

## COST BENEFIT ANALYSES OF DEVELOPING A LEGISLATION TO ATTRACT NON-RESIDENT HIGH NET WORTH INDIVIDUALS TO USE ESTONIAN PRIVATE FOUNDATION PLATFORM

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### Abstract

*On a global level, the high net worth population is expanding, and the wealth of high net worth individuals (HNWI) is increasing rapidly. For various reasons, high net worth families and individuals are searching for vehicles to assist them in safeguarding and conveniently managing their wealth. Private foundations represent one useful avenue for achieving this end, and the use of private foundations has become increasingly popular in recent years, particularly in European countries. Many countries have laws which regulate private foundations and several are looking for adjusting or introducing legislation.*

*In this article, authors analysing benefits for a country like Estonia in case the country increases the attractiveness of its jurisdiction for non-residents who are looking for establishment of a private foundation. The article comes to the conclusion that to be competitive, a country cannot collect tax revenues from private foundations established by non-residents except from income originated in the very same country. However, the country can earn benefits from revenues received by companies rendering services to non-residents and their private foundations. The article demonstrates that service fees a country earns and taxes collected from these fees would be substantial enough to make necessary changes to legislation beneficial for a country.*

**Keywords:** *Taxation, Private Foundation, Cost-Benefit Analysis*

### 1. Introduction

In the course of history, development of institutions has been both reactive and proactive beginning with social interactions, social behavioural code or social contracts develop. For example Ken Binmore (2010) defines social contract as “the set of common understandings that allow the citizens of a society to coordinate their efforts”. Social contract itself does not need a law as the social system holds it together, however, it works until all agents of a social system are motivated to keep the contract. At the point when some agents for a selfish reason see possibility to break the contract, then it will be time for the masonry arch<sup>1</sup> to fall down. This could indicate a point when a legal system is needed to secure the majority from potential damages by some selfish agents.

For example, high net worth individuals need a system to solve problem of their family business continuity and inheritance issues. Historically there were different social contracts, like in some cultures the oldest son inherited everything so continuity of family business was secured. The next development was introduction of trusts although they are more common in Anglo-Saxon countries. Among family members there is a possibility to agree on a way how to keep family business continuing in a healthy manner, however, with more than one descendant there is always a risk for conflict of interests. Even if it is possible that sisters and brothers can keep the interests aligned then their spouses with likely opportunistic behaviour of “gold-diggers” will make keeping a social contract close to impossible. Hence, the need for a special legislation is unavoidable to support the continuity of family businesses in the current economy. At the end of the last century European states introduced relevant laws for regulating private foundations of private purposes<sup>2</sup>.

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<sup>1</sup> A metaphor used by David Hume (1978).

<sup>2</sup> Whereas in Austria until 1993 foundations had no choice except to be charitable, the Private Foundations Law of 1993 enabled private foundations. In Belgium, the private foundation was introduced in 2002 and the foundation

In this paper first we look for how private foundation platforms satisfy more important concerns and needs of high net worth individuals. Next will be discussion on views in respect of social importance of the project and the methodology that should be applied. Afterwards analysis of social benefits, cost and net present value are going to be presented.

## 2. Literature Review

### 2.1. High Net Worth Individuals And Private Foundation

High net worth individuals is a group which is seen by private banks as a separate client segment. A common definition used is that these are individuals who possess individually investable assets (exclude private residence) more than \$1 million US dollars (Knight Frank LLP, 2016). To focus more on the higher end of the group another term, ultra-high net worth individuals is commonly used for persons who possess investable assets more than \$30 million.

Based on Knight Frank LLP survey (2016), HNWI-s are globally most concerned about family business succession issues, potential increase in wealth taxes and increased scrutiny of wealth by government. Although, private foundations do not address directly the second and third concern, it does directly help to solve the first issue.

In his presentation on non-tax needs of High Net Worth Individuals, Philip Marcovici (2015) lists among others: business succession, managing risks of divorce, “second” families, “living” wills, asset gathering and identification, family conflict resolution, asset protection and preservation, special assets (art etc.), disability/illness as main concerns of NHWI-s.

