The Austrian Private Foundation: between transparency and bank secrecy

Friedrich Schwank*

Abstract
The Austrian Private Foundation is organized like a company, but operates like a trust. It is a preferred for-profit vehicle, suitable for wealth preservation and management, as well as an alternate holding structure for companies. The Austrian Private Foundation is discreet about its assets and income but transparent in respect to its management. The far reaching erosion of Austrian bank secrecy through international pressure on Austria and Switzerland has had little effect on the operation of the Austrian foundation. On the contrary, offshore funds are being increasingly relocated into Austrian foundations.

Key points
- Austrian Private Foundations are solid structures for long-term planning and wealth preservation.
- The legislator created private foundations as corporate vehicles without shareholders or owners and for wide-ranging purposes.
- Private foundations protect settlors, their family and beneficiaries and can be used as ultimate holding companies.
- Information available to the public is limited to the Foundation Deed filed at the Company Registry, ownership of land in the Land Registry and/or information in financial reports filed by companies/corporations held by the foundation.
- Austrian bank secrecy is no longer fully available to foreigners.

Legal nature and structure of the Austrian Private Foundation
Until 1938 and the annexation of Austria by Nazi Germany, numerous foundations and family settlements existed in Austria. They played an important role not only in managing family wealth but also in social and cultural life. The greater part of these foundations had their roots in the past centuries of the Austrian–Hungarian Empire, when noble families, wealthy citizens, and benefactors established foundations and family settlements for the benefit of future generations, wealth preservation, and the management of large family estates, and for pursuing charitable, benevolent and religious purposes. The Nazis confiscated the wealth accumulated in these structures with a view to filling the coffers of their Regime and financing war-related industries. Numerous families and benefactors of these structures left Austria, others less fortunate who could not leave ended their lives in concentration camps.

*Dr Friedrich Schwank, Law Offices Dr. F. Schwank, Stock Exchange Building, Wipplingerstrasse 34, A-1010 Vienna, Austria. Tel: +43 1 533 57 04; Fax: +43 1 533 57 06; Email: offices@schwank.com; www.schwank.com

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and gas chambers. The wealthy Wittgenstein family were able to disguise their Jewish roots and bought protection by dissolving a Swiss family foundation and surrendering a metric ton of gold to Hitler.

As recently as the last decade of the 20th century Austria faced its past, by public acceptance of the collaboration of many of its citizens in Nazi atrocities and passing legislation for restitution in rem and acknowledgement of insufficient restitution procedures after WWII to the extent that they constituted gross injustice.

Coming to terms with its less than glorious past and mindful of the needs of families to preserve wealth over generations, in 1993 the Austrian legislature created the Private Foundation as a corporate vehicle for a wide range of purposes: for-profit, charitable, social, cultural or mixed purposes but always with the clear concept of creating a wealth preserving structure without any shareholders or owners.

As a corporate structure, the private foundation has strict legal rules to follow in its establishment, operation and householding. It is managed by a board of directors consisting of at least three individual members whereby two of the members must be resident in a country of the European Union. In addition to the board of the directors, the Foundation Deed may also provide for a supervisory board or an advisory council with specific powers and tasks allocated to them. The law allows the settlor a wide discretion in the design of the organizational structure, always provided that the ultimate management power and control rests with the board of directors.

A private foundation is subject to bookkeeping and financial reporting in the same manner and according to the same rules as a corporation. In view of the governance structure, the reporting and auditing requirements, the costs of householding are similar to the costs of operating a stock corporation structure. A basic Austrian Private Foundation will therefore incur annual householding costs in the range of EUR 30,000–50,000 at least.

**A structure for preservation and management of wealth**

Wealth and other assets kept within an Austrian Private Foundation are tax exempt and enjoy privileges and tax benefits otherwise not available to privately held wealth. A precondition for the tax exemption of the Austrian Private Foundation is the absence of any direct business activity by the private foundation. However, existing or intended business activities can and should be outsourced to companies owned and controlled by the private foundation.

