



Report of the EFC Tax Seminar 2007

How does EU law affect national foundation law?

Held on February 5th 2007

at

**Bellevue Museum
Brussels, Belgium**

Chair: Ludwig Forrest, King Baudouin Foundation

Executive Summary

A series of European Court cases, European legislative and policy initiatives as well as tax infringement procedures by the European Commission have created a momentum of challenges and opportunities for the foundation sector. The seminar initiated some fruitful discussions on how European law influences national foundation law, and how this fits into the broader context of promoting organised philanthropy and its operating environment in Europe and internationally. The EFC Legal Seminar, attended by some 60 participants, and organised in cooperation with the King Baudouin Foundation at the Bellevue Museum on 5th February 2007 addressed the aforementioned issues. The Fondazione Monte dei Paschi di Siena from Italy provided some financial support to the seminar. The Seminar was chaired by Ludwig Forrest of the King Baudouin Foundation.

Recent developments at EU level show that national laws governing foundations are under closer review by EU institutions, which are beginning to rule against national tax laws that discriminate against foreign-based public benefit organisations. The European Court of Justice decided in September 2006 against sections of the German tax code in the so-called “Stauffer” Case and in the beginning of 2006 the Court ruled that substantial shareholding in companies by foundations could be seen as economic activity, and therefore tax breaks received by these foundations could be regarded as unlawful “state aid” according to the EC Treaty. The seminar included a series of case studies of how European law influences the daily work of foundations in Europe. Implications of EU competition law and state aid rules on foundations’ work were discussed and the necessity for a European Foundation Statute for trans-European philanthropic organisations was highlighted.

Peter Schonewille of Directorate-General Taxation and Customs Union of the European Commission encouraged the participants to start infringement procedures at the European Commission to help bring national foundation tax laws in line with the EC Treaty. Launching a complaint at the European Commission is a very easy and effective tool to fight national laws that are in conflict with the EC Treaty. It is free of charge and anyone can launch such a complaint, including non-EU residents. Complainants do not have to have a formal interest in bringing the proceedings and can also ask for confidentiality. The European Commission has started infringement procedures against Belgium and, more recently in 2006, against Ireland, Poland and the UK. According to Mr Schonewille, it is just a question of time until the first infringement procedure is started against the tax treatment of foreign-sourced income of charities. Foundations have an increasingly diversified asset allocation and they invest across borders. However, foundations often have to pay foreign withholding tax on their foreign investment income without being able to recover this foreign dividend tax. Tax exemption or recovery schemes are often only applicable if both the recipient and the dividend distributing entity are domestic. Some participants stated at the seminar that they would seriously consider launching a complaint against tax rules. The current infringement case(s) could be an important breakthrough for cross-border giving and foundation tax law in Europe with regard to gift- and inheritance tax as well as income tax and corporate income tax incentives for foundations and their donors.

The EFC will keep monitoring legal issues at national and EU levels and will inform its members of any changes in the legislation. The EFC will also ensure that there is a continued dialogue with the EU institutions concerning the feasibility study on the European Foundation Statute.



European Foundation Centre (EFC)

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NOTE

An event organised by the European Foundation Centre (EFC) with the assistance and support of the King Baudouin Foundation (KBF) and the financial support of Fondazione Monte dei Paschi di Siena

Context of the seminar

A series of European Court cases, European legislative and policy initiatives as well as tax infringement procedures by the European Commission have created a momentum of challenges and opportunities for the foundation sector. The seminar initiated some fruitful discussions on how European law influences national foundation law, and how this fits into the broader context of promoting organised philanthropy and its operating environment in Europe and internationally. Recent developments at EU level show that national laws governing foundations are under closer review by EU institutions, which are beginning to rule against national laws that discriminate against foreign-based public benefit organisations. The European Court of Justice decided in September 2006 against sections of the German tax code in the so-called “Stauffer” Case and the European Commission has started infringement procedures against Belgium and, more recently in 2006, against Ireland, Poland and the UK. In the beginning of 2006 the European Court ruled that substantial shareholding in companies by foundations could be seen as economic activity, and therefore tax breaks received by these foundations could be regarded as unlawful “state aid” according to the EC Treaty. Some 60 participants gathered at the EFC Legal Seminar, organised in cooperation with the King Baudouin Foundation at the Bellevue Museum on 5th February 2007, to hear how these and other EU developments will impact on the operating environment of foundations. The EFC Legal Seminar was chaired by Ludwig Forrest of the King Baudouin Foundation.

Introduction

Gerry Salole opened the seminar and welcomed the attendees. He stressed that one of the key concerns of the EFC is to work on enhancing the operating environment for foundations and their funders. Mr Salole highlighted EFC developments to date in this area. Legal and Fiscal country profiles on foundations' operating frameworks across the EU were put together, which led to the publication of country profiles of the legal and fiscal environments in which foundations operate in the different Member States in May 2002. The country

profiles are also available online.¹ They are currently being reviewed and extended to the 12 new Member States.

The information provided by the country profiles and comparative charts helped to identify good legal rules and practices for public benefit foundations and was the basis for the EFC's so-called *Fundamental Legal and Fiscal Principles*². In 2003, these Fundamental Legal and Fiscal Principles were translated into a draft *Model Law for Public Benefit Foundations*. The EFC Model Law aims to positively influence the development of new foundation laws as well as the revision of existing foundation laws at national level.

