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**European Foundation Centre (EFC)
European Union Committee**

Report of the EFC Tax Seminar 2005

**Economic Activity and Major Shareholding – What is at
Stake for Foundations?**

Held on December 2nd 2005

at

**Fondazione Cassa di Risparmio di Torino (CRT)
Via XX Settembre 31
10121 Torino, Italy**

Chairs: Simon Hebditch, Charities Aid Foundation, Chair EFC Tax Task Force
Marco Parlangeli, Fondazione Monte dei Paschi di Siena, Vice Chair EFC Tax
Task Force

Executive Summary

Are foundations allowed to engage in economic activity either directly or through another legal entity? How is this economic activity taxed? Is major shareholding allowed? Is there a risk for foundations to be in conflict with EU competition rules? These key questions were discussed at the EFC Tax Seminar 2005 attended by over 65 participants, both foundation practitioners, and legal and fiscal experts.

Simon Hebditch of the Charities Aid Foundation and Chair of the EFC European Union Committee Tax Task Force chaired the tax seminar together with Marco Parlangei of the Fondazione Monte dei Paschi di Siena and Vice Chair of the EFC European Union Committee Tax Task Force.

The seminar addressed the current state of affairs concerning direct and indirect economic activity and its tax treatment in the old and new EU Member States as well as the US with the aim of benchmarking good existing legal and fiscal practice.

Participants of the seminar also gained an insight into the environment of Italian foundations of banking origin, which has over the past years gained a European dimension: A merger of European banks just took place between Unicredit and Hypovereinsbank and participants examined in more detail the merger and the effect it may have on foundations, which are shareholders in the bank. Another European issue for Italian foundations of banking origin as shareholders in banks is a potential conflict with EU competition rules. The European Court of Justice has been asked to examine if substantial shareholding in companies by tax-exempt foundations would be regarded as "state aid" according to the EC Treaty. Experts at the seminar claimed that only direct economic activities or a majority shareholding combined with real influence on the management of a company could be considered as economic activity in the meaning of EU state aid rules.

A recent Italian law proposal aims to restrict voting rights for foundations in case they are major shareholders beyond 30%. The debate at the seminar made clear that major shareholding of foundations is a reality in many countries. In Denmark, Finland, Germany, Sweden, Norway, the Netherlands, and Switzerland many large companies are foundation-owned.

Participants reviewed a number of areas in which reform of existing national laws would be desirable in order to ensure a strong, growing and sustainable foundation sector. The EFC has developed some proposals to push for a more favourable environment with regard to foundations and their economic activity. The EFC Legal and Fiscal Principles and EFC Model Law suggest that public benefit foundations should be allowed to engage in economic activities. Income from economic activities should be tax-exempt provided that revenues are applied to the public benefit purpose of the foundation and the trade is carried on in the course of the actual pursuing out of a public benefit purpose of the foundation. Where foundations, however, compete with other actors in the market, competition rules will have to be taken into account. Even in cases in which competition exists, it has to be examined whether potential conflicts with EU Competition rules could be justified.

The EFC will continue to monitor the issue and will keep its members informed about developments with regard to foundations and economic activities. Foundation representatives as well as third parties were invited to state their interest to the EFC in being involved in the debate.

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Report of the EFC Tax Seminar 2005

Economic Activity and Major Shareholding – What is at Stake for Foundations?

NOTE

An event organised by the European Foundation Centre (EFC) with the assistance and support of the Fondazione Cassa di Risparmio di Torino (CRT)

Context

Are foundations allowed to engage in economic activity either directly or through another legal entity? How is this economic activity taxed? Is major shareholding allowed? Is there a risk for foundations to be in conflict with EU Competition rules? These key questions were discussed at the EFC Tax Seminar 2005 attended by over 65 participants, both foundation practitioners and legal and fiscal experts. The seminar reviewed the current state of affairs concerning the issue in different EU Member States with the aim of benchmarking good existing legal and fiscal practice. In addition it highlighted current court cases pending before the European Court of Justice (ECJ) on the matter. The ECJ has been asked to examine if substantial shareholding in companies by tax-exempt foundations would be regarded as “state aid” according to the EC Treaty. Another case pending before the ECJ questions the German tax treatment of foreign-based organisations with rental income in Germany.

Simon Hebditch of the Charities Aid Foundation and Chair of the EFC European Union Committee Tax Task Force chaired the tax seminar together with Marco Parlangeli of the Fondazione Monte dei Paschi di Siena and Vice Chair of the EFC European Union Committee Tax Task Force.

1. Welcome and introduction

Andrea Comba, President of Fondazione CRT, welcomed participants on behalf of the host organisation. In his welcome he stressed that the issues of tax treatment of major shareholding of foundations and economic activity were extremely significant for his organisation.

He pointed out that this seminar would, on the one hand, enable Italian foundations and researchers and professionals to understand that the problems and issues they are dealing with are part of a bigger supranational context. One should bear in mind that the Italian reality was unique in Europe, due to the historical nature of Italian foundations of banking origin; today however it is important to bring the Italian juridical system into line with the European framework.

On the other hand, the international foundation representatives attending this seminar would have a chance to increase their knowledge about the Italian peculiarity in the realm of philanthropy. The Fondazione CRT thanked the EFC for its activities promoting philanthropy and ACRI for its role at the Italian national level. He concluded by wishing that this seminar would alert different operators and regulators to the fact that changes in the European market system affect the foundation sector.

