

Changes in the practice regarding tax exemption of charitable foundations in the Cantons of Zurich and Vaud

As of February 1, 2024, the Canton of Zurich has relaxed its practice on the tax exemption for charitable institutions, making Zurich a more attractive jurisdiction in particular for foundations. Reasonable remuneration, activities abroad and entrepreneurial support models (impact investments) are now explicitly permitted. On January 29, 2024, the Vaud Tax Administration published guidelines specifying its practice with regard to the remuneration of members of the governing bodies of tax-exempt charitable institutions. The changes generally apply to the tax exemption of all charitable institutions. In the following, the focus is placed on charitable foundations, whereby possible actions for existing foundations are highlighted.

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Change in practice in the Canton of Zurich

Appropriate remuneration

Previously, in order to qualify for tax exemption in the Canton of Zurich, foundation board members had to work on an honorary basis. Exceptions were only accepted for tasks that went beyond ordinary activities.

Charitable foundations in the Canton of Zurich may now provide for appropriate remuneration for

their governing bodies. The Zurich Tax Administration will, in principle, base its assessment of the appropriateness of the remuneration on the assessment of the Supervisory Authority for Foundations. The Zurich Tax Administration will only conduct its own review if the appropriateness of the remuneration appears doubtful, in particular if it seems that the foundation's funds are being used improperly.

Activities abroad

The previous practice of the Zurich Tax Administration required that the foreign activity take place in a developing or emerging country and be in the interest of Switzerland in order to qualify for tax exemption.

With the change in practice, the activities abroad of charitable foundations will generally be treated in the same way as those performed in Switzerland. The only requirement is that the activity has a positive impact in Switzerland or is at least considered worthy of support from a Swiss perspective. This is in line with the existing practice in several other cantons (e.g. in the Canton of Geneva).

Entrepreneurial support models (impact investments)

The change in practice also takes into account the fact that charitable foundations are increasingly using entrepreneurial support models. Thus, it is now permissible for charitable foundations to use entrepreneurial support models (loans, equity investments, convertible loans), even if a return of funds to the charitable foundation is possible (repayment and interest on loans, income from equity investments, profit sharing). However, this is only allowed in areas where there is no market (yet) and where investments would not be made by profit-oriented third parties. The funds returned must then again be used for charitable purposes.

Practice clarifications in the Canton of Vaud

The guidelines published by the Vaud Tax Administration are more limited in scope than the new Zurich practice. They focus on the question of the honorary or selfless nature of the activity of the members of the governing bodies of tax-exempt charitable foundations.

Remuneration

The Vaud Tax Administration continues to follow the principle that, barring exceptions, members of the boards of charitable foundations must act in an honorary capacity. In this respect, a distinction is made according to the number of hours devoted to the mandate per year:

- **Commitment up to 60 hours per year:** The member of the board must act in an honorary capacity. In this case, members of the board are only entitled to a reimbursement of expenses. It should be noted, that a lump-sum reimbursement of expenses requires the adoption of regulations which must be approved in advance by the Vaud Tax Administration.
- **Commitment over 60 hours per year:** In this case, the Vaud Tax Administration accepts, in principle, a remuneration. Any such remuneration must be set out in regulations submitted to the Vaud Tax Administration for prior approval, specifying in particular the member's duties and the method used to determine the remuneration. It must be subject to a ceiling.

Cases of a lack of selflessness

Even when a member of the board is not remunerated for their position, their activity may not be considered honorary or selfless if they have certain other links with the foundation. In particular, the Vaud Tax Administration considers a member not acting in a selfless manner when they are an employee of the foundation or of a company owned by the foundation. The new guidelines also address situations where a member of the board (e.g. attorney, notary or architect) or a related person is separately commissioned for a task. Such commissions should remain the exception. In these instances, a case-by-case assessment is required, which may involve consultation with Vaud Tax Administration.

Impact on new and existing charitable foundations

The changes and clarification in the practice of the Zurich and Vaud Tax Administrations described above will be particularly important for **newly established foundations**. They also illustrate the importance of taking into account the tax practice of each canton, when establishing a charitable institution.

The new practice in the Canton of Zurich will enable charitable foundations, especially those with international activities, to take advantage of the donor potential in the Canton of Zurich and in Switzerland. In this respect, the practice in Zurich comes closer to that of the Canton of Geneva, which has a long tradition of openness towards internationally active foundations. In contrast, the Canton of Vaud, remains more restrictive, requiring the foundation to be active in Switzerland while also having a local presence abroad.

Donations to a charitable foundation in Switzerland are generally tax deductible up to 20% of net income for individuals resident in Switzerland. Donations to a charitable foundation based in Switzerland or in the donor's canton of residence also carry less risk in terms of inheritance and gift taxes compared to foreign charitable institutions.

Subject to mandatory legal and statutory provisions, it is advisable in most cases to implement detailed provisions in a set of regulations, since they may be amended more easily if necessary.

Existing foundations and foundations relocating to Zurich or Vaud may also react to these changes in practice. It is necessary to distinguish whether the affected provisions are included in the foundation charter or in a set of regulations:

- **Foundation charter:** With the revision of the law on foundations as of January 1, 2024, amendments of the foundation charter were partially made easier. The Supervisory Authority for Foundations is given the power to make *insignificant amendments* that relate to the purpose or organization of the foundation, after consulting the foundation board, provided that the amendments are justified on objective grounds and that no rights of third parties are affected. Generally, the foundation board also has the possibility to file an application to this effect with the Supervisory Authority for Foundations. According to the doctrine and the practice, insignificant organizational changes include formalities of the foundation's internal procedures, which include provisions on remuneration. In addition, changes to the investment regulations are also considered to be insignificant. Foundation-specific provisions are always reserved. The line between what constitutes an insignificant and a significant amendment is blurred and is often a matter of discretion.

Significant amendments to the purpose of the foundation are only possible under strict conditions. Expanding the activities of the foundation abroad is likely to be considered a significant change of a foundation's purpose. Such a significant change in the purpose requires

(i) that the original purpose has taken on an altered meaning respectively effect to such an extent that the foundation has clearly departed from the founder's intent, or (ii) that the founder has reserved the right to amend the purpose in the charter and at least ten years have elapsed since the last amendment was requested.

Amendments to the foundation charter are subject to a ruling from the competent authority. A public deed is not required for the amendments.

- **Regulations:** If the relevant provisions are contained in a set of regulations, an amendment must generally be submitted to the Supervisory Authority for Foundations for approval.

It is to be assessed on a case-by-case basis in which manner an amended provision in the foundation charter or the regulations is to be submitted to the competent tax administration.

Further considerations

When remunerating members of the foundation board, it should be noted that the remuneration may be subject to social security and pension funds contributions. In addition, foundation board members with foreign connections may be subject to income taxation at source. The foundation board must therefore ensure that the foundation fulfills its contribution and reporting obligations.

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