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It takes hard work to keep foundations in Austria on their successful course!

Vienna, 20 May 2021

The Austrian Association of Foundations ("Österreichischer Stiftungsverband", hereinafter "OEStV") is grateful for having had the chance to participate in the meeting "The role of foundations", which took place as part of the Structural Mission of the OECD in April 2021, through its President, Dr. Cattina Leitner LL.M.. The OEStV would now like to take the opportunity to pen a few lines on foundations and foundation law in Austria and thanks you for your kind consideration.

<u>Historical outline concerning foundation law in Austria</u>

<u>Current civil law</u>

When speaking of foundations, most people primarily think of what is known as a private foundation. That said, it is essential to note that the private foundation is only one of several types of foundation that can be established in Austria. The idea of foundations has a long tradition in Austria, which looks back on a remarkable history of success in this field. Until 1975 the law on foundations in Austria was not codified in one piece of law, but was a collection of various legal sources, most of which originated from the monarchy. That changed in the last quarter of the 20th century with the creation of the Federal Foundation and Fund Act 1975 (Bundes-Stiftungs- und Fondsgesetz 1975; BStFG 1975), which was only applicable to non-profit and charitable foundations. In addition, various state foundation laws existed and still exist today.

In addition to the non-profit and charitable foundations regulated in the BStFG 1975, the Private Foundation Act of 1993 (Privatstiftungsgesetz 1993, PSG) created a legal basis for foundations whose purpose was no longer limited to the non-profit sector. Rather, the PSG, in the form of a foundation model that was new for Austria at the time, enables the establishment of a private foundation for any permitted private or charitable purpose determined by the founder. This paper focuses on this type of foundation.

This fundamental openness of purpose is accompanied by extensive organisational freedom, which is also reflected in the permissibility of enriching the foundation with corporate elements or with "trust" elements. For example,

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the founder can be the beneficiary of "his" foundation and/or reserve a right of revocation and/or amendment when the foundation is established. In practice, these two fundamental rights enable the founder(s) to determine the general direction of the foundation but also to influence its current business. There is no ongoing supervision by a state authority. Interventions by courts are possible on an ad hoc basis. Apart from the (initial) far-reaching tax advantages, it is above all the individual structuring options and the founder's high degree of intervention options that have led to the private foundation to become a popular instrument in private wealth planning and for it to be regarded as an attractive vehicle for forward-looking, comprehensive asset structuring. In this respect, the private foundation in Austria to some extent serves as a functional equivalent for the trust, which is an unfamiliar concept on the Austrian legal landscape.

This positive conclusion, however, should not hide the fact that founders and foundations have had to endure some bitter disappointments and legal uncertainties in the years since the PSG came into force in 1993. Although the intention of the legislator, which can be seen from the legal materials, was to shape the legal framework for a "liberal and founder or family-driven model", the courts were unable to implement an innovative type of foundation in the jurisdiction due to the fact that the legislature has ultimately not stated this intention clearly in the law. Numerous decisions by the Supreme Court of Austria underline the fact that the current legal situation is (still!) unsatisfactory in some regards and leaves several open questions that require interpretation by the Supreme Court of Austria.

To understand these disadvantages, the initial constellation, which has often formed the basis for the establishment of a foundation, must be explained: Although there is no legal definition, the type of private family foundation is firmly established in Austria. Private family foundations are characterized by the fact that the founder casts "his" company or "his" shares in the company in the form of a foundation.

There are many reasons for this, both from the point of view of the company/entrepreneur and from the point of view of the family. Almost all private family foundations are primarily concerned with protecting subsequent generations against financial hardship and safeguarding the education of beneficiaries. Similarly, the goal may be to withhold assets from the grasp of the next generation. The private family foundation is therefore a legal entity that protects the assets *of* the family and simultaneously protects the assets *from* the family.

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At the same time, the common denominator of both the foundation and the company is always continuity, which can be optimally ensured by merging the foundation and the company. However, precisely because the family is part of the company, it is all the more understandable that the family would also like to be part of the foundation, which can only be guaranteed through appropriate powers. It is precisely these powers that have been steadily decimated in recent years.

