Chapter 13
Foundations Law in Spain

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13.1 Spanish Foundations Law

13.1.1 Foundations and Spanish Constitution: Right to Establish a Foundation

Analysis of the Spanish Foundations Law needs to start from the basis of one of its unique characteristics, the recognition of the right to establish a foundation under Article 34 of the Constitution of 1978, which states: "The right to set up foundations for purposes of general interest is recognized in accordance with the Law". That which is established for the right of association (Article 24 of the Spanish Constitution) applies to the right of foundation in that "associations which pursue ends or use means classified as criminal offences are illegal" and, with regard to their dissolution, "associations may only be dissolved or have their activities suspended by virtue of a justified court order". The right to establish a foundation is covered under the rights in Section II, *Rights and Duties of Citizens*, of Chapter II, *Rights and Liberties*, of title I, *On Fundamental Rights and Duties*. Like all the rights and liberties in Chapter II, it is binding for the public bodies and the conditions for exercising the right must be developed by Law, although, unlike the right of association, this shall not take the form of Organic Law. As this right is covered under those in Section II, it is protected by appeal on the grounds of unconstitutionality, which falls within the jurisdiction of the Constitutional Court. Unlike the right of association, the protection of which may be sought by any citizen, it cannot be subject to an appeal for *amparo* before the aforementioned Constitutional Court.

There are historical reasons behind the recognition of the right of foundation under the Constitution in 1978, due to the disentailment process which started at the end of the eighteenth century and essentially took place throughout the nineteenth

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century in Spain (García de Enterría 1992, 124). Various disentailment processes were used by the liberals in an attempt to eliminate the so-called mortmain and entails, which had been in force up to then, to enable some amortised assets (taken from the free market), and in the possession of certain civil and ecclesiastic institutions, to be transferred. It should be noted that nineteenth-century disentailment legislation did not use the term foundation in the purely formal, civil sense of *universitas bonorum* as opposed to *universitas personae,* but as a synonym for a charitable institution. These sorts of charitable institutions were forbidden at the beginning of the nineteenth century yet were allowed later on, as the serious consequences of their prohibition were noticed. They were allowed, but only with major restrictions. Therefore recognition in the Spanish Constitution of the right of foundation has to be understood within this historical context and in the light of nineteenth-century legislation, which has been in force in part until very recently and which resulted in the disappearance of several institutions of this type with irreparable consequences.[1] Furthermore, as several authors point out, Article 34 of the Constitution prohibits or limits the State, defined constitutionally as a *social* and democratic State governed by the rule of Law, having a monopoly over securing the general interest, ensuring that private initiative may intervene in achieving that general interest (García-Andrade 2005, 28–29).

13.1.2 Distribution of Powers Between the State and the Autonomous Regions

In order to discuss and analyse the legal framework of the Foundations Law, mention must be made, albeit brief, of the system for the distribution of powers between the State and the Autonomous Regions as defined by the Spanish Constitution of 1978. Two types of powers need to be distinguished from the perspective of the Foundations Law. On the one hand, the administrative and supervisory powers – *Protectorate* – attributed to the Autonomous Regions and State Government, respectively, for foundations in their respective areas of competence. And on the other hand, the legislative powers attributed to the different regional parliaments and the State parliament or legislator with regard to legislation on foundations.

All the Autonomous Regions, apart from the autonomous cities of Ceuta and Melilla, have been given supervisory and monitoring powers over foundations, that is, over regional foundations, those which undertake activities *principally* within the territorial area of that autonomous region. These powers are exercised through the corresponding autonomous Protectorates, administrative bodies responsible for said functions in each Autonomous Region. The allocation of these powers does not

[1] García-Andrade (2001) makes a thorough analysis of the desentailment process and the use of the term foundation in a material, not a formal, sense.

remove that of the State, which exercises Protectorate or supervisory functions over foundations at State level, whose activities are undertaken *principally in more than one Autonomous Region*.

The various issues that are affected by the Foundations Law need to be outlined with regard to the legislative powers governing the foundational institutions. On the one hand, as the *right of foundation serving a purpose of general interest* is a right which is recognised under the Constitution; it falls to the State legislator – the Spanish Parliament – to regulate the basic conditions for exercising this right using a State law. Article 149.1.1ª of the Constitution, which attributes exclusive power to the State over the "regulation of the basic conditions guaranteeing the equality of all Spaniards in the exercise of their rights and in the fulfilment of their constitutional duties". Such provisions, affecting aspects such as, amongst others, the definition itself of foundation; the obligation for foundations to pursue purposes of general interest, or to acquire an independent legal personality, an address; and the regulation of foreign foundations, apply to any foundation, whether at State or regional level, and therefore are binding to the legislators of the autonomous regions.

On the other hand, some of the areas affecting the legal system governing foundations involve commercial and procedural legislation – liability action taken against trustees, precautionary suspension by a judge – and the state legislator is solely responsible for its regulation (Article 149.1.6ª of the constitution). Finally, some issues which affect the Foundations Law constitute civil legislation – the procedures for setting up the foundation, the content of its Statutes, endowment, trustee duties and other aspects – and its regulation falls to the State regulator, although without prejudice to the preferential application of some Autonomous Regions who have their own special Law or Law relative to the *fuero* and therefore have regulations which govern certain civil institutions, in which case such regulations shall have precedence over State legislation.

The remaining areas may be subject to regulation by the legislators of the autonomous regions. For the same reason, any other precepts of the state law on foundations which do not affect the areas reserved for the State shall apply only to state foundations, as defined above. Section 13.1.3 below shows that not all the Spanish Autonomous Regions have exercised their legislative powers in the area of foundations; in these communities State legislation applies to regional foundations.

In tax terms, the Spanish Constitution reserves power over *general finances and the state debt*, exclusively to the State (Article 149.1.14ª). Only the Autonomous Regions with their own *foral* regimes – the Basque Country and Navarre – have tax powers and therefore have regulated the tax systems for foundations and non-profit bodies and sponsorship.[2]

[2] The remaining Autonomous Regions only have the power to grant certain tax benefits which apply to donations made by natural persons.

13.1.3 Legal Framework: Critical Analysis

Act 30/1994, of 24 November, on "Foundations and Tax Incentives for Private Participation in Activities of General Interest" *(Ley 30/1994, de 24 de noviembre, de Fundaciones e Incentivos Fiscales a la Participación Privada en Actividades de Interés General)* provided legislative development of the right of foundation which is recognised under the Constitution. This Act regulated the substantive and procedural regime for foundations and the tax system, not only for foundations but also other non-profit bodies, such as associations serving the public interest. At the same time it established the tax incentives which apply to sponsorship. Some Autonomous Regions had passed their own laws on foundations after the promulgation of the Constitution and prior to the State Act of 1994; however, they had done so within the area of their respective powers. Given that certain areas could not and cannot be regulated by the Autonomous Regions, the Act of 1994 constituted a milestone in Spanish foundation Law.

The new law served to put an end to the fragmentary, piecemeal system in place until then and ultimately provided legal security for setting up and operating foundations. The explanatory notes to the Act explain that the updating of legislation on foundations was determined by the constitutional recognition of the right of foundation but was also *due to the importance acquired by the aforementioned right of foundation*. The effect that the Act of 1994 had on the pace at which foundations were created in Spain is vouched for by the aforementioned data, bearing in mind that 65.3 % of the foundations currently registered were created after that date.

Nonetheless, the practical application of the Act immediately brought to light some of its shortcomings and loopholes. On the one hand it was a law which still gave little autonomy to foundations, as it established an ex ante authorisation system for numerous acts of disposition of patrimony. It also granted the supervisory authorities, the Protectorate, a great many discretionary powers, enabling them to judge not only the legality of certain acts but also their expediency. In terms of tax, the Act of 1994 established a catalogue of non-profit bodies based on their legal form as long as they also fulfilled a series of objective requirements and vouched for these before the tax Administration. It declared some, but not all, of the income gained by these bodies exempt, setting a reduced rate for the rest. It also established the regime for sponsorship incentives for donations and contributions to these non-profit bodies made by individuals and companies. Thus, the foundation sector started to contemplate the need to amend this Act, a process which commenced in 2001 and which culminated in the passing of a new Act, Act 50/2002, of 26 December on Foundations (*Ley 50/2002, de 26 de diciembre, de Fundaciones*) at the end of 2002. This time, a different legislative technique was used and the tax regime for non-profit bodies and sponsorship incentives was regulated in a different Act, which was processed and approved at the same time as the Foundations Act: Act 49/2002, of 23 December, on the Tax Regime for non-profit Bodies and Tax

Incentives for Sponsorship (*Ley 49/2002, de 23 de diciembre, de Régimen Fiscal de las Entidades sin Fines Lucrativos y de los Incentivos Fiscales al Mecenazgo*).

