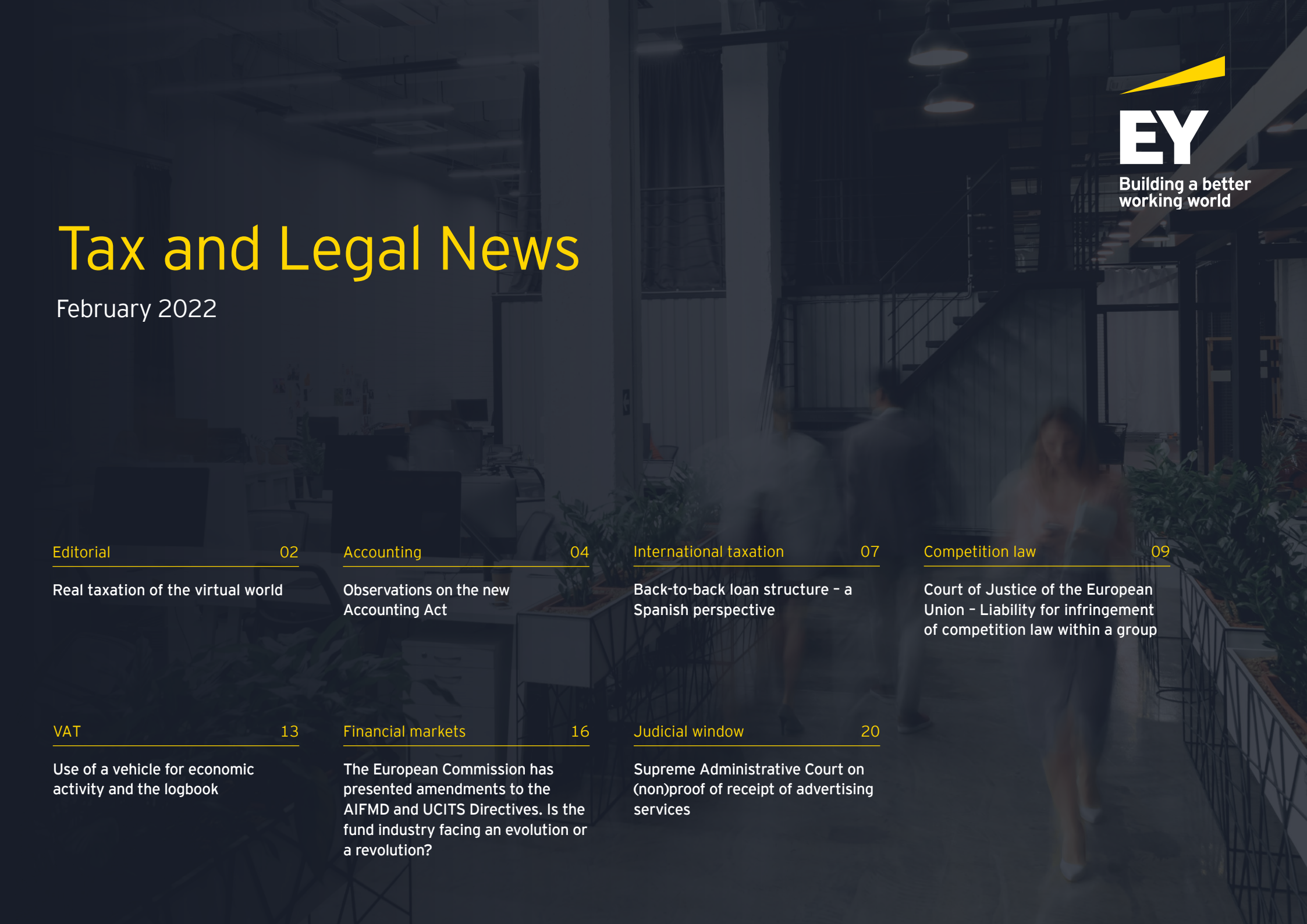

Tax and Legal News

February 2022

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Real taxation of the virtual world

Another turbulent year is behind us and we're slowly looking ahead to the tax return filing deadline. Most have resigned themselves to the need to tax, for example, Airbnb income. Although, again, it won't be a huge amount of money in the last year. The less successful some areas of the real world are, the more explosive the virtual market for various crypto-assets (cryptocurrencies, ICOs, NFTs, etc.) and the volume of transactions taking place there.