Private foundations are used for a large variety of purposes (Sepp and Kaarlep, 2016, pp. 96 - 104):

- They can be used to prevent the dispersal of the estate (business) after one’s death;
- They can ensure continuity in management. This could be useful when a founder has no children or if he considers some of his heirs not fit to run the business or they do not wish to do so.
- They can enable the reaching of a specific goal. The familial estate can be assigned to a specific purpose, such as providing for a relative in the case of incapacity or lack of financial maturity. For example, parents with a disabled or minor child may be concerned with identity of person who will manage their child’s assets after their demise, and perhaps when they themselves become disabled. Nowadays, people are tending to live longer, and there is an increase in the number of people who are affected by conditions such as dementia and Alzheimer’s disease, which can result in restricted active legal capacity.
- Another purpose is to protect specific assets, as in the case of keeping the family home out of the reach of creditors. This could be especially attractive for businessmen or for those whose professions open themselves up to the risk of civil liability (e.g., doctors or lawyers), but in the light of today’s economic and financial instability – and, in some regions, political instability - it could be attractive for anyone. It should be kept in mind, though, that there are usually some specific rules protecting creditors in a case wherein a private foundation is set up to harm existing creditors or with no actual change in the control of the property.
- They can also be used to optimize tax liability.

The principal structure of a private foundation is presented on Figure 1.

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sector in Belgium has been growing since. Malta enacted specific foundation legislation in 2007. The legal and tax landscape on Dutch private foundations dramatically changed with the introduction of a new tax doctrine on ‘segregated private capital’ as of 2010. Even before that, one specific foundation form, the so-called ‘depository foundation’ (*stichting administratiekantoor*, STAK) for the purpose of acquiring and administering assets (shares) was widely used. (Sepp and Kaarlep 2016)

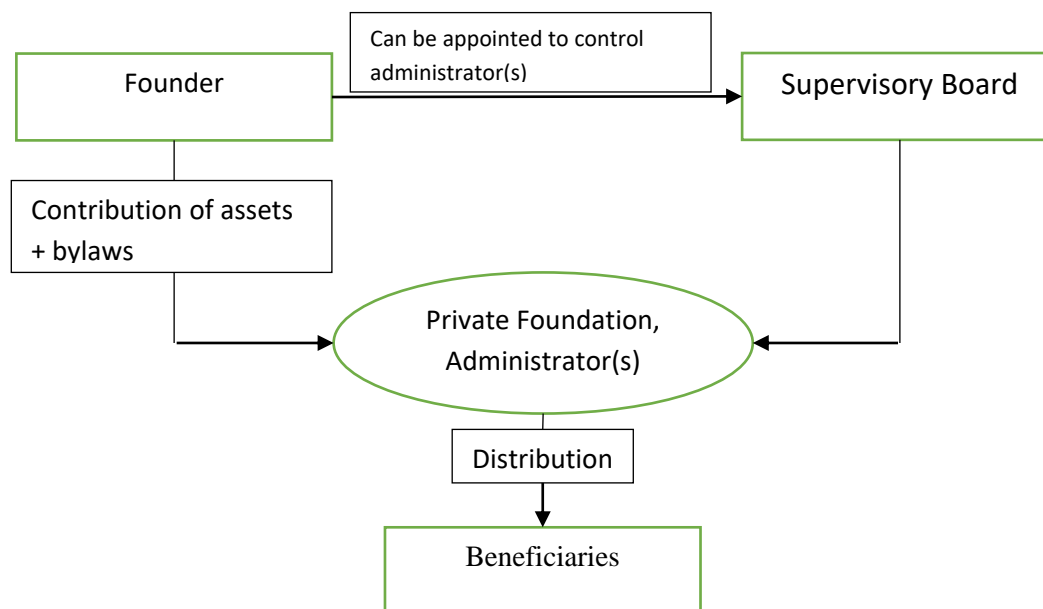


Figure 1.

## 2.2. Social Importance

Countries like Estonia facing at present a situation where it is difficult to attract foreign direct investments. One reason is that the cost level of labour has increased over years and is not so competitive as it was in the past especially for mass production. Other reasons are that limited market for labour and goods and services due to low level of population. There is not enough people neither for production nor for consumption of the products and services. Migration could be a solution however it will have its own side effects.