The Foundations Act of 2002, currently in force, was really a partial amendment of the previous Act, and one of its objectives was to respond to some of the demands of the foundation sector to combat some of the inflexibility of the previous legislation: simplifying administrative procedures, reducing the control procedures of the supervisory authority and reforming the organisation and operational structure for governing and representing the foundation. This Act certainly did eliminate some of the prior authorisation assumptions laid down in the previous legislation, but some were preserved. Furthermore, some obligations remain rigid, such as devoting a percentage of the income gained by the foundation to fulfilling purposes. And, from the foundation sector's point of view, the procedures have hardly been simplified.

As regards the tax system, Act 49/2002, also currently in force, maintains the same system as its predecessor, setting out a range of entities which, from a subjective point of view, may have recourse to a special or more beneficial tax system and laying out the set of requirements which, from an objective point of view, they need to fulfil. Unlike the previous Act, the tax benefits apply automatically and do not have to be requested exemptions, although their implementation needs to be vouched for year by year, by presenting a report to the tax Administration. This Act constitutes progress in terms of the corporate taxation of non-profit bodies, as almost all their income is declared exempt. However it leaves sponsorship incentives virtually unaltered.

Over the years, some Autonomous Regions have passed different foundation laws or have amended existing ones, within the scope of their respective powers. In this process, the passing of the State laws of 1994 and 2002 constituted a significant boost for the Autonomous Communities to legislate or make amendments in this area, although a few of them have barely made any changes from State legislation and therefore cannot be considered very innovative.

At present, in addition to the State laws, Act 50/2002, of 26 December, on Foundations (*Ley 50/2002, de 26 de diciembre, de Fundaciones)* and Act 49/2002, of 23 December, on the Tax Regime for non-profit Bodies and Tax Incentives for Sponsorship (*Ley 49/2002, de 23 de diciembre, de Régimen Fiscal de las Entidades sin Fines Lucrativos y de los Incentivos Fiscales al Mecenazgo)*, the following laws are in force in the Autonomous Communities mentioned: Act 10/2005, of 31 May, on Foundations in the Autonomous Community of Andalusia (*Ley 10/2005, de 31 de mayo, de Fundaciones de la Comunidad Autónoma de Andalucía*); Act 2/1998, of 6 April, on Foundations in the Canary Islands (*Ley 2/1998, de 6 de abril, de Fundaciones Canarias*); Act 13/2002, of 15 July, on Foundations in Castilla y León (*Ley 13/2002 de 15 de julio, de Fundaciones de Castilla y León*); Act 4/2008, of 24 April, of the Third Book of the Civil Code of Catalonia, relating to Legal Persons (*Ley 4/2008 de 24 de abril, del Libro Tercero del Código Civil de Cataluña, relativo a las Personas Jurídica*s); Act 12/2006, of 1 December, on Foundations of Galician Interest (*Ley 12/2006, de 1 de diciembre, de fundaciones*

de interés gallego); Act 1/2007, of 12 February, on Foundations in the Autonomous Region of La Rioja (*Ley 1/2007, de 12 de febrero, de Fundaciones de la Comunidad Autónoma de La Rioja*); Act 1/1998, of 2 March, on Foundations in the Community of Madrid (*Ley 1/1998, de 2 de marzo, de Fundaciones de la Comunidad de Madrid*); Foral Act 10/1996, of 2 July, regulating the tax regime of foundations and sponsorship activities (*Ley Foral 10/1996, de 2 de julio, reguladora del ré gimen tributario de las fundaciones y de las actividades de patrocinio*); Act of the Basque Parliament 12/1994, of 17 July 1994, on Foundations (*Ley del Parlamento Vasco 12/1994, de 17 de junio de 1994, de Fundaciones*); and Act 8/1998, of 9 December, on Foundations in the Valencian Community (*Ley 8/1998, de 9 de diciembre, de Fundaciones de la Comunidad Valenciana*).

Spanish legislation on foundations establishes one legal system and one system of obligations for all foundations, without distinguishing between the different types of foundation and therefore irrespective of their means of funding, funders, trustees or initial or subsequent patrimony. Thus, from a legal perspective, differences cannot be established between operating foundations, patrimonial foundations, and company foundations; however, we define them.[3] Nevertheless, whenever there is debate about the need to amend current legislation and how it needs to be directed, time and again the same issue arises – the validity of the same regulation for an institution, such as a foundation, which is becoming increasingly less monolithic. Opinion on the positive or negative effects of current legislation differs depending on the type of foundation in question. Although the sector has always defended uniform regulation, it should be highlighted that, paradoxically, legislation on foundations, still applied to operating foundations and patrimonial foundations alike, is more perverse and flawed for the latter than in the case of operating foundations. Areas which have already been flagged up such as the obligation to devote income and revenue to fulfilling the foundation's purposes, as shown in a recent study (Petitbò Juan y Hernández Marcos 2009), occasionally make it difficult to preserve the real value of the foundation's patrimony. Warnings of the possible harmful effects of this on patrimonial foundations had already been given as the Act of 1994 was in process and again in 2002, but these have come to light clearly in the current economic climate, with low rates of patrimony profitability and growing inflation. Also, a failure to adequately safeguard the founder's will, in the light of the almost absolute powers of the Committee of Trustees, who can modify some of the issues essential to the foundation and considerably deviate from the will of the foundation, is occasionally another area of uncertainty for patrimonial foundations. Amendment of some of the points of the Statute can be forbidden by the founder, but results in the operation of the organisation are becoming very rigid. Finally the authorisation system, relating mainly to acts of

[3] However, there are other types of bodies, which go under the name *Foundation*, which the Foundations Act itself excludes from its scope of application and which are different bodies to private-Law foundations: some public-Law entities referred to as public-health foundations or National Heritage Foundations. Religious foundations, including the canonical foundations of the Catholic Church, are also governed by their own specific legislation.

disposition of patrimony, do apply to grant making foundations mainly than to operational foundations.

13.1.4 Definition of Foundation

Act 50/2002, of 26 December, on Foundations defines these bodies as "organisations constituted as non-profit organisations whose patrimony is allocated permanently to the fulfilment of general interest purposes, according to the wishes of their founders". The Act of 1994 already contained this definition, and it should be noted that it abandoned the traditional definition of foundations as *patrimonies* intended for general interest purposes. It gives predominance to the organisational element of these entities and considers them *organisations*. In this way it is acknowledged that while foundations are patrimony-based entities, at the same time, as organisations, they are able to generate and provide their own resources towards the fulfilment of the purposes of the foundation. Therefore from a conceptual point of view, we outline the key features of a foundation as follows: (1) organisation, (2) a not-for-profit philosophy, (3) the will of the founder, (4) patrimony and (5) general interest purposes.

We refer here to two of these features: the patrimonial element and general interest purposes, as the essential features of foundations as non-profit organisations.

13.1.5 Endowment

A foundation's patrimony is made up of all the goods, rights and obligations subject to the financial valuation of that which is owned by the foundation. Within the patrimony, considered a whole, two different patrimony masses need to be considered, on the basis of their different legal jurisdiction: the goods and rights which form part of the endowment and the others acquired by the foundation following its constitution, whether or not they affect the endowment. In turn, the foundation's endowment, in accordance with Article 12 of the Act, shall comprise the goods and rights which made up the initial endowment and also by all others which, during the existence of the foundation, have been contributed as such by the founder or by third parties, or which are permanently allocated by the Committee of Trustees for the foundation's purposes.

An endowment *appropriate and sufficient* for fulfilling the purposes of the foundation is an essential condition for its constitution. The Act of 1994 did not include any presumption of a sufficient amount or indicate any minimum endowment for a foundation, leaving this at the complete discretion of the public Administration to classify the foundation in order to determine the amount. Nevertheless,

in practice, 6,000 € paid in full was accepted for the constitution of a foundation. However, Act of 2002 established the adequacy and sufficiency of a foundation's endowment, a monetary or other types of good or right, at 30,000 €. Thus, administrative discretionality was reduced, establishing a presumption *juris tantum*, but introducing a potential limitation of the right of foundation.

