

Article

Tool or tax dodge? Drawing the line for trusts in Czech holding structures

Karel Brychta*

*Associate Professor at the Faculty of Business and Management, Brno University of Technology, Czech Republic. Email: karel.brychta@vut.cz.

ABSTRACT

Simultaneously with the legitimate use of trusts as a means of asset protection and confidentiality, there is an observable trend towards, and potential for, the misuse of trust structures and their foreign equivalents in the context of aggressive tax planning. This article seeks to examine and evaluate the approach adopted by the Czech administrative courts towards trusts that are incorporated within holding structures, and to determine under what circumstances such use is deemed to constitute an abuse of law. The article concludes by formulating practical implications for legal professionals and the broader expert community.

TRUST IN THE CONTEXT OF HOLDING STRUCTURES AND ASSET MANAGEMENT

The institution of the *svěřenský fond* - the Czech legal equivalent of the common law trust - was introduced into the Czech legal order by the 2012 Civil Code,¹ a significant recodification that transplanted a common law instrument into a continental legal system.² The legislator defined two fundamental purposes for which a private trust may be established:

- primarily for the benefit of a specific person (the beneficiary) (*inter vivos*), or
- in his/her memory (*pro mortis causa*).³

The Civil Code explicitly permits a trust to be established for investment purposes with the aim of generating profit, which is subsequently distributed among designated persons; these persons may include the settlor, employees, partners, or other individuals.⁴

In its entirety, the trust and its inherent flexibility represent an attractive instrument for the effective management of private assets - particularly for intergenerational transfers, succession planning in family businesses, and the protection of assets from business or personal risks.⁵ The flexibility and unique legal characteristics of the trust make it suitable for a number of legitimate and socially beneficial applications, including within the business environment. Among the intended (and likely frequent) uses is the application of the trust in the context of:

- Succession planning: In the context of family businesses, the trust allows for a smooth and, crucially, unfragmented transfer of ownership to the next generation. By segregating shares of the family company into a trust, the settlor can, within the trust instrument, precisely define the rules for the future management of the trust and the conditions for the descendants' participation in management and profit distribution, thereby pre-empting potential disputes

¹ Act No 89/2012 Coll., the Civil Code, as amended (hereinafter 'the Civil Code'). This Act, which came into effect on 1 January 2014, constituted a complete recodification of private law.

² See Ministerstvo spravedlnosti České republiky (Ministry of Justice of the Czech Republic), *Důvodová zpráva k novému občanskému zákoníku—konsolidovaná verze* [Explanatory Memorandum to the New Civil Code—Consolidated Version] (online). <http://obcanskyzakonik.justice.cz/images/pdf/Duvodova-zprava-NOZ-konsolidovana-verze.pdf>, accessed 26 July 2025. The drafters noted that the chosen form was designed to be compatible with the domestic continental legal tradition.

³ See Section 1449(2) of the Civil Code.

⁴ *Ibid.*

⁵ For a broader discussion on the administration of another's property, see e.g., Jisková, Lucie and Pěšna, Lukáš, *Správa cizího majetku* [Management of Property Owned by Another] (Praha: Wolters Kluwer ČR, 2017) 180 pp, ISBN 978-80-7552-552-9; For the specific attributes of Czech trusts, see e.g. Pihera, Vlastimil and Ronovská, Kateřina, 'K některým mýtům a omylům o svěřenských fondech' [On Some Myths and Misconceptions about Trusts], *Bulletin advokacie*, no. 7–8 (2020), pp. 44–47. https://advokatnidenik.cz/wp-content/uploads/BA_07-08_2020_web.pdf, accessed 19 July 2025; Ronovská, Kateřina and Lavický, Petr, 'Foundations and Trust Funds in the Czech Republic After the New Civil Code', *Trusts & Trustees*, vol. 21, no. 6 (July 2015) 639–644. <https://academic.oup.com/tandt/article-abstract/21/6/639/1650182?redirectedFrom=fulltext>, accessed 19 July 2025.