The EFC has also drafted recommendations on a European Statute for Foundations, which were finalised in 2005.³ The aim is to develop a new legal tool for the increasing number of foundations that want to develop transnational cooperation, as well as individuals and other private funders with activities and assets in various EU Member States. Such a statute would establish a legal instrument for foundations which would be mainly governed by European law. The European Commission stated in its Action Plan for Company Law and Corporate Governance of May 2003, which was based on a broad consultation with the sector, that it intended to review the feasibility of a European Statute for Foundations by no later than 2006. In Spring 2006, a new consultation took place to review priorities in the field of company law. The vast majority of participants of the consultation supported the feasibility study on a European Foundation Statute. However, Commissioner McCreevy stated in his speech to the European Parliament Committee on legal affairs on November 21st 2006, that he is "not yet convinced about the ability of a European Foundation Statute to respond to the specific needs of foundations", but that the European Commission will "nonetheless pursue reflection on the matter". EFC and its members reacted immediately and stated their disappointment and concern towards Commissioner McCreevy about this statement. Mr Salole informed participants that the previous week, Commissioner McCreevy announced in a letter that his services will launch the feasibility study on a European Foundation Statute in 2007.

Case studies on the effects of EU law on the work of foundations

The seminar started with a session of case studies on how European law may influence the daily work of foundations in Europe.

- [Implications of EU Competition Law and Directive on Services in the Internal Market on foundations' work](#)

The discussion was opened by Ana Sastre of Fundación ONCE, who explained how EU legislation affects the foundation's work, and how it has tried to influence the legal framework. Fundación ONCE is a Spanish public benefit foundation operating in Spain. It was created in 1988 by the Spanish National Association of Blind People with a mission to improve the living conditions of people with disabilities in Spain. In its employment programme, Fundación ONCE tries to encourage employers to hire disabled employees, but this turned out to be a difficult task. Fundación ONCE therefore decided to create the Fundosa group of companies, which aims to generate and manage employment opportunities for people with disabilities. All shares of Fundosa belong to Fundación ONCE. These companies aim to show that business efficiency and social commitment are fully

¹ http://www.efc.be/projects/eu/legal/country_profiles.asp

² http://www.efc.be/projects/eu/legal/model_statute.asp

³ http://www.efc.be/projects/eu/legal/european_statute.asp

compatible. Spanish law permits foundations to engage directly in economic activities when these are related to their public benefit mission, taking into account the EU competition rules. Within this legal framework the Fundosa Group has consolidated a programme of business activities. Profits are always reinvested in the companies within the group or in new projects aimed at creating new opportunities for disabled workers. All these companies are considered sheltered employment and for this reason they obtain public funds in exchange for creating and maintaining employment opportunities for people with disabilities, an important part of the public funding coming from the European Social Fund. A special fiscal rate operates also for profits generated by these economic activities when reinvested in the general interest mission of the foundation. For these not to be considered as “state aid” the European institutions approved in 2002, within the block exceptions to the rules applicable to state aid, a Commission Regulation⁴ which exempts from the notification requirement state aid for job creation and aid to promote the recruitment of disadvantaged and disabled workers. At the time of approval, ONCE was actively working at the European level to ensure that the text would not have negative effects on the work of the foundation.

The recently approved Directive on Services in the Internal Market⁵ does not in principle apply to social services. The Commission recognises that social services play a special role within European society and the European economy. The European Commission mentioned in a Communication on services of general interest dated April 26th 2006 that providers of social services operate on the basis of the solidarity principle, they are not for profit, and the relationship between the provider and the beneficiaries of the service cannot be assimilated to a normal supplier-consumer relationship. On the other hand, Member States must ensure that their organisational arrangements in the area of social services are compatible with competition law and the rules on the freedom to provide services and freedom of establishment. Fundación ONCE is working towards the introduction of a new European Directive to regulate social services of general interest; and to ensure that this new legal framework takes into consideration the variety of social services which are important for social integration of people with disabilities. In some cases the organisations providing social services may also legitimately seek to make profits which are reinvested for the benefit of those receiving the social services. According to Ms Sastre, there will be uncertainty in this field until a clear legal framework is established at a European level to regulate services of general interest and social services of general interest. Fundación ONCE is currently seeking dialogue with the EU institutions and joining forces with other European stakeholders with similar interests.

Fundación ONCE has also contributed towards better EU regulation regarding equal opportunities and non-discrimination practices, through active participation at the European level. The Council Directive establishing a general framework for equal treatment in employment and occupation⁶ prohibits discrimination in the field of employment on several grounds, including disability. The approval of this directive led to the approval of the Spanish law regarding non-discrimination and equal opportunities of disabled people in all aspects, not only in the field of employment.

⁴ (EC) No [2204/2002](#) of 12 December 2002 on the application of Articles 87 and 88 of the EC Treaty to state aid for employment

⁵ http://ec.europa.eu/internal_market/services/services-dir/index_en.htm

⁶ Council Directive 2000/78/EC of 27 November 2000
http://ec.europa.eu/employment_social/news/2001/jul/dir200078_en.html

- EU state aid rules – implications for foundations

Volker Berding of the Deutsche Bundesstiftung Umwelt (DBU) spoke about how his foundation's work was in conflict with EU law. The DBU was founded in 1990 by a decision of the German Parliament and was established as a foundation according to Civil Law. The focus of the foundation is the promotion of environmental projects following the model of sustainable development. The DBU's promotional activities can be supplementary to state activities but they tend to go further than that. The DBU's guidelines for support include activities that support research, development and innovation of environmentally safe and health-friendly procedures and products; provision and exchange of environmental knowledge between science, business and other parties; protection and preservation of cultural assets impaired by environmental influences; and preservation and renovation of the national nature heritage. The conditions for support include: innovation, model character, relief of environmental strain, competence of project representative, proportional self-financing and combination of science, management and practical function. The DBU does not provide financial backing for performance of legal duties, institutional support, investment projects, or projects in operational or pure research, all of which should be the responsibility of the grantee.

