**Exam Foundations and Trusts FS 2022**

**Outline**

**Part 1**

*Note: The following considerations are possible, but not exhaustive. Other reasonable ideas can also be counted, but no more than 15 points can be awarded in total.*

1) Is the FFF void?

- Art. 335 CC is interpreted restrictively by present-day jurisprudence and prohibits pure maintenance and pleasure purposes.
- The foundation transaction must be interpreted; as a unilateral declaration, interpretation is done according to the principle of will.
- The founder wanted to establish an effective family foundation (see preamble); moreover, he makes clear reference to the wording of Art. 335 CC. Since today's case law on Art. 335 CC was not even known in 1920, an interpretation *in favorem validitatis* is indicated.
- As "cures" can also be seen in a healing context, the foundation council can interpret and handle the purpose in conformity with the law. This is also supported by the fact that the purpose speaks of "other emergencies", i.e., the foregoing examples should also not be seen in the context of holidays or pleasure but in an emergency context.
- At most, the FFF's purpose is *partially invalid* since it can be assumed that the founder would have established the foundation even without the (possibly illegal) part of the purpose.
- Moreover, the commercial register should limit itself to formal criteria or at least to obvious defects and leave difficult questions of interpretation to the civil court.
- The registration was therefore probably wrongly refused.
- One possibility would be to challenge the commercial register's order before the administrative court. The risk here is that the court may protect the commercial register. Moreover, the administrative court is not genuinely competent for civil law issues either.
- Another, likely better option would be to file a claim to establish the existence (declaratory action, *Feststellungsklage*) of the foundation before the civil court. Here, the statutes could also be amended at the same time, if considered necessary by the court or just to be on the safe side. Then the commercial register would have to register.
- Or would it be enough for the foundation council to only amend the statutes? It is controversial whether this is within the sole competence of the foundation council or if it has to be done before the court anyway. In any case, the criteria of Art. 85/86 CC must be complied with. Adapting the purpose to current case law would be a reason to amend the statutes.
- An alternative would be not to challenge the order of the commercial register. If the foundation has thus always been unlawful in the opinion of the register, it would either never have come into existence (Art. 52 para. 3 CC) or would at least have to be dissolved retrospectively (Art. 88/89 CC). In any case, a judgement of the court would be reasonable in order to remove the legal appearance. According to the prevailing opinion, Art. 57 para. 3 CC does not apply in this case; the money would flow back into the succession cycle of the

founder (which of course is also risky because almost 100 years would have to be "rewound").

2) Recognition of a Liechtenstein foundation with the same features

- From a Swiss point of view, this is a cross-border situation. Accordingly, the question of whether the foundation is effective depends on the rules of private international law to determine the foundation "statute".
- Pursuant to Art. 154 PILA, this is determined according to the incorporation theory, i.e., the law under which the foundation is validly established. Hence, if the foundation is effectively established in Liechtenstein, it is to be recognised in Switzerland.
- Liechtenstein foundation law does not have a provision comparable to Art. 335 CC. The purpose of the foundation is therefore unquestionably valid under Liechtenstein law. There are no other doubts about the effective establishment.
- Also, there is no evidence that the foundation is ineffective for other reasons; in particular, we learn nothing about aspects that speak in favour of "sham" or "piercing the veil".
- The question of whether Art. 335 CC is a "*loi d'application immediate*", which would necessarily overrule the application of Liechtenstein law, was answered in the negative by the Federal Supreme Court, because the values of Art. 335 CC are outdated and do not have to prevail in the international context. Therefore, public policy does not intervene either.
- As a result, the foundation would have to be recognised. Even if the inheritance statute is Swiss law, claw-back claims against the foundation established in 2010 would not be enforceable because the establishment (and the separation of assets) dates back more than 5 years (Art. 527 No. 3 CC) and there are no indications of abuse (Art. 527 No. 4 CC).

**Maximum achievable number of points of part 1: 15 points**

**Part 2**

*Note: The following considerations are possible, but not exhaustive. Other reasonable ideas can also be counted, but no more than 15 points can be awarded in total.*

Question 1

a) Does Swiss law allow this, is it a good idea, and why?

- Yes, Swiss law allows this. Switzerland has ratified the Hague Trust Convention, which has become binding law in Switzerland, and which requires that foreign law trusts be recognized in Switzerland, whether they are subject to the law of another HTC member state or not.
- It is a good idea, as putting the LLC shares in a trust means the trustee of said trust will hold the legal title and therefore full control over the company – the LLC and its shareholdings are therefore out of reach for Ms. Tartaruga's children.
- At the same time, Ms. Tartaruga's children will retain the beneficial interest in the LLC (the trust asset) and enjoy the financial benefits thereof. Ms. Tartaruga can choose someone suitable as a trustee.

b) What law(s) can she submit the trust to? Could it be Swiss law?

- She can choose any law she wishes so long as she chooses a trust jurisdiction.
- Switzerland does not yet have its own trust law; however, efforts are being made to change that. In a few years' time, Ms. Tartaruga might be able to set up a trust under Swiss law, if she chose to wait that long.

c) What types of trust are at her disposal, which one would you recommend she use, and why?