Amongst the arguments against establishing a minimum limit considered excessive was precisely the argument that the evolution made by the foundation from *patrimony* to *organisation* should be considered.[4] In defence of those who upheld the need to set an initial minimum endowment which required a sufficient financial commitment on the part of the founders, it should be pointed out that many of the foundations were set up with an initial outlay of at least 25 % of the minimum endowment required, with the commitment that the remainder would be provided within a period not exceeding 5 years – a possibility covered under the Act – it proved very difficult to obtain the remaining capital from the founders once this period had elapsed. In the report issued by the Council of State (1636/2002) on the draft bill, the advisory body indicated that establishing a minimum amount to set up a valid foundation was not a requirement "which prevented the constitution of Foundations with financial endowments of less than this amount, but only a presumption juris tantum that the endowment is sufficient when it totals 50,000 euros" – the amount which was initially required in the bill – "This presumption does not release each case from an evaluation of the adequacy and sufficiency of the endowment for the foundation's purposes, it only obliges those Foundations whose endowments are below 50,000 euros to present a first action programme and a financial study to demonstrate their viability using only said resources". It added "The required amount is not excessive for establishing the aforementioned obligation. The intervention of the Protectorate with regard to the sufficiency of the endowment is covered under article 36.2 of the current Act and is consonant with the purpose of said institution which is, as the Constitutional Court Ruling 49/1988 of 22 March states, "to ensure the fulfilment of the purposes of the Foundation and the proper administration of its assets", therefore there should be no objection to their being conferred the aforementioned duty".

In practice, in those cases where the initial endowment amounts to 30,000 €, the Protectorates do not require any other evaluation. However Protectorates very infrequently allow the constitution of a foundation with a lower initial endowment, despite the provision of the Act. In short, it can be very difficult to demonstrate viability by means of a financial feasibility study and the foundation's first action programme, with less than 30,000 € – or even with that amount – particularly in cases where the endowment is not monetary, and especially because it has to be taken into account that the Act sets a specific regime for acts of disposition of the

[4] Following the Act of 2002, the Catalan legislation regulating foundations which set the initial endowment at 60,000 was amended. This rule was amended to place it in line with State legislation.

goods and rights which make up the foundation's endowment, which is contradictory to the provisions of the Act with regard to the initial endowment.

Article 21.1 of the Act establishes "the disposal, for payment or otherwise, and the transfer of goods and rights which form part of the endowment, or which are directly linked to the fulfilment of the purposes of the foundation, require the prior authorisation of the Protectorate, which shall be granted if there is duly proven just cause". Amongst other conditions, the allocation of the moneys received from the disposal must be specified in the procedure for requesting authorisation and for valuing the goods and rights which are to be disposed of. Neither the Act nor the Regulations indicate which cases are considered to have a duly proven cause, and therefore it appears that the Administration has a wide margin in which to grant or refuse authorisation. Furthermore, this is the area which raises most concerns (Article 16.a) of the Regulation on Foundations under the Act, defining the goods and rights which make up a foundation's endowment, stating that "In the case of the disposal or transfer of an endowment's goods and rights, any goods and rights which substitute them shall be preserved within the endowment and it shall incorporate any capital gains which may have accrued". It seems that it can be concluded from this provision, the legality of which is in doubt, that despite the fact that the Committee of Trustees must indicate the allocation of the sum obtained for the goods and rights of the endowment, this allocation must be used for the acquisition of other goods and rights which might be of a different nature – securities, movable and immovable property, etc. – yet they would become the foundation's endowment and thus not viable for allocation to foundation expenditure. Thus, if the endowment may not be used, the foundation would have to cover their expenses, even for the first year, with the return from the endowment; therefore, in practice an endowment lower than 30,000 € would not be sufficient and neither would an endowment which reached that sum.

It is also true that the disposal of a *monetary* endowment is not really an alienation, and therefore it could be argued that the disposal of the endowment, whether initial or subsequent, does not require the authorisation of the Protectorate. However, to conclude the chapter on a foundation's patrimony, the Regulation states "When a foundation sees a serious reduction in their own funds over two consecutive financial years putting at risk the fulfilment of their purposes, the Protectorate may demand that the Committee of Trustees take the appropriate measures to correct the situation". Bearing in mind that, amongst other resources, the foundation's own funds are those of the foundation's endowment, the foundation which spends this endowment would find themselves in such a situation, and this would oblige their Committee of Trustees to replace the spent endowment.

To conclude, although the definition itself of a foundation has evolved, with some practical problems as we shall see, along with the other requirements, it requires a minimum patrimony, in the form of its endowment. A minimum initial amount is set for this and its value must be maintained and increased.

13.1.6 General Interest Purposes and Beneficiaries of Foundations

Foundations must pursue purposes of general interest. The Act on Foundations contains a very large list of these, although it is not a closed or numerus clausus list, and therefore many other purposes are possible.[5] This is an undefined legal concept and as such there is some ambiguity as to how they are regulated. However, as García de Enterría states (1996, 72) "the legal concept of public interest or general interest is used in the Constitution, and in all Acts, with an unequivocal intention to limit, which is really very broad (the difference between movable and immovable assets is also broad, and nobody would dare to discuss their scope, although in this case these are a couple of concepts which have been determined) but it is effective. The general interest or the public interest are clear guides used by the settlor to organise institutions or public action". Just as it falls to the supervisory authorities to assess the sufficiency of a foundation's endowment, one of their main missions is to judge the *appropriateness* of its purposes. It falls to the courts to settle any disputes.

The general interest of its purposes is one of the essential requirements for a foundation to be considered a foundation, but this requirement is not limited to the purposes themselves, as intrinsic to them are the beneficiaries. The Act rules that foundations, in addition to pursuing general interest purposes, must benefit generic groups of individuals (Article 3.2), expressly excluding the possibility of setting up foundations with the main purpose of benefiting the founder or the trustees, their spouses or persons with whom there is a similar relationship, relatives up to the fourth degree or separate legal persons who do not pursue general interest purposes (Article 3.3.). The Act does not define what should be understood by the generic concept of beneficiaries. Reference is confined to two particular assumptions. It states that generic groups of people are considered to be the workers of one or various companies; thus, the constitution of labour foundations is allowed, and the assumption of Article 3.3 excludes foundations whose sole or main purpose is the conservation and restoration of assets of Spanish historical heritage. Therefore, the conservation of an asset of cultural interest which an individual or a family – not the foundation – owns or has usufruct over may constitute the purpose of a foundation.

Beyond the doctrinal standpoints which can be taken on the concept of *general interest*, it is worthwhile highlighting some administrative doctrine which has been generated around this concept in the area of tax. Pursuing the general interest is a

[5] Article 3 of the 2002 Foundations Act states: "Foundations will have to pursue general interest purposes such as, defence of human rights, support for victims of terrorism and violent acts, social assistance and social inclusion, civic, educational, cultural, scientific, sports, sanitary, labour, institutional strengthening, development cooperation, volunteering, promotion of social action, environmental protection, promotion of the social economy, attention to people at risk of exclusion for physical, social or cultural reasons, promotion of constitutional values and defence of democratic principles and tolerance, development of the information society, scientific investigation and technological development".

requirement under Act 49/2002 in order for non-profit bodies, including foundations, to receive special or more beneficial taxation treatment. However, although this requirement is stated in tax law in identical terms as those used in the Foundations Act, the Tax Administration in various rulings consider that meeting this requirement demands that the foundation itself should *directly* pursue general interest purposes; they do not consider this requirement fulfilled by allocating income to other foundations. In short, under this interpretation, donor foundations ("grant making foundations") who give help to other entities, finance projects for others and in general do not undertake the activities themselves towards fulfilling their purposes would be excluded from special taxation treatment, it being considered that they are failing to meet general interest purposes in the sense established under tax law. It has to be stressed that this tax law is identical in its wording to the Foundations Act.

