Trusts (fiduciary funds) as transparent entities?

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The article summarizes fundamental guidelines that should be taken into account when examining the tax treatment of trust funds both in terms of intra-state income tax rules and the application of inter-state double taxation treaties.

Introduction

Trust, or in Slovak legal terminology "trust fund" or "fiduciary fund" [1], is an institution which is not laid down in the Slovak legal system. That, however, does not mean that the Slovak legal system does not recognize the concept of trust fund. A full-text search in the electronic Collection of Laws reveals that the concept of trust fund is mentioned in the Act on Automatic Exchange of Information on Financial Accounts[2] and its implementing decree[3] and, rather surprisingly, it was also included in the Act on Recognition of Professional Qualifications. [4]

In the Slovak legal environment, it is possible to encounter the concept of trust fund primarily in the context of tax planning, but any reference to trusts in this respect is completely absent both in the laws and regulations and in the Tax Administration guidelines. As a result, approaches to trust funds in practice vary, including views that they are akin to transparent entities (at least for tax purposes).

The objective of this article is, therefore, to provide a summary of some fundamental guidelines for assessing the tax treatment of trust funds. These are based on the legal nature of the concept of trust fund, the general rules of income taxation applicable in Slovakia and set out in Act No. 595/2003 Coll., on Income Tax, as amended (hereinafter the "**ITA**"), as well as on information compiled from available literature. [5]

The structure of the article is primarily based on two key aspects of the taxation of income of/from trust funds, specifically the issues of subject (i.e. the taxpayer) and object (i.e. the taxable event). The intra-state legal framework will be followed by an outline of the application of double taxation treaties and, finally, attention will be paid to the position of trust funds as instruments of aggressive tax planning and drafting of an appropriate legislative or practical response. Due to a lack of detailed information on this topic in literature, this article does not aspire to exhaustively cover all relevant aspects, and many of its issues will be just outlined as suggestions for future articles.

THE LEGAL NATURE OF TRUST FUNDS IN GENERAL

The key starting point for establishing tax treatment of a trust fund is to understand its legal basis. This is rather difficult to frame, as legislation varies from state to state, and there are forms of trust funds that are close to corporate in nature, as well as trusts that are purely in the form of obligations.[6] Some common features can be abstracted from the Hague Convention[7], however, it does not address the issue of legal personality.

The common characteristic in both cases is that the establishment of a trust fund involves the legal separation of the assets of the trust's founder (settlor) and their transfer to another entity that will administer the assets in its own name. In the case of a corporate trust, the assets are owned directly by the trust fund, with the administrator (trustee) acting on its behalf, and in the case of an obligation based trust fund, the trustee becomes the 'owner' of the assets.

1 For the purposes of this article, the term 'trust' or 'trust fund' will be used simply because it is more widely used in practice. It can be reasonably assumed, however, that any future legislative and other official documents will use the term "zverenecký fond" (fiduciary/trust fund) and the Slovak equivalent will come into common use.

2 Act No. 359/2015 Coll., on Automatic Exchange of Information on Financial Accounts for the Purposes of Tax Administration, and on Amendments and Supplements to Certain Acts.

3 Decree of the Ministry of Finance of the Slovak Republic No. 446/2015 Coll., laying down the details of the verification of financial accounts by reporting financial institutions.

4 Act No. 293/2007 Coll., as amended by Act No. 560/2008 Coll. The reason for the presence of the term trust fund was that in Annex No. 3 of the Act containing the list of fields of study with a specific structure, the field of Trust Fund Administrator was listed for the State of Liechtenstein. The Act has since been repealed and replaced by Act No. 422/2015 Coll., on the Recognition of Educational Qualifications and the Recognition of Professional Qualifications and on Amendments and Supplements to Certain Acts, which no longer contains the term. This is an apt illustration that the concept of trust fund may have a completely different tradition and thus a different reputation in different jurisdictions.

5 It should be noted that the topic of trust funds is very scarce in Slovak legal documents, while it can be observed that, to the contrary, academic discussions in the Czech Republic have intensified in response to the introduction of the concept of trust fund into the Czech legal system. For a brief overview of sources see KATKOVČIN, M. *Perspectives of use of a trust fund as a form of investment under legal and economic conditions of the financial market in the Slovak Republic. Bratislava Law Review, 2018, 2(2), 149-15,* https://doi.org/10.46282/blr.2018. 2. 2.111 and literature listed therein.