According to Mr Berding, the European Commission became aware of the organisation in context of a project in Lower Saxony, which they were funding after a citizens' initiative accused DBU of supporting waste incineration. DBU's support to the project was considered state aid (according to Article 87/1 of the EC Treaty⁷), due to the fact that the foundation was established by the Parliament and the board of advisors is appointed by the Federal Government. It became evident that the DBU needs to make a notification of projects involving enterprises, otherwise any financial backing for enterprises would need to be recalled. Mr Berding also outlined some of the rules involving the promotion of enterprises, such as Regulation 69/2001 on *de minimis* aid⁸, whereby aid of less than €100,000 during three years to the same enterprise is legal. In conclusion, Mr Berding mentioned that following the notification, the amount of promotion by DBU has not decreased but it has been recognised that there is a need for closer monitoring of the legal situation in order to avoid the recall of "illegal" aid. According to Mr Berding, it is helpful to contact the European Commission directly concerning support for enterprises and that the cooperation with the European Commission was constructive and useful in the case of DBU.

- Why do we need a European Foundation Statute?

Corrado Pirzio-Biroli of the European Foundation for Rural Investment Support for Europe (RISE foundation) explained why a European Statute for Foundations is needed. He considers the RISE foundation to be a model for European foundations; however its success depends on the development of a European legal framework for foundations. The RISE foundation is a new initiative and a multidisciplinary instrument for the promotion of investments in rural conservation and renewal, the advancement of private property and cooperation between landowners and rural communities in Europe and beyond. The RISE foundation aims to operate primarily across all 27 current EU Member States and therefore faces challenges supporting cross-border investments, including the financing of transnational projects, devising cross-border financing instruments, collecting cross-border donations, and dealing with different gift- and inheritance provisions and VAT systems.

⁷ The Treaty establishing the European Community, from now on referred to as the EC Treaty or the Treaty; http://europa.eu.int/eur-lex/en/treaties/dat/EC_consol.html

⁸ http://eur-lex.europa.eu/LexUriServ/site/en/oj/2001/l_010/l_01020010113en00300032.pdf

During the establishment of the foundation, there were many questions and hesitations as to the best way of inserting a transnational, primarily trans-European instrument of philanthropy into a national system of law in the absence of a European framework facilitating the attainment of the foundation's statutory objectives. The battle for finding the best legal form for a transnational foundation can distract the foundation's management from finding the best legal form for the foundation. The RISE foundation contacted the Director-General for the Internal Market claiming that current national law regarding donations was a case of discrimination among EU citizens in contravention of the provisions of the Internal Market. According to Mr Pirzio-Biroli, a subsequent meeting between the Directorate-General Internal Market and Directorate-General Taxation and Customs Union assessed and criticized such discrimination. Subsequently, the European Landowners' Organisation (ELO) made its own contribution to the public consultation by the Commission on the future of Modernizing Company Law regarding European Foundations (Question 13) on the same lines. They also supported the EFC statement on the "Future Priorities for the Action Plan on Modernizing Company Law in the EU".

The RISE foundation opted for Belgium as a base for its operations and considered the new 2002 Belgian foundation law satisfactory. The RISE foundation included a stipulation in its statutes saying that RISE would adopt the European Statute for Foundations as soon as such an option became available. It was discovered that obtaining from the Belgian Ministry of Finance the tax exemptions for donors would have to be confined to Belgian residents. As a European foundation under national law, RISE was moreover confronted with a confusing diversity of tax exemption rules for donors, and above all with the fact that they do not apply across EU borders. In the short term, the RISE foundation has solved this problem by linking up with the King Baudouin Foundation's Transnational Giving Europe (TGE) network, which enables tax-effective giving across borders in some EU Member States. However, the aim remains to push for a system offering an enabling environment for cross-border giving within the Union and the development of a European Statute for Foundations. Until recently, the European Commission has attached little interest to this matter, considering the continuing existence of the unanimity rule on the fiscal front, and the growing emphasis on subsidiarity.

Mr Pirzio-Biroli expressed his dismay at the increasing absurdity of ignoring the need for a European Foundation Statute in a Single Market, which includes the option of setting up Societates Europaeas. He also mentioned that the Statute on European Foundations should not deal with technical and bureaucratic aspects nor should it attempt to harmonize different national provisions of Member States. Instead it should develop an enabling environment for funders and foundations across the intra-EU borders. Mr Pirzio-Biroli finished his speech by stating that without a European legal framework, the RISE foundation and similar trans-European initiatives will have difficulties in promoting the European public good.

The competence and legal tools of EU institutions

Jacques Malherbe, an emeritus professor at UCL (Louvain-la-Neuve) and partner at Liedekerke, Wolters, Waelbrock Kirkpatrick gave an introduction to the overall relationship between European law and national law. He started by mentioning that between one-quarter and one-third of all national law originates from EU law, but it is not evident as the legislation with EU origin gets adopted in the national legislation. Mr Malherbe presented the competence of the EU institutions based on the EC Treaty. The Treaty does not focus on a particular topic but is defined by its goals, such as a common market, economic and monetary union and common policies or activities. It aims to promote development, employment, equality between men and women, growth, competitiveness, the environment

and standard of living. The activities of the European Community are outlined in Articles 3 and 4 of the Treaty. The policy areas in which the European Union acts in exclusive competence are common commercial policy, customs tariff, and monetary policy. In those areas, the power of Member States stops when the Community exercises exclusive competence.

