The change in beneficial interest within the Liechtenstein Private Purpose Foundation—can the principles of solidification and flexibility coexist?

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Abstract

The article deals with the principles of solidification and flexibility within private foundations. Typically, private foundations are used as will substitutes or as essential elements within an overall asset protection strategy. One of the key advantages of foundations, as compared to other instruments, is the high level of stability combined with very limited instruments to change the purpose as well as the beneficial interest. An adjustment of the statutory provisions related to the purpose can be required due to a change of circumstances, but might violate the governance regime. The article deals with the different legal issues involved and tries to give some guidelines for practitioners by discussing a case study to illustrate the legal issues addressed in this article.

The principle of solidification

Once a private foundation has been set up, it is considered to be solid as far as its governance structure, scope and beneficial interest are concerned. In fact, the so-called principle of solidification is one of the cornerstones within the Liechtenstein law of foundations.[1] When developing a wealth planning strategy for a family, those jurisdictions that grant a high level of stability combined with the opportunity to make some adjustments in the future are particularly popular. The Liechtenstein law of foundations contains very clear rules that allow a departure from the principle of solidification, whenever specific requirements are met. Later adjustments in the beneficial interests can be essential in order to fulfil the settlor's/founder's visions in the long run. This is due to the fact that it is typically very hard for the settlor/founder to predict the change of pivotal circumstances (e.g. within the family and/or the family business) in the decades after the wealth structure has been set up. The Liechtenstein legislator has reacted accordingly by allowing specific exceptions to the principle of solidification: first of all, natural persons acting as founders can reserve for themselves in the statutes the right to alter the foundation in general (and specifically the beneficial interest)[2] at a later

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1. cf D Jakob, *Die liechtensteinische Stiftung* (1st edn, 2009) 30 (recital 68 ss), 102 s (recital 221 ss); F Schurr, 'Die Einflussrechte des Stifters – eine Gratwanderung?', in F Schurr (ed), *Der Generationenwechsel in der Stiftungslandschaft* (1st edn, 2012) 45, 48 s.

2. cf art 552 § 30 Persons and Companies Act (PGR); all national, supranational and international legal provisions in their consolidated versions are published at www.gesetze.li. Unless stated differently in the notes, all references in this article are made to Liechtenstein case law or statutory law.

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stage.[3] Under certain circumstances, the foundation council (executive board of the foundation) may have a restricted right to change the purpose[4] or other elements[5] of the foundation, whenever the foundation's statutory provisions explicitly allow these alterations.

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Governance

Other than companies, foundations do not have shareholders that could take a decision on alterations of the purpose and/or organisation. The executive body (foundation council) has very limited powers: it exercises all the necessary actions, such as the investment and distribution of assets, in order to make sure that the goals defined by the founder can be achieved. Thus, the purpose as well as all the other essential elements contained in the foundation's statutes and by-statues are consolidated and cannot be altered.[6] In fact, there are very few exceptions where the foundation council may be entitled to make changes. Furthermore, the economic founder can reserve for himself/herself in the statutes the right to revoke the foundation or to alter the organisation and the purpose.[7] The statutes of the foundation need to state clearly any of these instruments. The adjustment of the beneficial interest of certain beneficiaries might have an impact on the foundation governance, e.g. when discretionary beneficiaries are cancelled from the list and therefore lose their right of control.

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Beneficiaries named in the by-statutes

The statutes of private foundations typically do not contain any detailed information about the identity of the beneficiaries, in order to safeguard a high level of privacy. That is why specific by-statutes are drafted where the names of the present and/or future beneficiaries are listed. The by-statutes have to define each beneficiary as fixed, discretionary, prospective or ultimate beneficiary. As far as the foundation's objects are concerned, the statutes often include a rather vague circumscription of the foundation's purpose. Whenever the circumstances in the family and/or in the family business change dramatically, an adjustment of the beneficial interest might be required. According to the internal governance design of a foundation, the economic founder and/or the foundation council might have some limited power to redraft the articles of the statutes and/or by-statutes. As mentioned previously, the change in beneficial interest of certain beneficiaries might have an impact on the foundation governance, since the internal control of the foundation council is carried out primarily by the fixed and/or discretionary beneficiaries (as compared to the prospective beneficiaries).