Government of a country like Estonia should ask about opportunities which are available for tackling limitations mentioned above. Opportunities should satisfy criteria of limited number of population and create higher value per person. The first criteria come from a limitation that there are few people available. The second relates to the fact that in given situation, cost of labour increases (Alavi, 2016 ,pp. 139-145). Because of increasing cost an opportunity should have less dependence on labour cost. To achieve the latter the delivered value should be more substantial to a limited number of population to reduce the cost of labour in determination of a location of a direct investment. Another important element for an opportunity would be that the size of a local market is not important. That would eliminate most investments into production of physical goods. Thus, countries like Estonia are left more or less with 2 options: to attract production of digital goods and/or attract non-residents to use services of the residents of the country.

An opportunity to attract non-residents to use jurisdiction of country like Estonia for the purpose of establishing private foundations satisfies the criteria described above. To render services to private foundations a country does not need massive number of people and it creates a need for people with higher skills and therefore the salaries of these people are expected to be higher. Cost of labour would be important also in respect of servicing private foundations however as it would not be mass production and ultimately the cost is not a final determinant for a location.

In the current situation with limited opportunities to attract foreign direct investments and to increase utility of residents of a country, an offer of the jurisdiction for establishing private foundations would be beneficial for the country. It is possible to prove it looking at the Kaldor-Hicks Criterion which say that “a given project will be desirable if those who gain from it could fully compensate the loss for those who will lose from it and still be better off”. After the project is finished there will be no one in the country who will pay more taxes if we do not impose higher taxes on HNWI-s. As per current plan local HNWI-s benefit from the change of legislation. A potential negative effect might be in case Estonia to become a very popular destination for private foundations and face with shortage of highly skilled professionals like accountants and lawyers. That would likely mean higher prices and decreased local demand.

In this paper, authors analyse costs and benefits for a country, however, we can also look for a wider social impact on a country. We can analyse if the results of the development of legislation can be regarded as Pareto-Improvement. If we look how HNWI-s have solved their wealth succession today then there are a lot of opportunities available like trusts and private foundations of different countries. However, these platforms are not available in all countries where HNWI-s are residents. Thus, there is a demand for wealth succession structures in the countries where there is no trusts nor private foundations. These HNWI-s are looking for a jurisdiction outside of their own and Estonia being an alternative option would not make anyone worse. Thus from this point of view the project would be Pareto improvement. Although it might be that some of HNWI-s who already using other jurisdictions for their wealth succession, might consider change of the jurisdiction. This would mean that the jurisdiction which will be abandoned would be worse off and thus it would not be Pareto improvement. However, likeliness of HNWI-s who already have settled themselves in a country to move elsewhere for less cost does not seem to be high. The benefits that a country can offer to a HNWI who already have established is very limited which means the main target would be anyway HNWI-s who are looking for a solution to their wealth succession. We can conclude despite theoretically there might be a few individuals/families who would change the jurisdiction it is unlikely and in most cases non-residents to be attracted have not established themselves yet anywhere.

### 3. Methodology

Standard cost-benefit analysis is structured in seven steps: (European Commission, 2014)

#### 1. Description of the context

This means description of social, economic, political and institutional context in which the project will be implemented. More important socio-economic conditions for the project are the facts that only limited opportunities for GDP growth in countries like Estonia exist due to labour market cost and limited number of people. The positive element for Estonia is that the country has reasonably flexible Foundation Act and business friendly tax system. So there is limited changes needed to make the platform attractive for non-resident HNWI-s. Important is also to be aware of current initiatives against tax evasion and end of bank secrecy. That gives opportunity for transparent countries like Estonia to compete with countries who have offered off-shore privacy. Beneficial element for Estonia is that the country does not have off-shore image which gives for non-residence more confidence to use the jurisdiction and there would be less chance for interrogation from home tax authorities.