The loyal reader of our regular Tax and Legal News shouldn't be surprised to learn that many of these transactions are likely to be taxable. Although we don't have any specific legislation or binding tax administration interpretation, at least among the professional public there's a prevailing view that any exchange of cryptocurrency constitutes taxable income. This is based primarily on the classification of cryptocurrency as any other asset. This includes the exchange of cryptocurrency for a fiat currency (CZK, USD, EUR...), but also the exchange of one cryptocurrency for another. And watch out for the purchase of goods or services with cryptocurrencies (including payment for online content downloaded via the internet) – while this might seem like an expense at first glance, tax-wise it's very likely the realisation of income from the "sale" of cryptocurrency and subsequent purchase. Again, nothing new and illogical, because according to Czech tax law we tax the exchange by default (apples for pears = two sales and a "settlement").

Anyone wanting to start blaming our tax administration in the Czech Republic should be reminded that a similar approach (also without robust local legislation) is applied in most foreign jurisdictions, e.g. see the OECD report. The US IRS has also long warned about the obligation to tax cryptocurrency transactions. Even the individual tax return form (1040) has a box right after the taxpayer's name and address asking "At any time during 2021, did you receive, sell, exchange, or otherwise dispose of any financial interest in any virtual currency? Yes/No".

The world is even more colourful for so-called "miners", for whom, in many cases, due to the consistency of this activity carried out for profit, it can be business income, which, in addition to tax, will also be subject to not insignificant insurance contributions.

But it didn't just stop at cryptocurrencies. The year 2021 was, among other things, marked by the boom in non-fungible tokens (NFTs). In short, unlike cryptocurrencies (where one bitcoin can be generically exchanged for another), it is a unique digital asset based on a public blockchain with confirmation of asset ownership (e.g. a digital image, a collector's card or an item from a game). According to the first published estimates, this market grew to $44 billion last year. And right at the beginning of the year, optimistic tax headlines began to appear "NFT – investors owe billions in taxes...".

How's that? It all stems from the standard exchange taxation outlined above. Buying an NFT for cryptocurrency = taxable transaction, exchanging an NFT for an NFT = taxable transaction, selling an NFT for anything = taxable transaction. In addition to the relatively simple answer to the question of whether to tax (yes), a number of related questions arise, such as how to determine the acquisition price of "sold" cryptocurrency (FIFO?), the (im)possibility of offsetting gains and losses from various crypto-transactions, withholding tax paid by the "author" of the NFT for payments for its use, how to tax the "rental of (virtual) real estate" in the metaverse, VAT implications, and many others.

But to end on a positive note, it all fits in very nicely with the government's stated concept of not raising taxes. There is no need to raise or reintroduce anything, just impose tax.

Final note: In the Czech Republic, the tax liability cannot be paid in cryptocurrency yet, but only in CZK (so don't forget to tax the necessary exchange from cryptocurrency or NFT sales next year).

And watch out for the purchase of goods or services with cryptocurrencies (including payment for online content downloaded via the internet) – while this might seem like an expense at first glance, tax-wise it's very likely the realisation of income from the "sale" of cryptocurrency and subsequent purchase.