3. cf F Marxer, *Liechtensteinisches Wirtschaftsrecht* (1st edn, 2009) 92.
4. cf art 552 § 31 Persons and Companies Act (PGR).
5. cf art 552 § 32 Persons and Companies Act (PGR).
6. cf H Bösch, *Liechtensteinisches Stiftungsrecht* (1st edn, 2005) 247 ss.
7. cf F Schurr, 'Die Einflussrechte des Stifters – eine Gratwanderung?', in F Schurr (ed), *Der Generationenwechsel in der Stiftungslandschaft* (1st edn, 2012) 45, 48 s.

Whenever the circumstances in the family and/or in the family business change dramatically, an adjustment of the beneficial interest might be required

Is the adjustment of the beneficial interest a change of the purpose?

When the foundation council redrafts the foundation documents (according to its statutory competence to do so), it needs to be questioned whether the adjustments of the statutes and/or by-statutes fall under the legal category of a change of purpose or not. Typically, the articles of the by-statutes have a very limited scope and simply set up internal administrative instructions (addressed to the internal bodies only). It goes without saying that minor adjustments, such as raising or lowering a few per cent of a beneficiary's beneficial interest, cannot be regarded as a change of the purpose. On the other hand, whenever beneficiaries are revoked at a later stage by changing the by-statutes or whenever new beneficiaries (e.g. not belonging to the founder's family) are added to the list, such an alteration of the by-statutes would typically fall under the legal category of a change of the foundation's purpose. This statement is true whenever the definition of the purpose in the statutes is based on an unclear and vague definition.

Different view in case of a detailed definition of the purpose in the statutes

A different perspective needs to be applied when the foundation's purpose (as defined in the statutes) is quite detailed and specific, e.g. when it is focused not only on the economic furtherance of the family members, but as well on other issues, such as the stability of the family business (structured in an underlying company). In such a scenario, it seems that even strong changes of the beneficiaries' interests need to be analysed from an overall perspective in order to figure out whether the change of beneficial interest can be regarded as a change of the purpose. The following example might be useful to understand this principle: for the realisation of the founder's intention to strengthen the family business in the long run, it can be essential to reduce significantly the beneficial interest of those beneficiaries that do not play any active role in the linked business activity. Hence, an overall analysis of the founder's intentions is essential. Such an analysis is required to categorise any alteration of the beneficial interest (by amending the by-statutes) as a change of purpose as compared to a basic adjustment of the internal administrative instructions (addressed to the foundation's bodies only).[8] The Liechtenstein legislator has created specific rules[9] that grant the executive body, therefore the foundation council, the right to change the purpose or to amend other contents (such as internal administrative instructions addressed to the internal bodies of the foundation) under certain conditions.[10]

When is the change of purpose void?

Whenever the adjustments of beneficial interest of the beneficiaries fall into the category of a change of purpose (as mentioned previously), it needs to be questioned if such a measure is valid. According to Liechtenstein law,[11] an amendment of the foundation's purpose by the foundation council shall only be allowed if the purpose has become unachievable, impermissible or irrational or if circumstances have changed to the

8. In order to find an answer to these questions, art 552 § 31 PGR as well as art 552 § 32 Persons and Companies Act (PGR) need to be applied; see D Jakob, *Die liechtensteinische Stiftung* (1st edn, 2009) 30 (recital 68 ss), 230 (recital 520 ss), 232 (recital 526 ss); on the role of beneficiaries under Liechtenstein law in general, see F Schurr, 'Begünstigtenrechte im Wandel der Zeit – Auskunft, Zuwendung und Asset Protection', in F Schurr (ed), *Wandel im materiellen Stiftungsrecht und grenzüberschreitende Rechtsdurchsetzung durch Schiedsgerichte* (1st edn, 2013) 99, 101.

9. cf art 552 § 31 as well as Art 552 § 32 Persons and Companies Act (PGR); these provisions entered into force on 1 April 2009 and are applicable also to foundations established before that date; see B Lorenz in M Schauer (ed), *Kurzkommentar zum liechtensteinischen Stiftungsrecht* (1st edn, 2009) 237 (Übergangsbestimmungen, art 1 recital 8).

10. cf H Heiss in M Schauer (ed), *Kurzkommentar zum liechtensteinischen Stiftungsrecht* (1st edn, 2009) 173 (art 552 § 31 PGR, recital 3).