Among others, two Supreme Court rulings from 2009, the so-called "Advisory Board Decision I"[1] and the "Attorney Decision"[2], address such a curtailment of influence and were reflected in the amendment to the PSG by the Budget Accompanying Act 2011[3]. The first of the decisions brought forward curtailments of the powers of an advisory board, which was staffed with beneficiaries. The second decision dealt with § 15 PSG. This legal provision standardized, among other things, that the foundation board must consist of at least three members. A beneficiary, his spouse, and certain relatives may not be members of the foundation board. One question was to what extent these incompatibility provisions apply to representatives of beneficiaries. In order to clarify this issue, the legislator created § 15 (3a) PSG in the course of the Budget Accompanying Act 2011. This new provision states that the incompatibility issues described also apply to persons who have been commissioned by the persons excluded for a foundation board position to safeguard their interests. This was intended to prevent circumvention of the incompatibility provision. As a result, however, any co-determination of beneficiaries or their representatives in the foundation board is prohibited.

After the legal situation seemed to have been clarified by the Budget Accompanying Act 2011, further decisions by the Supreme Court of Austria led to another (negative) surprise in the foundation world. With the decision "Advisory Board Decision II"[4], the Supreme Court again curtailed the beneficiaries' ability to exert influence by declaring that a majority of Supervisory Board members may not be appointed by beneficiaries. Experts have even spoken of a "civil-law mousetrap effect".

The possibility of exerting influence in the private foundation – which is often based on the family business – through appropriate appointments to the

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1 Beiratsentscheidung, OGH 6 Ob 42/09h.

2 Rechtsanwaltsentscheidung, OGH 6 Ob 145/09f.

3 Budgetbegleitgesetz 2011, BGBl. I 111/2010.

4 OGH 6 Ob 139/13d.

governing bodies and competencies was the basis of trust for many entrepreneurs when they contributed well-known family businesses to private foundations. This trust has been shaken massively in recent years, also and above all due to the further development of the law by the Supreme Court on the one hand and the inactivity of the legislator on the other. In order to restore it and also to remain competitive in comparison with foreign foundation models, it is absolutely necessary to quickly chart the correct legal course.

Civil-law milestones

- Since the PSG 1993, the establishment of foundations with any permitted private or charitable purpose determined by the settlor is possible in Austria.
- Some leading decisions of the Supreme Court of Austria have brought far-reaching curtailments of beneficiaries' rights of influence over the years, as a result of which the private foundation has lost part of its appeal and legal security.
- The amendment of the Foundation Act 2011 was not clear and precise enough to enable the Supreme Court to change its restrictive position in the subsequent decisions.
- The reform of inheritance law in the year 2015 also partially touched on foundations, for example by taking into account the granting of a beneficiary position when calculating the inheritance position.
- For some years now, an amendment to the law on foundations has been under discussion. A ministerial draft submitted in 2017 was not pursued any further. The Government Programme 2020-2024 contains as one point of the reforms in civil and commercial law "Reforming and making private foundation law more attractive in an international comparison while strengthening the position of beneficiaries".

Current tax system

The contribution of financial assets, shareholdings, etc. is subject to a special 2.5% transfer tax. As a general rule, the tax base is the market value of the assets contributed.

Depending on the legal form, shareholdings can lead to lower taxation. The contribution of real estate, however, is subject to a real estate transfer tax of 6%, based on a special plot value ("Grundstückswert").
The income of the Private Foundation itself is subject to 25% corporate income tax. However, a Private Foundation can receive income of all seven

types of income. Due to an exemption, domestic and foreign dividends are generally exempt from corporate income tax. Income from financial assets (e.g. capital gains, interest received from bank accounts, from publicly offered bonds and from mutual funds) or income from the sale of private real estate are subject to a 25% interim corporate tax. In this regard, the interim tax is credited when the income is distributed to the beneficiaries.

Distributions made by the Private Foundation to beneficiaries are basically subject to a 27.5% withholding tax. Payments from the originally contributed assets, though, are tax neutral as soon as all retained earnings to date have been distributed. Similar rules apply if a Private Foundation is revoked or a Sub-Foundation is established. However, only the original acquisition cost by the settlor (not the fair market value at the time of the contribution) is tax neutral. All amounts above are subject to a 27.5% withholding tax.