in inheritance proceedings and ensuring the continuity of the business according to the settlor's vision.⁶

- **Asset protection:** The principle of separate ownership effectively isolates assets placed in the trust from the settlor's business risks. If a settlor operates in a high-risk sector, segregating family assets (e.g., real estate) into a trust can ensure that these assets are not attachable in the event of business failure or in execution or insolvency proceedings against the settlor personally.⁷ This protection is not absolute, however. If it were proven that the trust was established with the intent to defraud creditors, such conduct would constitute a criminal offence.⁸
- **Holding structures:** A trust can function, for example, as the apex entity of a holding structure, that is, as the ultimate owner of the parent holding company. This arrangement can achieve long-term stability in the ownership structure and strategic management of the entire group. The settlor's vision, embodied in the trust deed and its ancillary documents, thus becomes the governing constitution for the entire holding. A well-drafted trust also provides protection against hostile takeovers or the dilution of ownership control.

The potential for aggressive tax planning

The very characteristics that make the trust attractive for legitimate purposes - the separation of assets, the flexibility of the trust instrument, and a historically perceived degree of confidentiality - also create the potential for its misuse within aggressive tax planning structures. In practice, holding models have begun to emerge whose primary objective appears to be the attainment of tax advantages that would not be available under a standard arrangement. This trend has inevitably led to increased scrutiny from the Tax Administration and, subsequently, the administrative courts. The application of the abuse of law doctrine has thus come to the fore, serving as a substantive corrective to conduct that is formally legal but abusive in its purpose. A fundamental tension arises between the private law concept of the trust as ownerless property and the public law requirements for transparency and compliance with public regulations, including tax law.⁹ In this regard, one

cannot overlook the powerful tools provided by the Act on Ultimate Beneficial Owners¹⁰ and all related AML regulations. These rules provide tax authorities with a potent instrument for tracing economic benefits and *de facto* control back to the settlor and beneficiaries, thereby strengthening any legal challenge to the structure or the role of the trust within it.

THE PROBLEM OF ABUSE OF LAW IN THE TAX CONTEXT: FROM DOCTRINE TO POSITIVE LAW

Abuse of law (*abusus iuris*) is a general legal principle that serves as a substantive corrective to an overly formalistic adherence to the letter of the law. Its essence is to deny legal protection to conduct that, while formally complying with a legal provision, circumvents its spirit and purpose and aims for a result that the legislator did not intend and which contravenes general principles of justice.¹¹ In Czech tax law, this doctrine was long applied as an unwritten legal principle derived primarily from case law (including that of the Court of Justice of the European Union).

A seminal judgment in this respect is a 2005 decision of the Supreme Administrative Court of the Czech Republic.¹² A watershed moment came with a 2019 amendment to the Tax Procedure Code, which explicitly codified the principle of abuse of law as follows: '*In the administration of taxes, no account shall be taken of legal acts and other facts relevant to the administration of taxes, the predominant purpose of which is to obtain a tax advantage contrary to the spirit and purpose of tax legislation.*'¹³ While this amendment did not alter the substance of the doctrine, as its application remained consistent with previous judicial conclusions¹⁴, it did enhance legal certainty and was explicitly linked to confirming that the burden of proving abuse lies with the tax administrator.¹⁵

In connection with the question of abuse of law involving trusts, the following question arises:

How do the Czech administrative courts assess the use of trusts within holding structures in order to distinguish legitimate asset management from an abusive arrangement whose predominant purpose is to obtain an undue tax advantage?

⁶ See Mayerová, Eva and Filippek, Jakub, 'Svěřenský fond a smrt zakladatele, aneb převod vlastnického práva k majetku vkládanému do svěřenského fondu v případě smrti jeho zakladatele' [Trusts and the Death of the Settlor: Transfer of Ownership Rights to Property Placed in a Trust Upon the Settlor's Death], EPRAVO.CZ (15 March 2023). <https://www.epravo.cz/top/clanky/sverensky-fond-a-smrt-zakladatele-aneb-prevod-vlastnicke-prava-k-majetku-vkladanemu-do-sverenskeho-fondu-v-pripade-smrti-jeho-zakladatele-116124.html>, accessed 19 July 2025.

