Update

Newsflash May 2011

Developments in Swiss Foundation Law

New Swiss VAT Act

The new Swiss VAT Act was modified in order to improve the VAT exposure for Swiss charities

On June 12, 2009, the Swiss Parliament approved a new VAT Act which entered into force on January 1, 2010. This legislation offers interesting new opportunities, in particular for Swiss charitable organisations.

Swiss charitable organisations previously have had to deal with various VAT issues. In particular, the deduction (recuperation) of input VAT was an important area of concern. In order to claim back the input tax (including self-declared input VAT on importation of services under the so-called "reverse-charge mechanism"), these organisations had to be registered as VAT taxpayers. In general, the registration was only accepted by the Federal Tax Administration if taxable transactions were generating a "VAT-able" turnover higher than CHF 75'000 per year. In addition, the right to claim back input VAT was reduced proportionally if the taxpayer performed certain non VAT-able or VAT exempt activities which were considered as out of the scope or if the taxpayer was financed via subsidies, gifts (donations) or similar contributions. The new VAT Act has partially reduced these drawbacks.

The criteria to become a VAT taxpayer have indeed been lightened. According to the new legislation, a taxpayer is any kind of entity which carries on a business or performs commercial activities, regardless of the turnover generated. The business thus does not necessarily have to be profitable.

For simplification purposes, charitable organisations that generate less than CHF 150'000 of taxable turnover in Switzerland within a year are exempt from the obligation to register themselves as VAT taxpayers. A general option right is however granted to each potential taxpayer, which allows them to voluntary register as a VAT taxpayer. As a consequence, any charitable organisation which carries on a business activity may register itself as a VAT taxpayer, irrespective of the amount of its taxable turnover or of its net profits.

Furthermore, the input tax deduction is no longer reduced if gifts (donations), dividends, and any other non "VAT-able" revenues are realised by the VAT taxpayer. This last rule, combined with an easier access to VAT registration, should significantly improve the input VAT recovery rate of Swiss charitable organisations.

Finally, the new Act states that advertising services provided by charitable organisations for the benefit of third parties or provided by third parties for the benefit of charitable organisations have to be considered as non VAT-able activities with no right to claim back the VAT input tax (i.e. VAT exempt transactions).

In such a case, it is however possible for the charitable organisation to "opt" for the voluntary taxation of these activities. Therefore, VAT has to be disclosed on the invoice and the advertising services are considered as ordinary VAT-able transactions. The option mechanism transforms an out of scope transaction into a VAT-able transaction. As

a consequence, the input VAT deduction has no longer to be reduced proportionally.

The various rules summarised above, if correctly implemented by Swiss charitable organisations, may result in significant tax savings. This, however, requires that those organisations perform at least business/commercial activities, irrespective of whether the latter are profitable or not.

Finally, it is noteworthy that Swiss VAT rates have been increased as from January 1, 2011. The ordinary rate is now 8%, whereas the reduced rate applying notably to food products, medicine and books is 2.5%, and the special rate applying to accommodation services is 3.8%.

Review of Swiss VAT Act (Part "B")

The new VAT Act which entered into force on January 1, 2010 was the first part of the VAT review. The second part of this revision (Part "B"), which was approved by the Federal Council on June 23, 2010, plans to pursue the simplification of the VAT Act by adopting a unique VAT rate at 6.5% and abolishing nearly all tax exception cases. The latter could have a negative impact on charitable organisations.

On December 15, 2010, the National Council rejected the proposed plan, requiring that at least the fields of health, education, culture, sport and charities continue to benefit from the VAT exemption on certain services. Currently the proposal is being reviewed by the Council of States.

New Practice under the Swiss Host State Act

In December 2010, the Federal Council signed for the first time Agreements on privileges and immunities under the Host State Act with four Geneva-based foundations

The Host State Act (officially entitled the Federal Act on Privileges, Immunities and Facilities as well as Financial Aid granted by Switzerland as Host State) was adopted in 2007 by the Swiss legislator in order to provide a legal basis allowing the Federal Council, at its discretion and under specific conditions, to grant in favour of certain types of international bodies headquartered in Switzerland various types of privileges and immunities.

In 2010, the Federal Council signed, for the first time, Agreements on privileges and immunities with entities considered as "other international bodies" under the Host State Act. According to Article 14 of the Host State Act, such organisations can, exceptionally and in the government's sole discretion, benefit from privileges and immunities if, among other conditions (i) they closely collaborate with governments or with intergovernmental organisations and international institutions based in Switzerland, in order to execute tasks usually assigned to these entities, (ii) they play a major role in an important field of international relations, (iii) they enjoy wide recognition at the international level and (iv) the grand of privileges is likely to substantially contribute to the realisation of their mandate.

Through these Agreements, four Geneva based foundations, namely DNDi (Drugs for Neglected Diseases initiative), MMV (Medicines for Malaria Ventures), FIND (Foundation for Innovative New Diagnostics) and GAIN (Global Alliance for Improved Nutrition) were recognized the special status provided by Art. 14 of the Host State Act (the text of these Agreements is published in the Official Compilation of Federal Legislation on 27 April 2011). With effect from January 2011, the above mentioned foundations benefit from additional privileges in the fields of tax (exemption of VAT) and immigration (possibility to hire foreign workers without having to comply with ordinary proceedings and conditions of Swiss immigration law).

Jurisprudence

Right of a foreign family foundation to file a claim before a Swiss Court (Summary of Swiss Supreme Court decision ATF/BGE 135 III 614 of 17 November 2009)

In a landmark judgement, the Swiss Supreme Court had to judge whether a family foundation based in Vaduz, Liechtenstein, could be considered as a valid legal entity from a Swiss law perspective for the purposes of filing a claim before a Swiss court, despite the fact that the said foundation's purpose was solely to provide an income to family members. Indeed, this type of foundation (the so-called *fidéicommis de famille*) is prohibited under Swiss mandatory law by Article 335 (2) of the Swiss Civil Code ("**CC**").

