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Foreign Private Foundations for Canadians

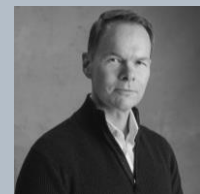
By James Bowden | 2 August 2022

A private foundation is a corporate entity with separate legal personality, but which has no owners, and therefore does not issue shares or other ownership interests. It is established by a founder who contributes initial funds or assets to the foundation. The foundation is governed by its constitutional documents, which typically consist of a charter and bylaws, and a governing body called directors or council members. There will typically also be a guardian or enforcer who is empowered to supervise the directors to ensure they are complying with the foundation charter and bylaws, and with their duties as directors under applicable law. The foundation's charter or (more likely) bylaws will identify the foundation's beneficiaries, if any, or its purpose, along with all other rules by which the foundation and its directors are to be governed. Those rules may include, for example, guidance as to how the foundation is to invest and manage its assets, how it is to distribute them to beneficiaries through generations or otherwise use them towards the foundation's stated purpose, and how decisions are to be made by the foundation's directors, among other things. Private foundations have a long history in the civil law world as useful vehicles for family wealth management, estate planning and asset protection across multiple generations. They are used for many of the same purposes as trusts in the common law world, and are indeed sometimes viewed as trust substitutes.

A private foundation offers certain advantages over a trust structure which make them very useful in the context of wealth and succession planning, which include¹:

- A foundation is a corporate entity with legal personality, which can own its own assets, contract in its own name, and which enjoys limited liability, but can carry out the functions of a trust, including a purpose trust. In order for a trust structure to achieve a similar result, a holding company is required in addition to the trust itself, resulting in a greater administration burden.

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James is the founder and Managing Director of Afridi & Angell's Toronto office, which primarily services the private client space in local and international estate planning, and creating structures using trusts and foundations.

Areas of expertise include succession planning, the use of trusts locally and internationally, tax planning, asset protection, tax-driven changes in residency, and estate structuring. The Toronto office also continues to provide corporate and commercial support in many instances.

¹ Some of the advantages described here can be achieved with trust structures as well, but these are inherent to foundations whereas trusts would need to be carefully drafted to achieve these benefits.

- Foundations are more readily recognized and accepted by financial institutions, asset registries (land registries), and contractual counterparties in many more parts of the world than trusts (including Europe, Asia and the Middle East). There is also growing formal recognition of private foundations in common law jurisdictions, some of which have introduced their own foundation laws.²
- Beneficiaries are not required to have rights to receive information from the foundation, allowing for much greater confidentiality than a typical trust structure.
- There is very limited, and sometimes no, publicly available information regarding a private foundation. The foundation's bylaws typically contain the detailed terms governing the foundation, and the bylaws need not be filed with any regulatory body.
- Foundations are not burdened by the often antiquated and seemingly arbitrary legacy of common law rules that afflict trusts, such as the rule against perpetuities or the right of beneficiaries to collapse a trust under what is known as "the rule in *Saunders v. Vautier*".
- The directors of the foundation are not subject to the equitable common law duties to which trustees are bound. They owe no fiduciary obligation to beneficiaries, only to the foundation itself. Similarly, beneficiaries need not be given any standing to enforce the terms of the foundation, and need not have any rights or entitlements from the foundation whatsoever.
- Because of their corporate status and limited liability, foundations are useful for holding higher risk assets which may attract claims. A trustee, by contrast, may be wary about accepting such assets or may charge greater fees to hold and manage them.
- Foundations offer the same, or potentially greater, asset protection benefits as trusts. Since claims must be made against the foundation itself (as opposed to a trustee), there is less direct concern around liability of directors (as opposed to trustees who do have that concern). Also, civil law jurisdictions may not recognize the existence of a trust and simply attribute trust assets to the settlor for purposes of, for example, a divorce settlement.

In view of the above, a Canadian may wish to consider a private foundation where there is a desire not to extend information and enforcement rights to beneficiaries, minimize potential for claims, where the foundation will be investing, banking, or holding assets outside of the common law world, or where a founder and founder's family resides in a civil law jurisdiction. As discussed below, a foundation may also be useful in a tax planning context.