This doctrine, which is a clear departure from the literal interpretation of the law and deviates from the will of the legislator, is significant not only in the area of taxation, in considering the most beneficial tax regime to apply to a foundation, but also in the substantive area, for two reasons which are relevant here. The first is because it has been allowed, albeit reservedly by some of the Protectorate's rulings, to deny the registration of a foundation whose purpose is to fund the activity of other non-profit bodies. The second, and perhaps most important, is because it calls into question the ability of the supervisory authorities – the Protectorate – to determine what the general interest is and how it affects other areas of the legal system. As we mentioned, Article 34 of the Constitution covers the right of foundation "for general interest purposes", and it is general interest which justifies public intervention in some aspects of a foundation's life, allocating these supervisory or control functions, by law, to the Protectorate. The Protectorate is in charge not only of monitoring the proper exercise of the right of Foundation and the legality of setting up and operating a foundation, but it also has the more specific function of evaluating the appropriateness of its purpose. It does not appear to be due process that the evaluation made by the administrative body competent to make such an evaluation should be called into question in the area of taxation.[6]

[6] We can also refer to some historical or legislative backgrounds which may refute this theory in the case of foundations. The Act of 1994 and its successor the Foundations Act of 2002 improve on historical regulation and combine the different types of foundations and how they are legally regulated under one concept. Thus foundations are defined as "organisations set up as not-for-profit which, according to the wishes of their founders, permanently allocate their patrimony to the fulfilment of general interest purposes". In addition to establishing a modern concept of a foundation, current legislation improves on the distinction under repealed Decree 2.930/1972, of 21 July, approving the Regulations for Private Cultural Foundations and Analogous Bodies of the Administrative Services in charge of the Protectorate over these foundations, which differentiated the regime for the so-called funding foundations, those awarding grants and subsidies, from promotion foundations, those which had their own programme of activities, or service foundations. Thus the definition itself of foundation under current legislation combines the two elements where there has been constant tension – patrimony and organisation.

As Falcón y Tella (2005) points out on the subject of the dispute in the area of taxation with unit trust companies, "beyond the wording of the applicable regulation, the impossibility of the Tax Agency pronouncing a judgement over areas which are the competence of other bodies" – in this case the National Securities Market Commission – "and especially the impossibility that the pronouncement of the (Tax) Agency should contradict that of the competent administrative body, originates from the very essence of the Rule of Law conceived as a technique for allocating specific powers without which the Administration cannot act (positive Bindung), unlike individuals who may do anything which is not contrary to the legal system (negative Bindung)". He continues "... the decision-making powers that are generally granted the Administration but not the Tax Authorities, so that the civil servants of the latter may determine (solely for tax purposes) the taxable event, but they may on no account make a decision which contradicts any maintained by the competent administrative body in the area in question".[7] We believe that these same arguments serve to put into question the criterion adopted by the Tax Administration in relation to the definition of the general interest pursued by foundations.

13.1.7 General Interest and Economic Activity: The Non-profit Aim

One of the questions which traditionally crops up regarding the definition of foundations is how compatible their being not for profit is with their undertaking financial or business activities, either directly or indirectly. Despite the clarity of the Foundations Act on this matter in Spain, there is constant tension around the subject, and concerns are continually being raised on the general interest and economic activity by legal practitioners, be they the Administration (supervisory bodies or Tax Agency), the courts or even auditors.[8]

Article 23 of the Foundations Act establishes that foundations "may undertake financial activities the aim of which relates to, is complementary or incident to the foundation's purpose, subject to the laws regulating fair competition". The Act also specifies, "they may take part in any financial activities through holdings in companies, in accordance with that which is set out in the following sections". The following sections provide that "foundations may have a holding in corporations in which they are not personally liable for the corporate debt. If this is a majority holding they should report this circumstance to the Protectorate". As a result of the evolution of the foundation sector, any likening of foundations to the

[7] Cazorla Prieto and Blázquez Lidoy refer to this problem (2011, 16 y 17).

[8] An analysis of the evolution can be found in the work entitled *La actividad económica de las fundaciones: tensiones legislativas e interés general* (The financial activity of foundations: legislative tensions and general interest) (Pérez Escolar 2008).

idea of charity and cost-free services has now been completely ruled out. The data shows that the reality of the situation is quite different, given that 56.7 % of the 1,432 foundations consulted, number the provision of services and the sale of assets amongst their sources of funding.

For some, obtaining a payment for undertaking such activities distorts the condition of non-profit. For others, it is the appeal to standards for fair competition and foundations obtaining tax benefits which give rise to opposing arguments. Although the debate has lost some intensity in the foundation sector in its strictest sense, probably due to the clarity of the Act, we should not ignore some of the arguments put forward from other areas in relation to other non-profit bodies like associations, particularly those serving the public interest. In our opinion there is a mixture of different issues in all of these arguments, such as making a profit and its distribution or the definition of the general interest purpose.

In the area of intellectual property, the issue has been raised about reproductive rights collective management organisations. These organisations, in accordance with the Intellectual Property Act (Legislative Royal Decree 1/1996, of 12 April), "may not be profit making", which means that they have to be set up with the legal status of an association. *In their 2009 report on the collective management of intellectual property rights,* the National Competition Commission (CNC) expressed their concerns about the non-profit nature of these organisations; they considered "that these are legal persons genetically predisposed by Law to undertake a typical business activity such as the commercial management of rights of a financial nature". The report concludes on this point, stating that there are no reasons for management organisations to take the form of non-profit bodies, as it reduces the possibility of other financial operators entering the market; therefore, this sector should not be closed to this sort of organisation. In their argument the CNC refers to the Services Directive and their transposition law in Spain, as they require these sorts of restrictions to satisfy the criteria of non-discrimination, necessity and proportionality. Furthermore, the report states: "Likewise, there are sectors of activity other than intellectual property where achieving certain general interest objectives is important, but where the operators are not obliged to set up as non-profit bodies. Otherwise, there is no legal concept of non profit, and it is more than questionable whether the non profit aim implies that it is not possible to distribute profits in the form of dividends between members or shareholders".

Although we agree with the conclusion reached by the CNC, we cannot share the arguments, as it is not the undertaking of a typical business activity, and no more, which distorts the non-profit aim, but the distribution of any profits, not only in the form of dividends but in any other direct or indirect form. The Intellectual Property Act contradicts itself by demanding that these bodies should be non-profit and at the same time requiring that their statutes should include, amongst other things, "the rules governing the systems for the share of proceeds". From our point of view, it is the necessary sharing of proceeds between members, a legitimate and natural function of these entities which calls into question their being assessed as non-profit. Moreover, as they are not associations which serve the public interest, they are not obliged to open up their activities to any potential beneficiaries, and in

their statutes they can restrict their activities exclusively to their associates. As we shall see, the area's general interest purposes, by definition general and *open*, cannot be disassociated from the potential beneficiaries.[9]

The non-profit aim has to be viewed in relation to the prohibition of the distribution of profits and therefore to how any patrimony and income influence the fulfilment of the foundation's purpose. As required by Article 27 at least 70 % of income gained must be allocated to the fulfilment of purposes within 5 years (the year the income has gained plus four) and the remainder may be used to increase the foundation's endowment. But this also has to be linked to the concept of general interest with the understanding that intrinsic to this is that the beneficiaries are generic groups of people and that it is not restricted to a specific group such as the organisation's own associates. For those who want to obtain public interest status, the Associations Act states: "their activity should not be restricted exclusively to benefiting their associates and should be open to any other possible beneficiary satisfying the conditions and characters required by the nature of their own purposes". It is a different issue if these bodies, foundations or associations directly undertake financial activities, as long as these are in relation to the foundation's purpose.

There has also been mention of how compatible the non-profit aim and the general interest are with performing financial or business activities with regard to the declaration or revocation of public interest status from associations. Unlike foundations which, having been constituted as such, must pursue general interest purposes, benefit generic groups of people and not distribute any income even if they are dissolved, such requirements are only required of associations that hold the declaration of public interest status. While all foundations are accountable to their corresponding administrative body, associations are only accountable if they hold the above recognition. Otherwise, they are only accountable to their members.

Recently and as Blázquez Lidoy (2011) explains, the Ministry of Interior, the body with the power to declare an association to be of public interest, has revoked this declaration, under the preliminary report of the Ministry of Economy and Finance, from those bodies which undertake financial activities on the markets "arguing that business ventures in markets where there is competition cannot be in the general interest, it must be private. And if this body were to enjoy the tax benefits of Act 49/2002 this might undermine competition with commercial companies. Consequently, they cannot enjoy public interest status or tax benefits".[10] As the author points out, this is a very specific argument, raised about an organisation, but it may have a very general dimension and, we add, not only apply to associations but, by extension, to foundations. This would mean that any public interest association might not be able to retain their public interest status because they have undertaken activities on the markets in competition with others.