⁷ A sole trader is subject to unlimited liability, meaning they are liable for business debts with all of their assets, including personal property.

⁸ See e.g., CZ: Resolution of the Supreme Court of 26 January 2022, Case No. 5 Tdo 1273/2021. **In the judgment in question, the Supreme Court stated the following:** 'The removal of part or all of a debtor's assets within the meaning of Section 222(1)(a) of the Criminal Code on the criminal offence of defrauding a creditor is also understood to mean its concealment, which allows the debtor to continue to dispose of such assets, to use them, and possibly to regain these assets later. The segregation of assets from the ownership of the debtor as settlor into a trust (§ 1448 et seq. of the Civil Code), which has no legal personality, must also be assessed in this way. In this case, it is not an alienation of assets, which consists of the transfer of the debtor's assets or part thereof to another person, e.g., by donation or sale, if they use the funds thereby obtained for a purpose other than satisfying the claims of their creditors.'

⁹ In particular Act No. 586/1992 Coll., on Income Taxes, as amended.

¹⁰ Act No. 37/2021 Coll., on the Register of Ultimate Beneficial Owners, as amended.

¹¹ See CZ: Judgment of the Supreme Administrative Court of 14 November 2019, Case No. 5 Afs 314/2016.

¹² Cf. CZ: Resolution of the Extended Chamber of the Supreme Administrative Court of 27 May 2010, Case No. 1 As 70/2008, according to which: 'the prohibition of abuse of law is in a certain sense an ultima ratio, and must therefore be applied most restrictively and with careful consideration of other similarly important principles inherent in the legal order, in particular the principle of legal certainty, with which it—quite logically—most often conflicts.'

¹³ See CZ: Judgment of the Supreme Administrative Court of 10 November 2005, Case No. 1 Afs 107/2004, in which it is stated, 'An abuse of law is a situation in which someone exercises their subjective right to the unjustified detriment of another person or of society; such conduct, by which an unlawful result is achieved, is only seemingly lawful. It is considered merely seemingly lawful conduct because objective law does not recognise conduct that is simultaneously lawful and unlawful; given that it follows from the principle of *lex specialis derogat legi generali* that the prohibition of abuse of law is stronger than the permission granted by law, such conduct is not an exercise of a right, but an unlawful act (see Knapp, V., *The Theory of Law* (C. H. Beck, Prague, 1995), pp. 184–185). Therefore, a court will not grant protection to an exercise of a right which is in fact an abuse of it.'

¹⁴ See Section 8(4) of the Act No. 280/2009 Coll., the Tax Procedure Code, as amended (hereinafter referred to as 'the Tax Procedure Code').

¹⁵ Cf. CZ: Judgment of the Supreme Administrative Court of 26 April 2022, Case No. 4 Afs 376/2021.

¹⁶ See Section 92(5)(f) of the Tax Procedure Code, which provides that: 'The tax administrator shall prove ... (f) facts decisive for assessing the purpose of a legal act and of other facts decisive for the administration of taxes, the predominant purpose of which is to obtain a tax advantage contrary to the spirit and purpose of tax legislation.'

The aim of this article is therefore to synthesise a coherent set of principles from the existing jurisprudence of the Czech Supreme Administrative Court and thus provide a predictive framework for assessing the legal risk associated with using trusts in holding structures.