In view of this common characteristic, a problem arises in reconciling the concept of the transfer of title to assets under traditional common law concepts with the concept of ownership under Slovak law. Specifically, according to Article 2 of the Hague Convention, common features of trust funds are that certain assets have been "placed under the control of the trustee" and that "title to the trust assets stands in the name of the trustee". The Article also states that the trust assets "are not part of the trustee's estate."[8]

The traditional civil law concept of assets, still based on the Roman law tradition, works with a set of elements, including the right to hold, use, enjoy their fruits and benefits and dispose of assets[9]. It is evident that in the case of a trust fund, the right of the trustee to use the trust assets and enjoy their fruits and benefits is reduced (and is restricted merely to his right to remuneration for the performance of his duties as trustee) and, in addition, the right of the trustee to dispose of the assets may be further restricted by the settlor's will. This, as discussed below, raises questions as to whether the trustee can be regarded in civil law terms as the owner of the trust assets and therefore as a taxpayer in relation to the income generated by those assets.[10]

Notwithstanding the foregoing, it is the trustee who has absolute rights to dispose of the assets entrusted to him, to take proper care of them and, in accordance with the terms of the deed by which the trust was established, to provide benefits from the assets to the beneficiaries. This constitutes a performance (as a separate legal action) on the part of the trust fund or the trustee provided to the beneficiary. The same applies for the revocation of a trust, where, as a rule, the trust assets are not automatically transferred to the settlor or the beneficiaries by direct application of the relevant law; only an obligation of the trust or the trustee to transfer the assets is stipulated.

The trustee is entitled to a remuneration (either agreed or on an arm's length basis) for the performance of professional administration of the trust assets.

In other permutations, other variables enter in the form of a circle of beneficiaries and the trustee's powers to modify that circle (not arbitrarily, but in accordance with the terms of the deed establishing the trust and in compliance with the statutory requirements for the trustee's professional diligence), and also the powers of the settlor and the beneficiaries to revoke the trust (the term 'revoke' is used for the settlor). Even though these issues are not wholly relevant to determining the legal nature of a trust fund in general (and the underlying tax treatment to which the trust or the benefits thereunder should be subject), they may be relevant to identifying possible indicators of aggressive tax planning and triggering anti-abuse rules.

The foregoing allows for establishing at the outset that, in legal terms, a trust fund is not a completely transparent concept, since regardless of whether it is granted legal personality, there is always an actual transfer of 'ownership' of the assets entrusted to the trust and, subsequently, transfer of the dispositive rights to the assets in question. Irrespective of the answer

to the question as to who is the owner of the trust assets, it is indisputable that the legal link between the settlor and the beneficiaries and the trust assets is severed for the duration of the trust fund.

6 It is noteworthy in this context that in the Czech Republic the academic community is also divided on whether a trust fund has legal personality under Czech law. For more details, see TICHÝ, L. *Ownership without an owner in the Czech trust fund (outline of the margins of the trust in Czech law), Bulletin of Advocacy No. 3/2020, pp. 18-24, and the response of* RONOVSKÁ K. - PIHERA, V. *On some myths and errors about trust funds, Bulletin of Advocacy No. 7-8/2020, pp. 44-47.*

7 The Hague Convention of 1 July 1985 on the law applicable to trusts and on their recognition. Available online at https://www.hcch.net/en/instruments/conventions/full-text/?cid=59

8 In the common law world, it is not an anomaly that an entity may have several separate estates, or that an estate exists by itself and someone only performs dispositive acts with respect to it. For more details, see RONOVSKÁ, K. - PIHERA, V. *On some myths and errors about trust funds, Bulletin of Advocacy No. 7-8/2020, pp. 44-47.*

9 Word-lex. Thesaurus of Slovak law. Property law [Online] https://www.slov-lex.sk/zoznam-tezaurov/-/tezaurus/koncept/-SK-tezaury-1-1-koncepty-198

10 For comparison, the Czech Civil Code in Section 1448(3) explicitly states that *"Ownership rights to assets in the trust fund are exercised by the trustee in his own name on behalf of the fund; however, the assets in the trust fund are neither the property of the trustee, nor the property of the settlor, nor the property of the person to receive benefits from the trust fund."*

INCOME OF/FROM TRUST FUNDS IN TERMS OF NATIONAL LEGISLATION

In determining tax treatment of income of/from a trust fund, the first two relevant conclusions may be arrived at in the light of the above. In principle, a trust should be treated as a taxpayer pursuant to Section 2(a) of the ITA if it is granted legal personality. A trust which does not itself have legal personality cannot be a taxpayer as a result of the application of Section 2(a) of the ITA *a contrario*.