#### 2. Definition of objectives

The objective of the project is to increase utility of a country like Estonia. In more detail the project is looking for positive effect on GDP and taxation revenues for state budget. More GDP means more working places and this project would envisage requirement for higher than average skill level. The latter would mean that these people will be paid more than average causing also improvement of average income per person to raise.

#### 3. Identification of the project

In principle, the project has one phase: analysis of current legislation and competition, and afterwards developing changes to the current legislation, in particular Foundation Act and Income Tax Act, to improve competitiveness of private foundation platform. Later further adjustments might be needed to respond changes on competitive landscape.

#### 4. Technical feasibility & Environmental sustainability

Technical feasibility relates to ability of information systems to govern the process and give necessary information for all stakeholders. For example, it might be that taxation of payments to beneficiaries of private foundation might depend on source of income from which the payments is made. That means source of income needs to be accounted, reported to tax authorities and updated if needed. At present the information system on tax authorities is able to separate income from dividends where tax has been paid from other income sources. Thus, it is highly likely that current level of information technology would not be a “deal breaker” and it can handle the implementation of the project.

The project does not envisage investments into “brick and mortar” or to say differently into “real economy” with property, plant and equipment. That means there would be only trivial indirect impact to environment (every additional business traveller to Estonia makes his/her additional carbon footprint and have a negative environmental effect although each non-resident visit brings more additional utility to residents of the country).

#### 5. Financial analysis

Financial analysis assessment provides profitability of the project for the owner and some key stakeholders and verify the project financial sustainability. Key stakeholders of the project are country’s financial sector (including accountants, asset managers, lawyers etc.) both owners and current/ future employees and all residents of the country (through additions to state budget).

In respect to financial sustainability, the project does not require huge financial investment at initial stage, mainly it consists of time of the involved personnel in development of the project. Later it depends on the marketing strategy as it is possible to take a passive approach or wait and see strategy. Another option would be choice of active marketing strategy and to participate in conferences, write articles etc in order to raise awareness among HNWI-s globally. It would be possible to limit marketing action to a certain budget available.

The methodology commonly used for financial analyses is the Discounted Cash Flow method where cash inflows and outflows are estimated. Afterwards net cash flows are discounted using appropriate discount rate to find Net Present Value of the project.

#### 6. Economic analysis.

Economic analysis covers shadow prices in addition to market benefits and cost in order to reflect the social opportunity cost of goods and services. At the financial analysis, we look explicit benefits and exclude implicit benefits/costs. In addition, externalities are supposed to be taken into consideration. For example, finance sector will benefit directly from rendering services to private foundations, however, due to existence of other business organizations in the country as well as its historical and touristic background, there might be interest to visit the country from the owners of above mentioned projects. That means there will be also benefits for hotels, airlines etc.

In result of economic analysis, we will calculate economic performance of the project which include Economic Net Present Value, Economic Rate of Return and Benefit/Cost ration.

#### 7. Risk assessment.

The recommended steps by European Commission for assessing the project risks include sensitivity analysis, qualitative risk analysis, probabilistic risk analysis and risk prevention and mitigation.

Sensitivity analysis identifies the “critical” variables of the project. In respect of legislation development project the most “critical” variables are the growth of HNWI number in the target countries and proportion of HNWI-s who are interested to set up private foundation outside of their home country.

Qualitative risk analysis is looking for a list of adverse events. With respect to legislation development for the project, main possible adverse event is rejection of the changes in legislation by Estonian parliament after clarification of necessary areas of change in law. Collapse of financial system is also possible, however, the level of uncertainty is very high as it is impossible to estimate the timing and extent of implications from this event.

One more important element would be a risk of tax heaven image. In the past tax heavens were normal part of global economic system. However, recently “a war” against tax avoidance has been announced by OECD and its Base Erosion and Profit Shifting actions (OECD 2013). A key element of a tax heaven is that it gives opportunity for hiding tax income and avoiding taxes. With the current tax transparency initiatives by OECD hiding tax income and avoiding taxes becomes close to impossible. Estonia has an image of transparent country the best tax code in the OECD (The International Tax Competitiveness Index 2016). Contrary to tax heavens selling their jurisdiction to avoid taxes, Estonia would sell the jurisdiction as transparent and competitive. The project is not about creating possibilities to create tax avoidance schemes but to offer modern platform for HNWI-s who are ready to comply with tax rules of all countries involved.