ANALYSIS OF THE ADMINISTRATIVE COURTS' JURISPRUDENCE

The practice of the Czech Supreme Administrative Court (SAC), both before and after the codification of the abuse of law principle, has been to consistently apply a two-step test, the elements of which must be cumulatively met to establish an abuse of law. As noted, the burden of proof for both elements lies with the tax administrator. The test consists of the following elements¹⁶:

- Objective element: *An examination of whether, despite formal compliance with the conditions set by law, a result has been achieved that is contrary to the spirit and purpose of the relevant tax provision. The issue is not a violation of the letter of the law, but a negation of its spirit and the legislator's intent.*
- Subjective element: *An examination of whether the predominant purpose of the conduct or series of transactions was to obtain a tax advantage. The court assesses whether sound non-tax economic or business reasons exist for the arrangement. If such reasons are absent or are clearly secondary and artificially created, the subjective element is met. The absence of economic rationality for the transaction (beyond the tax effect) is a strong indicator that this element has been satisfied.*

The case law also emphasizes the distinction between impermissible abuse of law and legitimate tax optimisation. Taxpayers have the right to choose the most tax-efficient option among several available and economically realistic alternatives. It becomes an abuse of law, however, when the taxpayer does not enter into real economic relationships but instead creates artificial, formal, and often unusual arrangements whose sole purpose is to generate tax savings.

Foreign trust and abuse of law

An individual, a Czech tax resident and the sole shareholder of a profitable Czech joint-stock company, undertook a restructuring.¹⁷ He established a trust in Cyprus. This trust became the sole owner of a newly established Cyprus holding company. Subsequently, the settlor sold the shares of his Czech operating company to this Cyprus holding company. Shortly thereafter, the Czech company paid dividends to its new Cyprus shareholder and claimed an exemption from withholding tax under the Czech Income Tax Act.¹⁸

The SAC upheld the decisions of the tax administrator and the regional court, which found that this constituted an abuse of law. The tax exemption was denied, and the Czech company was assessed a 15 per cent withholding tax on the

dividends paid. The Court found that both elements of the two-step test had been met:

- Objective element: The Court stated that the spirit and purpose of the dividend exemption within the EU is to prevent the double economic taxation of profits within a group of companies engaged in genuine economic activity. The aim is to promote the free movement of capital, not to facilitate tax evasion. In the case at hand, however, the Cyprus company was a mere 'letterbox' company with no real economic substance (no employees, premises, or independent activity). It served as an artificial intermediary (a conduit company) with the sole purpose of redirecting dividends from the Czech operating company to the ultimate beneficiary (the settlor of the trust) without the withholding tax that would have applied to a direct payment to an individual. Such use of the structure directly contravenes the intended purpose of the Directive and the Act.
- Subjective element: The Court focused on why such a complex, costly, and cross-border structure was chosen. The appellant advanced several non-tax reasons, such as securing assets for descendants and future succession; the Court, however, found these arguments to be implausible and, in any event, secondary. The arrangement lacked any economic rationale other than obtaining a tax advantage. Had succession truly been the main objective, it could have been achieved through simpler and cheaper means, such as establishing a domestic trust. The choice of Cyprus, the timing of the steps (establishing the structures just before the dividend payout), and the artificial nature of the entire transaction clearly indicated that the predominant purpose was tax avoidance. In this context, the trust itself was perceived not as a legitimate asset management tool but as another layer to obscure the true purpose and ownership.

The key red flags were:

- the use of an 'empty' company in a tax-favourable jurisdiction;
- the circular nature of control (the settlor was behind all entities); and
- and the close temporal proximity of the restructuring and the profit distribution.

Legitimacy of a holding structure

Individuals, partners in a Czech limited liability company, decided to create a holding structure.¹⁹ To this end, they established a new Czech holding company to which they subsequently sold their shares in the operating company. The purchase price was financed by the holding company partly through an external bank loan and partly to be repaid from future dividends received from the operating (now subsidiary) company. These dividends, paid from the subsidiary to the

¹⁶ Cf. CZ: Judgment of the Supreme Administrative Court of 9 August 2023, Case No. 4 Afs 231/2022.

¹⁷ The text of the subchapter based on CZ: Judgment of the Supreme Administrative Court of 6 September 2023, Case No. 2 Afs 82/2022.

¹⁸ Section 19(1)(ze) of the Act No. 586/1992 Coll., Income Tax Act, as amended (a clause implementing a rule from EU Parent-Subsidiary Directive).