Mr Malherbe explained the much-discussed subsidiarity principle, according to which, as mentioned in Article 5.2 of the Treaty, the Community can only act if a certain objective cannot be achieved by a Member State and can be better achieved by the Union. The principle of proportionality, also defined under Article 5, regulates the exercise of powers by the European Union, seeking to set within specified bounds the action taken by the institutions of the Union. Under this rule, the institutions' involvement must be limited to what is necessary to achieve the objectives of the Treaty. It may for example be more proportionate that the European Community acts through Directives rather than Regulations, as Regulations are binding and directly applicable to Member States, whereas Directives are binding upon Member States but they allow Member States to choose the form and methods of implementation for the Directive.

He also pointed out the principles of cooperation in good faith as mentioned under Articles 10 and 12 of the Treaty, which states that Member States must abstain from activities which jeopardise the objectives of the Treaty and that within the scope of application of the Treaty, any discrimination on grounds of nationality is prohibited.

The creation of an internal market, the primary goal of the EC Treaty, is defined in Article 14. At the time of the writing of the Treaty, the focus was on competition and the implications of the Treaty for foundations were not anticipated. However, as Mr Malherbe pointed out, foundations which take part in economic activity are clearly part of the internal market.

Harmonisation of legislation is addressed in Chapter 3 of the Treaty. According to Article 94, the Council shall act unanimously, following a proposal of the Commission and with consultation of the European Parliament and European Economic and Social Committee, to issue Directives for the harmonisation of such laws, regulations or administrative provisions of the Member States as directly affect the establishment or functioning of the common market.

The hierarchy of national law and Community law is fundamental for the EC Treaty. Community law, which is considered to be international law, prevails over national law in case of conflict. The EC Treaty forms the primary law and Directives and Regulations form secondary law. Regulations have a general scope, and they are obligatory in all their elements and directly applicable in all Member States of the European Union. Examples of Regulations in the field of European Company law are the Statute for a European Company (SE)⁹ and the Statute for a European Co-operative Society (SCE)¹⁰. It is most likely that the European Foundation Statute would also take the form of a Regulation. Directives must be implemented at national level. In case of non-transposition or incorrect transposition of Directives, the Member States will be liable. One example of a Directive with relevance for foundations is the Sixth Value-Added Tax (VAT) Directive¹¹. Decisions are the third form of binding legislative acts of the EU, but they are binding only on those to whom they are addressed, and if addressed to Member State, they are binding on the judiciary.

⁹ <http://europa.eu/scadplus/leg/en/lvb/l26016.htm>

¹⁰ <http://ec.europa.eu/enterprise/entrepreneurship/coop/statutes/statutes-coop.htm>

¹¹ <http://europa.eu/scadplus/leg/en/lvb/l31006.htm>

Recommendations and Opinions of the Council are not binding, but they have political weight.

Concerning the incorporation of community law in domestic systems, there are the monist and dualist approaches, depending on whether the country's legal system is based on common law or civil law. Most common-law countries apply a dualist principle in contending that international and domestic law are distinct systems of law, and that international law only applies to the extent that it does not conflict with domestic law. Most civil law countries apply a monist principle and contend that there is only one system of law that incorporates both international and domestic law.

As a final point, Mr Malherbe referred to the powers of the European Court of Justice (ECJ) and its role as the guardian of the EC Treaty. Article 234 of the Treaty states that the ECJ has the jurisdiction to make preliminary rulings concerning the interpretation of the EC Treaty. Any national court dealing with such a case can ask the ECJ for a preliminary ruling. In fact, the national court has to ask the ECJ for such a ruling if it is the last instance court at the national level. In addition, Article 226 of the Treaty gives the European Commission the power to bring a case in front of the ECJ if a Member State does not comply with the Treaty and has not reacted appropriately to a previous reasoned opinion of the Commission.

Concrete examples of the influence of European law on national foundation laws

- Foundations and economic activity – conflict with EU competition rules?

Are tax-exempt foundations that undertake economic activity in conflict with the EC Treaty? Luca Fantuzzi of Fondazione Monte dei Paschi di Siena addressed this issue by highlighting a recent decision of the ECJ and its impact on national foundation law. The case involved an Italian foundation of banking origin which was created during the privatisation process of the Italian banking sector in the early 1990s. In 1990 a new law in Italy required banks to separate their charitable activities and banking branches. The banking branches were incorporated in new companies with limited liability, entirely owned by non-profit entities. The non-profit entities managed the control shareholding in the bank, keeping the functional and operational connection with the banks. In 1998 the non-profit entities were renamed "foundations of banking origin" and they became subjects of private law. The foundations were asked to sell the controlling ownership in the banks and the process was encouraged by income tax breaks.

In 2000, the European Commission started an inquiry into the above-mentioned fiscal incentives given to Italian banks and to foundations of banking origin to question a potential conflict with EU competition rules. In 2002, the Commission decided that foundations were not subject to state aid provisions since they are not regarded as enterprises and they do not act on the market. Managing assets and using the profits to donate gifts to not-for-profit organisations is not an economic activity, and legislation on foundations of banking origin is therefore not incompatible with Article 87 of the Treaty.

The foundations of banking origin considered the tax incentives provided for in Article 6 of Decree no. 601/73 to be directly applicable to them but the financial authorities disagreed with the foundations' interpretation of the law and the court case was created. The Italian Supreme Court suspended its judgment on the matter and passed the file to the European Court of Justice referring to Article 234 of the EC Treaty. The Italian Supreme Court stated that it is unclear if the possession and management of substantial shareholding in companies by foundations could be seen as economic activity, therefore rendering the tax

breaks received by foundations as unlawful state aid according to the competition rules of the European Union.