Dario Disegni of Compagnia di San Paolo and Vice-Chair of the EFC welcomed participants on behalf of the EFC and thanked the Fondazione CRT for kindly hosting this second EFC fiscal seminar. He stressed that the EFC aims to promote the role of foundations and their visibility in Europe, at both EU and national levels. A priority area of the work of the EFC European Union Committee is to help develop and maintain a favourable operating environment for foundations and private funders in the European Union.

He gave a brief overview of the background and achievements of the EU Committee and its Legal Task Force led by Rui Machete, Executive Council President of the Fundação Luso-Americana para o Desenvolvimento of Portugal, and the Tax Task Force chaired by Simon Hebditch, Executive Director for External Affairs at the Charities Aid Foundation. The Task Forces have developed some key materials during the four-year period 2001-2004 to help rethink and advance foundations' legal and fiscal operating frameworks, and private giving in the EU.

The work of the two Task Forces began with a review of foundations' operating frameworks across the EU, which led to the publication in May 2002 of country profiles of the legal and fiscal environments in which foundations operate in the different Member States. Comparative charts of the legal frameworks for foundations and their donors in the original 15 EU Member States were also developed. Country profiles are updated on a regular basis and will soon be extended to the 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*. 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 recommendations on a European Statute for Foundations, which were published in 2005, aim to provide 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. The EFC presented its recommendations on the European Foundation Statute at a series of national and international conferences and will continue to do so.

Simon Hebditch, chair of the first part of the seminar, stated that besides keeping an updated information database about the legal and fiscal environment of foundations, the EFC wishes to monitor legal-fiscal developments at national and EU levels and to provide a platform for exchange and debate. The EFC therefore decided to organise seminars on a regular basis for a broader public on current legal and fiscal topics where practitioners and researchers can debate in an open atmosphere.

The issue of existing barriers to cross-border giving is one of the Tax Task Force's major concerns and the group organised a seminar on this topic in Spring 2004 in cooperation with

EFC members the King Baudouin Foundation and the Charities Aid Foundation, and the European Association for Planned Giving, which addressed current obstacles as well as potential solutions to improve the situation.

Another issue which the EFC Task Forces have started to examine is economic activity of public benefit foundations. The question of whether or not public benefit foundations should be allowed to have direct and indirect economic activity through ownership or major shareholding in another legal entity is the focus of some current court decisions and debates among foundation law experts.

Mr Hebditch stressed that the term “economic activity” is not always clearly defined in the different 25 EU countries. The EFC is working with the following definition, which for practical reasons was also proposed for use throughout the seminar: “Economic activity” is understood as “trade or business activity involving the sale of goods and services”.

Mr Hebditch noted that, being in Turin, the seminar participants would also gain an insight into the Italian foundation sector. He recalled that there are a series of very powerful, well-established traditional foundations in Italy and that some of the biggest European foundations were set up in the early 1990s during the restructuring and privatisation process of the Italian public banking sector. Italian public banks were transformed into stock companies, which were at the beginning majority-owned by newly created foundations of banking origin. Towards the end of the last century, these foundations were asked to sell their controlling ownership in the banks. There are more news to report upon in the banking sector. The merger of European banks just took place between Unicredit and Hypovereinsbank and participants would now examine in more detail the merger and the effect it may have on foundations which are shareholders in the bank.

2. The Italian cases become European cases

a. Italian foundations of banking origin in the light of the European integration process: the case of the Unicredit Hypovereinsbank merger

1. Perspective of the Fondazione CRT

Maria Leddi is the General Secretary of the Fondazione Cassa di Risparmio di Torino, lecturer in the postgraduate course in Administrative Science at the Faculty of Political Science of the University of Turin, Vice-President of Expo Piemonte, member of the board of the Special Agency Torino Incontri, designate attorney for Perseo SpA and board member of the Fondazione Centro per il Restauro di Venaria Reale.

Maria Leddi presented the perspective of an Italian foundation of banking origin. The foundations of banking origin have played a significant role in the consolidation of the major Italian banking group (Banca Intesa, Unicredit, Sanpalo IMI). In the early 1990s the foundations owned the banks but then started diversifying their portfolio. As of 2004, only a few foundations held more than a 50% property stake in the banks. At the same time the return on equity is improving, and the asset value and the grantmaking activities are increasing. Until 2004 foundations of banking origin received a 50% reduction of corporate tax and until 1999 there was no tax retention. Starting in 1999 tax retention became applicable, and as of 2004 the corporate income tax reduction is no longer applicable to those foundations.

The Fondazione CRT was the only shareholder of Banca CRT SpA from 1991 until 1997 when cooperation started with Cariverona Bank. In 1998 the Fondazione CRT became a shareholder of the Unicredit Group and is now a shareholder of Unicredit-HVB. The Fondazione CRT linked the proposed merger of the banks with European values and the building of a single market. From a political point of view, Ms Leddi stressed that long-term responsible ownership may help companies to perform innovatively. Foundations could play an equilibrating role in comparison to other company owners. From the point of view of

competition rules, she mentioned that tax benefits could be justified because of the public benefit character of the activities of a foundation. She also stressed that one has to put foundations into a European perspective and, in order to avoid *ad hoc* provisions, fiscal rules should be seen in a comparative perspective.

2. Perspective of Unicredit HVB Group

Since 2005, Chiara Burberi is Head of Group Organisation, Global Banking Services Division, Unicredit Italy. From 2001 to 2005 she was Head of Retail Foreign Banks and New Growth Division at Unicredit Italy. She is also a member of the board of Unicredit Romania and of KocBank.