11. cf art 552 § 31 PGR.

extent that the purpose has acquired a quite different significance or effect, so that the foundation is estranged from the intention of the founder. The amendment must comply with the presumed intention of the founder and the power to amend must be expressly reserved to the foundation council in the foundation statutes. Hence, the change of the purpose can be regarded as an *ultima ratio* measure to save the existence of the foundation in extreme circumstances.[12] The Liechtenstein legislation is based on the principle of the so-called *favor fundationis*. Furthermore, in these circumstances, the foundation council has the duty to check whether the envisaged change of purpose would be in line with the presumed intention of the founder.[13]

Amendment of other content apart from the scope

As mentioned previously, the executive body of a foundation sometimes needs to make changes to the foundation documents that do not directly regard the scope, such as internal administrative instructions addressed to the bodies of the foundation. This scenario has been considered separately by the Liechtenstein legislator.[14] First of all, it is required that a statutory provision grants the foundation council such a power to act.[15] Such an amendment of the statutes or the by-statutes, regarding in particular the organisation of the foundation, is permissible by the foundation council or another executive body if and insofar as the power of amendment is expressly reserved for the foundation council (or another executive body of the foundation). This reservation of rights needs to be drafted directly in the statutory provisions. The foundation council shall, safeguarding the purpose of the foundation, exercise the right to amend if there is a substantially justified reason to do so.[16] In fact, the foundation council could deliberate a change in the appointment of the beneficiaries (e.g. by changing the names of the beneficiaries), whenever such a measure would not fall under the above-mentioned category of an amendment of the scope.

Definition of the foundation's scope

Under Liechtenstein law, the purpose of the foundation is considered to be its centrepiece.[17] In fact, the determination of the purpose resulting from the intention of the economic founder is the essential element of any foundation and is therefore part of the so-called *essentialia negotii*.[18] As mentioned previously, the definition of the purpose within the statutes of a large number of Liechtenstein foundations has been extremely vague (e.g. coverage of expenses for the education and/or the furtherance and/or the livelihood in general and/or the economic furtherance in the widest sense of the relatives of certain families, etc.).[19] This means that the foundation council in order to act in accordance with the real intentions of the founder and the true purpose of a foundation is required to stick not only to a very vague definition of the foundation's scope but also to those provisions within the by-statutes, which define the class of present and future beneficiaries. Thus, the purpose of many Liechtenstein foundations has been defined not only in the statutes, but partly in the by-statutes that further substantiate the goals of the foundation. Any provision in the statute that refers to, e.g. relatives of certain families, makes sense only if these provisions are applied in accordance with the

12. cf Liechtenstein Supreme Court (OGH) 6.9.2011, LES 2002, p. 94; H Heiss in M Schauer (ed), *Kurzkommentar zum liechtensteinischen Stiftungsrecht* (1st edn, 2009) 175 (art 552 § 31 PGR, recital 7); See J Gasser, *Liechtensteinisches Stiftungsrecht Praxiskommentar* (2nd edn, 2019) 471 s. (art 552 § 31 recital 13).
13. cf H Heiss in M Schauer (ed), *Kurzkommentar zum liechtensteinischen Stiftungsrecht* (1st edn, 2009) 175 s. (art 552 § 31 PGR, recital 8 s.).
14. cf art 552 § 32 PGR.
15. cf D Jakob, *Die liechtensteinische Stiftung* (1st edn, 2009) 233 (recital 529).
16. cf H Heiss in M Schauer (ed), *Kurzkommentar zum liechtensteinischen Stiftungsrecht* (1st ed, 2009) 178 (art 552 § 32PGR, recital 6 s.).
17. cf H Bösch, *Liechtensteinisches Stiftungsrecht* (1st edn, 2009) 202.
18. cf F Marxer, *Liechtensteinisches Wirtschaftsrecht* (1st edn, 2009) 85.
19. cf Liechtenstein Supreme Court (OGH) 6.3.2008, LES 2008, 279; J Gasser, *Liechtensteinisches Stiftungsrecht Praxiskommentar* (2nd edn, 2020) 64 (art 552 § 1, recital 7).

by-statutes that actually identify the names of people that fall under the category of fixed, discretionary, prospective or ultimate beneficiaries.[20]

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Case study

The business person F, sole shareholder of the Beta Ltd., established the mixed family foundation Alpha. All the shares of Beta Ltd. were transferred to Alpha. The purpose of the foundation has been defined very vaguely as "coverage of expenses for the education and/or the furtherance and/or the livelihood in general and/or the economic furtherance in the widest sense of the relatives of certain families". According to the by-statutes, the four children S1, D2, S3 and D4 are identified as first beneficiaries. According to the same provision in the by-statutes upon the death of one of these first beneficiaries, his/her descendants need to be appointed as beneficiaries in equitable shares per stirpes. Three years after the establishment of the foundation, there is a severe family conflict between F and two of his children. That is why F wants these two children to be cancelled from the list of beneficiaries in the by-statutes.