[9] Supreme Court Ruling of 4.4.2003.

[10] The literal transcription of the ruling and the arguments used are included in the aforementioned article by Blázquez Lidoy.

From our point of view, there are two arguments which need to be addressed. The first is, in essence, the assumed incompatibility between the general interest and engaging in business activities on the markets. As we have mentioned in reference to such arguments, the fact that non-profit bodies pursue general interest purposes does not equate to cost-free services or the absence of a profit making aim – and we add – it does not imply that they should not be funded by market resources but rather that they should not distribute any profit directly or indirectly to their associates or members. In the case of foundations, the possibility of their engaging in financial activities to fulfil their purposes or even outside the foundation's purposes, as long as such activities do not exceed a certain percentage of the entity's total income and revenue, is also expressly covered in tax law for non-profit entities (Article 3.3. of Act 49/2002, of 23 December).

To address the second argument – any non-profit body which receives tax benefits and undertakes financial activity where there is competition with other companies might infringe laws on the protection of competition – we can refer to recent Supreme Court case law. For these purposes the ruling of 20 July 2009 is very relevant. The court rules on two levels with their ruling on a dispute brought under the previous Act of 1994. The first refers to the status of non-profit bodies from a tax and, a substantive point of view, of those who carry out a commercial activity. The Court, opposing the arguments of the State Lawyer, rejects such arguments:

> In the first place, because a glance at reality shows us that there is practically no sector of activities aimed at meeting general interest needs which nowadays is not the object of profit-oriented companies. The maximalist theory of the defender of the Administration would, for example, exclude a company running a centre for people with physical or mental disabilities from tax benefits merely because it operated in a market which included profit-oriented organisations. Another example: profits are sought in the area of cultural services as well; therefore, a general interest association offering such services would find itself excluded from the regime desired by the legislator. We can continue to repeat examples ad infinitum. The position of the Administration would render title II of the Act irrelevant, making it completely redundant; this result demonstrates the irrationality of this position.
>
> Secondly, an in-depth analysis of the process of Act 30/1994, which we summarised in the previous consideration with regard to this appeal, shows us that, as we have already mentioned, with the provision of Article 24.2 the legislator wanted to prevent structures of cultural interest, whose line of business is primarily run for profit, being included under the legal personification of a foundation or association, on the pretext of serving one of the purposes covered under articles 2.1 and 42.1 (1). Therefore the aforementioned Article 42.2 excludes them when "the principle activity is the undertaking of commercial activities" but not if this type of occupation is a tool for meeting the goals for which they were created. Thus, as we have also seen, Act 30/1994 allows foundations to take part directly or indirectly in commercial or industrial operations and allows them to enjoy the privileged tax regime which applies to entities which allocate at least 70 percent of their net revenue and income obtained "from any concept" to the purposes of the foundation or association [(article 42.1.b)], a concept which includes the proceeds from the aforementioned industrial and commercial activities.
>
> Finally, the interpretation we uphold is confirmed by the current Act 49/2002, of 23 December, on the tax system for non-profit bodies and tax incentives for sponsorship (BOE of 24 December), the successor to title II of Act 30/1994 (sole repeal provision), which stipulates that the activity undertaken by the organisations to which it applies should

> not consist of financial operations "outside their statutory aim or purpose", it being considered that the requirement has been met when "the net business turnover for the financial year from all non-exempt financial activities outside their statutory aim or purpose does not exceed 40 % of the total revenue of the organisation". As can be seen, the mere fact that financial criteria have been used in order to fulfil a foundation's purposes does not exclude a non-profit organisation from the scope of the Act.

Having explained this, the Court moves on to the second level, dealing with the argument put forward by the State Lawyer, in his attempt to refuse the exemption of corporate tax given that "The activity for which the tax benefit is being requested is undertaken in the market in a system of free competition, in such a way that, if their request is granted, this would be discriminatory to competitors, and they would gain an anti-competitive advantage". In this regard the Court states that from the point of view of the law, and in order for a financial activity undertaken by a non-profit body to be considered exempt, it is essential that the activity be linked to the purposes of the entity: "As a general rule the entity's objective and the financial activity it undertakes are not required to be the same, but should be in concert with its purposes. Only when that aim, that activity and those purposes co-exist can exemption be granted. In other words, for those seeking dispensation, the objectives of the entity concerned must be embedded in those of its financial activity (rulings of 19 December, 2007, FJ 4º, 26 December, 2007, FJ 2º, and 19 February, 2008, FJ 2º). And, in this context, the legislator offers some interpretative guidelines on the combination they require for the exoneration to operate. Firstly the activity which produces a return must be directed at fulfilling the general interest purposes of this class of structure; secondly it must not generate any "unfair competition"; and, finally, it should be allocated to a generic group of people".

With regard to the second question, the Court states:

> . . .the debate centres on what should be understood, from the effects of Act 30/1994, by "unfair competition". The notion could be upheld strictly, as covered under Act 3/1991, of 10 January (BOE (Official State Journal) of 11 January), i.e. limited to anti-competitive behaviour against the requirements of good faith (Article 5, in relation to the 1st), or more broadly, as under Act 16/1989, of 17 July (BOE of 18 July), covering any action which is liable to impede, restrict or distort competition (Article 1), currently covered in Act 15/2007, of 3 July (BOE of 4 July).
>
> In the Court's view Act 30/1994 applies in the latter sense, because it would be difficult to find the volitional component required under article 5 and the articles which follow it of Act 3/1991 on the distortion of competition arising out of the recognition of a tax benefit regulated by law. Therefore, we understand that the 1994 legislator wanted to refuse dispensation for the proceeds from the financial activities of non-profit entities connected with their corporate or specific purpose, whose exemption from corporation tax might distort the rules of free competition. This understanding is corroborated if we refer to Act 49/2002, currently in force on the subject, which, more stringently demands, for the exemption to be viable, that activities outside the statutory purpose should not infringe the rules on the protection of competition with regard to companies which share the same activity (Article 3.3). This broad and flexible criterion is the one we have applied in the five previous rulings that we have referred to throughout this pronouncement.

As Blázquez Lidoy (2011, 45) states, for the Tax Administration to merely allege that acknowledging the exemption would generate unfair competition is

not sufficient in order to deny a dispensation, since, as has been repeatedly stated on other occasions, not all discrimination is unfair competition, it is essential that reasons are given, describing the market that would be affected, its operation and the position of the beneficiary.

Continuing this line of argument, the Court eventually rejects exempting the foundation without entering into the latter analysis, since it considers that the financial activities for which it would be intended do not coincide with the foundation's purpose and are not aimed at the foundation's own beneficiaries: "No great effort is required to acknowledge that this accumulation of financial activities, which are not the specific objective of the foundation's purpose do not coincide with that purpose in the sense desired by the legislator in Article 48.2 of Act 30/1994, since, in addition to occupying a much vaster area than that of that purpose, they would cause, if the dispensation were to be awarded, distortion to the system of free competition, giving an unjustified advantage to the "Real Fundación" in financial activities which do not constitute its particular objective. In the terms of our previous rulings, it is not enough for the turnover for which the benefit is being requested to affect the field of town-planning and construction but rather it needs to show its effects in terms which basically coincide with the "being", "objective" and "purpose" of the foundation, because as we have already stated, it is essential that the quest for general interest which article 42.1 (a) alludes to in Act 30/1994, is inexorably embedded in the financial activity for which exemption is sought".

13.1.8 Other Current Issues Related to Economic Activities

Foundations have been experiencing a boom in the area of research, innovation and development, not only in Spain but in other neighbouring countries. Many foundations with these purposes have been set up by individuals and companies and by public, national and regional Administration. The data gathered by INAEF and Eurostat (1999–2000) included in the report *Giving more for research in Europe: The role of foundations and the non-profit sector in boosting R&D investment* – September 2005 – drawn up by a group of experts at the initiative of the European Commission. For Spain, the report highlights two major phenomena. The first is public-private collaboration in research via public initiative foundations, as a vehicle for channelling public resources devoted to research combined with private resources. The second are the university foundations, highlighting their role in technology transfer, human resources management for research projects and the provision of resources for scientific and technical personnel in these projects. The suitability of foundations as instruments to channel and target small donations for research projects which otherwise would remain dispersed is also recognised. The report concludes that despite the recognition of the role of foundations in the area of research in our country, their resources and impact in this area need to be further developed.