Chiara Burberi addressed the role of foundations before and after the merger of Unicredit with Hypovereinsbank. Before the merger, the Fondazione CRT held 8,7% of the shares and the Fondazione Cassa Risparmio di Verona held 7,4%. After the merger Fondazione CRT now holds 5% of the shares and the Fondazione Cassa Risparmio di Verona holds 4,3%. She gave an overview of the opportunities that the merger of the two banking groups would create for shareholding foundations. The merger would create a new force in European banking with better diversification and a lower risk profile. A clear perspective of shareholder value generation, clear governance and well-defined strategic alliances are seen as some of the unique strengths of the new group. The group's main focus is on Germany, Austria and Italy but is at the same time covering fast-growing markets in Central and Eastern Europe.

b. Shareholding as a conflict with EU Competition rules (ECJ case C-222/04)?

Tommaso Di Tanno is the Founder-Partner of Di Tanno & Associati and Professor of International Tax Law, University of Cassino; Chairman of Assicurazioni di Roma; board member of INA - Istituto Nazionale delle Assicurazioni S.p.A.; Chairman of the Surveillance Committee of Vodafone Italia, BNL - Banca Nazionale del Lavoro S.p.A., Caltagirone S.p.A. and British American Tobacco Italia S.p.A.; Editor-in-Chief of "Bollettino Tributario"; Mr di Tanno is also a member of the European Advisory Committee of Aareal Bank (former Depfa); Counsellor on Fiscal Affairs to the President of the Lazio Region and a member of the Scientific Committee of Ernst & Young.

Tommaso di Tanno reported on the following case (C-222/04): On March 23rd 2004, the Italian Supreme Court suspended its judgment in a case involving a foundation of banking origin, the Fondazione Cassa di Risparmio di San Miniato, and sent the file to the European Court of Justice (ECJ). The Italian Court claims that it is unclear if the possession and management of substantial shareholding in companies (banks and others) by foundations could be seen as economic activity, therefore involving the application of competition rules rendering tax breaks received by the foundation unlawful "State Aid" according to the EC Treaty.

Already in 2000, the European Commission launched an inquiry into the fiscal incentives given to Italian banks and to foundations of banking origin. In August 2002 the Commission took the decision that fiscal measures introduced by Italy in 1998-1999 in favour of foundations of banking origin were not subject to EU State Aid provisions. The European Commission considered that the activity of managing one's own assets and using the profits to donate gifts to not-for-profit organisations is not an economic activity and that foundations would not be regarded as enterprises. Therefore, the European Commission stated that Italian foundations of banking origin were outside the scope of EU competition rules.

Mr di Tanno pointed out that besides the Fondazione Cassa di Risparmio di San Miniato (the taxpayer involved in the case) the Italian Government and the EU Commission have also presented their comments with regard to the legitimacy of the benefits retention. The

Commission confirmed that foundations in general are not enterprises if their activities result in possession and administration of shareholding (regardless of the percentage), provided that no intervention in the actual management of any connected company is made, or giving grants to third parties in the fields covered by the foundations bylaws.

Advocate General Jacobs of the ECJ published his Opinion on October 27th 2005. According to him, public benefit foundations with tax-exempt status that pursue economic activities, either directly or through another legal entity, could be in conflict with EU competition law. An Italian foundation of banking origin would be considered an enterprise or undertaking if it conducts an economic activity as mentioned by ECJ jurisprudence. According to Mr Jacobs this would be the case if the foundation:

- managed controlling shareholding in companies (banks and others) if private undertakings could carry out the same activity in order to make profits; or
- offered goods or services in a market where competition exists when the foundation undertakes statutory public benefit purpose activities; or
- through controlling shareholding was directly or indirectly involved in the management of undertakings (banks or other businesses).

According to Mr Di Tanno the statements of Mr Jacobs would require some clarification and he commented on them as follows:

- Regarding the first point, the existence of a market for controlling shareholding, Mr Di Tanno stated that markets for controlling shareholding exist inevitably. Any possession of assets/shares can theoretically be sold. If the sale of a controlling shareholding would immediately result in a commercial activity, any individual doing the selling would also need to be considered an “entrepreneur”. In addition, the level of participation (controlling or non-controlling) would determine whether the activity is of an economic nature. The conclusion of Mr Jacobs would be that any controlling shareholding by a tax-exempt organisation could lead to a conflict of competition rules.
- On the second point, the question of whether activities run by a foundation would be considered as economic activities, Mr Di Tanno stressed that this would only be an issue for operating foundations, whereas most Italian foundations of banking origin are grantmaking organisations, which do not offer goods and services in the market.
- With the third point Mr Jacobs wanted to underline that controlling shareholding would result in economic activity as soon as the foundation had influence on the management of the controlled company. Mr Di Tanno stressed that it is crucial to identify the point when relevant influence starts. According to him, attendance at shareholder meetings to make decisions on the management of the company including board composition cannot be considered economic activity. The influence on the management of the controlled company must be more active and visible.

Provided that the other requirements of State Aid rules are fulfilled, namely a distortion of competition and an effect on trade between Member States, the Advocate General states in his opinion that the tax benefits for the foundations would qualify as State Aid under Article 87 of the EC Treaty. However, an assessment would have to be undertaken at the national court level. Participants of the seminar stated that the conflict with EU Competition rules could still be justified by the nature and the general scheme of the system.

