

Is the Estonian Foundation Act ready for private purposes?

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Abstract

Although it does not yet contain explicit provisions regulating private foundations, the Estonian Foundation Act 1996, even in its current form, provides sufficient leeway for establishing foundations in pursuit of any legal objective. In addition, Estonian law today already offers a high degree of flexibility in establishing and administering a foundation. To further expand Estonia's appeal to ultra-high net worth individuals seeking intergenerational wealth management options, the Estonian government should soon amend the Foundation Act to also expressly cover private foundations.

common law countries. Private foundations are popular in European countries, and are attracting the attention of the UHNW population.

Currently, private foundations are not regulated by law in Estonia. Until the collapse of Communism which brought independence from the Soviet Union, the people of Estonia had no need for such an instrument for intergenerational wealth management. However, Estonia is expected to soon amend its laws to address private foundations. Even under the current Estonian Foundation Act,² due to its flexible character, there is very convenient legal ground for establishing foundations for any private purposes. Some of the advantageous features of the Estonian Foundation Act are as follows:

Introduction

In today's world, the population of ultra-high net worth (UHNW) individuals is expanding, and the wealth controlled by such individuals and their families is increasing rapidly. These individuals and families are in search of efficient vehicles to assist them in safeguarding and conveniently managing their wealth, while protecting it and ensuring its safe transfer to succeeding generations.¹ In Europe, private foundations are very useful vehicles to achieve these goals, presenting an alternative to the trusts encountered in

- There is no restriction on the purpose of a foundation. Any legal purpose is allowed.
- There is no restriction on the residency of founders, members of the supervisory board, and beneficiaries of a foundation.
- The founder can take an active role in the administration of the foundation.
- e-residents can establish an Estonian foundation and administer it online.
- There is no fixed lifetime for a foundation unless the founder so specifies.
- Estonia has a very friendly tax climate.³

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1. T Kuleli and U Kaarlep, 'What makes Estonia an attractive jurisdiction for global non-charitable private foundations?' (2017) 23(3) *Trusts & Trustees* 263–272.

2. For the authentic text of the Estonian Foundation Act, please visit <<https://www.riigiteataja.ee/en/eli/ee/Riigikogu/act/504022016004/consolide>> accessed 17 March 2017.

3. Estonia has the best tax code in the OECD as per the International Tax Competitiveness Index 2016. Available at <<https://taxfoundation.org/2016-international-tax-competitiveness-index/>> accessed 17 March 2017.

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Thanks to such advantages, the Estonian Foundation Act – even in its current form – provides a secure basis for foreigners to establish foundations to fulfil private objectives.

The origin of Estonian foundation law

The Estonian Foundation Act entered into force on 1 October 1996. The Act is based on the Austrian Private Foundations Act that took effect in 1993, at which time it introduced a completely new form of foundation to Austria, comparable to the legal form of trusts in Anglo-Saxon countries. While in Austria one of the main objectives of the law was to offer a tool for managing family wealth, the level of family wealth in Estonia was quite low, and Estonia's better-off citizens were mostly too young to be immediately concerned about succession planning. This is why the term 'private foundation' is not recognized in the Estonian Foundation Act. The main purpose for introducing foundations was to establish a platform for charitable purposes, although the law is sufficiently broad so that foundations can also be established for other purposes. According to the *Statistical Yearbook of Estonia* (2016), there were 772 registered foundations in 2015.⁴ Around 10 per cent of these foundations were established by the state.⁵

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There is currently no special type of foundation for private purposes, but a proposal is currently pending to amend the Foundation Act to explicitly permit such 'private foundations' which may not have as their objective the earning of income from active economic activities.

The purpose of a foundation

According to the Foundation Act, a foundation may be established to administer and use assets to achieve the objectives specified in its articles of association. The Act implies that foundations may only engage in passive economic activities, although active trading and even production are not specifically prohibited. The Act contains no restrictions on the permissible objectives of a foundation, which may therefore pursue any legally permissible goals. However, would-be founders should note that a foundation may use its income only to achieve the objectives specified in its articles of association, and that the articles can be amended only in accordance with the objective of the foundation. It can thus be concluded that the objectives of the foundation cannot be amended once the foundation has been registered.

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4. *Statistical Yearbook of Estonia* 2016, 231.

5. The exact number is 76. Summary report of state ownerships in companies, foundations, and non-profit organizations, 4.

Residency of the founder and administrators of a foundation

Foreigners may establish a foundation in Estonia. The Foundation Act contains no restrictions on the residency of founders, members of a foundation's supervisory board, and the foundation's beneficiaries. The only limitation is a clause specifying that at least half the members of the management board must be residents of Estonia or of another Member State of the European Economic Area or Switzerland.