The project’s residual risk exposure due to relatively low level of investment is small. That means probabilistic risk analysis for this project is not appropriate.

### 3.1. Social Benefits and Social Costs

The social benefits of the project to develop legislation for private foundation platform can be divided among following stakeholders: (figure 2 and table 1)

1. Owners of the companies in financial sector rendering services needed by private foundations like domiciliation, accounting, auditing, legal and other services.
2. Employees of the companies in financial sector mentioned in the point 1.
3. The state who will get more tax revenues.
4. Other companies, their owners and employees who benefit because the founders and beneficiaries of private foundation would visit the country.

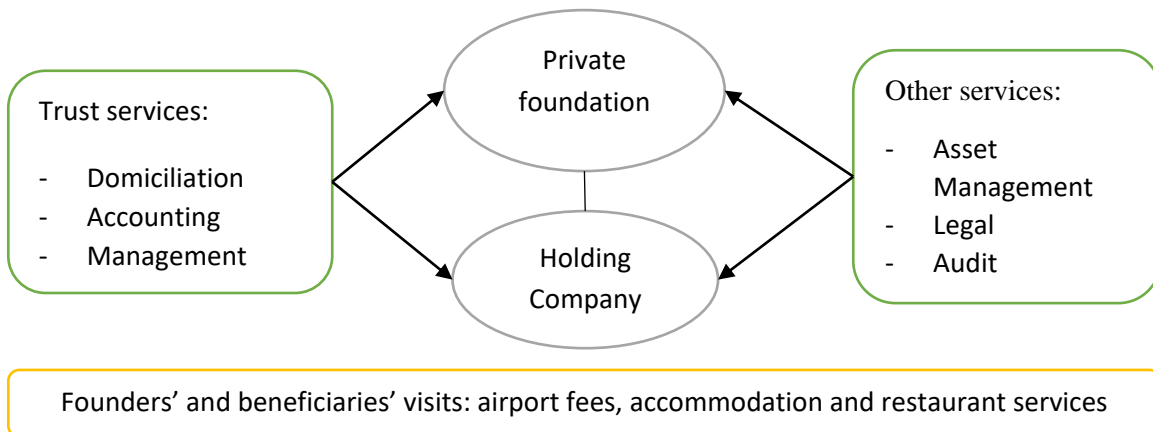


Figure 2.

The social costs consist mainly of time spent by developers of the project. The developers group include the employees of finance sector and relevant ministries (Finance Ministry and Justice Ministry). At the later stage when the proposal goes to comments round there will be involved employees of different organisation and finally parliament commissions need to express their opinion and parliament members need to vote to approve the changes.

We should also consider the promotional costs after implementation of the changes. The cost can be born either by government or service providers or both. There is also an option for government to promote the project together with another initiative. For example, e-residency project would clearly benefit from the attractive private foundation platform and the budget of e-residency program is more than 800 thousand euros (Enterprise Estonia 2017). It is

highly likely that HNWI-s who today have no clear reason to become Estonian e-residents would seriously consider to become after establishment of their family foundation in Estonia.

Social Benefits	Social Cost
Service fees	Development of the legislation
Salaries to employees	Approval of the legislation
Taxes for government	Promotional cost

Table 1.

### 3.2. Calculation Method

#### 3.2.1. Benefits

It worth to ask why a government should bother with establishing a legal instrument like a private foundation (Sepp and Kaarlep, 2016 pp. 96 - 104). An immediate answer could be that the country’s wealthy voters need such an instrument for their family and business succession needs. However, it would be useful to assume the number of wealthy voters in the country. In case of Estonia, such number is so limited that government would not definitely worry about them. However, there can be another financial reason why several governments establish such a legal instrument.

