Foundations and trust funds in the Czech Republic after the recodification of Civil Law: a step forward?

Kateřina Ronovská* and Petr Lavický†

Abstract

Although the major social and political changes happened more than 25 years ago, the Czech Republic is still in a 'transformation stage' of its legal system. The New Civil Code, in effect from 1 January 2014, has introduced new possibilities in the area of administration of assets, giving rise to a whole range of legal instruments: foundations ('nadace'), foundation funds ('nadační fond'), trust funds ('svěřenský fond'), and additional legal forms of an obligatory nature. The norms of international private law have also enabled the recognition of foundations, trusts, and similar foreign trust-like structures in the Czech Republic. This article briefly outlines the fundamental characteristics of the new legal framework and summarizes first reactions, based on experience with the new regulation.

Introduction

In Europe, foundations have traditionally been considered as 'separated assets dedicated by a settlor to a specific purpose', mostly beneficial to the public. Over the past few years, however, legal regulations in many European countries have undergone various changes, diverging from the traditional conception and gradually allowing foundations to be used for private purposes as well. This shift has occurred as a response to an increasing demand for these instruments in Europe because they can be applied, for instance, to prevent disputes in families, preserve the continuity of companies, set up an optimal framework for the administration of one's personal assets, as well as offer an alternative to hereditary succession. In the Anglo–American legal environment, these purposes are very efficiently addressed by means of a popular form of asset administration, namely the trust. Legislators in many European countries have, therefore, tried to achieve the same functional effect by means of similar legal instruments of various forms (obligational, substantive, status-related) because it is relatively difficult to combine the trust institute with the conception of private law in continental Europe.

The legal basis for 'trust-like' forms of asset administration may be found in many countries, such as Liechtenstein, Luxembourg but, more recently, also the Czech Republic and Hungary. Other countries opted to refrain from adopting this form of regulation, deciding to instead allow for an unlimited application of foreign trusts through the norms of international private law (eg Italy and Switzerland).

This trend was also taken up by the Czech legislators during the process of the recodification of the Czech private law. The Czech New Civil Code,[1] in effect from 1 January 2014, has introduced a range of diverse instruments for the administration of

* Kateřina Ronovská, JUDr., Ph.D., Associate Professor, Faculty of Law, Masaryk University, Veveří 70, 61180 Brno, Czech Republic; Tel: (+420) 549 491 211; Fax: (+420) 541 210 604; Website: www.law.muni.cz

† Petr Lavický, JUDr., Ph.D., Associate Professor, Faculty of Law, Masaryk University, Veveří 70, 61180 Brno, Czech Republic; Tel: (+420) 549 491 211; Fax: (+420) 541 210 604; Website: www.law.muni.cz

1. The Act No 89/2012 Sb, the Civil Code.

 doi:10.1093/tandt/ttv053

property. In addition, the norms of international private law have enabled foundations, trusts, and similar trust-like structures to be recognized in the Czech Republic.

Let us briefly outline the basic characteristics of the new legal regulation, summing up the first reactions to and experience with the regulations the New Civil Code in the area of asset administration.[2]

Foundations and foundation funds: a big change in the conceptual framework?

Foundations have been met with a degree of suspicion in Czech society, mainly due to what we can call the missing 'tradition of foundations'. After the formation of Czechoslovakia in 1918, the Czech foundation sector[3] did not have enough time—due to the economic crisis and the Second World War—to become sufficiently established and stabilized. The take-over of power by the Communist regime in 1948 was a catastrophe for the then existing foundations: foundations were abolished, their assets nationalized. Foundations were reintroduced only after the occurrence of the social and political changes at the beginning of the 1990s. However, since foundations were not a political priority at that time, their importance and scope were underestimated. While foundations were allowed to exist, their position was that of 'piggy banks' assisting the state in the support of 'public benefit'.

This approach, however, turned out to be unsatisfactory, particularly in comparison with the conception of foundations in surrounding countries and was finally reassessed during the recodification process. While the previous foundation law had been based on the Austrian tradition of regulation by means of public law[4] combined with the 'charity concept', that was 'imported' into Central Europe from the USA in the 1990s,[5] the new legal framework for foundations that was incorporated into the Civil Code (the General Part), reflects the German, Swiss, and Dutch models. The private law nature of foundations was emphasized and the centerstone became the will of the settlor. Consequently, the regulation has returned to its 'European roots'.