¹⁹ The text of the subchapter based on CZ: Judgment of the Supreme Administrative Court of the Czech Republic of 23 July 2024, Case No. 10 Afs 16/2023.

parent company, were exempt from income tax in accordance with the law. The SAC overturned the decisions of the tax authorities, concluding that this was not an abuse of law. The creation of the holding structure was deemed legitimate. In this instance, the SAC held that the tax administrator had failed to satisfy its burden of proof with respect to the subjective element of the test. The taxpayers successfully argued and documented the existence of sound non-tax reasons for creating the holding structure. The Court accepted the following commercial and strategic objectives:

- to consolidate fragmented shares under a single parent company;
- to create a structure more attractive and straightforward for a potential sale of the entire group to a single strategic investor;
- to facilitate the future entry of new partners or the exit of existing ones at the holding company level, without affecting the ownership structure of the operating subsidiaries; and
- to establish a platform for central management, financing, and the separation of risks associated with different business activities.

The SAC also stated that the fact that acquisition activities and other initiatives occurred with a delay did not imply an abusive purpose at formation. A holding company is not obliged to demonstrate immediate success, as the business environment is dynamic and risky. The Court reiterated that a taxpayer may legitimately choose the most tax-advantageous option, provided there is a sufficiently significant non-tax purpose for the transactions undertaken. This judgment serves as a key counterpoint to the previous case and demonstrates that the courts will respect structures which, although they provide tax advantages, are underpinned by a credible and well-documented business strategy. The decisive factor is the existence and proof of long-term commercial objectives that transcend the immediate tax effect. In the author's opinion, this conclusion is equally applicable to a trust and its integration into a holding structure.

Artificial splitting and the single economic unit principle

This case concerned Value Added Tax (VAT). An individual entrepreneur artificially split his single economic activity among several newly established limited liability companies.²⁰ All the companies had the same object of business, the same employees, the same registered office, and were controlled by this single individual. The aim was to keep the turnover of each individual company below the statutory threshold for mandatory VAT registration. The SAC confirmed that this constituted an abuse of law. The Court disregarded the formal legal independence of the individual companies and viewed them as a single economic unit controlled by the individual. Consequently, it aggregated their turnovers, determined that

the threshold had been exceeded, and assessed the VAT liability directly to the individual, effectively 'piercing the corporate veil'. Although this is a VAT case, its principles are fully transferable to the area of income tax and holding structures. The judgment clearly demonstrates the courts' willingness to apply the 'substance over form' principle and to treat formally separate entities as a single whole if their separation is artificial and motivated primarily by tax relief. This approach is directly relevant for assessing structures involving trusts. If a trust and a series of underlying holding companies were all controlled by one settlor and served a single economic purpose without any other sound reason, a court could likewise deem the structure to be a single economic unit and assess the tax consequences as if the transactions had been carried out directly by the settlor. In the case at hand, the court stated that the structure was created solely to achieve a tax advantage that the appellant would not otherwise have obtained. The SAC agreed with the tax administrator's conclusion that the tax liability could not be attributed to any of the companies, as they were part of an abusive structure; the liability was correctly attributed to the appellant as the individual entrepreneur who was the *de facto* operator of the economic activity.²¹

The legitimacy of a leveraged buyout

In the context of the acquisition of a Czech operating company, the transaction was financed by a bank loan. The financing bank made the provision of the loan conditional on the debt being subsequently transferred to the target operating company, so that the debt would be serviced directly from the operating cash flows of the acquired company.²² The tax administrator saw this as an abuse of law aimed at obtaining an undue tax advantage in the form of tax-deductible interest on the loan at the level of the operating company. The SAC disagreed with the tax administrator and did not find an abuse of law in the transaction. The Court recognized that pushing the debt down to the operating entity was economically rational and motivated by a sound non-tax reason: an explicit requirement of the financing bank. By this step, the bank minimized its risk. The Court stated that it was economically logical for the investment group to accede to this requirement, as without the bank financing, it could not have realized the acquisition at all, or only on less favourable terms. The subjective element of abuse of law was therefore not met, as the main purpose was not to obtain a tax advantage but to meet the conditions for securing acquisition financing. The tax deductibility of the interest was a legitimate consequence of this commercially motivated transaction.