Dividends received by the private foundation from its shareholdings are tax exempt, regardless of whether these dividends are distributed by Austrian or by foreign companies. Foreign companies have to meet the preconditions of the international participation exemption of the Corporate Tax Act.

Income of the private foundation in the form of interest or capital gains is subject to taxation at
12.5 per cent. The tax paid by the private foundation for such interest or capital gains income will be fully credited against the withholding tax of 25 per cent to be withheld by the private foundation when making distributions to beneficiaries. Distributions equal to interest and capital gains income will therefore be taxed with the balance of 12.5 per cent only. Distributions in excess of such income will attract a 25 per cent withholding tax.

For beneficiaries tax resident in Austria the withholding tax of 12.5 per cent, or 25 per cent, completely replaces their personal income tax. Non-resident beneficiaries are advised to claim treaty protection which may vary with the tax treaty applicable. A case-by-case analysis of the applicable treaty is required to determine the type of income accruing when the beneficiary receives a distribution from an Austrian Private Foundation.

Non-resident beneficiaries are advised to claim treaty protection

Repayment of endowments to the settlor of the foundation or distribution of such endowments to the beneficiaries are tax exempt, provided these endowments have been made after 31 July 2008. Endowments made prior to that date attract a withholding tax of 25 per cent when repaid to the settlor or distributed to the beneficiaries. Taxation on the repayment or distribution of ‘old endowments’ was only introduced in 2009, to the dismay of quite a number of Austrian settlors and beneficiaries who had the intention to empty the capital base of their private foundations after a certain period of time. This tax is now commonly referred to as the ‘mouse trap effect’ of private foundations.

At the same time, a private foundation entry tax of 2.5 per cent on endowments has been introduced. This tax becomes payable whenever endowments are made to a private foundation. The entry tax is increased to 25 per cent in circumstances where incomplete disclosure of the beneficiaries is made to the tax office. As a result the tax office is able to obtain information about beneficiaries who are listed in an undisclosed ancillary document of the settlor.

No entry tax is payable if contributions are made to a foundation for consideration. This is the case, for instance, when property is transferred to a private foundation but the settlor retains its use or its ‘usufruct’ for his or her own benefit.

The board of directors of an Austrian Private Foundation has, therefore, many ways and means of wealth planning and wealth management. The main strategies are the outsourcing of their own business activities into subsidiaries, limiting interest and capital gains income to a level commensurate with expected distributions, otherwise using corporate planning techniques and, in particular, subsidiaries for reshuffling interest and capital gains into dividend distributing subsidiaries, acquiring properties, hunting grounds, skiing lodges, yachts and other assets for the purpose of providing their use to beneficiaries, rather than distributing capital for acquisition by the beneficiaries. Distributions in kind are also subject to a 25 per cent withholding tax payable by the foundation. The tax base is the capitalized value of the use, e.g., rent, and not the capital value. Some planning is possible with the use of Austrian properties as the lower tax value of the use of the properties will be the basis for calculating the 25 per cent withholding tax, rather than the higher market value of the use.

The Austrian Private Foundation as an ultimate holding structure

When the Austrian legislator drafted the Private Foundation Act in 1993, one of the concerns was the protection of medium and small enterprises which generate about 80 per cent of Austria’s gross domestic product. The ongoing success of the small and medium enterprises was and still is threatened by succession within the families controlling such enterprises. These threats often arose as a result of disagreements between family members who had succeeded to the ownership and management of such enterprises. There is also the commonly known lack of experience and entrepreneurship in the second
or third generation of such families. Last but not least, the succession law itself makes matters difficult, in particular with a view to the Austrian forced heirship provisions for spouse and children, in conjunction with the taxable events resulting from death or the transfer of the business *inter vivos*. For these possible dilemmas, the private foundation provided a perfect solution. Once the private foundation is created, the ownership in the shareholding of the company owning the business is transferred as an endowment into an Austrian Private Foundation. As a result, the board of directors of the foundation has, as representatives of the shareholder, the ultimate control over the management of the company running the operative business. In the Foundation Deed, family members are designated as beneficiaries of the foundation, which enable the settlor to create even-handed benefits amongst the family members, thereby avoiding family disputes threatening both the ongoing success and the existence of the business. Furthermore, the board of directors of the private foundation will be composed of experienced professionals tasked to act in the best interests of the foundation. In turn, the members of the board are subject to the scrutiny of the independent auditor. Members of the board of directors attract a never ending directors’ liability as a foundation does not have any owners or shareholders who could grant them a discharge.