The Italian Court asked a series of questions to the ECJ. Two questions sought clarification as to whether foundations of banking origin as major shareholders in assignee banks qualify as undertakings in the meaning of EU Competition rules. The court decided that an entity is regarded as an undertaking when it engages in economic activity (provision of goods and services in the market regardless of whether the entity is a non-profit organisation). Mere holding of shares (even majority shareholding) does not automatically imply economic activity unless the control of the shareholding in a company leads to direct or indirect influence on the management of the company. The Court considers that the grantmaking activities of a foundation are not considered economic activities. However, if a foundation operates in an area where a competing market exists, it has to be qualified as an undertaking even if this operational activity is directly linked to the public benefit purpose of the foundation, and it is up to the national courts to make their judgments on this on a case-by-case basis.

The ECJ recalled that prior to 1999, foundations of banking origin had significant influence on the banks, and those foundations would have been considered undertakings. Today's legal regime allows foundations of banking origin to own instrumental undertakings when pursuing their public benefit purposes. These could be considered by national courts to be undertakings, where competition exists.

The Italian Supreme Court handed down a ruling following the ECJ's decision as follows: 1) The management of control shareholdings in banks or the acquisition and management of control shareholdings in other companies by foundations through a specific and organized internal structure is enough to qualify those foundations as enterprises. 2) It is a foundation's duty to demonstrate that the activity of shareholdings' management has a non-predominant role or it is instrumental for the funding of the social activity. The Italian foundations are now at a crossroads where they have two options: They can either comply with the ECJ judgement and make sure their activities do not qualify them as undertakings or they can operate under the *de minimis* rule which states that a limited amount of state aid is allowed for small- and medium-size enterprises in order to cut down administrative barriers. However, it is unclear how the *de minimis* rule would apply to foundations.

- Taxation of foreign based foundations in Germany – conflict with European law?

Thomas von Hippel of the Max Planck Institute for International Private Law introduced the so-called "Stauffer" case to the participants. The Stauffer case is a German law case, despite the fact that it concerns an Italian foundation, Centro di Musicologia Walter Stauffer which pays scholarships to Swiss students to study in Italy. The Italian-based foundation owns property in Germany from which it receives rental income. According to German law, rental income is taxed, except for non-profit organisations, but public-benefit organisations have to be based in Germany to benefit from the tax break. The Centro di Musicologia Walter Stauffer questioned the tax authority's decision and took the matter up to the German Federal Tax Court, which requested a preliminary ruling from the ECJ to find out whether the German tax law is in conflict with the EC Treaty.

One of the points addressed by the ECJ Advocate-General was: Do the basic freedoms granted under the EC Treaty apply to foundations and if so, which freedom would it be? The ECJ stated that public benefit foundations and national tax rules governing them could be covered by the EC Treaty. The legislative competence in the field of taxation lies with the

Member States, but they must ensure that these national laws do not discriminate on grounds of nationality. Concerning the applicability of the EC Treaty provisions to public benefit foundations, the crucial issue is the economic nature of the organisation's activity rather than the public benefit character of the organisation. Concerning the basic freedoms granted under the EC Treaty, the ECJ considered that the renting out of real estate does not fall under the freedom of establishment in this case, as the Italian foundation does not have a permanent establishment in Germany. However, the ECJ regarded the free movement of capital applicable with regard to the real estate activity. The purchase of real estate in Germany by a foundation based in Italy is a typical case of freedom of capital movement.

The ECJ then considered whether there is a breach of EC Treaty provisions concerning the free movement of capital provided for in Article 56 of the EC Treaty. Article 58.1 allows Member States to distinguish between taxpayers who are not in the same situation with regard to their place of residence or where their capital is invested. This rule has been interpreted strictly to avoid arbitrary discrimination against persons who are in the same position. The German tax exemption does not apply to foreign organisations based in another country, and the ECJ decision concludes that the German tax laws treat organisations with a residence in another Member State less advantageously than those based in Germany, which would imply a violation of Article 56. The ECJ then considers the justification from the viewpoint of public good. The court decision allows each Member State to set requirements for tax-exempt status for public benefit organisations, which can require that the activities must benefit the national level. However, the German tax law was interpreted by the Higher Court of Finance in a way that it does not require foundations which are tax-exempt in Germany to benefit the German public good only. The German Higher Court was of the opinion that the Italian foundation meets all the requirements that Germany sets for tax-exempt organisations apart from residence. The court decision does not see any grounds of justification for the different tax treatments of resident and non-resident public benefit foundations. The German Government argued that tax exemptions were provided because domestic organisations would relieve the German State from some of its duties. This did not convince the Court and the Advocate General, who stated that this could only be an argument if tax-exempt status required that the organisation benefit the national public good. German tax law, however, does not require that public benefit activities in this context benefit nationals of the Federal Republic of Germany or its inhabitants.

There was discussion among the participants on what the rules in various countries are like concerning public benefit criteria, which leads to tax incentives for donors and foundations. Should the rules be changed in such a way as to require foundations to benefit the national public good? Participants stressed that this would render many forms of foreign aid and foundation activity invalid. Some representatives at the seminar raised concerns regarding the possibility of overall removal of tax breaks for all public benefit organisations, if national tax laws were seen to be in conflict with the EC Treaty. Such a decision would however be politically unpopular and therefore unlikely to happen.