Accounting

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Observations on the new Accounting Act

We've received a draft of the new Accounting Act. Below we present selected brief observations on the aspects that caught our attention:

- The contemplated effective date of the new law is 1 January 2024.
- The structure and general approach are changing – the new law places more emphasis on principles, definitions and approximation to IFRS.
- The approach to the activities of foreign entities should be modified – it will generally be governed by tax (or other regulatory) requirements.
- Changes regarding technical appreciation – the new law works with a percentage threshold for its recognition.
- It should be possible to keep Czech accounts in a functional currency (EUR, USD, GBP).
- There should be changes for mergers – the concept of the final financial accounts and opening balance sheet at the decisive date seems generally to be abandoned (and replaced by interim).
- It should be possible to treat a foreign branch as a separate accounting unit and also to simplify the conversion of their operations into CZK at the average exchange rate.
- There should be changes in valuation, e.g. the use of discounted expected cash flow (for selected long-term debt/receivables) or the possibility of subsequent revaluation at any time.
- We may see changes to the retention period for accounting records.
- There may be changes to fines – a move to fixed (not percentage) thresholds.
- Consideration is being given to extending the mandatory application of international accounting standards to certain entities operating in the financial market (as well as the possibility of voluntary application for entities under the SFO).
- Explicit provision for FIFO and weighted arithmetic average for securities disposals.
- There may be changes to the recognition of finance lease assets.

It will be interesting to see how the tax rules react to these planned accounting changes.

If you have any questions, please contact either the author or your usual EY team.

It should be possible to keep Czech accounts in a functional currency (EUR, USD, GBP).

International taxation

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Back-to-back loan structure – a Spanish perspective

In this issue, we'd like to inform you about a recent Spanish tax case that caught our attention.[1]

Simply put, the situation was that a Spanish company was paying interest on a loan granted by a Dutch company of the same group, while the Dutch company was financed by a loan from its US parent company.

The Spanish authorities refused to apply the zero withholding tax rate generally applicable to Dutch tax residents because they considered that this was an artificial and abusive structure – the recipient was merely a "conduit" and the beneficial owner of the income was a US company.

In this context, the Spanish tax authorities pointed in particular to the following facts and circumstances concerning the Dutch company:

- it had no employees;
- it was headquartered in a "trust office" (where thousands of other unrelated companies were also headquartered);
- a significant proportion of its directors were "trust office" employees working in other unrelated companies;
- it had no other financial assets;
- it was a back-to-back structure and the margin was subsequently distributed as a dividend to the US company.

If you have any questions on the above topic, please contact the author of the article or your usual EY team.

The Spanish authorities refused to apply the zero withholding tax rate generally applicable to Dutch tax residents because they considered that this was an artificial and abusive structure – the recipient was merely a "conduit" and the beneficial owner of the income was a US company.

1 This outline summary has been prepared on the basis of an alert prepared by our Spanish colleagues – more HERE.

Competition law

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Court of Justice of the European Union – Liability for infringement of competition law within a group

On 6 October 2021, the Court of Justice of the European Union ("Court of Justice") issued a decision in case C-882/19 Sumal following a request for a preliminary ruling from the Barcelona Court of Appeal.

The Court's judgment in Sumal could have a real practical impact for victims of competition law infringements, as it could open the door to legal action against a cartel participant's domestic subsidiary. The Court of Justice held that the victim of an anti-competitive act must be able to claim compensation from a subsidiary established in its Member State for damage caused by the conduct of the parent company (which has been sanctioned by the Commission) if:

- the subsidiary and the parent company together form a single economic unit; and
- there was a concrete link between the economic activities of that subsidiary and the object of the competition law infringement for which the parent company is held liable.

The European Commission has imposed a record EUR 2.93 billion fine on Europe's leading truck manufacturers for a 14-year cartel involving agreements on truck selling prices (decision adopted 19 July 2016). One of the parties to the cartel agreement was the parent company of the defendant in the present case.

The applicant, a Spanish trucking company, asked the Spanish courts to order the defendant (a Spanish subsidiary not mentioned in the European Commission decision) to pay damages of EUR 22,204.35. The Court of First Instance dismissed the case and the Spanish trucking company appealed to the referring court, which stayed the proceedings and essentially referred the following four questions to the Court of Justice:

1) Whether the economic unit theory, on which European competition law is based, permits the extension of the parent company's liability to the subsidiary, and thus top-down liability, and if so, under what conditions (questions 1 through 3), and

2) If so, whether the Spanish competition rules, which do not provide for such top-down liability, were compatible with European law (question 4).