What is the benefit of private foundation to a country after being used of such instrument by non-residents? We assume that the private foundation will not be involved with trading and other active business and tax neutral approach is also applied. It is common that under the private foundation a holding company to be established as well (Vogel 2015). The total benefit for the country can be expressed with a formula:

$$B = (k + uk) \times (p + r) + \sum (k + uk) \times (a_i + b_i) \text{ for } i = 1, \dots, n, \tag{1}$$

where  $k$  is the number of families who will establish a private foundation in a country;  $u$  is the proportion HNWI-s who establish an holding company;  $p$  represents state fee on establishment per unit;  $r$  is a service fee to establish a legal entity;  $a$  represents annual service fees per entity (domiciliation, management and accounting services which are normally provided by companies who provide trust services);  $b$  is annual fees for other services (legal, audit, asset management etc.) per entity;  $i$  is a fiscal year and  $n$  is a lifetime of the legal entity.

There are other indirect revenues for the country coming from high net worth individuals. For example  $v$  their visits to Estonia which are not included in the formula above like airport fees, accommodation and restaurant services etc. Elements of the formula is drawn on Figure 2.

#### 3.2.2. Cost

As mentioned earlier the costs of the project are time cost of participants and promotional cost. Time cost relates to the time spent by members of parliament and employees of government and financial sector companies. One alternative for determining development and approval cost (later named “initial cost”) would be to look at what would be the salary compensation at the time implementing and running the project. We can estimate total time  $T$  needed to complete the project by all participants and multiply it with average salary cost for the employer in the financial sector:

$$C_1 = T \times (S_{av} \times e), \tag{2}$$

Where  $S_{av}$  is average salary in the financial sector and  $e$  represents taxes payable by employer on the salary cost. It would be more reasonable to take salary data in the financial sector where compensations are higher compared with average salary in the country as it is expected that participants have higher skill and experience level. Thus, their salary cost is expected to be higher.

Another way to look at initial cost is to analyse what would be the alternative benefit that participants would create in case they would use the time somewhere else. One option to calculate an opportunity cost would be to find GDP contribution by an employee in the finance sector:

$$C_2 = [(G \times f) : N] \times T, \quad (3)$$

Where  $G$  is total GDP for a country,  $f$  represents contribution of financial and insurance activities sector to the GDP,  $N$  is number of people working in the sector and  $T$  represents total time needed for the project. When using the formula, attention should be given to time period. If we take annual GDP figure also time needed should be represented in man-years.

### 3.2.3. Discount factor

To calculate net present value, we need discount rate for discounting future cash-flows. Selection of discount rate is an ongoing debate among social scientists. Zhuang et al. (2007) have made a survey about different rates used in different countries. They state that public discount rates used around the world vary significantly with developed countries applying lower rates (3-7%) than developing countries surveyed (8-15%). Years which were covered by this survey were a period with steady and relatively fast growth in global economy with significantly higher interest rates than today.

European Commission's guide when talking about financial discount rates gives nominal annual return simple average of estimates 5,1% and long-term inflation rate 2,2%, and real annual return simple average of estimates 2,9%. As common way of inflation rate calculation does not include all goods traded in the world (for example value of land) I prefer to ignore inflation (that means I will not adjust by inflation also the calculated social benefits) and use real discount rate.

One way to approach social discount rate is to use social rate of time preference (SRTP). A relatively easy and largely used way to estimate the SRTP is based on the following formula, which is obtained from the Ramsey economic growth model (European Commission, 2014):

$$SRTP = \rho + e \times g \quad (4)$$

where  $\rho$  is the pure time preference,  $e$  is the elasticity of the marginal utility of consumption, i.e. the percentage change in individuals' marginal utility corresponding to each percentage change in consumption;  $g$  is the expected growth rate of per capita consumption.

It is reasonable to assume the growth rate of per capita consumption in long run as 1 and to use empirical evidence of the utility discount rate for pure time preference. Based on Zhuang et.al. (2007) survey the variation of the utility discount rate is from 0,1-3% with simple average 1,3%. The same authors also surveyed elasticity of marginal utility of consumption and found out that it varies between 0,2 and 4 with simple average 1,55%. The results based on SRTP formula above gives  $1,3\% + 1,55\% \times 1 = 2,85\%$ . As a coincidence, the result is almost the same as simple average financial real discount rate 2,9% stated above.