It can be concluded, that the new foundation law aims to be more flexible and, possibly, also to extend the scope of its applicability, as indicated by first signals derived from its application in legal practice.[6] In many respects, however, it has remained 'midway'.

It can be concluded, that the new foundation law aims to be more flexible and, possibly, also to extend the scope of its applicability, as indicated by first signals derived from its application in legal practice. In many respects, however, it has remained 'midway'

That likewise reflects the current ambivalent approach of society towards foundations and the position of foundations in the Czech legal context.

The Civil Code provides for two specific forms: 'foundations' and 'foundation funds', which are subordinated under the common term of 'Fundace' in Czech. Both forms are characterized by three conceptual features: purpose, assets, and a certain degree of organization.

A 'foundation' should have a long-term existence and exert stability; it must serve its purpose 'permanently', creating an inalienable foundation capital in the minimal statutory limit (ie approximately 20,000 EUR). The legal regulation for foundations is somewhat 'overregulated' (it contains more than 70 statutory provisions). It is also evident that the regulation

2. For more detailed introduction see: B Havel and K Ronovská, 'New Instruments of the Fiduciary Administration of Assets after the Recodification of Private Law in the Czech Republic—Foundation fund, Trust fund, Affiliated fund' in Hüttemann, R., Rawert, P., Schmidt, K., Weitemeyer, B. *Non Profit Law Yearbook 2013/2014* (Bucerius Law School, Hamburg, Germany 2014) 177.

3. It became separated from the Austrian foundation sector on the basis of the St Germain Peace Agreement (1919).

4. Following the example of the Austrian Bundesstiftungs- und Fondsgesetz 1974.

5. K Ronovská, 'Foundations in the Czech Republic: Yesterday, Today and Tomorrow' in CH Prele (ed), *Developments in Foundation Law in Europe* (Springer, The Netherlands 2014) 37.

6. The increased interest is also manifested in an increased interest in foundation law studies.

was drafted mainly with public benefit purpose foundations in mind. It may thus be expected that out of all the possibilities offered by the new Czech foundation law, the legal form of the foundation will be used for private purposes rather infrequently.

By contrast, the legal framework for 'foundation funds' is quite brief, leaving a substantially broader space for the settlor. The law has as few as eight provisions that regulate only basic issues regarding their status. The legal framework is also covered by the three provisions dedicated to foundations and the sophisticated general regulation of legal persons. Its applicability for private purposes is indisputable. Currently, however, there are debates among politicians on the belief that the legal regulation of foundations is too 'liberal' and that it needs to be subject to 'more regulation'. It has been suggested that it would be appropriate to have the law introduce the subsidiary application of the regulation on foundations to foundation funds.[7]

Should that happen, however, it would always be a matter of an ad hoc argumentation requiring the assessment of the limits of the settlor's autonomous will on the one hand and the subsidiary applicability of regulation for foundation to foundation funds on the other.

'Svěřenský fond' (trust fund): useful trust-like instrument in the Czech law?

The Czech legislation also introduced, next to the forms of asset administration with legal personality, a new 'trust-like' instrument—a 'trust fund' (svěřenský fond). The inspiration for this regulation was found in the Canadian province of Québec. The reason for adopting this concept was explained on the grounds that 'the Québec regulation still retains its strong continental law nature which affected a common law institute'.[8]

The Québec regulation still retains its strong continental law nature which affected a common law institute

The essence of the trust fund[9] consists in the donation of assets by the settlor, whereby separate and independent property is created to which the original owner does not have ownership rights any longer. The owner is neither the trust fund (because it does not have legal personality), nor the trustee or the beneficiary. The separated assets thus form an autonomous property that does not belong to anybody, the administration of whose property is performed by the trustee. He is obliged to 'perform' ownership rights and to meet the purposes set out by the settlor with respect to the rights of the beneficiaries. Every trust fund must have a statute made in the form of a public deed. That is—at least in comparison to the informal nature of Anglo–American trusts (as well as the Québec model)—a somewhat unusual requirement which is stipulated by the Civil Code only in a very minimal way. There is, however, substantial space for further autonomous regulation in this area.

Where the trustee fails to perform the administration of the trust fund properly, the settlor, the beneficiary, or any other person having a legal interest may request a court to impose on the trustee the obligation to act, or to refrain from acting, in a certain way. The ultimate possibility is the dismissal of the trustee and the appointment of a new one.