In general, the trustee (whether an individual or a legal entity) may be considered a taxpayer, at least in relation to his own activities and his assets, but it is understandably justifiable to ask whether he can also be a taxpayer in relation to the assets in the trust, since he disposes of them in his own name and also receives income. Even if we were to accept that the trustee is a taxpayer *per se*, a separate question arises whether income from the trust assets can be identified with income of the trustee and thus be subject to taxation (see below).

On this basis, the possible tax residence of the trust fund may be tested pursuant to Section 2(d) and (e) of the ITA. A practical problem may arise if the trust has several trustees located in geographically different places. If the trust fund has legal personality, the issue of determining tax residence should be limited to finding its registered office or place of actual administration. If the trust fund does not have legal personality, it is likely to be necessary to examine whether all individual trustees dispose of all the trust assets or whether the asset disposal is to some extent divided. It seems more realistic to assume that the assets are divided among individual trustees as tangible assets will either be physically located in a particular territory, or be subject to registration (e.g. in the land, motor vehicle, ship or aircraft registries) with a particular person, or will be held as a receivable of a particular person (e.g. a receivable due from a bank current account). The tax residence of a particular trustee should also be relevant in terms of income generated by the trust assets.[11]

It may be postulated that a benefit either to the trust or by the trust to another person will be classifiable as income pursuant to Section 2(c) of the ITA, since legally it will be a performance, i.e. a transfer of ownership of assets between two separate entities.

However, a considerably more complex issue is how the income received by the trust or paid out of the trust should be classified and whether this income is subject to taxation pursuant to the ITA.

Increased attention should be paid primarily to the general definition of the subject of taxation pursuant to Section 2(b) of the ITA, which is *"income (proceeds) from the taxpayer's activities and from the disposal of the taxpayer's assets"*. Assuming that the trust assets will primarily generate passive income, application of the part of the sentence *'from the disposal of the taxpayer's assets'* may be considered.

Difficulties may arise when interpreting the term 'taxpayer's assets' where in the case of a trust fund without legal personality it needs to be determined whether those assets are 'assets of the trustee'. Theoretically, the relevant provision may apply in the following variants:

- If the term 'taxpayer's assets' is interpreted to mean "assets to which the taxpayer has an ownership right,"[12] then, in light of the foregoing discussion, it might be concluded that income from assets in a trust fund is not subject to

taxation by the trustee because the trustee does not have an ownership right to the trust assets. The consequence of this interpretation is that the trust income would not be taxed at all in Slovakia, since it would not be possible to identify the taxpayer from whom the tax is to be collected.[13]

- If we considered a looser interpretation where we understand this term as "assets which the trustee disposes of in his own name" (i.e. without reference to the concept of ownership right), then income generated from assets in a trust fund without legal personality would in the first step be perceived as income subject to taxation by the trustee.[14]

For now, I will leave open the conclusion as to which interpretation should take precedence. Let me just point out that, given that the second variant leading to taxation is less intuitive and to some extent contradicts the grammatical wording of the relevant regulation and the traditional concept of rights *in rem* in Slovakia (i.e. it is more difficult to advocate it in the context of standard interpretative approaches and constitutional principles applicable to tax law), it has been impossible to date to discern any ambition of the Tax Administration to grasp this issue and try to defend the position leading to taxation of trust income in Slovakia.

The foregoing allows for a partial conclusion that this constitutes a deficiency of the current regulation in the ITA, which is primarily a product of the civil law tradition and it inevitably 'struggles' with common law concepts.[15] If the Slovak Republic aims to tax income from trust assets, it seems appropriate to remove this ambiguity by modifying Section 2(b) of the ITA, because I am not convinced that the variant leading to taxation can simply be implemented through interpretation.