The criminal law perspective on purposeful asset segregation

After the initiation of insolvency proceedings, a debtor segregated her key asset (a plot of land with a guesthouse) into a newly and purposefully established trust to make it inaccessible to her creditors.²³ The Supreme Court confirmed that

²⁰ The text of the subchapter based on CZ: Judgment of the Supreme Administrative Court of the Czech Republic of 22 January 2025, Case No. 6 Afs 193/2024.

²¹ *Ibid*, para. [34] which reads as follows: 'After disregarding the corporate structure created by the appellant for the purpose of obtaining an undue tax advantage, it was the appellant, as a sole trader, who remained, and to whom the tax liability was assessed, since before the artificial and purposeful creation of the corporate group, he himself carried on a business activity unburdened by the abusive practice. The Supreme Administrative Court, in agreement with the regional court, thus considers the conclusion that the tax liability be attributed to the appellant to be logical and substantiated by the established facts of the case.'

²² The text of the subchapter based on CZ: Judgment of the Supreme Administrative Court of the Czech Republic of 25 June 2024, Case No. 8 Afs 246/2022.

²³ The text of the subchapter based on CZ: Resolution of the Supreme Court of 26 January 2022, Case No. 5 Tdo 1273/2021.

such conduct fulfilled the constituent elements of the criminal offence of defrauding a creditor. Although this was a criminal proceeding, the court's legal conclusions are highly relevant to tax law. The Supreme Court drew a precise distinction, ruling that segregating assets into a trust in this context does not constitute 'alienation' (a transfer of ownership to another person) but rather a 'removal' of assets from the debtor's estate. The reason is that a trust is not a legal person, and the property thus does not pass to another owner. Crucially, 'removal' was defined as concealing property in a way that allows the debtor (the settlor) to continue to dispose of the property and retain the possibility of regaining it.

In the author's opinion, this principle is directly transferable to the tax domain. If the tax administrator can prove that the settlor has retained *de facto* control over the assets through the trust's set-up, it can be argued that the assets were not genuinely transferred but merely formally 'removed' from the reach of the relevant taxation,²⁴ which is a typical feature of an artificial arrangement. The court in this case stated that the trust was created only formally; it did not genuinely fulfil its declared purpose but rather served to shield assets from creditors. A trust can similarly be misused for the purpose of 'shielding' assets from taxation.²⁵

Issue of De facto control and conflict of interest

In 2017, former Prime Minister Andrej Babiš placed shares of his Agrofert holding company into two trusts to formally comply with the requirements of the conflict of interest act. Within the trust structure, he figured as both the settlor and the sole beneficiary.²⁶ The courts ruled²⁷ that, despite the formal segregation of assets into the trusts, Andrej Babiš continued to control the Agrofert holding and was therefore in a conflict of interest.

These cases, although primarily concerned with public law rather than tax, set a fundamental precedent for assessing de facto control over assets in a trust. The courts were not satisfied with the formal separation of assets but examined the substantive reality of the matter, including the trust instruments and the position of the settlor. The courts concluded that, in substance, the trust structure failed to achieve the statutory purpose of insulating a public official from influence over the assets. The conclusion that a settlor who is also a beneficiary and who has retained influence over the administration in the trust instrument *de facto* controls the assets in the trust is directly applicable in tax disputes. For the tax administrator, this provides a strong argument that they can and should 'look through' the formal structure of the trust to examine who truly benefits from the arrangement and who really controls it. This approach weakens the ability to use trusts as a mere screen for transactions that would be tax-disadvantageous if carried out directly.