Although the idea of trust funds had been around for more than five years, it never came into focus of any significant debates during the drafting of the Civil Code. Only after it had come into effect, various emotional arguments (usually politically oriented and sometimes distorting reality) started to appear in the media, calling for the instant abolition of this legal form because of a high risk of its abuse. Finally, the opinion prevailed that there is no relevant reason for the abolition of the trust fund regulation.

7. This was the determining principle in the earlier regulation of foundation law, abolished as of 1 January 2014.
8. cf the Explanatory Note to the Civil Code.
9. s 1448 and seq of the Civil Code.

However, the trend to 'place' trust funds under a stronger 'public' control is evidently present among many politicians.[10]

Amid these—sometimes extreme—debates, the real essence, sense, and purpose of trust funds recede into the background, namely the separation of assets for a particular purpose, their separation from the trustee's assets, and their administration, which follows pre-set rules for the benefit of beneficiaries.

Amid these—sometimes extreme—debates, the real essence, sense, and purpose of trust funds recede into the background, namely the separation of assets for a particular purpose, their separation from the trustee's assets, and their administration, which follows pre-set rules for the benefit of beneficiaries

Procedural and tax rules: a short introduction

The fact that trust funds do not have legal personality means—with respect to procedural law—that they are not capable of being a party to proceedings. The role of the claimant or the defendant in contentious proceedings concerning the assets of the trust fund is performed by the trustee because only the trustee may exercise, in his own name and at the expense of the trust fund, the rights and duties relating to the assets in the same way as if he were the owner, save for the above-mentioned case of a court authorizing the settlor, the beneficiary, or a third person having a legal interest, to institute proceedings instead of the trustee. The fact that the trustee acts at the expense of the trust fund, rather than in his own name and for this own account, is reflected in the manner by which the trustee is identified in the claim: the claim must state that a given person is a trustee, specifying the specific trust fund he administers.

Not only does the trust fund lack the capacity to be a party to proceedings but it is also not capable of taking procedural steps. In proceedings concerning trust funds, the trustee is thus both a party and the person taking all procedural steps.

In contrast to trust funds, the procedural position of foundations and foundation funds is significantly different; this situation arises from their different status under substantive law. Foundations and foundation funds are therefore capable of being parties to civil proceedings and are likewise capable of performing procedural acts. Foundations and foundation funds can act as claimants or defendants; these roles are not limited to the person acting on their behalf.

Foundations and foundation funds with private (and also mixed) purpose are essentially taxed in a manner quite similar to that of other legal persons (such as business corporations). Although the trust fund does not have, from the point of view of private law, legal personality, tax law nevertheless accords it the role of a tax subject, placing the trust fund in a position similar to a legal person. The key person as regards procedural tax law is the trustee, whose role, for the purpose of taxation, approximates the statutory representative of legal persons.[11] With foreign legal persons and trust structures without legal personality, it must be determined whether a given entity constitutes a taxpayer under the Czech law.

In the case of legal persons, there is no problem because all legal persons constitute taxpayers under Czech tax law (this applies worldwide, regardless of the legal system under which they were constituted or where they are domiciled).[12] In the case of entities that do not have legal personality under Czech law,

10. For explanation, the Czech Ministry of Justice is currently thinking about introducing a registration of not only Czech trust funds but also of foreign trusts. That trend goes counter to the mainstream thinking in Europe since it is more than likely that European supreme courts will ultimately infer that the freedom of establishment and free movement of capital applies to trust and similar institutes as well. On the issue of 'infiltration' of the freedom of establishment and free movement of capital for trusts, see the Judgment of the EFTA Court: Fred Olsen and Others and Petter Olsen and Others v. The Norwegian State, represented by the Central Tax Office for Large Enterprises and the Directorate of Taxes, Joined Cases E-3/13 and E-20/13.

11. s 24 (6) of the tax code contain a standard provision for other payers without legal personality (eg mutual funds, structural components of the state, and trust funds).