On the first three questions, the Court held that "the victim of an undertaking's anti-competitive conduct may bring an action for damages indiscriminately against either the parent company, which has been penalised by the Commission for that conduct in the decision, or a subsidiary of the parent

company that is not named in the decision, where those companies together form a single economic unit".

In order to establish the existence of such an "economic unit", the applicant will have to prove – whether by relying on a decision adopted by the Commission under Article 101 of the Treaty on the Functioning of the European Union (TFEU), or in any other way ("in particular where the Commission has remained silent on this point in the decision or has not yet been invited to take a decision"):

- The economic, organisational and legal ties that link the two legal entities, and
- The specific link between the economic activity of the subsidiary and the economic activity related to the infringement for which the parent company was held liable.

In the present case, the Court imposed on the applicant, the injured company, the obligation to prove that the same products which are the subject of the anti-competitive conduct were promoted and marketed by both the parent company and the subsidiary. The Court also stressed that:

- The subsidiary must have been and must be able to defend its rights by being given "all the means necessary for the effective exercise of its rights of defence, in particular to challenge the fact that it belongs to the same economic unit as its parent company".
- However, the subsidiary was not able to challenge the existence of the infringement before the national courts because it too was bound by the European Commission's finding of an infringement of Article 101 TFEU.

As regards the fourth question, the Court replied that:

- Article 101(1) of the TFEU should be interpreted as precluding national legislation which makes it possible to impute liability for the conduct of one company to another company only where the latter company controls the former company, and
- If the national court considered it could not adopt an interpretation of the national competition law, which was consistent with the interpretation of Article 101(1) of the TFEU, it must have infringed that national provision and directly applied Article 101(1) of the TFEU in the original proceedings.

The Court thus reaffirmed its broad understanding of "economic unit" – this time not only to extend liability from the subsidiary to the parent company, as it did in 2019 in case C-724/17 Skanska, but now vice versa. This is quite foreign to the legal systems of many EU member states, including the Czech Republic.

It is also worth noting that the General Data Protection Regulation (GDPR) also refers to Article 101 of the TFEU as regards the definition of liability for fines within a group of companies. In setting administrative fines, data protection agencies rely on Article 83(5) of the GDPR, which sets maximum amounts, and Recital 150 of the GDPR, which provides that "Where administrative fines are imposed on an undertaking, the undertaking should be regarded as an undertaking within the meaning of Articles 101 and 102 of the TFEU" (which implies that competition law and data protection rules have the same broad interpretation of the term "undertaking", i.e. as an economic unit irrespective of the legal personality of the individual companies forming that undertaking). Consequently, the Sumal decision may also have relevance in the area of data protection. This convergence mimics the current trend affecting large

technology companies facing simultaneous compliance and enforcement requirements under competition, data protection and consumer protection rules.

If you have any further questions, please contact the author or other members of EY Law or your usual EY team.

The Court clarified that a subsidiary can be sued and held liable for competition law infringements committed by the parent company. This liability is subject to the condition that the parent company and the subsidiary are part of a single economic unit and that, in the case in question, the parent company and the subsidiary provide the same services or market the same products to which the infringement of competition law by the parent company relates.

VAT

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Use of a vehicle for economic activity and the logbook

A VAT payer who uses cars for his business and claims a VAT deduction on the related inputs (fuel, parking, car wash, servicing, emission measurement, technical inspection of the vehicle, etc.) must be able to prove to the tax authorities that he used them for the purpose of carrying out his taxable outputs.

The VAT Act leaves a free hand in proving this, but in practice a paper or digital "logbook" is often used. Keeping a logbook is not compulsory for VAT[2] and right at the outset it can be said that the mere keeping of a logbook does not prove the use of inputs for economic activity. Conversely, nothing can be automatically inferred from the failure to keep a logbook.

For the sake of completeness, we add that, for income tax purposes, Directive D-22 of the General Financial Directorate provides details of the so-called journey register meant to prove the application of tax expenditures on fuel. Such a journey register should contain at least the following information: date of journey, destination, purpose of journey, kilometres travelled, type of vehicle, registration number, mileage as at 1 January (where applicable, the date of commencement of the activity or use of the vehicle) and on 31 December of the calendar year (or on the date of cessation of activity or use of the vehicle). This list may also serve as an inspiration for VAT purposes.