- c. Tax treatment of an Italian foundation with rental income in Germany – conflict with EU law (ECJ case C-386/04)?*

Marco Parlangeli is the Chief Executive Officer of the Fondazione Monte dei Paschi di Siena since 2003. Since 2003 he has also been a member of the Fondazione Accademia Chigiana's board of directors and a member of the Fondazione Ravello's policy board. In 2002 – 2003 he was a member of Sansedoni SPA's board of directors. Since 2000 he has been a member of the EFC Legal Task Force and Vice-Chair of the Taxation Task Force. He has a long tradition with Monte dei Paschi di Siena: in 1983 he joined the Monte dei Paschi di Siena Bank where he became bank executive in 1994 and in 1997 he moved on to the foundation, where he was Administrative Director until 2003.

Marco Parlangeli highlighted the so called "Stauffer case": German foundation tax law is currently under review by the European Court of Justice. According to German tax law, the general corporate income tax exemption which exists for German public benefit organisations does not apply to foreign public benefit organisations that have their registered office and/or governance structure outside Germany. In July 2004, the German Federal Tax Court requested a preliminary ruling from the ECJ regarding the compatibility of German taxation of foreign public benefit private law foundations with the basic freedoms contained in the EC Treaty (Freedom of Establishment, Freedom of Movement and Free Movement of Capital). The ECJ will have to determine whether the taxation of foreign public benefit foundations in Germany is an obstacle to the above-mentioned Freedoms set out in the Treaty.

Participants of the seminar mentioned the wider implications of this case. Should the ECJ decide that public benefit foundations fall under the Freedoms provided for in the EC-Treaty, national laws that discriminate against foreign public benefit organisations would potentially be in conflict with the EC Treaty.

3. How are foundations economic activities taxed in different EU countries?

Hanna Surmatz is a German lawyer with specialisation in German and international company law with a focus on European foundation and tax law. From 2001 until mid-2004 she worked as Legal Counsel for the European Foundation Sector at the Bundesverband Deutscher Stiftungen - Federal Association of German Foundations and was seconded on a part-time basis to the EFC. Since mid-2004 she has been Legal Counsel at the EFC.

Hanna Surmatz presented highlights of the 2005 survey undertaken by the EFC Legal and Tax Task Forces. The purpose of the exercise to draft comparative charts on the legal environment for economic activities of foundations was three-fold: First, to compile and make accessible legal information to the interested public and, second, to analyse laws and third to develop international good practice with the aim of helping countries and develop an enabling environment in this regard for foundations. The following issues were addressed:

- Are foundations allowed to have economic activities?

Almost all EU countries allow foundations to engage directly in economic activities. In some of the new Member States, however, more restrictive rules apply. Foundations in the Czech Republic are not allowed to have economic activity other than renting property and organising lotteries. In Slovakia, foundations are prohibited from engaging in economic activities other than leasing a property and organizing cultural, educational, social and sport events if these ensure more efficient use of their assets and if they are in accordance with the foundation's mission. In Lithuania, foundations may not directly undertake economic activity but may conduct them through another legal entity.

- Are foundations that undertake economic activities governed by a special act?

Only Denmark provides for a special act. Foundations that conduct considerable economic activity or exercise control over a commercial enterprise are governed by a special act on commercial foundations (*lov om erhvervsdrivende fonde*).

- Are foundations allowed to be major shareholders?

With regard to this question, further research needs to be undertaken to be able to map the field. So far, the legal environment of the countries examined varies considerably. The majority of countries allow major shareholding without limitation of voting rights. In Germany, however, the exercise of voting rights may put the tax-exempt status of foundations at risk. A few countries do not allow major shareholding, such as the Czech Republic and Lithuania and, until recently, France. Since a law dated July 13th 2005 came into force, public utility foundations in France may be the major shareholder in a company provided such ownership is in line with the purpose of the foundation (the so-called “principe de spécialité”). This major shareholding is normally regarded as simple investment/administration of assets and therefore also tax-exempt. Only in the case where the foundation would act as the actual manager of its subsidiary, would the shareholding be considered a taxable economic activity.

- How is income from economic activity taxed?

Income from economic activity is in most countries tax-exempt only if it meets certain conditions, in particular if the activity is related to the public benefit purpose of the foundation (related economic activity). Three basic categories can be found:

1. All business income is taxed in full whether from:

	related activity
	unrelated activity
2. Most countries clearly tax income from

unrelated activity	
But exempt income from	related activity
3. Some Member States (Germany, Hungary, Spain and the UK) go even further as they also exempt unrelated economic activity (related activity is tax-exempt in those countries). However, no unlimited tax exemption of unrelated economic activity can be found. All those countries only exempt ancillary unrelated economic activity. Some have introduced a ceiling into the law – this is the case in Germany, Hungary and Spain.

- How is investment income taxed?

Income from passive investment (dividends, interest, rents, etc.) is in most countries tax-exempt. All Member States permit public benefit foundations to earn income from passive investments. However, Lithuania and Slovakia only allow investment in selected fields e.g. state obligations and bonds, and (in the case of Lithuania) government or municipal securities. Four basic categories can be identified with regard to the taxation of investment income:

- Investment income generally taxable
- Partial exemption and reductions
- Full exemption of all investment income used for public benefit purposes
- In most Member States, investment income is generally tax-exempt

- How is major shareholding taxed?

It was stated that, thus far, too little information was available to analyse the field. The majority of countries allow major shareholding. In Germany, the exercise of voting rights does put the tax-exempt status of foundations at risk. A few countries do not allow major shareholding, such as the Czech Republic, Lithuania and Slovakia and until recently France. Since a law dated July 13th 2005 came into force, public utility foundations in France may be the major shareholder in a company provided such ownership is in line with the purpose of the foundation (the so-called “principe de spécialité”). This major shareholding is normally regarded as simple investment/administration of assets and therefore also tax-exempt. Only in the case where the foundation would act as the actual manager of its subsidiary, would the

shareholding be considered a taxable economic activity. Of those countries that allow major shareholding, most do not tax this major shareholding (e.g. Belgium, Portugal, Spain and the UK); Germany does not tax it when voting rights are not exercised (otherwise it is taxable).