12. The determination of who constitutes a legal person is carried out under the conflict rules of international private law, the Act No 91/2012 Sb on International Private Law.

the legal regime is determined by a special conflict rule.[13]

In the case of legal persons, there is no problem because all legal persons constitute taxpayers under Czech tax law (this applies worldwide, regardless of the legal system under which they were constituted or where they are domiciled). In the case of entities that do not have legal personality under Czech law, the legal regime is determined by a special conflict rule

As the legal regulation of foundations, foundation funds, and trust funds is very new, we may expect the tax regime to be developing and settling with the passage of time. The system of taxation is very complicated, with many exceptions and exceptions from exceptions, and it is sometimes difficult to navigate. However, it respects the basic principles, which are consistently enforced as well as upheld in the judicial decisions of the Czech supreme administrative court.

Concluding remarks

In many respects, the limited scope of the old foundation law valid in the Czech Republic until 1 January 2014, and the absence of instruments similar to the German *Treuhand* or the Anglo–American *trust* has left some space for consideration of other suitable forms of property administration for private or mixed purposes in which the main role is played by the settlor.[14]

The Civil Code introduces a number of new useful instruments. The owners of assets may thus choose from the following 'status-related' forms: the foundation, the foundation fund, the trust fund, and also other obligational forms. These, however, partially overlap and are even in conflict with each other. The selection will be guided by the space available for the assertion of the settlor's will, the assets, the adequacy of the legal regulation, the extent of public supervision, the protection of privacy, as well as the tax regime, which is usually the most important element in assets administration.

In spite of all the important shifts that have occurred with the recodification, the new Czech foundation law *de lege lata* is apparently not (yet) 'programmatically' shaped to be used for solely private purposes.

In spite of all the important shifts that have occurred with the recodification, the new Czech foundation law de lege lata is apparently not (yet) 'programmatically' shaped to be used for solely private purposes

The legal form of the foundation fund thus appears to be relatively well suited for these purposes. The flexibility of the trust fund, however, is somewhat higher, and, thus, probably more suitable. What is problematic, is the nature of a 'legal transplant' and its ambivalent acceptance by legal professionals. At the same time, it represents an 'alien element' in the Czech legal environment. It is thus difficult to estimate what position will be adopted by judicial practice.

Although the Czech Republic experienced the major social and political changes more than 25 years ago, it is still undergoing 'a period of transformation' of its legal order. We have grown accustomed to the frequency of amendments and the climate of general legal uncertainty. The fundamental changes in private law, resulting from the recodification of 1 January 2014, should have been the culmination of the whole process, bringing the much-needed stabilization and, eventually, the stability of Czech private law, which is a decisive factor in the long-term preservation of legal certainty.

All those who believed that the situation would calm down after the enactment of the New Civil Code have been disappointed by the current developments. This is because it has emerged that 'legislative

13. cf s 17 (1g) of the Income Tax Act.

14. The Czech Republic has not (yet) signed the Convention of 1 July 1985 on the Law Applicable to Trusts and on their Recognition, in effect from 1 January 1992.

optimism' in the Czech Republic is truly boundless. Not even a year has passed since the effective date of the reform and, despite protests from legal professionals, the Ministry of Justice has already started to work on what is, in many respects, a politically motivated revision that is to affect foundations and trust funds as well.

We can only hope that Czech legislators will realize the risks of such steps. The area of asset administration is a very sensitive one, requiring—apart from the above-mentioned stability—trust in the functionality of the legal environment. Otherwise it may happen that the new possibilities provided for by the new Civil Code will not be used and the chance to create a positive legal environment for asset administration will be missed once and for all.

From a certain point of view, the current discussion on trust funds may, after all, be seen in positive terms as well. This is because legal and political debates have started, focusing on the conception of trust and foundation structures in their broader contexts (particularly tax-related). These discussions, which had previously been missing in the Czech Republic, can be considered as useful and beneficial. However, what is also typical for the Czech Republic is that the discussions started only after the adoption of the new legal regulation and not before, ie at the time when the new rules were being drafted.

***Kateřina Ronovská**, JUDr., Ph.D., works as an Associate Professor at the Faculty of Law, Masaryk University, Brno, Czech Republic. Kateřina teaches Civil Law, Foundation and Trust Law, and is involved in the systematic study of this field in the European context. E-mail: katerina.ronovska@law.muni.cz*

***Petr Lavický**, JUDr., Ph.D., works as an Associate Professor at the Faculty of Law, Masaryk University, Brno, Czech Republic. Petr teaches and researches mainly in the field of Civil Procedure Law. E-mail: petr.lavicky@law.muni.cz*