Notwithstanding the foregoing, if I correctly assume that taxation of trust income in Slovakia is a desirable goal (at least from the perspective of budget revenues), for the purposes of the following text and to develop further argumentation, I will work with the variant where income of a trust fund without legal personality is identified as subject to taxation by the trustee.

Under such an assumption, income received by the trust can in principle fall into two categories of income:

- The first is assets acquired from the settlor (or other persons) in connection with the establishment of the trust fund and the creation of its estate. For this type of income, the gratuitous nature of benefits can generally be assumed. The settlor (or any other person) does not, as a result of the contribution, acquire the right to any consideration from the trust or any ownership interest in the trust. That leads to a conclusion that such a deed amounts to income acquired through donation, which is not subject to taxation pursuant to Sections 3(2)(a) and 12(7)(b) of the ITA.

11 By comparison, Baker reaches the same conclusion that there must always be an entity that is the taxpayer of the trust income (whether the trust itself or individual trustees), but advocates as a more elegant solution a general perception of the trust fund as a separate entity with tax personality (for the purposes of applying international double taxation treaties). See BAKER, P. *The application of the convention to partnerships, trusts and other, non-corporate entities. GITC Review, 2002, 2. 1., p. 16.*

12 By comparison, in defining the concept of business property, Section 2(m) of the ITA expressly refers to the concept of ownership, which indicates that the ITA actively works with this concept.

13 It should be noted that this conclusion also applies in the case of the application of withholding tax under Section 43 of the ITA, where it is not a separate tax, but only a method of tax collection, meaning that fulfilling all elements of the tax relationship (subject/taxpayer, object/taxable event, base, rate) is also tested in this method of tax collection, and if there is no definition of an entity subject to taxation, income should not be subject to taxation either.

14 There is a formalist argument in favour of this alternative, which is essentially in contrast to the position in the previous note. If the trustee is acting in its own name when managing trust assets, this trustee is listed in relevant records (including bank records and lists of members and shareholders of companies paying dividends). In practice, therefore, in the first step, the paying entity (e.g. for withholding tax purposes pursuant to Section 43 of the ITA) does not know that it is paying to the estate "without the owner", but it can clearly identify that it is paying to a specific natural person or legal entity.

15 As noted above, common law literature does not view this issue as a problem at all (see *supra 11*), but this also makes it more difficult to transpose its conclusions into our legal environment.

- The second is income generated by the trust assets, which can take different forms depending on the nature of the assets, such as rent, interest, dividends, royalties. In general, it can be assumed that this would constitute predominantly passive income (although in theory it is possible to consider a whole business being held in trust, in practice such situations are rather rare and the business is more likely to be run by a separate legal entity whose ownership interest would be subject to the trust assets). The key factor in determining the category of income for income tax purposes should be the income itself, whereas it should not matter that the trust fund is the beneficiary (except in the case of legal personality of the trust fund where it will matter whether it is income of an individual or of a legal entity). With regard to the passive nature of the income, it can also be assumed that its taxation will take the form of a withholding tax under Section 43 of the ITA.

In the event of income received from a trust fund, the relevant factor is the nature of the legal relationship between the trust and the beneficiary. Taking into account the historical purpose of the trust (provision for the family), it may to some extent be expected that the predominant legal relationship will be gratuitous transactions (i.e. donations) executed by the trust for the benefit of the beneficiary.[16] Such performance would not be subject to income tax pursuant to Section 3(2)(a) or Section 12(7)(b) of the ITA.[17] It may also be noted that the receipt of a benefit from the trust by the beneficiary is generally income which is not contributed by the beneficiary (i.e. the income does not originate in the beneficiary's activity or disposal of the assets). This is an obvious deficiency in the wording of the ITA, since, *stricto sensu*, income acquired through donation could never be subject to income tax due to the application of Section 2(b) of the ITA, and therefore the provisions of Sections 3(2)(a) or 12(7)(b) of the ITA would be obsolete in this respect.

It must be admitted, however, that in practice there may be situations where a trust fund will provide a particular performance (in favour of the beneficiary or another person) as a consideration. In such a case, it will again be necessary to examine the economic basis of the benefit from the trust (e.g. fulfilment of an obligation from a service rendered, acquisition of property, etc.), which would also determine its tax treatment, as it might be income that would be subject to taxation. Again, the fact that the benefit would be provided from the trust assets should in principle be irrelevant to the determination of the tax treatment of such income.