Change of purpose when cancelling two beneficiaries from the list?

Even though the statutes and by-statutes expressly grant the economic founder as well as the foundation council the right to change the appointment of the beneficiaries during his/her lifetime, the revocation of any beneficiary out of S1, D2, S3 or D4 (including his/her respective children) from the list of beneficiaries would not be in line with the current law of foundations.[21] Due to the fact that Alpha's purpose is defined very vaguely in the statutes, the real purpose of the foundation can only be identified by taking into consideration both, the statutes as well as the by-statutes together. This means that the provision within the by-statutes that appoint S1, D2, S3 and D4 as beneficiaries is an essential component of the statutory definition of Alpha's purpose. Cancelling any beneficiary out of S1, D2, S3, or D4 from the list would therefore be regarded as a change of purpose.

Requirements for the change of purpose to be in line with the law?

A change of purpose would only be lawful if Alpha's purpose had become unachievable, impermissible or irrational or if the circumstances of Alpha had changed to the extent that the purpose has acquired a quite different significance or effect, so that Alpha would be estranged from the intention of F. According to the Liechtenstein case law, the foundation purpose has to be written down precisely enough to give the bodies of the foundation the chance to recognise the actual intention of the founder. The members of the foundation council need to be in a position that allows them to execute the founder's intentions.[22] The principles defined in the case law have been absorbed by the legislator in the latest reform of foundation law entered into force in 2009.[23] The foundation deed needs to define the purpose of the foundation, including the designation of tangible beneficiaries, or beneficiaries identifiable on the basis of objective criteria, or of the category of beneficiaries, unless the foundation is a common-benefit foundation or the beneficiaries are evident from the purpose of the foundation, or unless there is instead express reference to a by-statute regulating this. The measure of cancelling the conflicting children (out of beneficiaries S1, D2, S3 or D4) would

20. cf M Schauer, 'Die Machtbalance zwischen Stifter, Stiftungsrat und Begünstigten' (2018) Zeitschrift für Stiftungswesen (ZFS), 31, 35 ss.
21. cf M Schauer, 'Die Machtbalance zwischen Stifter, Stiftungsrat und Begünstigten' (2018) Zeitschrift für Stiftungswesen (ZFS), 31, 35 ss.
22. See Liechtenstein Supreme Court OGH 17.3.2003, 1 CG.2002.262-55; for further details on this case, see Heiss, 'Zur Sanierung fehlerhafter Stiftungsstatuten' (2004) Liechtensteinische Juristenzeitung (LJZ), 80; F Schurr, 'Zur Umwandlung einer Familienstiftung in eine gemeinnützige Stiftung' (2011) Liechtensteinische Juristenzeitung (LJZ), 68, 69; this court decision has been confirmed substantially by the Constitutional Court, see StGH 18 November 2003, 2003/65, published in Jus & News 2003, 281.
23. See art 552 § 16 n 4 Persons and Companies Act (PGR).

only be in line with the current law of foundations if due to the family conflict the purpose had acquired a quite different significance or effect, so that Alpha would be estranged from the intention of F.[24] Hence, in the case of Alpha, it is very unlikely that the family conflict would be so serious to justify a dramatic change in the beneficial interest. The cancellation of two children out of the group of S1, D2, S3 and D4 would therefore hardly be in line with the above-mentioned rules of Liechtenstein law. This measure adopted by the foundation council would therefore be void.

According to the Liechtenstein case law, the foundation purpose has to be written down precisely enough to give the bodies of the foundation the chance to recognise the actual intention of the founder. The members of the foundation council need to be in a position that allows them to execute the founder's intentions

Issues related to discretionary foundations

Assuming that Alpha was a discretionary foundation, the foundation council might have a broad range of discretion when assigning certain amounts of money to be distributed to D2 in the first year, and then eventually a similar amount of money to be distributed to S1, S3 and D4 in the following years, etc. Whenever the list of beneficiaries remains the same, a periodic change in the amounts distributed to one or another person named in the list of beneficiaries would not be considered to be a change of the declaration of intention of the founder.

