and this entitlement shall be independently qualified. The Dutch Supreme Court has made it clear that such an entitlement does not qualify as a period payment pursuant to Art. 3.101 (1 (c) of the Income Tax Act 2001 since the entitlement is a counterpart to the separation by a third party in the trust.[21] We therefore do indeed arrive at a qualification in box 3 on the basis of Art. 5.3 (2) (f), irrespective of the question as to how the entitlements of the entitled person(s) have been precisely formulated. Naturally, the entitlement of such person may also relate to a substantial interest, in which case – under certain circumstances – the qualification of the entitled person is determined according to the rules of box 2.

In this context, the term 'periodic payment' cannot play a role in a foundation, since a foundation – unlike a trust – is a legal entity and a period payment received from a legal entity is only taxed in box 1 as a 'designated periodic payment' if it is payment that is *not* enforceable in law.[22]

The fund of a foundation that is originally attributed on the basis of Art. 2.14 of the Income Tax Act to the attributed person may change its complexion in tax terms if the management board of the foundation decides to confer a legally-enforceable right in the form, for example, of a lifetime payment to a beneficiary. From that moment onwards, the beneficiary is liable for the tax on the income from this fund in place of the person to whom it was attributed.

3.4 Chameleon-like responses due to the APV being involved in tax imposition

The legislature formulated a significant exception to the notional attribution of an APV under Art. 2.14 a (7) of the Income Tax Act 2001. The attribution does not apply to fund components and the income and payments from these for which the APV is included in the tax on profits resulting in an – in Dutch terms – actual tax liability.

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[19] Art. 4a (1), Income Tax Implementation Regulation 2001.

[20] J.P. Boer and R.M. Freudenthal: 'De identiteitscrisis van de Anglo-Amerikaanse trust; afgezonderd of niet?', WPNR 2009/6802; E.R. Roelofs: 'Niets is zeker, ook de fiscale behandeling van de fixed trust niet', WFR 2010/6887.

[21] For example, Hoge Raad 26 oktober 2007; BNB 2008/122. Contrary to what Roelofs argues in the article cited in the preceding footnote, the Supreme Court finds that there is no element of a periodic payment and it did not specifically find that a fixed trust should be regarded as an 'entity'.

[22] Art. 3.101 (1) (d) Income Tax Act 2001.

The principle is that the attribution of the fund of an APV to a person liable for income tax is different if the fund of the APV itself is 'included in a tax on profits'. The terminology appears to refer to the terminology usage of Art. 13 (11) of the Corporate Income Tax Act 1969, which deals with the subjection of a participation to a tax on profits that 'results in a resulting in an – in Dutch terms – actual tax liability'. This liability is assumed to arise in the case of a system having a regular rate of at least 10%

Now an APV registered outside the Netherlands is comparable to a Dutch foundation with regard to liability to an actual tax liability in Dutch terms, because a Dutch foundation as such is only liable to tax on profits from a business operated by the foundation. From this fact alone, it appears that the primary idea behind the exception to attribution is wrong, since here there is essentially a difference between APV foundations registered in the Netherlands which, as such, are not liable to tax, and APVs registered outside the Netherlands. If these are subject to any tax liability, there is no attribution of the fund to another tax subject, since this would lead to economic double taxation. The memorandum in response to the report explains that it is a partial approach involved here, whereby the application of Art. 2.14a of the Income Tax Act 2001 remains limited to the activities or fund components that do not satisfy the conditions of an actual tax liability in Dutch terms.

Furthermore, the Other Tax Measures Act 2010 (wet Overige Fiscale Maatregelen 2010) adds a provision – by means of a 'technical amendment' – to Art. 2.14 (7) whereby the APV is deemed to operate a business with the aid of its entire fund. The intention of the legislature is to emphasise that what is required here is an actual tax liability upon the entire fund of an APV if the attribution intended by Art. 2.14a of the Income Tax Act is to be excluded. This amendment is inspired by the fear that a nil rate tax liability under Dutch terms would also be an actual tax liability since a Dutch foundation is only liable to tax if and insofar as it operates a business. Even before the new legislation had been introduced, it had accordingly been amended again. If only a third of the fund of an APV is subject to a tax liability of (for example) 25%, then this addition would not incur an actual tax liability per balance, not even in respect of these fund components.