To determine the law applicable to foreign legal entities, Article 154 of the Swiss Private International Law Act ("**PILA**") applies the "theory of incorporation". This means that all matters relating to a foreign legal entity are gov-

erned by the law under which it is established, in particular its legal nature and validity. However, based on the "reserve of public order" applicable in private international law, certain legal rules considered as a matter of public order in Swiss public policy may apply to foreign legal entities regardless of the governing law of their place of incorporation (Art. 18 PILA), provided that the said legal entity has a certain connection with Switzerland.

In the present case, as the family foundation was established and based in Liechtenstein, it was also governed by Liechtenstein law and was therefore in principle not limited by the prohibition of Article 335 (2) CC. However, the question was whether this legal rule had to be considered as belonging to Switzerland's public order, so that its scope of application was to be extended to a legal entity governed by foreign law. To settle this point, the Swiss Supreme Court analysed the history of this rule and observed that, at the time it was adopted, it forbade only the creation of new family foundations without making the existing ones illegal. Based on this reasoning, the Court came to the conclusion that Article 335 (2) CC was not part of the Swiss public policy and, hence, that it could not be used to deny legal personality of the Liechtenstein foundation in the present case. The family foundation was therefore considered as valid and entitled to file a claim before a Swiss court.

This decision gave rise to discussions and criticism among legal scholars. By expressly recognizing the validity of a type of foreign legal entity that would be considered as unlawful in Switzerland, the Supreme Court had settled a long debated question and opened room for discussion about a possible abrogation of Article 335 (2) CC in the future. Furthermore, the reasoning followed by the Court can be directly applied to a trust, the recognition of which will no longer be denied in Switzerland, provided that it is duly incorporated according to its applicable foreign law, even if such trust qualifies as a prohibited *fidéicommis de famille*. This liberal approach has strengthened Switzerland's openness to trusts, a legal institution that the Swiss legal order has always had difficulties integrating.

Suspension of a Board member by a Court (Summary of Swiss Supreme Court decision 5A_401/2010 of 11 August 2010)

In a recent decision, the Swiss Supreme Court confirmed a Cantonal Court's temporary suspension of a Board member of a foundation. In this respect, it should be recalled that in the case of family foundations, regular Courts exercise functions that are normally assigned to the supervisory authority vis-à-vis ordinary foundations.

In the present case, the Cantonal Court suspended a Board member from his functions and nominated a custodian to manage the foundation, as a provisional measure for the duration of ongoing proceedings and upon request of the claimant.

The suspended Board member challenged the decision before the Supreme Court arguing that this measure was unlawful, as it was not mentioned in Article 83d (1) of the CC as a measure that the supervisory authority or Courts could take in case of failings in the foundation's organization.

According to Article 83d (1) of the CC, the supervisory authority (or the Court in the present case) must take necessary measures if the planned system of organisation of a foundation proves inadequate or if the foundation lacks one of the prescribed governing bodies or one such body is not lawfully constituted. To this end, the supervisory authority may in particular (i) set a time limit within which the foundation must restore the legally required situation or (ii) appoint the body which is lacking or an administrator.

The Supreme Court confirmed the interpretation made by the Cantonal Court and considered that supervisory authorities of foundations (whether a Court or supervisory authority) are entitled to take any measure deemed appropriate to remedy a problematic situation, regardless of whether it is expressly mentioned in the CC. Such measures include the suspension, or even revocation, of a Board member's mandate.

Although the intervention of an authority into the organisation of a foundation is quite infrequent, this case demon-

strates that supervisory authorities are entitled to interfere and dispose of a wide range of possibilities to this end.

Legislatives Initiatives

Motion Luginbühl (Foundation)

On March 20, 2009, Mr Werner Luginbühl started a motion which aimed at rendering Swiss foundation law more attractive and maintaining Switzerland as an attractive country for foundations.

The core of this motion relates mostly to tax law aspects, with the objective that Switzerland remains an attractive country in comparison with its European neighbours, especially since these countries are planning to establish a European Foundation Statute.

The motion also intends to fight against inactive foundations which have been granted tax exempt status, but do not try to achieve their goal of public interest.

The Luginbühl motion has already been adopted by both chambers of the Swiss parliament (National Council in 2009 and Council of States in 2010). The Federal Council has now been requested to prepare a draft bill.

Motion Kuprecht (Tax exemption for association with idealistic purposes)

On March 20, 2009, Mr Alex Kuprecht launched a motion which aims at granting Swiss associations with complete or partial tax exemption if they pursue an idealistic purpose, which notably includes all non-profit activities.

To date, only such associations which pursue a goal of common interest ("*but d'utilité publique*") may benefit from tax exemption. The Kuprecht motion proposes to extend this fiscal advantage to associations with idealistic purpose, such as youth support or sport.

The Federal Council suggested to decline the motion. Nevertheless, it has been adopted by both chambers of the parliament (National Council in 2009 and Council of States in 2010).

Constitution of a parliamentary Group on philanthropy and foundations

In collaboration with *proFonds* and *Stiftungsforum*, *Swiss-Foundations* has created a parliamentary group called "**Philanthropy / Foundations**", which is composed of the three organisations mentioned above, Mr Werner Luginbühl, Mr Fulvio Pelli, Ms Anita Fetz and Ms Brigitte Häberli-Koller.

This new lobbying group aims to draw the parliamentarians' attention to requests from the philanthropic sector and to foster networking between stakeholders in this area.

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