The biggest issue with social time preference and marginal utility of consumption is that majority of people have a relatively short-term view. Often they prefer utility today and devalue the future benefits especially if the timing is so far away that next generation will get advantage of benefits. Expected growth of per capita consumption is also debatable as the growth is possible until we have enough natural resources available although when this is not a case anymore the growth can start to be negative. The issues described in this paragraph are not covered further by this paper.



## 4. Discussion And Findings

### 4.1. Benefits

To give an example I try to estimate for Estonia what could be an annual effect for GDP and state budget. We assume the main target markets for Estonian private foundations would be Europe, Russia & CIS and Turkey. And the target client group would be HNWI-s with more than \$10M investable assets (multimillionaires). Based on current numbers there are 205 thousand multimillionaires in the countries mentioned above and forecast for 2025 is 273 thousand. (Knight&Frank 2016) For example there were in 2011 in Belgium 725 and in 2010 in Austria 2881 private purpose foundations (European Commission 2015). In 2009, the Dutch trust firms served about 16 400 clients (though not all were related to HNWI-s), who together held about 20 100 legal entities, that is on average 1.2 legal entities per client (Risseeuw and Dosker 2011). For now we can expect there are more as existing data belongs to the period when tax havens were widely used due to bank secrecy,. Based on above a conservative estimation will be that Estonia can attract only 1,000 new non-resident clients who establish a private foundation. Based on Dutch empirical evidence (Risseeuw and Dosker 2011) it is reasonable to assume that at least 20% of private foundations establish also a holding company. Current prices for domiciliation, management and accounting services start from 7,200 Euros included VAT (the tax is not reimbursable for private foundation as it cannot be registered for VAT) per entity (Henley Business Services (Estonia) OÜ 2016, Prospera Eesti OÜ 2016). That means in average  $7,200 \times 1.2 = 8,640$  euros. From a survey of the Dutch trust industry examining the amount of other services (legal, auditing, etc.), these entities' needs come to around 70% of the amount for trust services.

Hence the total fees per investor could be easily around 15 thousand euros ( $8640 \times 1,7 = 14,688$ ). If we multiply the result with a number of expected investors, the outcome will be 15 million euros additional GDP annually. To calculate potential tax revenue for state budget we use latest officially available total tax revenues of GDP – 32,5% (Eurostat). That means for state budget annually at least 5 more million euros for government to spend.

### 4.2. Timing of benefits

It is unlikely that all 1000 private foundations will be established in the year after implementation of the changes to the law. Thus, we make 3 estimates for how fast the number of entities will grow presented in the table 2. Optimistic view would be that 1000 private foundations will be established by the end of 7<sup>th</sup> year, realistic estimate assumes to reach the number by the end of 10<sup>th</sup> year and conservative estimate would assume to reach the level of 700 foundations by the end of 10<sup>th</sup> year.

Table 2. Number of private foundations

Year	1	2	3	4	5	6	7	8	9	10
Optimistic	100	250	400	550	700	850	1000	1100	1200	1300
Realistic	100	200	300	400	500	600	700	800	900	1000
Conservative	50	100	175	250	325	400	475	550	625	700

In respect of when the year 1 starts I expect realistically that the implementation of the project and final approval of the parliament takes on more year that means that benefits start to emerge starting from 2018 or in average 1 year from now.

It is clear that benefits of the project will not end after 10<sup>th</sup> year however uncertainties will increase and for the current paper I have excluded these benefits.

### 4.3. Cost

First we need to estimate of time. We have 2 more or less distinct teams: one team is working with necessary changes in respect of Foundation Act and liaising with Ministry of Justice and the second team is working with unavoidable changes in respect of Income Tax Act and cooperating with Ministry of Finance. Both teams have 2 participants from private sector, from Ministry of Justice there 2 employees and from Ministry of Finance there are 4 employees involved however most of the time in both cases are spent by 2 persons.

The first phase of analysis of the current situation and comparing it with competition took around 6 man-weeks. Next phase would be agreeing concrete changes with ministries. That is estimated to take 4 more man-weeks. The final stage of getting it approved by parliament might take around 15 man-weeks. That means altogether around 25 man-weeks or 1000 man-hours.