Foundation governance

In the analysed case, the names of S1, D2, S3 and D4 (as well as their descendants per stirpes) are to be considered as part of Alpha's purpose. If these beneficiaries were revoked at a later stage by the foundation council, this would be a change of the purpose.[25] Cancelling beneficiaries from the list in the by-statutes would also reduce the number of persons in charge of control. As mentioned previously, the foundation governance of private foundations is based on the internal control rights of beneficiaries that are carried out by their right to access information as well as to apply to court.

Categories of beneficiaries

It is also useful to distinguish between the various legal categories of beneficiaries when discussing the question of whether the change of the list of beneficiaries in the by-statutes of a specific foundation, such as Alpha, is in line with the Liechtenstein law. If the children S1, D2, S3 and D4 had been just prospective beneficiaries (instead of discretionary or fixed beneficiaries), it would be less likely that their cancellation from the list of beneficiaries contained in the by-statutes could be regarded as an unlawful change of purpose and therefore void. This is due to the fact that the ratio for acknowledging a change of beneficial interest as a change of purpose is inter alia linked to issues of foundation governance. Typically, discretionary and fixed beneficiaries have a stronger position regarding the control as compared to prospective beneficiaries.[26]

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Different solution when purpose is defined more accurately

As a formula it can be summarised that a vague definition of the scope in the statues is legally hazardous since

24. See art 552 § 31 Persons and Companies Act (PGR).
25. According to art 552 § 31 PGR; see J Gasser, *Liechtensteinisches Stiftungsrecht Praxiskommentar* (2nd edn, 2020) 478 (art 552 § 32, recital 3a).
26. Particularly when prospective beneficiaries can expect to be appointed as discretionary (and not as fixed) beneficiaries in the future, see J Gasser, *Liechtensteinisches Stiftungsrecht Praxiskommentar* (2nd edn, 2020) 3 (art 552 § 9, recital 3).

it produces the effect that the list of beneficiaries in the by-statutes becomes a part of the definition of the purpose. This means that a change of the beneficial interest in the by-statutes would be excluded. This is due to the fact that such a measure would therefore be in contrast with the legal requirements for the change of the purpose.[27] Therefore a changing the list of beneficiaries, e.g. by cutting out certain names, is much easier, when the foundation contains a solid and precise definition of its purpose in the statutes. This can be illustrated by modifying the case of Alpha. Thus, our solution pictured in the above-mentioned case study would be significantly different if the founder F had set up Alpha in the first place to maintain and expand Beta Ltd. (its family business that has been brought into the foundation), while the furtherance of his children S1, D2, S3 and D4 would only be an additional component of Alpha's scope. In such a scenario, Alpha's purpose regarding the maintenance and expansion of the family business as well as the furtherance of the certain families in general would typically be contained in the statutes, while the names S1, D2, S3 and D4 would appear just in the by-statutes. By temporarily or permanently reducing the beneficial interest of some of the beneficiaries (e.g. to zero), the foundation council could take a measure necessary to achieve the goal related to the maintenance and expansion of Beta Ltd., e.g. if the measure strengthened the beneficial interest of those beneficiaries who are particularly active in the administration of Beta Ltd. Such a dramatic change in the beneficial interest would not only help to increase the turnover and profits of Beta Ltd., but would also indirectly contribute to the furtherance of the family who is emotionally and financially linked to the family business incorporated in Beta Ltd. The modified case of Alpha shows that a very harsh change of beneficial interest (such as, e.g. the temporary reduction of a beneficiary listed in the original version of the by-statutes to zero) does not necessarily imply a change of the purpose. The legal limits imposed by the Liechtenstein legislation (especially that the purpose needs to have become unachievable, impermissible or irrational, etc.)[28] would therefore not hinder the change of beneficial interest in our modified case.

Conclusion

The Liechtenstein model of private foundations shows that the principles of solidification and flexibility can coexist perfectly. Whenever a private foundation is used as will substitute or as an essential element within an overall asset protection strategy, a later adjustment of the purpose or of other content of the statutes and/or by-statutes might be required in order to fulfil the founder's intentions. The consistent application of the specific legal rules analysed in this article creates legal certainty. Any measure taken by the foundation council that aims at the change in beneficial interest needs to be categorised as a change of purpose or of other contents (such as internal administrative instructions addressed to the internal bodies). Whether such an alteration is valid or void typically depends on the question of whether the purpose of the foundation is changed or not. The precise regime within the Liechtenstein legislation allows for a perfect coexistence of the principle of solidification and the principle of flexibility by granting a high level of legal certainty.

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27. cf art 552 § 31 Persons and Companies Act (PGR).
28. cf art 552 § 31 Persons and Companies Act (PGR).

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