While the benefits of private foundations are compelling in the right circumstances, it is important to consider how the Canadian courts view foreign private foundations, and consequentially how they are viewed from a Canadian tax perspective. As noted, private foundations do not exist in Canadian law.³ The approach taken by the Canadian courts when faced with a foreign legal entity which does not exist under Canadian law is a two-step approach, whereby it first examines the characteristics of the entity as defined under the applicable foreign laws and the entity's own constitutional documents, and then compares those characteristics with those of entities recognized under Canadian law.⁴ The foreign entity

² The Cayman Islands and the UAE's common law financial free zones (the Dubai International Financial Centre and Abu Dhabi Global Markets) offer private foundation structures under their domestic laws, for example.

³ While private foundations are not expressly contemplated under Canadian law, the *Income Tax Act (Canada)* does expressly contemplate foreign corporate entities that do not have share capital, at section 93.2, which is a description that could very well apply to a private foundation. Section 93.2 allows the CRA to treat interests of beneficiaries effectively as shares for tax purposes if the interests of the beneficiaries amount to a right (absolute or contingent) to receive payments.

⁴ This approach was developed in *Backman v. Canada* [2001] 1 SCR 367, 2001 SCC 10 and applied many times in subsequent decisions, and is the approach used by the CRA as well.

will be treated as the type of Canadian entity it most closely resembles. Using that type of analysis, a Canadian court will treat a foreign private foundation as either a corporation or a trust.

There are many potential factors that will influence a court's and the Canada Revenue Agency's (CRA) determination that any particular foreign private foundation is more analogous to a corporation or a trust. These include such things as how the foundation is controlled, any rights reserved by the founder, who can enforce the foundation's terms, the nature of beneficiary rights, duties of directors, how the foundation is described under local laws, and how the foundation actually functions in practice. The CRA has stated expressly that the most important attributes to consider are the nature of the relationship between the various parties and the rights and obligations of the parties under applicable law and the foundation's constitutional documents.⁵ The Canadian courts, in the very limited jurisprudence that exists on the subject, have also focussed on the nature of the relationships and the respective rights and duties among the parties to the foundation in order to arrive at their determination.⁶ The hallmarks of a trust relationship will include such things as a trustee's fiduciary duty towards beneficiaries, the existence of beneficiary rights, and a beneficiary's ability to enforce its rights against the trustee (among other things). A foreign private foundation can be structured in a manner that creates similar relationships to a trust, or in a manner that does not. Since it will be a case-by-case analysis, it is not possible to achieve absolute certainty as to whether any particular foreign private foundation will be treated as a corporation or a trust by a Canadian court (or the CRA). The analysis, however, can be predictably and materially influenced by how the foundation is structured. The Canadian legal and tax treatment of a foreign corporation (and a Canadian shareholder) is materially different from the legal and tax treatment of a foreign trust (and a Canadian beneficiary). Therefore, thoughtful structuring of the foundation is key from a Canadian planning perspective.

With the right planning at the outset, a foreign private foundation can be part of a stable, efficient and effective wealth management, protection, and succession plan for Canadians. Private foundations are available under the laws of several jurisdictions worldwide, including notably Lichtenstein, The Netherlands, The Cayman Islands, Panama and the UAE. Specialist advice is essential.

If you would like to discuss whether a private foundation structure is right for you, please contact us. ■

⁵ See for example CRA Income Tax Technical News No. 38. It should also be noted that the CRA has expressed its view that, generally, it will consider a Lichtenstein foundation to be a trust. That stated position is not binding and has no legal force, and does not change the fact that the courts will consider each foundation according to its own characteristics in order to determine whether it should be treated as a corporation or a trust. The CRA's position was specific to Lichtenstein foundations, and may not apply to foundations established under other regimes which differ from the Lichtenstein regime. For the CRA positions see Technical Interpretation 2008-0266251 I7 dated 15 April 2008, reiterated in Technical Interpretation 2010-0388611 I7 dated 7 March 2011.

⁶ As summarised in the 2012 Federal Court of Appeal judgment in *The Queen v Peter Sommerer* (2012 FCA 207), and the Tax Court of Canada decision in the same matter, *Sommerer v. The Queen* (2011 TCC 212).

Afridi & Angell

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Afridi & Angell Professional Corporation, Afridi & Angell's Toronto office which was established in 2021, takes advantage of the firm's many Canadian ties and brings to our Canadian clients, and those with Canadian interests, the highest standards of advice and client service for which Afridi & Angell is known. Our Toronto office, which operates as a separate legal entity from Afridi & Angell's UAE offices, provides legal and advisory services in the following areas: corporate and commercial; mergers and acquisitions; tax planning and advisory; asset protection; private client and estate planning; anti-money laundering and anti-bribery compliance; IT outsourcing and contracting; consulting on Canada-UAE opportunities and cross-border legal issues.

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