It is possible for e-residents of Estonia to establish a foundation via the Internet using a digital signature. In Estonia, founders and members of supervisory and management boards have the opportunity to become e-residents of Estonia and obtain a government-issued digital identity. Such e-residents can manage a foundation online. With e-residency, one can digitally sign documents, verify the authenticity of signed documents, encrypt and transmit documents securely, establish an Estonian foundation online, administer a company from anywhere in the world, conduct e-banking and remote money transfers, access online payment service providers, declare Estonian taxes online, and more.⁶

The role of the founder in the administration of a foundation

In the Foundation Act, a founder is defined as a natural or legal person who establishes the foundation. A person who transfers assets to a foundation after it has been founded does not acquire the legal status of a founder. Before a foundation is registered, the founders must also approve the articles of association of the foundation as an annex to the resolution establishing the foundation. Among other matters, the articles of association shall set out the procedure for appointing and removing members of the supervisory board, and set their term of office. This means that founders can decide whether they wish to retain the

right to appoint and remove members of the supervisory board, which in turn decides on the appointment and removal of members of the management board. A founder is permitted to serve as a member of the supervisory or management board, but no member of one body may also be a member of the other.

Once a foundation has been entered in the register, founders may only amend its articles of association in accordance with the objectives of the foundation in order to take into account changed circumstances while a foundation may be dissolved by a resolution of the founders if this right is granted to the founders by the articles of association.

If a foundation is dissolved by resolution of its founders who are natural persons, the assets remaining upon liquidation will be transferred to such founders unless the articles of association prescribe otherwise. Unless otherwise provided in the articles, the assets will be transferred to founders who are natural persons in equal shares.

International activities of foundations

The Foundation Act contains no geographic restrictions on where a foundation may carry out economic activities, and no such limitations are currently proposed. A foundation can administer and use its assets anywhere in the world until the stated objectives of the foundation are achieved.

Taxation of foundations

In general, foundations are taxed like companies. Similar to corporate taxation, foundations do not pay taxes on reinvested profits. Foundations that operate in the public interest can apply to be entered on the list of foundations benefitting from income tax incentives if the foundation fulfils the other requirements of section 11 of the Income Tax Act.⁷ The main

6. See T Kotka, J Rozov and L Karpištšenko, 'e-Residency in e-Estonia' in J Borbinha, Z Szatucsek and S Ross (eds) (DLM Forum - 7 h Triennial Conference Making the Information Governance Landscape in Europe, Biblioteca Nacional de Portugal 2014).

7. For the authentic text of the Estonian Income Tax Act, please see <<https://www.riigiteataja.ee/en/eli/ee/Riigikogu/act/516012017002/consolide>> accessed 17 March 2017.

benefit to a foundation of being included on the list is that gifts or donations made to such a foundation by a natural or legal person resident in Estonia are deductible from income tax, up to a certain limit.

A resident foundation pays income tax on expenses and payments not related to its business and on expenses incurred in purchasing services or property not related to the activities specified in the person's articles of association (section 51 of the Income Tax Act).

One significant difference between the taxation of a company and that of a foundation arises in the event that the latter distributes dividend income to its beneficiaries. When an Estonian parent company receives dividends and the profits have been taxed at the subsidiary level, no income tax is charged if the parent makes further distributions of those earnings. This exemption cannot be applied to a foundation, as it has no owners and the payments cannot be regarded as dividends or any other type of payments from equity. There is no difference in principle in the case that the private foundation owns shares of a non-Estonian legal entity, as the non-resident companies also normally pay taxes in their countries of incorporation before transferring dividends to the private foundation. Thus, double taxation occurs when a foundation transfers funds to beneficiaries from dividend income received from an investment. Under the current proposed amendments, this double taxation will be abolished.

In addition to the abolition of this double taxation, the proposed amendments include provisions which will make Estonian foundations tax transparent for non-residents. This means that, if non-residents establish a foundation in Estonia, only income earned in Estonia will be subject to taxation, just as non-resident natural persons are taxed.

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Dissolution of foundations

The Foundation Act states that a foundation may be founded for an indefinite term, until its stated objectives are achieved, or for a specified term. The rules are to be set out in the foundation's articles of association, which should also state whether and under what conditions the founders have the right to dissolve the foundation. The law does not prescribe or limit what conditions are legally accepted. Thus, founders are free to dissolve the foundation if this is set out in the articles.

The supervisory board may decide to dissolve the foundation only in those cases prescribed in the articles of association; here again, the law places no limits on what conditions may be imposed. One should note that founders can dissolve the foundation by majority decision; on the other hand, a resolution of the supervisory board for dissolution of foundation is only adopted if all members of the board vote in favour.

Conclusion

To summarize, although it does not yet contain provisions explicitly regulating private foundations, the Estonian Foundation Act even in its current form provides sufficient leeway for establishing foundations in pursuit of any legal objective. As mentioned above, Estonian law already offers a high degree of flexibility in establishing and administering a foundation. To further expand Estonia's appeal to UHNW individuals seeking intergenerational wealth management options, the Estonian government should soon amend the Foundation Act to expressly cover also private foundations.

Turgay Kuleli has expertise in international wealth and tax planning, corporate law, international trust law, cross-border transactions, and foreign private foundations. Together with the team of Sirel Attorneys at Law, he coordinates the business demands of non-Estonian clients who are either doing or wishing to do business in Estonia. He regularly publishes in international journals on selected topics relating to the above.

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