The foregoing leads to a conclusion that, on first approach, it should be practically irrelevant that the trust fund is the beneficiary of certain income, or that certain income originates in a benefit from the trust. Payments into or out of a trust fund should be viewed as any other transactions between separate legal entities, and the primary consideration should be the nature of the transaction. Thus, a trust fund *per se* should not be treated *a priori* as a transparent entity for tax purposes.

This conclusion can only be modified by taking into account specific circumstances of the application of anti-abuse rules, which will be discussed below.

It is also imperative to consider the situation where, at the initiative of the settlor, the trust fund is revoked and the trust assets are transferred back to the settlor. Although the transfer would again be virtually gratuitous, it cannot be unequivocally considered as equivalent to a donation. The trust fund or the trustee transfers the assets to the settlor because that obligation arises from the deed by which the trust was established or from the general regulations governing trusts in the relevant jurisdiction.

In my opinion, it follows that in this specific situation (practically possible only in the case of a revocable trust fund), the settlor's income should be taxable income pursuant to Section 2(b) of the ITA as income from the disposal of the taxpayer's assets (where the taxpayer, i.e. the settlor, first places certain assets into the trust structure and then withdraws them after they have appreciated in the trust fund). Where it is natural person's income, it should fall within the category of other income subject to taxation under Section 8, since only this category is comprised of just a demonstrative list of revenues that fit this category, whereas *numerus clausus* revenue lists in the other categories do not include the settlor's income generated upon revocation of the trust.

The tax base pursuant the provisions of Section 8(2) of the ITA should be net income, i.e., the gain on the assets that occurred in the period from the transfer of the assets to the trust fund and their transfer back due to trust revocation.

Even in this specific case, it is difficult to arrive at a conclusion that the trust should be viewed as a transparent entity, as this would require disregarding at least two legal actions (depositing of assets into the trust fund and their transfer back), for which there is no clear legal basis. Procedurally, ignoring the (tax) legal personality of the trust fund would necessitate retroactive reassessment of the settlor's tax base once the trust has been revoked. Furthermore, the tax-related consequences, despite

the additional complexity, would not be significantly different from a treatment where the trust fund is granted (tax) legal personality and, as a result, taxation would proceed in accordance with the preceding paragraphs.[18]

With regard to the foregoing, it does not seem justified or desirable that, under the basic tax treatment, income from assets contributed to a trust fund should be taxed either on the part of the settlor or on the part of the beneficiaries.

16 It is worth noting that within this "basic" tax treatment it is perfectly legitimate for the settlor of a trust fund to be viewed as an "ordinary" beneficiary as well, since there may be situations where the settlor finds himself in a circle of entities 'dependent' on support from the trust. To the contrary, it should be up to the tax administrator to identify such a situation and demonstrate that it is the result of the application of aggressive tax planning practices and apply the relevant anti-abuse rules accordingly (see below).

17 Taking into account the historical purpose of trust funds, the discussed situation is equivalent to a transfer of assets to a "reliable family member" who assumes a moral obligation to provide for the other members. In such circumstances, there is no reason to question in practice the classification of the related income as a series of donations. The tendency to debate such a conclusion in the case of trust funds stems from the fact that they have often been the instrument of aggressive tax planning schemes (and have been publicly promoted as such), thereby sidelining the historical purpose of trust funds in the public mind.

INCOME OF/FROM TRUST FUNDS IN TERMS OF INTERNATIONAL DOUBLE TAXATION TREATIES

The first important question is whether a trust fund can be an entity eligible for the application of a double taxation treaty. Literature leans to the conclusion that it is possible, arguing that a trust fund should be included in the concept of "person" in Article 3(1)(a) of bilateral treaties on avoidance of double taxation based on both the OECD Model Treaty and the UN Model Treaty (hereinafter the "**Model Treaties"**) as "other body of persons".[19] Baker notes that this issue should not be subject to controversy, because if the trust fund was not awarded legal personality directly, the trustee himself should hold that status.[20]

Similarly, when determining the domicile of a trust fund, it should be considered pursuant to Article 4(2) of the Model Treaties as the domicile of a "person other than a natural person" if the trust is granted separate personality for tax purposes, or pursuant to Article 4(1) of the Model Treaties if the trustee's domicile is taken into account.