Recently, the Supreme Administrative Court ("SAC") has repeatedly addressed the validity of logbook). In judgements 10 Afs 65/2021-32 and 8 Afs 313/2019-35 the SAC agreed with the tax administrator who considered the logbooks to be inconclusive. On the contrary, in the more recent judgment 4 Afs 217/2021-54, according to the SAC, the logbook was sufficiently conclusive as the missing information was adequately supported by other means of evidence. Below is a summary in a few paragraphs of what can be taken as practical lessons from the judgments:

- The logbook is an "easy target" for the tax authorities. If kept on paper, it is often a bottomless well of incomplete and erroneous entries. Car users often don't bother with details. A GPS-based digital logbook will have a higher level of conclusiveness, but this too must be backed up by other evidence;

2 Confirmed, inter alia, by the Ministry of Finance as part of its contribution to the Chamber of Tax Advisors of the Czech Republic Coordination Committee 281/16.09.09

- It is evident that tax administrators are indeed thorough when checking logbooks and are able to identify many inconsistencies. For example, the tax administrator can easily detect that the same person was driving two different cars at the same time or that the same car was in two different places at the same time;

- The tax administrator is able to evaluate doubts about reported kilometres and the reality of journeys on the basis of data obtained from the mapy.cz portal. In judgments, the tax administration has successfully challenged a business trip lasting only six hours, during which the driver drove 1,800 km. While this case was extreme, it shows that tax administrators cannot be fooled by meaningless numbers;

- The very broadly defined reasons for business trips and place designations also contribute to the inconclusiveness of the logbook. For example, the descriptions "visit to a lawyer" or "visit to a tax advisor", "property inspection" without reference to specific persons or properties, or the definition of the route by the names of cities only (the route from Brno to Brno), were considered insufficient;

- The use of CCS and similar fuel cards in no way demonstrates the use of the car for economic activity. It is only a way of paying for fuel;

- If a company fails to demonstrate that the car is used for economic activity, this has a knock-on effect on all costs related to the car and the cost of the car itself. For example, the tax authorities did not hesitate to refuse to deduct VAT on invoices for emissions testing and technical inspection of the vehicle;

- In addition to the logbook itself, the VAT payer must be prepared to produce other supporting evidence – for example, invoices from suppliers for the goods or services for which the worker travelled, logs of activities carried out on site, logs of meetings attended, witness statements, company purchases "en route";

- If the vehicle is also used for private purposes, these journeys must be consistently distinguished and, even in these cases, basic records must be kept which include at least the date and time of the start and end of the journey, the exact place of departure, the odometer reading at the start and end of the journey, the number of kilometres travelled and proof of the purchase and quantity of fuel. In this case, the logbook serves as a basis for the VAT deduction adjustment at the end of the calendar year.

It can be summarized that the evidentiary logbook is not merely a list of records of individual journeys, but a coherent body of means of evidence that build on and do not contradict each other and which together form a clear trail of the use of the car for economic activity. All such documents must be kept for ten years. Our company offers an independent external audit of the logbook and related documents, allowing you to identify systemic weaknesses and prepare for a real audit. We will be happy to tailor a quote to our needs.

If you have any questions, please contact either the author or your usual EY team.

If the company fails to demonstrate that the car is used for economic activity, there is an across-the-board impact on all costs related to the car and on the cost of the car itself.

Financial markets

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The European Commission has presented amendments to the AIFMD and UCITS Directives. Is the fund industry facing an evolution or a revolution?

Why did the European Commission make the change? The European Commission has undertaken a functional assessment of Directive 2011/61/EU on Alternative Investment Fund Managers ("AIFMD"). As a result of this process, on 25 November 2021, the European Commission submitted to the European Parliament and the Council a proposal to amend the AIFMD and Directive 2009/65/EU ("UCITSD") concerning so-called UCITS funds investing in transferable securities.