It is evident that in the current wording there may well be an economic double taxation; if only one-third of the fund of a foreign-registered APV is brought within a Dutch company and the remaining fund not taxed as such within the APV, then by virtue of Art. 3 in conjunction with Art. 17 (3) (b) of the Corporate Income Tax Act 1969 the APV would face a Dutch tax liability. Nevertheless, pursuant to Art. 2.14 of the Income Tax Act, the entire fund is attributed, as a result of which the same interest in the Dutch company is attributed to a party liable to income tax. This is not in accordance with the intention of the legislature and appears to be a consequence of hastily-made "sticking-plaster law".[23]

Furthermore, double taxation would also have arisen in the original draft of the legislative proposal in the event that in the country of its registration the APV would be subject to a tax that did not result in what we in the Netherlands understand as an 'actual liability'. A change to our definition of

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[23] See also X.G.R. Auerbach: 'Afgezonderd Particulier Vermogen: constructiefouten', WFR 2010/6874, P.1180. Furthermore, I don't share the view of Auerbach that the problem here is that Art 2.14 a of the Income Tax Act 2001 does not work through to Art. 3 of the Corporate Income Tax Act 1969, since the intention of the legislature is that income tax should withdraw in favour of corporate income tax.

an 'actual liability' or a change of the local tax system[24] or a change in the structure of the fund of the APV may produce a chameleon-like response from the APV resulting in the entire fund no longer being attributed on the basis of Art. 2.14a of the Income Tax Act 2001. It is hard to understand how the legislature so easily ignored the clear and constructive comments of the Council of State with regard to the proposed stop on attribution contained in Art. 2.14 (7) of the Income Tax Act 2001:

"This exception is detrimental to the regime, because the attribution of the assets and liabilities is ignored. The explanation does not deal with the reasons that justify this encroachment. The fact that a tax is levied on profits is not in itself sufficient to justify this exception, since double taxation can also be avoided by levying this tax on profits of the party that separated the fund as though this tax were a tax on income."[25]

The combination of an economic double taxation of a partial tax liability of an APV and a non-facilitated transfer of sphere of a chameleon-like response of an APV will, under certain circumstances, lead to extremely unreasonable results that go much further than the introduction of the APV regime wished to go.

4. CONCLUSION

The tax-law consequences of a foundation have become a complicated issue in 2011, something that tax experts will be puzzling over for years to come. The Netherlands is unique in the multi-faceted scope it applies to the foundation and in its broad qualification thereof for tax purposes. The introduction of the APV has led both to an admiration for the vigour of the Dutch legislature ("cowboy country") and to cynicism in respect of the lack of thought and nuance invested in the regime. More important, however, is the question of how far this new legislation forces funds or fund-owning families to relocate to places that - in the eyes of those seeking justice or their advisors – are better regulated, or whether the new APV regime will actually be able to provide APVs or fund-owning families with a stable home base. The revenues generated for Dutch society dependent upon the answer to this question are many times greater than the tax revenues that had been estimated by the Ministry of Finance to result from the introduction of the APV,[26] since at issue here is not just tax revenues, but the more general economic consequences of the migration of funds and fund-owning families. I therefore sincerely urge that the originally repressive APV legislation be evaluated with an eye to its pragmatic and realistic application in practice.

[24] Within the EU sphere of influence offshore jurisdictions refer to the introduction of a minimum rate of 10% in order to create a new 'level playing field'. See, for example, discussions on the Channel Islands in the context of the EU Code of Conduct.

[25] Advice from the Council of State and further report, Parliamentary Papers II, 2008-2009, 31930, nr. 4, V-N 2009/22.4.

[26] Just one example of this is the recent study by Stonehage of the influence of tax changes to the non-domiciled resident' regime in the UK, see http://www.stonehage.com/assets/articles/2010_03.pdf.