4. Public benefit purpose foundations with direct economic activities

Marco Parlange of the Fondazione Monte dei Paschi di Siena took over the chairmanship for the second part of the meeting and introduced the issue of direct economic activities undertaken by public benefit foundations. In 2001, the Metropolitan Museum of Art in New York had an income of almost 100 million US dollars through its museum shops, restaurants and parking place. Also in Europe, non-profit organisations, including foundations, are undertaking more and more direct economic activity and looking beyond traditional ways of income generation. In these times of financial difficulties for foundations and uncertain investment market returns, foundations are looking into the option of running their own business activities. Some foundations have always run their public benefit purpose through economic activities. In some cases the public benefit purpose can only be pursued through the running of economic activities, e.g. if the foundation runs a hospital or home for the elderly.

- a. *A comparative overview of public benefit purpose foundations with direct economic activities in Germany, the UK and the US, Carsten Carstensen, Ernst & Young Foundation*

Carsten Carstensen studied Economics at the University of Hamburg. In 1977 he joined the Volkswagen Stiftung and until mid-2004 was head of Finance and Administration. In 1994 he finished his PhD at the University of Hanover. After his retirement from the Volkswagen Stiftung last year, Carsten Carstensen started working as an adviser to the Ernst & Young Foundation. He was Treasurer of the EFC from 2002 to 2004 and has been a member of the EFC's European Union Committee and its Legal and Tax Task Forces since 2002.

Carsten Carstensen reviewed the general question of whether serving the public interest and running an enterprise are compatible with one another. A foundation serves the public interest, having at its disposal assets/income which are devoted exclusively to the pursuit of its public benefit objectives, whereas a commercial enterprise runs a business activity involving the sale of goods and services, the ultimate objective being the maximisation of its profits. Mr. Carstensen questioned the following thesis: "A foundation qualifies for tax privileges, whereas a business enterprise is taxable. A foundation is not an economic entity, whereas a business enterprise is an economic entity." He then raised the question of whether a foundation is not an economic institution. He first looked at the philosophy of tax exemptions. Would tax exemptions for public benefit foundations from an economic point of view be considered a state subsidy? A state subsidy is defined as a contribution to individuals/entities without a return at market price. Applied to foundations, one could argue that the state refrains from collecting taxes from public benefit foundations, which would be an unrealised tax payment of the foundation and could therefore be considered a state subsidy. Mr. Carstensen however questioned whether there would be a return at market prices because the foundation devotes unrealised tax payment and any other income ("profit after taxes") to its public benefit purposes. This unrealised tax payment could be seen as seed money by the state. He concluded that the tax exemption would not be a real state subsidy in this sense and that the foundation is to be considered an economic entity. The tax exemption of public benefit foundations leads to two fundamental consequences: The foundation must, on the one hand, not invest its assets at returns below market prices and, on the other, any economic activity must not compete with business enterprises.

Another issue that one should take into account is whether the executive staff of a public benefit foundation would qualify as entrepreneurs and know how to run direct economic activities?

Looking at the tax treatment of foundations' economic activities, Mr. Carstensen presented different ways of how the national tax laws distinguishes between taxable and tax-exempt income from economic activity:

According to the destination test, income from economic activities is not taxable if it is spent for the foundation's public benefit objectives. According to the relatedness test, income is not taxable if the economic activities are related to the foundation's public benefit objectives. With the impact of competition rules on taxation one can divide the income of foundations into four spheres: public benefit activities, asset management, public purpose business activities and private purpose business activities.

In Germany, income from public benefit activities is not taxable (state subsidies, donations). Income from asset management is in general not taxable. Mr. Carstensen pointed out that the distinction between private purpose business activities and tax-exempt public benefit activities is not always clear-cut. Income from renting and leasing out real estate is not taxable, whereas income from running a hotel is taxable. Trade in shares is tax-exempt, whereas trade with real estate is taxable. Even major shareholding is tax-exempt; however exercising voting rights leads to taxable income. Income from public purpose business activities is not taxable if the activity is considered necessary to pursue the public benefit purpose of the foundation and does not compete with comparable for-profit organisations e.g. hospitals, kindergartens, retirement homes. Income from private purpose business activities is taxed with a tax-free allowance of 30,678 euros and the activity must not become the foundation's main purpose.

In the UK, income from asset management is not taxable. With regard to the taxation of income from economic activities, the relatedness test applies. Primary purpose trade is not taxable, if the economic activity is necessary to pursue the public benefit purpose of the organisation. Trade ancillary to the primary purpose is not taxable if the activity is ancillary and related in a broader sense to the primary public benefit purpose. Trade only partly undertaken to pursue primary purpose is tax-free up to 50,000 pounds, not exceeding 10% of foundation's total turnover. Mr. Carstensen mentioned that fundraising activities for the primary purpose are not taxable and small-scale unrelated economic activities are tax-free up to 5,000 pounds in principle with an absolute maximum amount of 50,000 pounds, in no case exceeding 25% of the foundation's gross income. The sale of donated goods is not taxable, nor is rental income.