The fund investment industry has tripled the volume of assets under management ("AuM") in the EU since 2008, from EUR 50 trillion in 2008 to EUR 150 trillion in 2020, with the share of assets managed by investment funds in total assets managed by financial institutions in the euro area rising from 13% to 20%, according to the European Central Bank. The AuM of domestic funds increased from CZK 123 billion to almost CZK 470 billion. As the stability of the fund industry becomes increasingly important for overall financial stability, the European Commission has proposed measures to limit systemic risks in both alternative and standard funds. At the same time, it responded to some of the obstacles to the functioning of the sector and the need to harmonise the rules.

What changes does the draft AIFMD II and UCITS VI contain?

1. Changes common to both AIFMD and UCITS

a) Delegation/Outsourcing

- There will be harmonisation of the UCITS rules according to the level of the rules in the AIFMD and extension of the delegation rules to all regulated activities, not only activities under the UCITS Annex and the AIFMD.

- Maintaining the regulatory substance (presence of the administrator in the EU) will now require, in the case of delegation, that at least two senior managers overseeing the delegated activities are resident in the EU and work full-time for the administrator. "Letter box" entities are undesirable. By "manager" we mean a management company, i.e. an investment company or a self-managed investment fund.

- Critical cases of delegation outside the EU will be monitored by ESMA.

b) Liquidity Management Tools (LMT)

- The Directive introduces a catalogue of liquidity management tools for open-ended funds (UCITS and open-ended alternative funds, "AIFs"). Similarities in their use will be proposed by the European Securities Authority (ESMA) through a Regulatory Technical Standard (RTS) type regulation. Instruments include suspension of redemptions and subscriptions, redemption gates, notice periods, LMT swing pricing or anti-dilution levy, redemptions in kind, side pockets. Some instruments will require more substantial amendments to the Act on Investment Companies and Investment Funds, e.g. side pockets or gates.

- Managers will be required to select the appropriate instruments for a particular investment fund and put in place a procedure for activating and deactivating LMTs. The actual use of LMTs must be reported by managers to national supervisory authorities, which in turn will have the ability to impose the use (or non-use) of LMTs on the trustee in certain cases.

c) Regulatory reporting

The AIFMD aims to revise regulatory reporting to strengthen standardisation, eliminate duplication and remove restrictions on the information that a supervisor can require from a manager. However, we do not have much faith in the lightening of the reporting burden.

d) Cooperation between depositories and central depositories

Investment instruments held in central depositories are in the grey area of investment fund depositary supervision. The changes will allow CSDs to be seamlessly integrated into the custody network without being subject to delegation rules, but will ensure that depositaries have access to information on the fund's holdings of financial instruments with CSDs.

e) Cooperation between oversight bodies and ESMA

It is proposed to strengthen ESMA's cooperation with national oversight bodies and to introduce the possibility to request ESMA to intervene indirectly in cases of failure of the requirement for cross-border supervisory cooperation. Confidentiality requirements will also be relaxed in relation to the publication of aggregated data.

2. Changes common to the AIFMD area only

a) Loan funds (loan origination)

Managers of AIFM funds that specialise in direct lending (and, to a limited extent, funds that enter into secondary market lending positions) will be subject to additional rules, namely:

- rules on credit risk management processes,

- closed-end fund requirement for exposures to direct lending >60% of net asset value (NAV),

- applying a diversification limit to financial institutions (20% of NAV),

- an obligation for the AIF to retain at least 5% of the nominal value of all loans it originates and sells on the secondary market (limiting the possibility of lending for secondary transfer),

- restrictions on loans to related parties,
- the obligation to communicate portfolio composition to clients.

b) Cross-border activities of a depository

The national supervisory authority of the AIF may authorise the selection of a depositary from the Member State of the AIFM (if the AIF is not subject to supervision, the authorisation will be granted by the supervisory authority of the AIFM). This is a temporary solution and will be further reviewed by the Commission. A full passport is not excluded in the future.

c) Scope of licence

The list of additional services will be expanded to include benchmark management and loan management services.

d) Transparency

Investor disclosure requirements regarding LMTs and fees will be expanded.

e) Third-country aspects

The list of countries at risk has been aligned with the AML Directive. As a consequence, AIFs, managers and depositaries from risky countries (FATF list) or non-cooperative countries will not be able to benefit from the advantages of offering in the EU, including private placement.