Synthesis of key criteria applied by the courts

The analysis of key judgments allows for the synthesis of a set of criteria that administrative courts consider in their holistic assessment of whether a given structure constitutes an abuse of law. It must be emphasized that no single factor is decisive on its own; the courts always evaluate the overall context and the totality of the circumstances of the case.²⁸

It is clear from these decisions that judicial review focuses on substantive truth and economic reality. Formal legality is merely a prerequisite for applying the abuse of law test, not a refutation of it. The presence of a trust in a structure is, *a priori*, neither a positive nor a negative factor in itself. It does, however, become a subject of inquiry as to why the trust was used and whether its role contributes to a legitimate objective or serves merely as another layer to conceal an artificial and tax-motivated scheme. Furthermore, the transferable conclusions from criminal and public law confirm that courts across different legal branches are willing to examine the settlor's *de facto* control and the true purpose of a transaction, which strengthens the position of the tax administrator in challenging artificial structures.

RISKS AND RECOMMENDATIONS FOR PRACTICE

Identification of key risk factors ('red flags')

Based on the analysed jurisprudence, a set of warning signs ('red flags') can be identified that are highly likely to attract the attention of the tax administrator and increase the risk of the structure being challenged as an abuse of law. Advisers and settlors should pay extraordinary attention to these factors when planning and implementing any structure involving a trust.

- Artificiality and Undue Complexity

Structures that are more complex than required by the declared business or personal objective. The use of multiple layers of companies, circular fund flows, or unusual legal steps without apparent commercial logic are strong indicators of artificiality.

- Lack of Economic Substance

The use of so-called 'letterbox' or 'conduit' companies that have no real economic function, lacking employees, offices, assets, or independent decision-making power. Their sole or primary purpose is the formal holding of shares or the redirection of financial flows.

- Suspicious Timing

The creation of a structure in immediate temporal proximity to a major taxable event, such as the distribution of accumulated profits or the sale of a significant asset or entire company. Such timing strongly suggests that the main motive was precisely that transaction and its tax consequences.

²⁴ This is particularly relevant to holding structures that involve foreign entities.

²⁵ Under Czech law, this relates principally to profit distributions paid to a natural person, which are subject to withholding tax. cf the section 'Foreign Trust and Abuse of Law' above.

²⁶ The text of the subchapter based on CZ: Judgment of the Municipal Court in Prague of 10 September 2024, Case No. 11 A 126/2023; CZ: judgment of the Supreme Administrative Court of 25 March 2025, Case No. 7 Afs 172/2024.

²⁷ The text of the subchapter based on CZ: Judgment of the Municipal Court in Prague of 10 September 2024, Case No. 11 A 126/2023; CZ: judgment of the Supreme Administrative Court of 25 March 2025, Case No. 7 Afs 172/2024.

²⁸ The claimant initiated a series of legal proceedings to challenge the denial of public contracts and subsidies, which was based on an alleged conflict of interest.

Cf. CZ: Judgment of the Regional Court in Brno of 12 October 2023, Case No. 30 Af 16/2022.

- Choice of Jurisdiction

Establishing a trust or holding company in a jurisdiction known for low or zero taxation or a high degree of banking secrecy, when there is no compelling business reason for such a choice (e.g., entering the local market, presence of key partners).

- Continuing *De Facto* Control by the Settlor

A situation where the settlor, after segregating assets into a trust, continues to deal with those assets as their own, bypassing formal administrative bodies and using the trust as a 'personal piggy bank'. Such conduct undermines the principle of separate ownership and the credibility of the entire structure.

- Absence of a Credible Non-Tax Rationale

The inability to present and substantiate a convincing, commercially logical, and consistent reason for the structure's existence that would stand even without the tax advantage. If a taxpayer cannot satisfactorily explain why they chose a particular arrangement, the courts will be inclined to conclude that the predominant purpose was tax savings.

Recommendations for settlors and advisers: constructing a defensible structure

Prevention is key in this area. The following recommendations are aimed at creating a structure with a high probability of withstanding judicial scrutiny.

- Ensure Substance

Every company in the structure, especially a holding company, must have a real economic purpose and function. This purpose must be demonstrable. It is essential to maintain meticulous documentation that proves the company's activities, such as minutes of board meetings, business plans, executed contracts, and market analyses. Crucially, this documentation must be created *ex ante* (in advance and on an ongoing basis), not *ex post* in reaction to the initiation of a tax audit.