There were 255 working days in Estonia in 2016. If we deduct statutory holiday 4 weeks or 20 working days, then in 2016 it is expected that average employee worked 235 days or 1880 hours. Calculating the time needed for the project in man-years we get  $1000 : 1880 = 0,532$ .

Average monthly gross salary of employees in financial sector in 2016 was 1,856 euros (Statistics Estonia 2017). Showing the result as annual gross salary we end up  $1,856 \times 12 = 22,272$  euros. Employer taxes in Estonia consist of social tax 33% and unemployment tax 0,8%, together 33,8%.

Using the formula (2) we get total estimated employment cost  $0,532 \times (22,272 \times 1,338) = 15,854$  which makes in round numbers 16 thousand euros.

Now we calculate the initial cost of the project using the formula (3). Based on official statistics total GDP in 2016 was 20,9 billion euros (Statistics Estonia, 2017) and contribution of financial sector to the GDP was in 2015 3,9% (Statistics Estonia, 2016). It is reasonable to assume that annual change of the contribution is marginal so we can find total GDP of the sector  $20,9 \times 3,9\% = 0,815$  billion or 815 million euros.

Number of people working in the sector is close to 10,000 (Laming et al. 2016). That means annual GDP contribution per one employee in the financial sector is 815,000 thousand euros :  $10,000 = 81,5$  thousand euros. To find level of initial cost we need to multiply the result with the number of man-years estimated above:  $81,5 \times 0,532 = 43$  thousand euros.

In respect of operating cost the service providers will incur cost for office equipment and furniture, rental cost and opportunity cost for staff to do something else. For the calculation in this paper we assume total economic cost to be 50% from revenues. For simplicity of the calculation we also assume that promotional cost of the sector is included in the 50%. Further analysis of the financial statements of these companies would give more exact data however it is highly likely that the possible adjustment would not change the overall result of the analyses.

To consider also government promotional activities, we add 200 thousand euros annually to support the marketing of the project. Comparing with total budget of e-residency program around 800,000 in 2017 the amount used seems reasonable assumption.

### 4.4. Net present value

For net present value calculation, I will use calculated above SRTP in the amount of 2,85% and I use 15 thousand euros as average annual benefit from one investor and 43 thousand euros as initial cost. I ignore inflation as I use a rate close to real discount rate. In the table 3 Net Present Value calculation is presented.

Table 3. Net Present Value calculation (thousand EUR)										
Discount rate	2,85%									
Minimal benefit per investor (EUR)	15									
Service providers' cost per investor (EUR)	7,5									
Net benefits per investor (EUR)	7,5									
Annual government budget for promotion	200									
Year	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
Discount factor	0,958629	0,932065	0,906238	0,881126	0,856709	0,832970	0,809888	0,787446	0,765625	0,744410
Optimistic	519	1548	2519	3435	4298	5110	5874	6296	6691	7058
Realistic	519	1198	1839	2443	3013	3548	4052	4525	4968	5383
Conservative	159	499	989	1452	1888	2299	2685	3048	3389	3708
Discounted cash-flow (thousand EUR)				Initial cost						
									Net Present Value of the project (thousand EUR)	
Optimistic		43347		43		<b>43304</b>				
Realistic		31488		43		<b>31445</b>				
Conservative		20118		43		<b>20075</b>				

## 5. Conclusion

A distinct group of high net worth individuals is an interesting target for countries who are looking for more foreign direct investments. Based on analyses of the needs of the group one of solutions a country can offer is an institution called private foundation.

There are undisputable social benefits for finance and business tourism sector of a country. Although timing and speed of development of the market are uncertain. As costs of the project to develop legislation for private foundations are limited then even conservative Net Present Value of the project is 20 million euros positive and as per optimistic scenario we could even get 43 million euros benefits. These numbers exclude benefits after 10<sup>th</sup> year.

Results gives us confidence that it is socially beneficial to change legislation and attract non-residents to establish private foundations in a country to address their business and wealth succession issues.

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