In the United States, the central focus of the tax treatment of economic activities are competition rules. Economic activity of foundations is taxable if it concerns trade or other activity involving the sale of goods and services, run regularly (only then are competition rules considered to be affected) and not related to the public benefit purpose. Economic activity which significantly serves the public benefit purpose (loose connection between purpose and activity) is not taxable. Passive investment income is not regarded as trade and is therefore not taxable. Mr. Carstensen pointed out that it seems that the US criteria for tax exemption are generously interpreted. The existing "unrelated business income tax" is obviously of minor importance.

Mr. Carstensen concluded by stressing some similarity between the rules in Germany, the UK and the US with regard to the tax treatment of economic activities of public benefit foundations: the rules have the relatedness test in common. Overall, the interpretation and execution of rules in the UK and the US seem more liberal than in Germany.

b. A perspective from new Member States (Hungary, Latvia, Poland, Slovakia and Slovenia), David Moore, European Center for Not-for-Profit Law (ECNL)
David Moore currently serves as Program Director with ECNL based in Budapest, Hungary. ECNL is dedicated to promote an enabling legal framework for civil society and public participation in Europe and globally. Mr. Moore previously served as a Rule-of-Law Liaison in both Uzbekistan and Belarus with the American Bar Association's Central and East European Law Initiative. Mr. Moore is a professor at the Central European University in

Budapest (2002-present), and previously taught at Catholic University in Lublin, Poland (2001), and the European Humanities University in Minsk, Belarus (2001). Mr. Moore holds a Juris Doctorate and Bachelor of Arts degree from the University of Virginia.

David Moore gave an overview of the legal and tax environment for foundations that wish to undertake economic activity in some of the new Member States. Looking at the culture and mindset, it is often assumed that there is a more restrictive regulatory approach toward foundations and economic activities in the new Member States. The legal environment, however, varies from country to country with a bright-line division in Poland and a rather liberal approach in Hungary. When it comes to defining a foundation, different approaches can be found, ranging from non-membership criteria (Poland) to an asset-based approach (Czech Republic, Hungary, Poland, Slovakia, Slovenia), a focus on the grant-making activity of the organisation (Czech Republic, Slovenia) or the establishment for public benefit purposes (Czech Republic, Hungary, Poland, Slovakia, Slovenia). With regard to the requirement of initial capital, the laws differ considerably:

- Czech Republic: 500,000 Czech crowns (17,200 euros)
- Hungary: sufficient assets to achieve its purposes – or at least start its operations (in practice, approx 2,000 euros)
- Poland: no minimum capital requirement, but if a foundation plans to engage in economic activities, then a minimum of 1000 zloties (250 euros) is required
- Slovakia: 200,000 Slovak crowns (5,200 euros)
- Slovenia: the assets have to be appropriate to pursue the purpose

A special legal form is the public benefit company (Hungary, Czech Republic, Slovakia). The aim is to distinguish between grant-making and service-providing organisations. The public benefit company is governed like a private enterprise and is dependent on grants or income from economic activities. Another special legal form are the funds in the Czech Republic, which are a form of a grant-making organisation without an endowment.

Mr. Moore stressed that for the purpose of this comparison, economic activities are defined as regularly pursued trade or business involving sale of goods or services and do not include gifts, donations, occasional activities (e.g. charity dinners) and activities using volunteer labour. In Hungary, entrepreneurial activity is economic activity aimed at or resulting in obtaining income and property. Public benefit or statutory purpose activity as well as revenue generated from selling goods serving solely public benefit or statutory purposes are excluded from entrepreneurial activity.

Foundations in the Czech Republic and Slovakia cannot engage in economic activities. Foundations are prohibited from engaging in economic activity directly or through other entities, except for leasing real property, organising cultural, social, sporting and educational events, and lotteries/raffles. In Hungary, Poland, Slovenia, as well as Estonia and Latvia, foundations may engage in economic activities, however within certain limits, which are defined by law in different countries in various ways such as: these activities are not the primary purpose; they are related to statutory objectives; all profits are used to support the purposes, they are necessary to achieve goals or advance purposes; do not jeopardise statutory purposes; are identified in the foundation's statute or the foundations has to be registered in the Court register on business activities. With regard to tax treatment, Mr. Moore informed participants that Slovenia fully taxes all income from economic activity. He outlined the legal regime of selected other countries, which provide for exemptions as follows:

According to the “relatedness test”, which is applicable in Latvia and Estonia, income from economic activity, which is related to the statutory purpose is exempt, while income from

unrelated economic activity is taxed on the same basis as the income of businesses. Often it turns out to be difficult to draw the line between related and unrelated activity.

Poland has the “destination of income test” according to which income from economic activity is exempt to the extent that it is dedicated to the pursuit of public benefit (statutory) activities specified in the law. Mr. Moore stated that unlike the relatedness test, the problem of unfair competition could arise.

Exemptions based on a threshold defined by monetary value or percentage of organisational income (a system which is often linked with other tests as well) are applicable in the majority of the new EU countries. Mr. Moore highlighted the Hungarian case as an example: in Hungary, income from statutory/public benefit activities is exempt, whereas income from entrepreneurial activities (unrelated economic activities) is taxed at a corporate tax rate only if the income is greater than 10% of the organisation’s entire income or 10 million forints. Some public benefit organisations have higher thresholds.

With regard to investment income, Mr. Moore stated that all new EU Member States permit foundations to earn income from passive investments. It would be fully taxed in Latvia, Slovakia and Slovenia, and partially exempt in Hungary. Exemptions can be found in Lithuania and Poland.