- Document a Credible Non-Tax Purpose

The primary motivation for creating the structure must be commercial (e.g., preparation for a sale, expansion, centralisation of management) or personal (e.g., protection of family assets, intergenerational succession). This purpose should be clearly formulated in the founding documents (articles of association, trust instrument) and subsequently pursued consistently in practice.

- The Role of the Trust Deed

The trust deed is the constitution of the trust²⁹ and, along with other related documents,³⁰ a key piece of evidence regarding the settlor's intentions. The instrument itself should clearly and convincingly describe the legitimate purpose of the trust. Given that the trust deed is generally immutable, it is afforded exceptional evidentiary weight in any subsequent assessment of the settlor's original intentions.³¹

- Ensure Trustee Independence

If the settlor is also one of the trustees, the law requires the appointment of another, independent co-trustee.³² Genuine, not merely formal, independence of the trustee, who actively performs their duties and ensures the fulfilment of the trust's purpose, lends credibility to the entire structure.

- Mind the Timing

- If possible, restructuring should be carried out with sufficient time elapsing before planned taxable events. This weakens the tax administrator's argument that the sole reason for the structural change was to avoid tax on that specific transaction.

CONCLUSION

The Czech administrative Courts, led by the Supreme Administrative Court, are likely to approach the assessment of trusts in holding structures with a high degree of caution, consistently applying the principle of substance over form. The key findings can be summarised as follows:

- Firstly, judicial review is not limited to the formal legality of the established structure. The fact that a trust and a holding company were founded in accordance with all statutory requirements is merely the starting point for applying the abuse of law test, not a defence against it.
- Secondly, the decisive factor is the structure's predominant purpose, examined through the cumulative two-step test enshrined in the Tax Procedure Code. In applying this test, the case law has clearly demarcated the boundary between permissible tax optimisation - the right to choose the most tax-efficient path among genuine economic alternatives - and impermissible abuse of law. The latter is defined by the creation of artificial, economically irrational arrangements and is identified by applying the fundamental legal principle of substance over form.
- Thirdly, the courts conduct a holistic analysis of the economic reality and substantive nature of the arrangement. A structure is deemed abusive if it lacks a credible, substantial, and documented non-tax rationale (business, strategic, or personal) and if its design, complexity, and timing suggest that its predominant purpose was to obtain a tax advantage contrary to the legislator's intent.
- Fourthly, the presence of a trust in a structure is not automatically considered problematic. It may, however, lead to deeper scrutiny as to why this particular instrument was used. If the trust serves as a transparent and logical tool for fulfilling a legitimate objective (e.g., long-term succession), its role will likely be accepted. If, however, it is perceived as a mere layer to obscure ownership or as part of an artificial chain for redirecting profits, it becomes a key argument for establishing an abuse of law.

Future jurisprudence will likely further refine the boundaries of what constitutes sufficient 'economic substance' and a

²⁹ See Section 1482 of the Civil Code.

³⁰ Examples include the trust management agreement and the letter of wishes.

³¹ The author proceeds from the conditions in the Czech Republic.

³² See Section 1454 of the Civil Code.

‘credible non-tax purpose’ in response to increasingly sophisticated planning techniques. Continued international pressure for tax transparency, embodied by instruments such as DAC6 and registers of ultimate beneficial owners, will continue to provide tax administrations with new and more effective tools for detecting and challenging artificial structures. An emphasis on substance, transparency, and a well-documented legitimate purpose should thus become an absolute necessity for anyone wishing to use trusts and holding structures responsibly and with minimal legal and tax risk.

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AUTHOR BIOGRAPHY

Karel Brychta is an Associate Professor at the Faculty of Business and Management, Brno University of Technology. His research focuses on tax law (including international and EU law), comparative tax law, and the reflection of selected tax law principles in the jurisprudence of administrative courts. He is a member of the European Association of Tax Law Professors and the Association of Accounting and Tax Advisers (Czech Republic). Email: karel.brychta@vut.cz