Direct tax infringements in the foundation sector

Peter Schonewille from the European Commission Directorate-General Taxation and Customs Union opened the session on tax infringements and foundations. He encouraged participants to start infringement procedures at the European Commission to help bring national foundation tax laws in line with the EC Treaty. Launching a complaint at the European Commission is a very easy and effective tool to fight national laws that are in conflict with the EC Treaty. Anyone can launch such a complaint, including non-EU residents. It is free of charge and complainants do not have to have a formal interest in

bringing the proceedings. Students or tax advisors may launch complaints and complainants can also ask for confidentiality. A standard form can be downloaded at the Commission website. The only essential part is the quote of the relevant national tax rules and an explanation of why there is a conflict with the EC Treaty.

In the field of foundation tax law, the European Commission questions the compatibility of a series of different types of laws with the EC Treaty. Mr Schonewille presented three main types of infringements: a) no income or corporate tax relief for donations to charities established in other Member States (pending infringement cases against the UK, Poland, Ireland and Belgium), b) higher succession or gift duties for legacies and gifts to charities in other Member States (Walloon case is pending) and c) higher taxation of foreign-sourced income of charities. According to Mr Schonewille, it is just a question of time until the first infringement procedure is started against the tax treatment of foreign-sourced income of charities. He reported on 17 infringement cases pending on outbound dividend paid to foreign pension funds.

The current infringement cases could be an important breakthrough for cross-border giving and foundation tax law in Europe with regard to gift- and inheritance tax as well as income tax and corporate income tax incentives for foundations and their donors. However, some participants of the seminar stated their concern that this EU action might be counterproductive if national reactions were to limit or even abolish tax incentives to reach the requested equal treatment of local and foreign-based public benefit organisations. There is no guarantee that Member States react like Poland, which has now introduced tax deductibility of cross-border donations.

Mr Schonewille's presentation was followed by a round-table discussion. Charles Whiddington of Field Fisher Waterhouse remarked on a recent bequest left by a Belgian national to benefit the Great Ormond Street Hospital in London. Within Belgium the tax rate of such a donation would have been approximately 7-8%, whereas the tax rate on the bequest will now be up to 80% due to the fact that the recipient is based in another country. It was decided that the case would be taken to court, which is a very slow process in Belgium and the first court hearing normally takes place five years after the complaint is filed. A complaint was also filed with the European Commission, which will probably prove to be the faster method. The case is still pending as Wallonia has not changed its legislation concerning the matter and the Commission has referred the case to the ECJ as it considers that the Walloon inheritance and tax laws violate the prohibition of discrimination on grounds of nationality and the freedom of establishment (Art. 12, 43 and 48 of the EC Treaty). There has been some confusion between the two countries regarding the characteristics of non-profit organisations as the association-sans-but-lucratif is not similar in format to the charitable trusts of the UK.

Jakub Wojnarowski of the Foundation for Polish Science discussed the efforts of the Polish non-profit sector concerning the Polish government's law proposal to abolish tax incentives for corporate donors who give to public benefit organisations. The government's main rationale for the proposal was the fact that current tax treatment of donations violates EU law with regard to freedom of establishment and free movement of persons and capital. They had also received a letter from the European Commission to this effect. Due to intensive lobbying by the Polish non-profit sector, the members of the Parliament's Commission on Public Finance voted unanimously to accept an amended proposal which retained current tax reductions and extended them to public benefit organisations in other EU Member States.

Paul Bater of the International Bureau of Fiscal Documentation, explained that the discrimination against foreign charities in UK tax law derived from a judgment of the House of Lords 50 years ago that relief from income tax only applies to domestic charities, and this decision has been applied in practice by the UK tax authorities to all direct tax reliefs for charities ever since. Although the UK Government has not announced its response to the European Commission, it is understood to be of the opinion that the legislation is compatible with the EC Treaty. According to Mr Bater, there may be several possibilities for the UK Government to justify not granting tax breaks to public benefit organisations based in other EU Member States. It can be argued that such discrimination is justified on the grounds of the different legal forms of charitable organisations in other countries and on grounds of public security. In the Stauffer case the ECJ rejected these justifications. However, the court appeared to leave open to Member States the option to treat foreign public benefit organisations differently to the extent that they do not satisfy objective criteria in domestic law for determining the public benefit status of organisations for tax purposes. On this basis, if the UK were to eliminate the requirement that a charity be established in the UK to qualify for UK tax reliefs the UK would be able to retain its concept of the essential characteristics required to demonstrate the charitable status of an organisation.

Foundations and Value Added Tax (VAT)

The following session, presented by Helen Donoghue of European Charities' Committee on VAT Conference (ECCVAT), concentrated on the implications of the VAT 6th EC Directive for foundations and the charitable sector in general. Governing law: EU's Sixth VAT Directive on the harmonisation of the laws of Member States relating to turnover taxes.¹²

The Directive provides no special recognition of foundations, but the needs of *beneficiaries* are recognised by Article 13 exemptions (exemptions for disabled and disadvantaged people). Foundations are often regarded as the "final consumer" due to the fact that non-business activity is not recognised by the Directive. Charities, including foundations, can have 3 separate VAT supplies: exempt business, taxable business, non-business. The governing law is at the European level and there is very little scope for national variations. In the early 1990s there was a drive towards complete European harmonisation and the proposals included abolition of all zero rates, abolition of all exemptions and a standard rate of VAT to increase to 25%. All these proposals would have an enormous impact on charities and foundations as well as their beneficiaries. Following the proposals, there were consultations at the European Commission and awareness-raising at the European Parliament. Possible solutions proposed included: Bringing charities into the VAT system (outputs charged at a super-reduced rate and full input tax recovery); where no charges are being made, agreement on notional consideration for supplies and allowing full input tax recovery and even a European-wide refund scheme, which would be acceptable under EU law according to the previous EU Commissioner. The Commission secured a reduced rate on outputs of charities and organisations engaged in social security work. The original Commission proposal included a reduced VAT rate on inputs of charities and organisations engaged in social welfare work, but when the Directive was passed to the Council of Ministers for approval it was blocked. The Commission and Parliament explored various solutions to provide reduced VAT rates to charitable organisations, but the proposals were always blocked at the level of Council of Ministers due to the wider political implications of providing tax relief to one sector only.