A disputable issue is primarily the application of the clause in Article 4(1) of the Model Treaties, according to which only a person subject to (global) taxation in a Contracting State is deemed to be a resident. Different conclusions in terms of the applicability of a bilateral treaty to a trust fund thus arise from whether the pertinent jurisdiction deems income generated by trust assets subject to taxation (either directly at the level of the trust fund as a separate taxable entity, or at the level of the trustee)[21].

However, once the aforementioned criteria have been met, the fact that the trust fund is the recipient of certain income should not subsequently affect the classification of that income or the application of specific articles of the bilateral double taxation treaty.

In this context it is noteworthy that, in principle, it is accepted that a trust may also be regarded as the beneficial owner of income for the purposes of the application of Articles 10, 11 and 12 of the Model Treaties. For instance, the OECD Commentary[22] explicitly states that *"where the trustees of a discretionary trust[23] do not distribute dividends paid to the trust in a given period, those trustees [...] (or the trust if it is considered a separate taxpayer) may be treated as the beneficial owner of the income [...] even if their respective law governing trusts does not treat them as the beneficial owner."*

In global terms, possible disputes do not concern fundamental legal issues as to whether a bilateral double taxation treaty may be applicable for a trust fund *per se*, but they rather deal with factual issues concerning whether a particular trust fund possesses the required degree of discretion to be regarded as the beneficial owner of the income.[24]

On the other hand, literature on payments from a trust fund tends to conclude that such payments should fall under Article 21 of the Model Treaties (Other Income) [25] with the implication that such income should only be taxed in the state of residence of the beneficiary as the recipient of the income. Even such general conclusion may, however, result in some modifications; for example, in the case of trust funds established under the Czech Civil Code, there are reasonable arguments for classification of such income pursuant to Article 10 (Dividends) of the double taxation treaty between the Slovak Republic and the Czech Republic.[26]

The foregoing indicates that trust funds should not be disqualified *a priori* from the application of bilateral double taxation treaties.

But again, this conclusion can be modified when applying anti-abuse rules.

INCOME OF/FROM TRUST FUNDS IN THE LIGHT OF ANTI-ABUSE RULES

Although it is possible to formulate general conclusions that trust funds should not *per se* be subject to a fundamentally different tax treatment, there may be factual circumstances which practically invalidate such conclusions.

First of all, it should be briefly mentioned that the above conclusions may be modified by the substance-over-form rule in Section 3(6), first sentence, of Act No. 563/2009 Coll. on Tax Administration (Tax Code), as amended (hereinafter the "**Tax Code"**). We may assume that the application of this rule will be rather rare, but it cannot be completely ruled out. This will be the case, for instance, where it is apparent from the facts that the trust structure exists 'only on paper', while the settlor retains full control over the trust assets.

18 This view is even more "favourable" for the revenue side of the budget, since the mass of assets in the trust fund can theoretically increase by income that would otherwise be exempt from taxation or subject to a more favourable tax rate (e. g. on dividends).

19 Supra 8

20 Ibid.

21 For more details, see e.g. PREBBLE, J. Trusts and Double Taxation Agreements. *eJTR, 2004, 2: 192.*

22 Paragraph 12.1 and related footnote of the Commentary to Article 10 of the OECD Model Treaty, 2017 edition. OECD, Model Tax Convention on Income and on Capital 2017 (Full Version), OECD Publishing, Paris, 2019 https://doi.org/10.1787/g2g972ee-en.

23 A discretionary trust fund is a type of trust where the trustee has discretion, including whether to pay any benefit out of the trust assets to certain beneficiaries.

24 See e.g. MANZITTI, A. Trust recognised as a "person", but fails to get treaty benefits [Online] https://www.europeantax.blog/post/102g6ry/trust-recognised-as-a-person-
-but-fails-to-get-treaty-benefits

25 Supra 8, p. 19

26 Announcement No. 238/2003 Coll. Ultimately, however, this issue will have to be resolved by the Czech courts in the first instance and then ideally the Slovak tax administrator should accept this classification and allow the tax paid to be set off against any tax liability in Slovakia.