In 2011 a new Science, Technology and Innovation Act (Act 14/2011 of 1 June) (*Ley de la Ciencia, la Tecnología y la Innovación (Ley 14/2011, de 1 de junio)*) was passed in Spain which recognises the current Article 33.1, (b) as a way of promoting investigation into research, innovation and development activities and stimulating cooperation between companies and the use of "legal possibilities for cooperation such as economic interest groupings and temporary joint ventures in which collaborators share investment, implementation of projects and/or the application of the results of the research". In addition, research foundations are recognised under the aforementioned rule as a part of the Spanish science and technology system. However this recognition is paradoxical, if we look at the current substantive regulation of the current Right to Foundation.

As mentioned, the current Act, like the various regional laws, has recognised foundations as operators like any other, permitting company foundations and foundations with companies alike. As we stated, according to the Foundations Act, these may engage in financial activities, the objective of which relates to is complementary or incident to their foundation purposes. Similarly, the Act recognises the possibility that foundations may have holdings in limited liability corporate entities. However, given that members of Economic Interest Groupings are personally and severally liable for its debts, although in a subsidiary way to the group, and members of Temporary Joint Ventures are joint and severally liable to third parties for the acts and operations for the common good, it is considered doubtful whether foundations could collaborate with other entities using these legal possibilities. In practice, although the use by some foundations of Temporary Joint Venture has been allowed in very specific cases and with some limitations, in general this possibility has been rejected, particularly by foundations set up by National State Administration.

As an argument in favour of foundations taking part in this form of collaboration, these possibilities have been considered to constitute yet another scenario in which foundations may directly conduct business activities and as such are expressly permitted under the Foundations Act. However, there would certainly have to be an amendment to the Foundations Act for such a possibility to be clearly allowed, to inject more dynamism into foundations, particularly in the area of research but also in the area of public contracting, and enable them to collaborate with other national, European or international entities, using these legal possibilities, as long as the activities of such entities related to and were carried out in compliance of the foundation's purpose.

13.1.9 The Non-profit Aim and the Dissolution of Foundations

If one of the characteristic features of the non-profit aim is the reinvestment of any profits obtained through the activity of the foundation and the allocation of

patrimony towards achieving such purposes, the Foundations Act requires that such allocation should not be distorted even in the case of the entity being dissolved. The goods and rights resulting from liquidation shall be allocated to foundations or non-profit private entities which pursue general interest purposes and whose assets are allocated, even by dissolution, towards achieving those ends or to public entities, not foundation based, which pursue general interest purposes. This precept is also covered in all regional laws on foundations except the Law of the Autonomous Region of Galicia and the Law on Foundations of the Community of Madrid.

Indeed, Article 27 of Act 1/1998, of 2 March, on Foundations of the Community of Madrid states that the goods and rights resulting from the liquidation of an extinct foundation shall be "allocated as foreseen by the founder". Only in a case where the founder has not anticipated this allocation shall this be decided, in the first instance, by the Committee of Trustees, if they have been acknowledged this power by the founder. Otherwise, it shall be up to the supervising authorities to carry out this task. And only in this latter case does the Act require that such assets be allocated to foundations, private non-profit entities or public entities which pursue general interest purposes, which principally undertake their activities in the Community of Madrid, and whose assets, even by dissolution, are allocated to fulfilling such purposes. Under this wording, therefore, unlike state law, the allocation of the foundation's patrimony in the event of its dissolution to other entities which are not necessarily non-profit and also its reversion to the founder regardless of its legal nature would be permitted.[11]

No sooner had the Act been published, senators from the *Grupo Parlamentario Socialista* (Socialist Parliamentary Group) lodged an appeal of unconstitutionality against this and other precepts, as they considered that this release contravenes the Constitution for two reasons: firstly, because the definition of the allocation of assets constitutes a basic condition of the exercise of the right of foundation, which the regional legislator must respect in compliance with Article 149.1.1 of the Spanish Constitution, and secondly, because it violates the institute warranty covered by our Constitution, as new civil bodies are included under the concept of foundation, which already exist in other legislations, such as trusts, where profit is allowed at the time the foundation is dissolved. Thus, they considered that "Under the Foundations Act of the Community of Madrid there are genuine foundations which are altruistic and non-profit-making coexisting alongside "false foundations" which violate the allocation of patrimony to the common good and enable the enrichment of the recipient of the liquidated assets of the foundation".

Years later in the ruling of 21 December, 2005, the Constitutional Court made their judgement and deemed that the aforementioned article of the Foundations Act of the Community of Madrid complied with the rules set in the Constitution, in the terms of Court Consideration Nº 7, as they consider that the perpetual allocation of

[11] The reversion of assets to the founder is a controversial issue in several legal systems and also in the Spanish Foundations Law. See, amongst others, Caffarena Laporta (2009, 29–58).

goods or rights to the service of the general interest cannot be concluded as forming part of the recognisable image of the institution which is preserved in Article 34 of the Spanish Constitution. The legal interest protected by Article 34 of the Spanish Constitution demands that the assets and rights provided to the foundation should serve the "general interest" as long as the foundation is in existence, but it does not prescribe their permanent allocation after the foundation has been dissolved. The considerations add that "in addition, it should not be forgotten that under our legal system the dissolution of a foundation – not regulated as such under the contested Act – substantially escapes the will of the founder, expressed outside the act of foundation, or the body governing the institution, which helps to prevent its sense being adulterated . . . Therefore, if in specific cases serious deviation should arise in the application of the Act, in a way that liquidation produces a profit for the founder or (for the physical or legal persons nominated by the founder) which is incompatible with the general interest that should govern the foundation, the State of Law has sufficient instruments to exercise the appropriate controls. . .". And it concludes, and this is important, that "the description of foundations as non-profit organisations would not be compatible with potential reversion clauses which extended to goods or rights other than those endowed by the founder itself to the foundation".[12]

In conclusion, the Constitutional Court considers that the allocation of a foundation's assets to the general interest is not perpetual, but they are allocated for as long as the foundation exists, making reversion of the goods and rights to the founder acceptable constitutionally, as long as the assets were provided by the founder. This latter issue is not without its practical problems at the time of dissolution, which include any improvements which might have been made to such goods and rights and determining the criteria to be used to value transferred goods and rights. In any case, foundations anticipating reversion of their assets to the founder, if not a different non-profit entity or a public not foundation-based entity, would not be able to benefit from the special tax regime.

13.2 Governance: Regulation and Self-Regulation

There must be a body responsible for governing and representing every foundation which is called the Committee of Trustees, a collegiate body which must be formed by at least three trustees. Both physical and legal persons may be trustees. The Committee of Trustees may delegate their powers to one or more of their members, for which they may set up an internal executive commission or committee, except the powers to approve accounts and the action plan, modification, merger and dissolution powers or any actions which require the authorisation of the supervisory authorities.

[12] Moreno Cea (2010, 600–609) makes an analysis of the constitutional conflict of the Foundations Act of the Community of Madrid and of this ruling.

As we have already mentioned elsewhere (Peñalosa and Sanjurjo 2010), regulation under the Foundations Act of the operating standards of the Committee of Trustees, both in the nomination and replacement of trustees and the way agreements are adopted, is deliberately sparse, as this is one of the areas which should clearly reflect the autonomy of the will of the founder and in setting the purposes of the foundation. Therefore, as established in Article 11.1 (e) of the Act, mention has to be made in the Statutes of the composition of the Committee of Trustees, the rules for nominating and replacing its members, the reasons for its cessation, its remit and the way agreements are considered and adopted.

The *Reglamento de Fundaciones de Competencia Estatal* (Regulation on Foundations under the Competence of the State) approved in 2005 contains, as an innovation, a new complete chapter devoted to governing a foundation, highlighting, of course, that the rules covered in it will apply in the absence of regulation contained in the Statutes. But without prejudice to the regulation in the Statutes, the fact is that the rules contained in this chapter not only fill frequent statutory gaps, they also make up the body or set of practices, decisions and criteria often contained in foundation statutes and on occasion applied to excess by the Protectorates.