Possibility of comments and expected timing

The Czech Republic is participating in the negotiations on the basis of the official position prepared by the Ministry of Finance. This has given the fund market, through the Capital Market Association in January 2022, the opportunity to influence the CR's position by agreeing, disagreeing or proposing other necessary changes to the Directives.

Estimated AIFMD II and UCITS VI timeline:

- 2021 – EC draft,
- 2022 – approval of directives,
- 2024/25 – implementation,
- 2024/25 – effectiveness of changes in the Czech Republic.

For any comments on the proposal or additional questions, please contact the authors of this article.

A proposal to amend the AIFMD and UCITS Directives relating to UCITS funds investing in transferable securities was submitted by the European Commission to the European Parliament and the Council on 25 November 2021.

Judicial window

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Supreme Administrative Court on (non)proof of receipt of advertising services

In this issue, we'd like to draw your attention to an interesting Supreme Administrative Court (SAC) judgment regarding proof of the receipt of (online) advertising services.

The case involved a situation in which the tax authority assessed corporate income tax on a company for the tax years 2012 and 2013 because it concluded that the company had failed to prove that it had received online advertising services (PPC advertising in Google AdWords; keyword analysis and optimization).

The Regional Court (RC) subsequently agreed with the conclusion of the tax authorities. According to the Regional Court, the company failed to prove it had received the advertising. Even the screenshots from October 2012 to December 2013 did not prove the advertising, as they were taken at the same time.

The SAC agreed with the conclusions of the RC.

According to the SAC, the claimed service from Google AdWords is evident from the submitted service listings (number of keyword searches of the website, number of times the website was opened, price of the service). The statements shall also indicate the month in which the service was provided and the contact details of the managing director of the supplying company. However, these are simple data records which, according to the SAC, cannot in themselves prove the actual receipt of the advertisement.

Thus, according to the SAC, it was necessary for the company also to prove receipt of the advertisement through screenshots capturing the advertisement directly on Google's internet search engine. If the advertisement is provided exclusively online, then according to the SAC there is no other way to capture it than with a screenshot. Although the company attached the images to the individual tax documents, all the images were identical and the same data (both the time data for the individual search pages and the data at the top of the page on the number of search results) always appeared. The SAC therefore agreed with the RC that these images could not prove advertising for the period from October 2012 to December 2013.

The SAC expressed incomprehension as to why the company repeatedly received confirmation of the claim in the form of photographs that were clearly not different from each other or bearing a standard date. According to the SAC, any person acting with due diligence would have checked whether a supply worth hundreds of thousands had been

delivered and, if necessary, chosen (or required) a different method of documentation from the supplier. However, if the company failed to do so, it could not reasonably rely on having secured sufficient evidence of its tax claims and being able to bear its burden of proof.

This judgment confirms that the tax deductibility of advertising services is a popular area of interest for tax authorities and also documents the trend of increasing demands for proof of these and other types of services.

If you have any questions about the above topic, please contact the authors of the article or your usual EY team.

Thus, according to the SAC, it was necessary for the company also to prove receipt of the advertisement through screenshots capturing the advertisement directly on Google's internet search engine.

For further information please contact either your usual partner or manager.

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ED None

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Did you know:

- The UAE plans to introduce corporate tax as of mid-2023?
- The Ministry of Finance published selected answers and questions concerning VAT on prices and values determined in accordance with the Asset Valuation Act?
- One of the initiatives the EU is planning for this year is the possible introduction of "DEBRA" (Debt Equity Bias Reduction Allowance)?
- On 18 January 2022, EU finance ministers met regarding a global two-pillar reform of the international tax system?
- On March 1, EY is organizing a transfer pricing seminar?