¹² Directive 77/388/EEC http://europa.eu.int/eur-lex/en/consleg/pdf/1977/en_1977L0388_do_001.pdf

The Commission recognises that the current tax system is inappropriate particularly in relation to taxation of public bodies and on social exemptions with a view to renewing it in the near future. However, radical reform is unlikely although it has not been ruled out. The lack of fiscal neutrality and harmonisation are very real problems. There has also been some discussion concerning a possible “right of deduction for input VAT relating to outside the scope supplies”. This option will be in place for public bodies and it may also be considered for charitable organisations. Commission analysis of the current situation provides two different options: a) no modification of the 6th Directive, in which case there could be a national VAT refund scheme for charitable organisations and better implementation of reduced rates to supplies of goods and services made by certain charities; b) modification of the 6th Directive with the following options: zero-rating for supplies by charities (although the Commission has difficulties with the general application of zero rates across the EU) and abolishing (some) exemptions while introducing the possibility of applying more reduced rates.

There have been campaigns in various Member States to introduce national VAT refund schemes, and the European Commission has confirmed that this is allowed under EU VAT law. Partial VAT refund schemes have been introduced in the UK, informal schemes operate in Belgium, there is a refund scheme operating in Germany and a new scheme on the way in Denmark. However, according to Ms Donoghue, the best solution would be an EU-wide VAT refund scheme, which at the moment does not seem very likely. At a Member State level however, there are some valuable lessons to be learnt from countries which have already introduced national VAT refund schemes. At the end of her presentation, Ms Donoghue questioned the logic of many countries that give tax reliefs on donations to charities but then tax their expenditures.

Withholding tax on foreign investment income

Marnix van Rij from Ernst & Young tax advisors introduced the issue of foreign withholding tax and a possible conflict with EU law with regard to implications for foundations. Asset allocation of foundations is growing more diverse with the increased number of cross-border investments. However, foundations (and other non-profit organisations) often have to pay foreign withholding tax on their foreign investment income without being able to recover this foreign dividend tax. Tax exemption or recovery schemes are often only applicable if both the recipient and the dividend-distributing entity are domestic.

Mr Van Rij highlighted an example of a Dutch foundation which has made a German portfolio investment. There is a limited tax liability to Germany of 21.1% withholding tax (possible reduction to 15%) for the dividends paid out to the investor. If the charitable organisation is based in Germany, it will be granted a refund of levied German withholding taxes on dividends received from German sources. The tax-exempt status of an organisation is not accepted as soon as it ceases to have German residency. German withholding tax levied becomes final for the non-resident charitable organisation as there is no prospect for a refund. There is neither recognition of a Dutch organisation’s tax-exempt status nor any possibility of a refund for the withholding tax to the Dutch foundation. In the opposite case, the Netherlands will also refuse to refund the German withholding tax to the Dutch foundation.

Mr Van Rij raised the possibility that the matter is in conflict with the EC Treaty and he referred to the ECJ judgments on the Stauffer case and the Denkavit case as precedents. As explained before, the ECJ ruling states that the unequal treatment of an Italy-based public benefit foundation with taxable income in Germany, compared to a German public

benefit organisation based in Germany, is against EC Treaty Article 56 on free movement of capital. The situation of a Dutch foundation investing in Germany and being subject to withholding tax could also imply a conflict with the EC Treaty. The Denkavit case involves a Dutch company with subsidiaries in France being subject to a differential tax treatment compared to a French company with subsidiaries based in France. According to the ECJ decision, the French taxation law is in conflict with Article 43 of the EC Treaty on freedom of establishment.

In conclusion, Mr Van Rij stated that as long as the non-resident charitable organisation complies with the concept of charitable purposes in the host state, unequal treatment will most likely be considered to be in conflict with the EC Treaty. The non-resident public benefit organisation therefore has the right to claim equal tax treatment as that granted to the resident foundation. As a solution, Mr Van Rij mentioned the possibility of filing claims for the refund of withholding tax levied in other Member States. This may be possible retroactively. However this is likely to be time-consuming if it requires legal proceedings. Another option is to push the amendment of the OECD model tax treaty, but this option is likely to take a few more years or even decades to be initially implemented in double tax treaties. According to Mr Van Rij, a complaint with the European Commission to start infringement procedures is likely to be the quickest and most efficient procedure.

Dutch participants reacted immediately to Mr van Rij's presentation and stated that they would seriously consider launching a complaint against tax rules, which would tax foreign-sourced income without the possibility of claiming it back.

European Commission communication against terrorism financing in non-profit organisations

Dora Balazs from Directorate-General Justice, Freedom and Security presented the European Commission's recommendation to Member States and framework for a code of conduct for non-profit organisations to promote transparency and best practices. The Commission Communication^[1] has its origins in the recommendations from the Financial Action Task Force, which has issued Special Recommendation VIII against financing of terrorism through non-profit organisations^[2]. At the European Council in 2004, the EU's strategies to battle terrorism financing were discussed^[3], including the prevention of misuse of non-profit organisations (NPOs) for terrorist financing purposes.