- Ms. Tartaruga will choose a private express trust as the one type of trust that is set up intentionally (as opposed to statutory, implied, resulting, and constructive trusts). A public trust would not fulfil her needs.
- Express trusts can be fixed interest and discretionary. Ms. Tartaruga will choose a fixed interest trust if she wishes to predefine the exact beneficial interest of each beneficiary and create a discretionary trust if the wants to let the trustee decide on each beneficiary's beneficial interest.
- As she has three children, neither of which she appears to have any preference for, a fixed interest trust (where each child holds an identical beneficial interest) probably best fulfils her needs.
- The trust can also be created revocable or irrevocable, the former being advantageous in case Ms. Tartaruga has second thoughts about the arrangement, the latter being better for estate planning purposes (cf. questions d and e).

d) Do you foresee any inheritance law issues? Is there a way to deal with them *ex ante*?

- Yes. Ms. Tartaruga, as well as her children, reside in Switzerland. Upon Ms. Tartaruga's death, Swiss inheritance law will apply (art. 90 PILA).
- Under Swiss inheritance law, children have a mandatory indefeasible share of ¾ of their legal share. As Ms. Tartaruga is widowed, her children are her only legal heirs, their legal share being $^1/_3$ each, making each child's indefeasible share $^3/_{12}$ (= 25%) of the estate (total indefeasible share = $^9/_{12}$, 75%). If she puts the LLC (80% of her estate) into a trust, the remaining 20% will not suffice to satisfy her children's indefeasible share.
- Per Art. 15 lit. c HTC, Swiss inheritance law can take precedence over the recognition of a trust, meaning the children would be able to sue the trustee to satisfy their indefeasible share.
- A good way to prevent this would be by way of an inheritance agreement and by informing the children of their beneficial title in advance.

e) What are the advantages of setting up the trust *inter vivos* vs. *mortis causa*?

- Setting it up *inter vivos* may mean the 5-year period of Art. 527 no. 3 CC might have run out by the time Ms. Tartaruga dies, as long as the trust is irrevocable (cf. question c).
- Ms. Tartaruga can also oversee the initial management of the trust and perhaps even serve as a trustee herself. Setting it up *mortis causa* would entail making the trustee an heir or a legatee of Ms. Tartaruga's estate.

f) Would a common law foundation be a suitable alternative to a trust? What are its advantages compared to a trust or a Swiss foundation? Is there a particular jurisdiction providing for common law foundations that you would recommend, and why?

- Yes. One advantage is that a common law foundation can hold a single asset without the need to diversify, which can be helpful as Ms. Tartaruga primarily wants to protect her LLC as a whole.
- Her children could be beneficiaries of the foundation but will not hold a beneficial interest in the foundation asset, as the asset is self-owned (no beneficiary principle).
- She could use Guernsey or Jersey (or another common law foundation model) depending on whether she wants to grant her children stronger or weaker beneficiary rights.
- A common law foundation does not have a prohibition of maintenance purposes, unlike the Swiss foundation.

Question 2

- Ms. Tartaruga could set up a blind trust, which means she will not have any idea what her LLC's current shareholdings are. This is often used by politicians to avoid the semblance of a conflict of interest.

**Maximum achievable number of points of part 2: 15 points**

**Part 3**

Question 1

a) According to KS Nr. 30 a Swiss resident cannot settle an irrevocable discretionary trust that is respected for tax purposes. Thus, the trust will be treated like a revocable trust – transparent. This means that the transfer of the LLC to the trust does not have any tax consequences.

b) Because of the transparent treatment, Ms Tartaruga declares the LLC directly in her tax return, as before. As long as the LLC does not make any distribution, no income tax is due. If she receives a distribution, she declares it in her tax return and can profit from the partial taxation regime (*Teilbesteuerung*).

c) Any distribution from the trust to her will not trigger any taxes.

d) The trust typically becomes an irrevocable discretionary trust upon her death since the children have no powers and no fixed interest. This would trigger inheritance tax at the highest rate in Berne.

Question 2

a) The same as in Question 1.
According to KS Nr. 30, a Swiss resident cannot settle an irrevocable discretionary trust that is respected for tax purposes. Thus, the trust will be treated like a revocable trust – transparent. This means that the transfer of the LLC to the trust does not have any tax consequences.

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| b) The trust will be the heir of Ms Tartaruga. As the trust is an unrelated person, inheritance tax is due in the highest bracket.<br><br><u>Question 3</u><br><br>• Unlike in Question 1 and 2, the children have the power to decide in their last will who shall benefit from their share in the trust fund. This could be viewed as having a power to dispose of the trust assets.<br><br>• The trust would remain tax transparent upon the death of Ms. Tartaruga as the settlor. Thus, no inheritance tax would be due as children are exempt from taxation.<br><br>• They will have to include their share in the trust fund in their tax return. | |
| **Maximum achievable number of points of part 3: 15 points** | |
| **Total** | **45** |