Specific rules for endowments can be found in the Czech Republic, where certain passive investment income from registered endowments is not subject to tax. Foundations may only invest up to 30% of the endowment value in bonds and up to 20% in shares of stockholding companies. In Slovakia, investments are allowed only in state obligations, state bonds, and specified securities.

Mr. Moore highlighted the case of the Polish Science Foundation. The Treasury Chamber charged the foundation with overdue corporate income tax amounting to \$20 million, springing from the foundation’s purchase of securities. In January 2001, the Supreme Administrative Court affirmed the ruling: expenditure of funds to buy securities could not be considered a furtherance of the foundation’s statutory purposes. In March 2002 however, the Supreme Court reversed the decision: it ruled that acquiring securities falls within the statutory purposes of the foundation.

c. Case study: Fundación ONCE, Spain Ana Sastre

Ana Sastre Campo is a policy officer at the Fundacion ONCE and also currently works as Employment and Training Manager for the Spanish Business Confederation of the Social Economy CEPES. Prior to joining CEPES, she worked for the ONCE Foundation for social integration of people with disability, where she was a policy officer for the International Department. She had also worked directly with the European Institutions as a legal adviser for the Spanish Council of Lawyers (CGAE) delegation in Brussels.

Ana Sastre presented in brief the tax situation for foundations with economic activity in Spain illustrated from the perspective of Fundación ONCE, an organisation that runs its own businesses through the Grupo Fundosa in the following fields: technological products and services (e.g. data processing, telemarketing, management of accident and emergency centres), the industrial sector (e.g. industrial cleaning, printers supply sector), the accessibility sector (e.g. consulting e-accessibility, architectural accessibility orthopaedics), the service sector (e.g. labour intermediation, news and communications, convenience stores, sport facilities) and the social health sector (day care centres, personal care and sanitary waste). Ms. Sastre stated that the linkage of the foundation’s mission with an entrepreneurial approach turned out to be very successful. The turnover of the Fundosa Grupo went up from 40 million euros in 1995 to 179 million euros in 2004.

5. Public benefit purpose foundations as major shareholders in companies

Following up on the example of Fundación ONCE being the owner of the successful Fundosa Grupo, Marco Parlange mentioned that in Northern Europe it is quite common that

non-profit foundations own majority shares in companies. In Denmark, Germany, Sweden, Norway, the Netherlands, and Switzerland many large companies are foundation-owned. Majority shares of companies like Ikea and Trelleborg from Sweden, Novo and Carlsberg from Denmark or Robert Bosch and Carl Zeiss from Germany are held by foundations. Foundations also play a key role in the Swedish Wallenberg empire and only a couple of years ago the British Wellcome Trust diversified its portfolio.

Foundation-owned companies do not perform badly at all. Mr. Parlange referred to Steen Thomsen, a Danish researcher at the Copenhagen Business School, who examined the Danish case. He found out that foundation-owned companies actually performed slightly better than companies with different ownership. He looked at the data of the 300 largest Danish companies and their performance in the years 1982 –1992. He presented evidence that a sample of foundation-owned companies listed on the Copenhagen Stock Exchange are at least as efficient as other listed companies in terms of risk-adjusted stock returns, accounting returns and firm value. These findings raise the question of whether profit-seeking ownership is a necessary condition for competitive enterprise and whether foundations might not be a worthwhile legal structure to hold companies.

Danish foundations that engage in commercial activities or hold a controlling interest in a commercial company are regulated by a special Act on Commercial Foundations (*Lov om erhvervsdrivende fonde*). Commercial foundations which have a significant number of shares in a company can qualify for some tax deductions on the investment revenue so long as it is used for public benefit purposes. In 1999, it was reported that 1078 commercial foundations were registered, out of which 210 are major shareholders in bigger companies.¹

Mr. Parlange presented in brief the case of Carlsberg, one of the largest European breweries. The Carlsberg Foundation was established in 1876 by Brewer J.C. Jacobsen. Following his death in 1887, the foundation became the sole owner of the Old Carlsberg Brewery. In 1902, the Carlsberg Foundation also became the owner of Carl Jacobsen's New Carlsberg Brewery. When Carlsberg merged with Tuborg in 1970, the Carlsberg Foundation was awarded a mandatory ownership of at least 51% of the shares in Carlsberg A/S. The Carlsberg Foundation is a commercial foundation which qualifies for tax exemptions according to Danish law because it distributes profits to its public benefit purposes in scientific areas. Today it still has 80% of the voting rights in the company.

There are more good news to report. Mr. Parlange pointed out that since a law dated July 13, 2005 came into force, public utility foundations in France may be the major shareholder in a company provided such ownership is in line with the purpose of the foundation (the so-called "*principe de spécialité*"). This major shareholding is normally regarded as simple investment/administration of assets and therefore tax-exempt. Only in the case where the foundation would act as the actual manager of its subsidiary, the shareholding would then be considered as a taxable economic activity.

However, not all legal regimes allow foundations to be major shareholders in companies. In some countries like Germany foundations limit their voting rights in order not to risk their tax-exempt status.

1. *Recent developments in Italy*

Mr. Parlange reported that in July 2005, the Italian Parliament presented a law proposal that aimed to limit the voting rights of foundations in the banks in which they own 30% or more of the shares. This law initiative was seen by many as an unconstitutional limitation of the freedom and autonomy of foundations.

2. *The Finnish case*

Professor Paavo Hohti was until 2003 Secretary General of The Finnish Cultural Foundation. Since 2004, he is the Managing Director of the Council of Finnish Foundations (Säätiöiden ja rahastojen neuvottelukunta). The most important task of the council is to provide its members

a channel for exchanging information and ideas. The council also represents its members to government officials and looks after their interests by, for example, issuing statements about legal changes affecting foundations.