In an international context, the tax effects of distributions have to be analysed case by case. There are certain situations in which Austrian withholding tax is not levied.

Tax milestones

- 2008: General abolition of Austrian inheritance and gift tax (up to 60%), but special transfer tax of 2.5% (in exceptional cases 25%) on contributions to foundations remains.
- 2001: Establishment of corporate income tax on capital gains of financial assets (earlier: tax exemption on capital gains).
- System: Once contributed, assets can only be distributed with withholding tax. A capital repayment is not possible. This is a disadvantage as opposed to corporations.

Foundations in numbers in Austria

In an empirical study, the OEStV collected and evaluated key economic data on foundations in Austria, determining the following facts and figures:

- 3,014 private foundations appear in the Austrian company register
- These registered foundations hold interests in around 10,200 companies, in which about 350,000 staff are employed
- Intangible assets of the aforementioned companies amount to around EUR 2.52 billion.

- These companies generated consolidated net retained earnings of EUR 40.2 billion in 2018.
- In approximately 4,000 companies – some of which are held by a private foundation – at least one founder is part of the company's management board.

Foundations as a pillar on the way out of the crisis

The facts and figures above demonstrate that foundations are an important pillar in the entrepreneurial landscape and for economic success. However, this also means that foundations must not be seen as something static but as long-term business partners and so as a significant provider of opportunities on the way out of the crisis triggered by the Covid-19 pandemic.

Private foundations are reliable partners to corporate interests, which contribute significantly to the prosperity of Austria. Family businesses and foundations have a lot in common: They are "ownership based" and their mutual understanding rests on trust, stability and continuity. Strategic investments and reliable partnerships between these two are particularly high quality.

In the past, private foundations have often proved resilient against the buying interests of foreign financial investors. Especially in times of crisis, it has become clear that the survival power of Austrian companies is closely aligned to private foundations – a fact that is also supported by the empirical figures cited above.

The future of foundations in Austria

The history of foundations dates back centuries and shows that foundations are not only able to adapt to changing times but still enjoy great popularity. Nevertheless, there is both room to utilise existing potential and for the further development of both foundations and foundation law.

As we have seen, private foundations hold values that work economically in Austria's favour. Nevertheless, they are still hidden champions and – unfortunately – gaps in knowledge still shape public opinion. This could and should change because one thing is certain: foundations are important for Austria as a business location. In the current crisis, foundations have a potentially valuable, future-oriented protective function – which should be used and supported.

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However, since Austrian foundation law already dates back to 1993, some amendments to the law itself would be desirable. The OEStV has addressed this issue and is working on a scientifically based proposal for a reform project concerning foundation law. The reform project has the following main objectives: Increasing the attractiveness of foundations, making foundation law more flexible and increasing legal certainty. The main issues are proper foundation governance that is open to beneficiaries as well as their relatives and the perpetuation of the right of amendment of the founder.

The attractiveness of private foundations should be enhanced, above all, by further expanding the scope of options available to founders. On the one hand, it is important to prevent foundations becoming rigid in the future and, on the other hand, to improve the design options with regard to the governance structure of private foundations. Optional control bodies should be designed as flexibly as possible in accordance with the wishes of the founders; in particular, the wishes regarding involvement of the family should be taken into account. Conversely, however, the transparency of the board structure should be increased.

In the course of the amendment, questions of doubt regarding the PSG need be clarified. However, this does not concern ambiguities in connection with voluntary supervisory bodies.

Legal certainty should also be increased by improving legal protection, thereby increasing the appeal of Austria as a location for foundations. At the same time, supervisory law should be made more flexible: Following the example of Liechtenstein, the court should not only be able to dismiss foundation bodies, but less serious deficiencies should result in less serious legal consequences. All disputes should be bundled in more modern and flexible extrajudicial proceedings. In order to relieve the ordinary courts and to promote private autonomous dispute resolution, the admissibility of arbitration courts is expressly enshrined in law.