More often, the application of general anti-abuse rules[27] pursuant to the second sentence of Section 3(6) of the Tax Code is likely to be considered. A trust fund may represent one of the elements that will not have economic substance in a certain structure (subjective test) and, at the same time, its incorporation in the structure will tend to negate the scope and purpose of a certain tax rule (objective test). In particular, the main difference with the application of the substance-over-form rule is that the factual circumstances make it apparent that the trustee/trust in effect disposes of the assets entrusted to him/it (i.e. that there has been both legal and actual transfer of the assets).

Factual circumstances may, however, still suggest that the primary (historical) purpose of the trust fund will not be fulfilled (or will be completely negated). One indicator may be where the settlor is also the sole beneficiary of the trust fund and, as a result, the structure is inherently circular. From a tax perspective, the objective test criteria might be met if the circular structure serves only to reclassify otherwise taxable income (interest, royalties, dividends) as non-taxable income (gratuitous benefit from the trust in favour of the beneficiary).[28]

In any event, the determination of whether the objective and subjective test criteria are met will depend on specific facts of each trust fund, and the primary burden of proof will lay on the tax administrator.[29]

In addition, it is also possible to consider the application of the CFC rules pursuant to Section 17k of the ITA and Section 51h of the ITA. The application of these provisions is, however, tricky as trusts are generally not supposed to have registered capital, voting rights or a profit share. Therefore, under the CFC rules for legal entities pursuant to Section 17k of the Tax Code, in order to classify a trust as a CFC of a Slovak legal entity, it will be necessary to infer meeting one of the above criteria from the facts, which may be difficult.[30]

In the case of CFC rules for natural persons pursuant to Section 51h of the ITA, the situation is similar, as no formulation of the law directly encourages testing of actual control, i.e. the right to "*decide on the disposal of the company's or entity's assets and the proceeds of those assets.*"

In the absence of facts to the contrary, it may be generally argued that the presumption of actual control will be significantly weakened where the beneficiaries of the trust fund are distinct from the settlor and where the trust fund is a discretionary and irrevocable trust.

But even if the criteria for classifying a trust fund as a controlled foreign company are met, it will be crucial to determine whether the trust assets generated income in connection with the involvement of functions and risks (pursuant to section 17k(6) of the ITA), or whether the trust assets were associated with personnel and premises (pursuant to section 51h(3)(c) of the ITA).)[31]. In principle, an authentic trust fund administered by a professional trustee should have no difficulty in demonstrating compliance with the aforementioned criteria (particularly in the case of passive income, where the demands on material and staff capacity are generally not so extensive).

Taking into account all of the above rules, the *de facto* consequence of their application is that trust funds are perceived as transparent entities. However, this perception is not a blanket one, but precisely if and only if the criteria for the application of anti-abuse rules are met.

The conclusion of the foregoing is that the tax administrator's competences are essentially sufficient to effectively distinguish *bona fide* trust funds from trust structures established for the purpose of aggressive tax planning. Only the practice of application will determine if any clarification of applicable legislation will be necessary.■

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Trust funds are not expressly regulated by Slovak law, although trust structures are widespread in Slovakia. When applying the general principles of tax law in Slovakia, trusts *per se* should not be perceived as transparent entities. At the same time, current legislation does not allow for an unequivocal supposition of how (and if at all) income generated by trust assets should be taxed in Slovakia, hence lawmakers' intervention seems appropriate. Trusts should not *a priori* be disqualified from the application of international double taxation treaties either. However, if the facts of a particular case justify the application of anti-abuse rules, in particular the substance-over-form rule, the general anti-abuse rule (GAAR), and the CFC rules, the conclusions may be different.

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28 In particular, if the payment of such income would show signs of regularity, which would also indicate that the trust is not discretionary.

29 It appears practically inevitable that the tax administrator will have to make use of international information exchange tools. For more details, see SZAKÁCS, A. Exchange of information for tax administration purposes. Bulletin SKDP. 1/2021, pp. 15-23 and literature quoted therein.

30 Again, the position may be marginally easier for the tax administrator if the settlor is also the sole beneficiary.

31 For the sake of simplicity, we consider a trust fund established in a state that is on a "whitelist" pursuant to Section 2(x) of the ITA.