However in addition, foundations are and must be included in the self-regulatory phenomenon of the corporate governance of other legal persons and are increasingly voluntarily adopting their own codes of conduct, codes of ethics or good governance as complementary rules to their statutes or as rules to develop them. Sometimes these development rules are purely internal or combine other types of regulation. In addition to regulating how their funds are allocated or the relationship with their donors, or particular guidelines to follow with suppliers, they frequently contain rules on the operation of the governing body. In the absence of hard law, self-regulation takes on a special meaning. However, despite the fact that hard law is sparse in all matters to do with the operation of the Committee of Trustees, these codes and regulations do have to take into account the *statutory reserve*, and therefore they have to fulfil a real function in developing the Statutes in relation to reserved matters, which is not always easy.

There are increasingly more foundations in Spain that have their own codes of good governance, and there are ever more initiatives to promote their adoption by these entities. The Spanish Association of Foundations (*Asociación Española de Fundaciones*) (www.fundaciones.org) provided a guide or set of guidelines to help foundations draw up these codes: *Buen Gobierno y Buenas Prácticas de Gestión. Criterios para su desarrollo por las fundaciones (*Criteria for foundations in the development of good governance and good management practices*).*[13] This guide not only covers aspects concerning the governance of foundations but also other practices in their management, referring to elements such as transparency and communication, monitoring and financial supervision or the foundation

[13] Another initiative in this area is that promoted by Instituto de Consejeros y Administradores (ICA) that has published a *Guide on Good Governance for Public Benefit Associations and Foundations*, 2013.

relationships with donors and volunteers. As stated in the document preceding these criteria, "As organisations, foundations have been adopting management methods and procedures, seeking better efficiency and efficacy in the use of their resources for performing their activities, in an ever more professional way. As entities which serve the public interest, the legislator has established a supervision system, under which they must regularly submit information to the Protectorate. Nonetheless, it is appropriate that foundations take a step forward both in their management and their transparency".

The foundation sector makes few criticisms of current legislation in relation to the regulation of the Committee of Trustees. Only the provisions referring to trustees offering their services without payment and their signing contracts with the foundation pose a few problems. Given the unpaid nature of the post of trustee, this being another of the features of a foundation as a non-profit entity, if the trustees wish to establish a contractual relationship with the Foundation, be it civil, commercial or even deriving from a work relationship, they must request prior authorisation from the supervisory authority. In practice this poses a few problems, as the Administration may take up to 3 months to respond, when, for example, it might be a matter of hiring a trustee to give a conference to the foundation.

13.3 Transparency, Accountability and Legal Reports

The Foundations Act obliges all foundations regardless of their size, activities or means of funding to submit their accounts annually to the Protectorate – supervisory authorities – on which they depend. Once they have been submitted, the Protectorate formally examines and revises the accounts and the audit report (in the event that they are legally obliged to perform audits or they have done so voluntarily). Once it has been checked that the documents correctly adjust to current legislation, the Protectorate proceeds to file them with the foundations' register. This remains without prejudice to the physical checks which they may carry out as part of their duties within 4 years of submission. The Protectorate shall report any foundations who have failed to present their accounts or rectify any errors of which they have been advised by the Tax Administration.

The Accounting Plan for Non-profit Entities (*Plan de Contabilidad para las Entidades sin Fines Lucrativos*) (RD 776/1998) was passed in Spain in 1998, adapting general accounting rules to the sector. In 2008 the new General Accounting Plan came into effect in Spain, passed in order to adapt accounting to the new International Accounting Standards, which made it necessary to amend the Commercial Code. The effect of the new accounting rules was the partial derogation of the accounting scheme for the non-profit sector. From that moment on and by the resolution of the *Instituto de Contabilidad y Auditoría de Cuentas* (Institute of Accounting and Account Auditing), non-profit entities had to adapt their accounting to the new plan approved for commercial entities, applying their sectoral adaptation to that not covered in the general rules. This gave rise to a temporary situation in

which both the supervisory bodies and the foundations had to adapt their obligations to submit their accounts to new legislation in which there were major deficiencies and uncertainties for these entities, and this diverted resources from both the entities and the Administration as they had to devote more time and resources towards meeting their obligations. The *Instituto de Contabilidad y Auditoría de Cuentas* approved some new balance sheet and income statement models for non-profit entities following the new commercial models, but they did not approve a new report model. The new Accounting Plan for Non-profit Entities was finally approved in 2013.

The progressive incorporation of non-profit entities into the different financial activity sectors has led some schools of thought to consider that their accounting obligations and accountability for them should be no different to those of commercial entities. But others hold the belief that given the non-commercial nature of non-profit entities, certain operations regulated under their legislation do not have an appropriate and correct accounting response. These sorts of considerations arose, once again, in the process of drafting the new sectoral adaptation. According to Rúa (2010, 222), despite these considerations, "The problem lies at the source, i.e., when the legislator on foundations decided rightly to enforce accountability, they made the mistake of taking the accounting model of commercial entities and applying it to entities of a different nature. This meant that as the accounting information of the business model was considered "insufficient", substantive legislation on foundations tried to add to the information that they had to submit using specific terminology which does not fit current accounting legislation, which further complicated the situation". The fact is that the accounting information of non-profit entities should serve not only to provide financial information on them but to assess the fulfilment of their purposes, an objective not met by commercial legislation. That is why, sometimes rather mistakenly, other relevant information is added referring to the activities of the foundation, the beneficiaries served or the effective fulfilment of the foundation's purposes. In short, as Rúa (2010, 222) also points out, it is possible that the progressive increase in information obligations has not served to increase the transparency of the information on these entities "but is an accumulation of information, which is occasionally disjointed, very complicated in the way it is prepared and not very useful to its users".

At the same time, the debate on transparency goes beyond the purely legal and refers to the accountability obligations covered under the Foundations Act. The information filed in the Foundations Register is accessible to the public, but as consequence of their mission, foundations and non-profit entities "must convey information to society on their purposes and activities and be accountable to their donors and beneficiaries, on how they manage their resources. Equally, citizens must be informed because they contribute towards their funding, sometimes directly, by contributions, and sometimes indirectly, as foundations enjoy tax benefits and occasionally receive State subsidies. Despite the system of obligations already set out by Law, the self-regulatory phenomenon which we referred to in the previous section on the governance of a foundation is progressively extending to the foundation sector, as a way of promoting transparency and the uptake of best

practices.[14] Also the website – www.fundaciones.es – built up by the Spanish Associations of Foundations collects information from all foundations, through the information collected from the sector and supervisory authorities.

13.4 The Savings Banks, Origin, Legal Nature and the Current Process of Transformation: *Special Nature Foundations and Banking Foundations*

The process of restructuring the Savings Banks began in Spain in 2009. These are bodies which are deeply rooted in our country, although they started later here than their European counterparts. Savings banks are defined as foundation-based, non-profit, credit institutions with a social and charitable function; they do not depend on another physical or legal person and are dedicated to attracting, administering and investing the savings placed in their trust. The Constitutional Court, in their ruling of 22 March 1988, highlighted the different nature of savings banks compared to foundations and other credit institutions, irrespective of a description, which due to their structure as legal persons and the largely credit-based nature of their activity might be more appropriate for them. Savings banks are obliged by law to develop programmes of a social, charitable, welfare or cultural nature to protect and help grass-roots needs, to which they must devote all surpluses which do not have to be applied to reserves by legal mandate or allocated to voluntary reserves.

The transformation process of savings banks began in 2009, undertaken much later than the Italian process. It was imposed due to the structural limitations associated with the nature of Savings Banks (*Cajas)*, but was accelerated due to the current financial crisis. This process started with the passing of Royal Decree Act 9/2009, of 26 June, and was the start of a major process of integration between various savings banks, changing the map of this sector in Spain. A short while afterwards Royal Decree Act 11/2010, of 9 July, was passed, which opened up the possibility for Savings Banks to undertake their activity via a bank and thus gain access to capital markets. Royal Decree Act 2/2011, of 18 February, launched the third phase of the restructuring process of the Savings Banks.

[14] The *Compromiso Empresaria*l foundation: www.fundacioncompromisoempresarial.com has some useful guides and reports which might help foundations on this path. It tackles aspects such as the evaluation of results ("from good intentions to impact"), the definition of mission, and it has even performed research studies on the transparency of Spanish foundations analysing the information they convey via their websites: Martín Cavanna, Construir confianza 2010. *Impulsando la transparencia en la Web de las fundaciones españolas* (Building confidence 2010. Driving transparency on the websites of Spanish foundations).

For many years the *Lealtad* foundation, www.fundacionlealtad.org, has been studying the transparency and best practice of NGOs which volunteer to be the subject of analysis, in order to provide information to potential donors.