Discussions undertaken in the Financial Action Task Force and at the EU level led to the affirmation that some NPO characteristics make them vulnerable to financial crime, including the financing of terrorism. Such characteristics are for example the lack of human and financial resources, cash intensity as well as the lack of public or of self-regulatory monitoring. The question being very complex and sensitive, any policies to tackle NPO misuse should fully respect the principle of freedom of NPOs, avoid any criminalisation of the sector, respect the diversity of non-profit organisations in various Member States and should not hamper the work of non-profits.

¹³ Commission communication, COM (2005) 620, The prevention of and fight against terrorist financing through enhanced national level coordination and greater transparency of the non-profit sector http://europa.eu.int/eur-lex/lex/LexUriServ/site/en/com/2005/com2005_0620en01.pdf

¹⁴ FAFT Special recommendations VIII on Terrorist financing and NGOs.

http://www.fatf-gafi.org/document/9/0,2340,en_32250379_32236920_34032073_1_1_1_1,00.html

¹⁵ http://www.consilium.europa.eu/ueDocs/cms_Data/docs/pressData/en/ec/83201.pdf

The Commission Communication aims to reduce vulnerabilities of non-profit organisations to financial criminal abuse including terrorist financing. Its approach has two pillars: Recommendation to Member States and Framework for a Code of Conduct for non-profit organisations. Recommendation to Member States includes the following: a) A more coordinated public or self-regulatory oversight of the non-profit sector. Member States should have the capacity to obtain information about non-profit organisations through monitoring bodies and they should operate publicly accessible registration systems for non-profit organisations, which enjoy favourable tax treatment, collect funds from the public or have access to public grants. b) Member States should encourage non-profit organisations to comply with a Code of Conduct. c) NPOs should be encouraged to assess their existing good practices to further strengthen the prevention of their misuse for terrorist financing and other criminal purposes. The Communication also contains a Framework for a Code of Conduct for non-profit organisations, which encourages them to keep available certain basic identification information about themselves; follow proper book-keeping practice, prepare annual reports and financial statements of income and expenditure; use formal channels for money flows for all transactions (whenever there is reasonable possibility to use the formal financial system) and follow the “Know your beneficiaries and associate non-profit organisations” rule. It is also emphasised that simplified accounting and reporting requirements should apply to organisations under a certain size.

In February 2006, the Financial Action Task Force provided an interpretative note on Special Recommendation VIII to non-profit organisations¹⁶. Furthermore, EU Member States have agreed upon five principles at the Council of December 2005, containing the following principles: key aspects of transparency, accountability and governance of non-profit organisations, responsibilities to be shared between the non-profit organisations themselves and the governments of each country when preventing NPO misuse. The need for increased dialogue with the non-profit sector was recognised.

Since then it has been decided that an expert group should be set up at EU level with representatives from the public sector as well as the non-profit and private sectors, which will aim to: assist in developing policy on non-profit organisations; and analyse the feasibility of an EU-level code of conduct for non-profit organisations and sharing of best practices. In the long run, the aim is to encourage non-profit organisations to show their initiative in handling funds responsibly. At the individual Member State level, Ireland has already announced details of a new statutory framework for charities and the UK is currently assessing regulation of the charitable sector with a view to preventing terrorist financing. There was some discussion among participants concerning the mapping of regulations on the non-profit sector prior to the Commission Communication, and Ms Balazs mentioned a mapping which has been conducted at the Joint Research Centre of the European Commission that is hoped to be made available to the public shortly. Participants also stressed the importance of an ongoing dialogue with the foundation sector.

Closing round

In the closing round of the seminar, participants presented their views on current challenges and opportunities for the European foundation sector. New political and legal developments await action and monitoring. Mr Rui Machete stated that foundations’ work and donors’ concerns have grown international, but the legal environment for cross-border giving and cross-border activities of foundations lags behind. Foundations often have to set up foundations in several countries if they want to be active at an international level. The development of a

¹⁶ <http://www.fatf-gafi.org/dataoecd/16/6/36174688.pdf>

European legal form is one important tool to consider in this regard and it is high on the political agenda of the European Commission, which announced in the beginning of 2007 that the feasibility study on a European Foundation Statute will be undertaken in 2007.

Jan Scherphuis recalled that the European Commission as well as the European Court of Justice has over the last few years questioned the compatibility of a series of national tax laws for public benefit organisations with the EC Treaty and foundations should review how to make best use of this window of opportunity. A continued dialogue with EU institutions was seen as crucial to monitor current developments in this regard. Mr Scherphuis also mentioned the Dutch efforts in achieving a 0% tax rate for gift and inheritance taxes for foundations, achieved through dialogue with the Dutch government. In addition, transparency has been improved: Public benefit foundations need to be registered, and the number of registered foundations can now be expected to increase from the current 17,000 public benefit foundations in the Netherlands (it is estimated that there are another 15,000 unregistered foundations).

The participants in the closing round of the panel concluded by stating that they remain optimistic about the results of the announced feasibility study on a European Foundation Statute and the EFC will continue its dialogue with the European institutions to ensure positive developments on this front. In this dialogue, the EFC will seek to demonstrate that the foundation sector is a credible player in the European arena and can make a valuable contribution to the European Union. A European statute would help to resolve a variety of cross-border operational problems faced by foundations in Europe today and would enable foundations and funders to more effectively contribute to the European public good.