Many Austrian family-owned enterprises took advantage of the private foundation as an ultimate holding structure. Big industrial enterprises which had to be restructured for survival or in order to maintain jobs, public utility companies and businesses owned by associations or interest groups followed suit. As a result, nowadays a considerable part of the Austrian workforce is in the employ of companies or corporations directly or indirectly owned by private foundations.

The Austrian Private Foundation has also been discovered by foreign business interests and corporate strategic planners as a viable solution for an ultimate holding structure without ownership or shareholders. This solution is useful *inter alia* for business activities traditionally carried on by cooperatives, as well as for debt financed structures and private equity.

**The transparency of the Austrian Private Foundation**

One of the attractions of the Austrian Private Foundation for both Austrian and foreign settlors is the limited access of the public to information relating to the private foundation. In relation to the tax authorities, but certainly not to the public, the private foundation has to disclose all material facts including the identity of the beneficiaries.

In particular, the public has no access to the audited annual reports of the foundation and only the tax authorities are aware of its income, wealth and assets. Real property held by the private foundation will of course be visible in the public records of the Land Registry but information as to financial assets will be kept from the general public. Some of the information may be available in the financial reports filed by companies and corporations held by the private foundation but this will be piecemeal information as it will only reflect one of the assets held by the private foundation.

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The Foundation Deed of the private foundation, plus any additional amendments thereto, must be filed with the Company Registry and will be accessible to the general public. However, the Austrian Act on Private Foundations provides that the settlor may establish an ancillary document in which the beneficiaries are nominated and directions are given as to distributions to be made to the beneficiaries. This

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The document remains undisclosed to the public although it will be disclosed to the tax authorities. As a result there is a certain degree of confidentiality surrounding Austrian Private Foundations, the purpose of which is to protect the settlor and his or her family and the beneficiaries. As a result of the strict reporting and auditing requirements and filings with the tax office there will always be full control by the Austrian tax authorities and any foreign tax authorities entitled to an exchange of information under any existing tax treaty. At present, Austria has tax treaties with about 80 countries.

Also, banks providing their services to private foundations will have full access to the financial situation of the foundation under the due diligence and Know Your Client (KYC) rules. Austria has implemented the Third Anti-Money Laundering Directive of the European Union and is fully compliant with all Organisation for Economic Co-operation and Development (OECD) standards.

**Austrian bank secrecy**

For historical reasons, in particular as a result of the confiscation by the Nazis in 1938 of bank accounts and savings held with banks, Austria introduced strict bank secrecy which, before Austria became a member of the European Union, even allowed anonymous savings books and securities deposits, in circumstances where not even the banks knew the identity of the owners.

After the accession of Austria to the European Union in 1995, bank secrecy as such was maintained, although the banks had to verify and document the identity of their customers.

Under the EU Savings Directive, Austria, together with Belgium and Luxembourg, was able to retain the privilege of not having to report foreign account holders to their home jurisdictions. Austria’s statutory bank secrecy is a matter of constitutional law and may only be changed or amended with an increased quorum and a two-thirds majority vote of the members of parliament.

The statute provides that bank secrecy may only be lifted by a court order once criminal proceedings in relation to tax fraud have been commenced, where there is a suspicion of money laundering, on the death of the customer for purposes of succession or with the consent of the bank customer.