Mr. Hohti presented in contrast to the Italian situation the Finnish legal regime, which is favourable in terms of foundations that are shareholders. Finnish foundations own (even majority) shares in public companies as part of their normal asset allocation. Public benefit foundations as major shareholders are not taxed. The dividends are tax-free and when selling shares, capital gains are tax-free. There is no legal limit to the extent of shareholding in one company (1 or 100% is allowed). Moreover, many Finnish foundations are also actively involved in a company's management. There are no limitations to voting rights. Mr Hohti announced that this legal regime might change in the future as the current definition of public benefit will be reviewed in due course. In particular, the tax situation of operating foundations, which run hospitals, for example, will be examined.

3. The Belgian case

Ludwig Forrest is Project Manager at the King Baudouin Foundation in Brussels, established in 1976 to improve people's living conditions. Mr Forrest has been involved with the launch of givingineurope.org, a website set up by the KBF as a new European philanthropic tool, providing information on legislation and tax regulation in cross-border philanthropic transactions.

Ludwig Forrest stated that, unlike Denmark or Italy, Belgium does not have a tradition where public benefit foundations hold a major shareholding in commercial companies and use the income (dividends) for the financing of philanthropic activities. However, the Belgian legal regime includes so-called enterprise foundations ("fondations d'entreprises"), which are set up as public benefit purpose foundations by one or more companies. These foundations pursue a philanthropic objective and are, among other ways, funded by tax-deductible gifts from their founder(s). In 2002 a new legal form, the private foundation, was introduced. This type of foundation has far fewer legal constraints than public benefit purpose foundations: e.g. its legal personality is not granted through a Royal Decree. Private foundations have mainly been conceived for purposes other than philanthropic ones. They are intended to be used for transmitting family companies to subsequent generations without running the risk of dividing the shareholding between the heirs. Apart from this type of structure with a specific family purpose, foundations do not appear as major shareholders of companies even though there are no rules that would hinder foundations from being major shareholders.

Besides the fact that the amended legislation on foundations is too recent (2002) for seeing new ways to use these structures, Mr Forrest stated that some tax considerations may also explain why public benefit foundations in Belgium are not major shareholders. In the general scheme of a public benefit purpose foundation as major shareholder in a company, the company would fund the charitable activities of the foundation through dividends. In Belgium, the company would have to tax such a dividend at the full corporate rate. Unlike in some countries, e.g. Germany, there is no reduced corporate tax rate on the portion of profits distributed as dividends. If the foundation is exempt from the corporate tax, it will however be subject to a withholding tax on dividends (25% or 15%), which is considered a final tax (tax on legal entities). For a company, financing the activities of a foundation by making gifts to this foundation can be more interesting than through dividends: the gifts are, under some conditions and below a certain ceiling, tax-deductible for the distributing company and will be tax-exempt in the hands of the foundation, while there would be a tax of 25% or 15% in the case of a dividend.

6. Debate and closing remarks by Pierro Gastaldo of Compagnia di San Paolo

In the final debate, participants reviewed the advantages and risks for foundations of owning companies. The advantage of this structure is seen in a sustainable long-term structure for

the company and long-term investment in public benefit purposes. However, there also is another side to the coin. Some foundation-owned companies did close down in difficult times because they reacted too late to negative developments and some experts claim that they could have been saved had investments been made in them in a public stock market. Falling values of shares and a dissatisfied investment community as well as the risk of a hostile takeover do put companies under a different kind of pressure.

Pierro Gastaldo of the Compagnia di San Paolo stressed that there are a number of areas in which reform of existing national laws would be desirable in order to ensure a strong, growing and sustainable foundation sector, for example allowing public benefit foundations to undertake economic activities either directly or through another legal entity, and allowing major shareholding. He stated that major shareholding of foundations is a reality in many countries. In Denmark, Germany, Sweden, Norway, the Netherlands, and Switzerland many large companies are foundation-owned. Six of Denmark's largest companies are foundation-owned. In the United States one can also find many examples of foundation-owned companies. The fundamental lesson learned from today's seminar is that there is no clear evidence that the ownership of companies by foundations would have dangerous consequences. Mr. Gastaldo referred to the current case pending before the European Court of Justice, which is reviewing whether major shareholding should be considered an economic activity. He stated that in today's world, many foundations are in one way or another involved in economic activities in quasi-competitive markets. He is, however, of the opinion that public benefit foundations should not be subject to competition rules because of their public benefit character and the fact that their income is used to pursue public benefit purposes.

It was recalled that the EFC has developed some proposals to push for a more favourable environment with regard to foundations and their economic activity. The EFC Legal and Fiscal Principles and EFC Model Law suggest that public benefit foundations should certainly be allowed to engage in economic activities provided that any income is used in pursuance of their public benefit purpose. The EFC Model Law proposes that income from economic activities should be tax-exempt provided that profits are applied solely to the public benefit purpose of the foundation and the trade is carried on in the course of the pursuing of a primary purpose of the foundation. Income from unrelated economic activities should be taxed. Where foundations, however, compete with other actors in the market, competition rules will have to be taken into account. Even in cases where competition exists, it has to be examined whether conflicts with EU Competition rules could be justified.

The EFC will continue to monitor the issue and inform its members about new developments. Foundation representatives as well as third parties were invited to state their interest to the EFC in being involved in the debate.

ⁱ 1999 study on commercial foundations, which was published by four Danish ministries: Debatoplæg om aktivt ejerskab (Page 255)