Article 5 of Royal Decree Act 11/2010, on government bodies and other aspects of the legal system for savings banks, introduced the possibility of savings banks to engage in their financial activity indirectly. According to this rule savings banks have three options: (a) to remain as savings banks, (b) to become foundations which have at least 50 % of the bank's shares or (c) to remain as credit entities but transfer all their financial assets to a bank, controlling a minimum of 50 % of the capital.

Article 6 of this Royal Decree regulates on so-called special nature foundations, foundations which may be created in three cases, voluntarily by giving up the authorisation to act as a credit institution or in other provisions for withdrawal of authorisation. As mentioned, they must as a consequence lose 50 % of their rights to vote in the bank created for the purpose of transferring their financial assets. They must also become special nature foundations, in the event of the savings bank's intervention in cases provided for in the Act on Discipline and Intervention of Credit Institutions. Savings banks which form part of the so-called SIPS (Institutional Protection Systems), a mechanism for the protection of credit institutions which some savings banks have subscribed to, representing a contractual agreement between various credit institutions whereby they establish a mutual solvency and liquidity commitment, may also agree to become special nature foundations, under the voluntary or compulsory assumptions.

Special nature foundations shall be created by transferring all the patrimony attached to their financial activity to another credit institution in return for shares in that institution. In accordance with the rule, the foundation shall centre their activity to devoting and developing their social and charitable work, for which they may undertake the management of the share portfolio. The foundation must allocate the product of their funds, shares and investments which make up their patrimony to their social and charitable purpose. Subsidiarily, they may undertake activity to promote financial education. The agreement to become a special nature foundation is subject to meeting the requirements for setting up a foundation and means the Savings bank transforms into a special nature foundation. The separation of financial activity, in turn, shall be governed by Act 3/2009 of 3 April, on structural modifications to business corporations.

This legislation has been overcome by Act 26/2013 of 27 December, on Savings Banks and Banking Foundations. According to this regulation, are considered as banking foundations those that hold almost 10 % of the shares of a bank, or have the right to designate a member of the board in the bank, regardless of their origin. Special nature foundations will be transformed into "ordinary" foundations or banking foundations, depending on the shares that they hold, if they do, but other savings banks still existing, under certain conditions, are also obliged to be transformed into banking foundations or ordinary foundations. Moreover, private foundations that fulfil these requirements – more than 10 % of the capital of a bank or right to designate an administrator – have also to be transformed, which could represent, in some opinions, an infringement of the right of Foundations, as far as the new banking foundations are a new figure created by legal imperative while ordinary foundations are private institutions. The banking foundations have a special regulation in the Act 26/2013, which states a different supervisory system

and some requirements on good governance practices. Act 50/2002 of Foundations is applied subsidiarily.

13.5 Tax Law

The objective of this section is not an in-depth analysis of the tax regime for foundations in Spain or of the problems which arise from a legal or administrative point of view with the application of current regulations. Some problems have already been noted, when they cannot be disassociated from the substantive rules on foundations. However, we do make a broad-brush reflection of the reforms needed to the Spanish foundation sector.

The requirements for access to the special tax system are some of the most critical issues in the current regime. Act 49/2002, defining these requirements, of course, started with those covered under substantive rules, adapting one system to the other. However, there are a great many issues to do with the substantive system which were not taken into consideration and which could currently even be considered to be contrary to the tax system. Furthermore, some of these tax requirements are also substantive in areas which might be undergoing development by the Autonomous Regions, for example, in the area of the allocation of income and revenue. In addition, tax requirements are naturally a subject for interpretation by the tax Administration, although on an increasingly regional basis separate to the substantive rules, without taking into account that foundations are not entities which are exempt from all control. It should be borne in mind that being covered under the special tax system means being considered an entity which benefits from sponsorship, meaning that incentives do not apply unless requirements are fulfilled.

Some improvements to the taxation of some financial activities are also necessary, as not all those undertaken by foundations are included in the list of activities which are exempt. Some technical improvements are also needed to in the area of local taxation. As outlined, Act 49/2002 provides for the automatic application of exemptions subject to the fulfilment of certain conditions. However, in practice, many of the exemptions in local taxation have really become exemptions upon request. Certain amendments to the Local Taxation Act (*Ley de Haciendas Locales*) are also necessary to adapt some of the exemptions which it provides for any taxable person, to foundations.

VAT is a critical issue in the taxation of foundations, a tax for which foundations are considered end consumers and the structure of which is difficult to adapt to the nature of these entities, decreasing the resources that they allocate for general interest purposes or increasing the price of their services to the end user. The possibility needs to be examined of national refund systems, already in use in other countries, although this is not an optimal solution. At the same time the initiatives underway at a European level need to be looked at for an overall analysis of how VAT operates, focussing on the situation of non-profit entities which, as acknowledged, were not taken into account when the Sixth Directive was drawn up,

or to study VAT and how it applies to public entities in relation to exemptions of a social nature.

Another issue raised in our country with regard to VAT – although not in relation to the tax itself – refers to the consideration of this tax in public procurement procedures, when tenderers who are exempt and tenderers who are not exempt from VAT are bidding. Foundations are exempt from VAT in rendering certain services of a social, sports or cultural nature; therefore, their bid does not include this tax, compared to corporate entities who present their bids including VAT. This is not necessarily an advantage for foundations, as not charging the Administration VAT in this case; they cannot deduct the VAT charged. Companies that charge VAT can however deduct the VAT charged and make it neutral. On the issue of how to determine the most financially beneficial bid when tenderers who are exempt and those who are not exempt are bidding, the *Junta Consultiva de Contratación Administrativa del MEH* (Consultancy Board for Administrative Contracting of the Ministry for Economic Affairs and Finances) concluded that VAT should be excluded. However should the Administration, following this criteria, award the contract to a corporate entity whose bid did not include VAT, they would pay the tax charged to them equally without being able to deduct it, as the Administration has a VAT system which is similar to that of non-profit entities. After many proposals from the sector, the additional provision of the Sustainable Economy Act established that the government would draw up a report within 3 months analysing the possibility, within the framework of community legislation, of including VAT in the price of public contracting procedures, when tenderers who are exempt from the tax are bidding, in particular entities from the third sector, bearing in mind the principle of awarding services to the bid which is financially most advantageous for the public administration and the other principles which should govern public contracting. This is a relevant issue not only for the entities but also for the Administration in the current climate of reducing public spending and outsourcing certain services. It is therefore necessary to push for this report to be drawn up, as it would have repercussions for all Administrations.

However the sponsorship system definitely requires improvement. The Act of 2002 did not imply progress in terms of tax incentives for sponsorship, falling far short of incentives provided in other countries. This improvement would help to encourage the participation of citizens and companies in engaging in general interest activities in the different fields in which foundations operate. The aim of awarding tax benefits to those who collaborate with non-profit entities by donations or contributions with no consideration of any type is to promote the general interest activities they undertake and the participation of civil society in these activities. Improved applicable deduction percentages, currently at 25 % for physical persons and 35 % for legal persons, would clearly result in the increased collaboration of individuals and companies, as has been demonstrated in France, where the increase in deduction percentages to 60 % and 66 % on Corporation Tax and Personal Income Tax has resulted in a clear increase in collaboration. Far from considering sponsorship incentives a waste of public resources, it should be acknowledged that the cost of donations goes towards serving the general interest activities undertaken

by the private non-profit sector, activities which otherwise would have to be covered by the public sector or they would not be served and would no longer contribute towards social welfare. In some cases the contribution of donors, and therefore their effort, is greater than that of the Public Treasury, as for some the deduction rate is lower than that of taxation. In other cases the deduction is not an effort for the Public Treasury finances as the donations exceed the amounts which can be deducted and therefore incentives are limited.

The deduction percentages which apply to donors and the deduction limits need to be increased, and some of the concepts included in the current Act need to be improved, including collaborative business agreements for general interest activities, sponsorship in kind or priority sponsorship. Priority sponsorship activities, set every year in the General State Budget, beyond any general deductions, are a way of promoting certain general interest activities, which may include cultural activities. However, in recent years the priority activities covered under General State Budgets principally refer to programmes which have been developed either by public entities or private entities but with public funding, therefore not contributing towards the promotion of private initiative in activities of general interest. These activities also need to be given stability as, because they are set annually, some programmes are not receiving continuity or financial support. Furthermore, it would be desirable for the sector to play a part in defining them.

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