The OECD and the other member countries of the European Union have put Austria under pressure to relax its strict bank secrecy or at least to enter into tax information exchange agreements and change the restrictive administrative practice on information exchange under existing treaties. In addition to the treaties for avoidance of double taxation with about 80 countries, Austria has entered into more than 20 tax information exchange agreements with offshore jurisdictions. The OECD has removed Austria from its grey list to the white list and considers Austria to be fully compliant with information exchange. The administrative practice on exchange of information under existing tax treaties is no longer as restrictive as in the past. The Austrian administration now accepts that all international treaties, including tax treaties, override constitutional law. As a result, the administration no longer refuses to exchange information held by banks invoking Austrian bank secrecy and the application of Austrian bank secrecy and its
constitutional protection is now limited to Austrian citizens and/or residents.

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At present, Austria and Luxembourg are blocking negotiations over antifraud agreements between the European Union and third countries, in particular Switzerland, Liechtenstein, Monaco, Andorra and San Marino. The main reason for Austria’s attitude is to achieve within Europe a level playing field of personal taxation. Some other countries in the European Union, notably the United Kingdom, provide tax benefits to ‘non-doms’. While these benefits are admittedly being curtailed, they still exempt non-domiciled residents in the United Kingdom from taxes on their world-wide foreign income. In contrast, Austria taxes all residents - irrespective of nationality—and does not have a concept similar to that of ‘domicile’ in the UK legal and tax system. In Austria, there are also no tax holidays or other tax benefits available to foreigners relocating to Austria, as is the case in other EU countries. For instance, Spain grants a five year tax holiday on the foreign income of foreigners relocating to Spain.

The Austrian Private Foundation must operate within a strict legal framework, with special rules keeping the interests of the settlor, the board of directors and the beneficiaries strictly apart, while trusts in other countries, in particular trusts established in common law jurisdictions, including the Channel Islands and other offshore centres, are less regulated and allow the settlor and/or beneficiary a much wider leeway in avoiding taxation while still being able to control the funds and assets kept in the trust. This has given rise to some concern on the part of the Austrian government.

Outlook and planning strategies with the Austrian Private Foundation

As a corporate entity with strict rules governing its structure, its governance and operation, the Austrian Private Foundation is a solid, though expensive, structure for long-term planning. While a not-for-profit foundation can be established for an indefinite period, a for-profit foundation can be established by the settlor for a term of 100 years. Upon expiry of the 100 years the beneficiaries have the power to decide whether or not to continue with the foundation. They are able to resolve on the continuation of the private foundation, so that after another 100 years the beneficiaries may decide again whether to continue or dissolve the foundation.

Austria has faced criticism that quite a number of beneficiaries of private foundations are not on the public record, as they may be nominated in an undisclosed document ancillary to the Foundation Deed. This criticism is not justified as private foundations, like foreign law trusts, are private in the same manner as bank accounts or credit card statements, but they are not secret. The information has to be provided to the tax authorities and also to the banks in the course of financial transactions. Therefore, the identity of beneficiaries may well be disclosed in the course of an information exchange between Austria and foreign tax authorities or regulatory or criminal authorities. In any case, it is unlikely that the rules for the Austrian Private Foundation will be changed while the rules for foreign law trusts remain unchanged.

As a result, it can safely be said that the Austrian Private Foundation, though private, is, for tax and regulatory purposes, transparent and not opaque. As the private foundation is an Austrian resident legal entity, its Austrian bank accounts will be fully protected by Austrian bank secrecy although non-resident beneficiaries will not be able to rely on bank secrecy in respect to distributions they receive.

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In view of the enhanced international cooperation in tax matters and the ever increasing requirements of disclosure for regulatory and security purposes, the Austrian Private Foundation, due to its strict
corporate law regime and independent auditing requirements, is a most suitable vehicle for the international wealth industry and family offices for years to come. The tax burden may be somewhat greater than in offshore jurisdictions and also the householding costs may be higher but that downside is more than compensated by the upside of a suitably long-term and stable structure in an onshore jurisdiction of high repute.