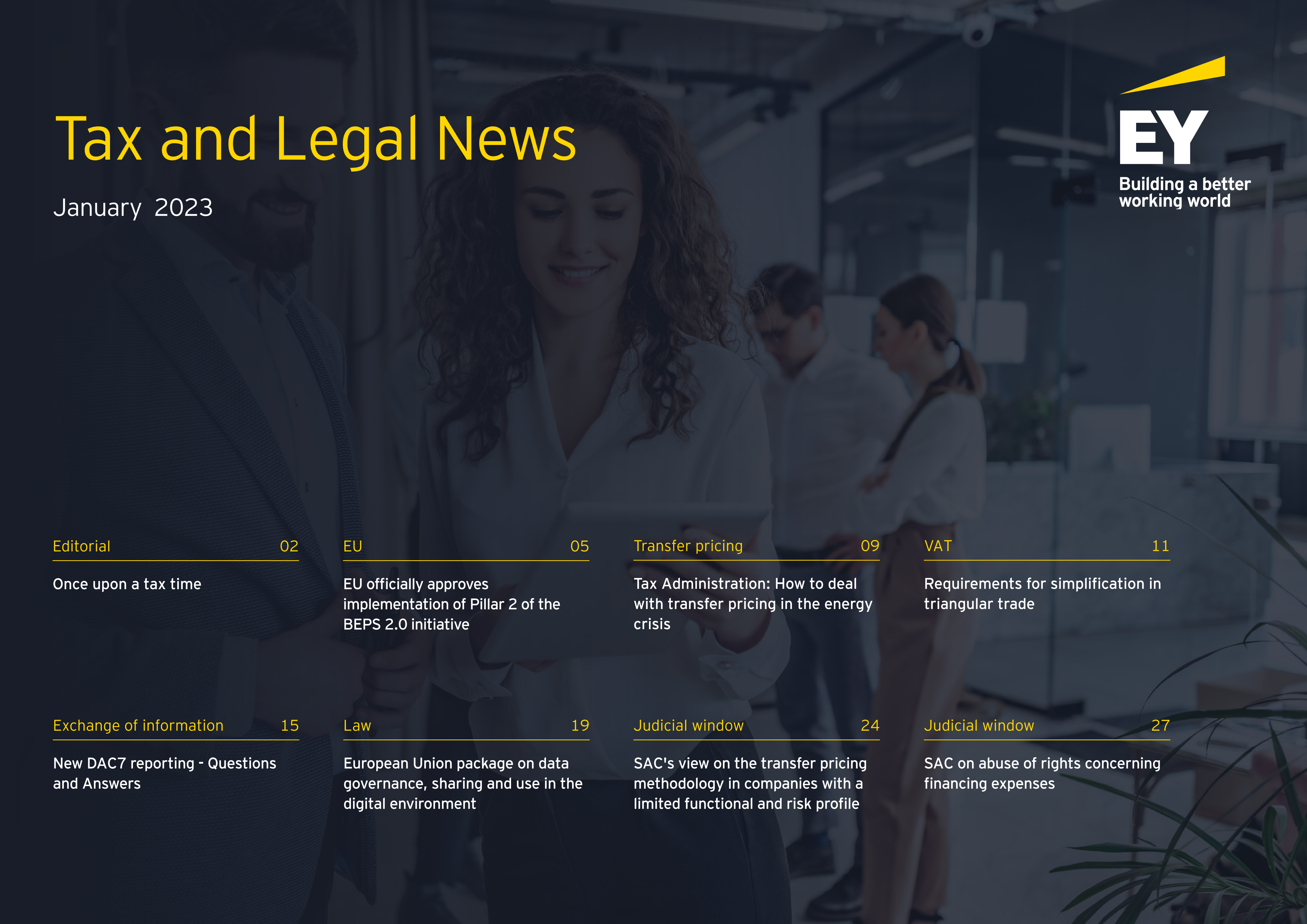

Tax and Legal News

January 2023

Building a better working world

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Once upon a tax time

Most of us simply can't imagine the end of the year without fairy tales. Every year, filmmakers and TV stations compete to see who can come up with the best idea, who can surprise the discerning viewer or who can impress with something quite special.

The legislature has apparently decided to take part in this year's competition for the most original Christmas event. That's why it has already published an Energy Act amendment in the Collection of Laws slightly in advance (30 November 2022), introducing the so-called levy on excessive revenue into Czech legislation. The subject of the levy is defined as the positive difference between the market income generated from the sale of electricity and the statutory price cap on market income: simply put, the amount by which a producer or distributor sells electricity at a price higher than the price ceiling. The levy reaches an impressive 95%.

Let me start with a little excursion into tax theory. The current legal and economic literature generally agrees that the concept of tax can be defined as a mandatory, non-refundable, statutory payment to the public budget that is a non-purposed and creates no entitlement to an equivalent consideration.

At first glance, it might seem that there is no significant difference between the above definition of a tax and a levy on excessive revenue (it certainly seems so to us). The levy on excessive revenue is undoubtedly a compulsory and irreversible payment that is a revenue of the state budget. The person liable to pay this levy receives no consideration for it. The administration of the levy is carried out in accordance with the Tax Code; the law uses the institutions of advances, notification or overview in the same way as the tax regulations. Although the administration of the levy is rather surprisingly carried out by the Energy Regulatory Office, the latter may request the Specialised Financial Office or another Financial Administration body to carry out its actions. The law even refers to the person liable for the levy as the taxpayer. But be careful, it's not a tax.

If the situation described above reminds you a little of the fairy tale by Božena Němcová, The Clever Highland Woman, or, for the younger ones, of Werich's The Carousel Queen I, who was forced to come to the king, dressed-not dressed, coiffed-not coiffed and to bring a gift-not a gift, you are not alone.

The reason for the legislature's effort to exclude the levy on excessive revenues from the tax system is quite simple. The levy is based on part of the European Council Regulation (EU) 2022/1854, and if it were a tax, such a regulation (at the EU level) would have to be unanimously approved by all Member States. However, it is enough not to call the aforementioned fee a tax, but, for example, a levy or a temporary solidarity contribution, thus (perhaps) elegantly avoiding this unpleasant complication.

From a tax advisor's point of view, the tax fairy tale is interesting from several aspects. For example, the accelerated legislative process itself or the effective date just one after the date of publication in the Collection of Laws. Or the combination of different lengths of levy periods, where the first levy period is a calendar month (December 2022) and the second levy period is a calendar year (2023). The first levy period is not subject to the advance payment obligation, while the second is. The result is a rather convoluted arrangement whereby the advance payment for the second levy period is due earlier (27 February 2023) than the payment for the first levy period (28 February 2023).

And other questions arise – can an excessive revenue taxpayer freely decide that it is not economically rational for it to sell electricity at an amount above the price cap because, while its profits will increase only marginally, the impact on the quality of its relationships with its trading partners may be many times more significant? Can such a justified price be considered a normal price within the meaning of § 23(7) of the Income Tax Act? If not, can such a pricing strategy (in the case of related persons) be regarded as satisfactory evidence of the difference under the provisions of § 23(7) of the Income Tax Act?

It is also important not to confuse this levy with the 60% windfall tax, which, on the contrary, is a part of the tax package and has received considerable public and media attention.

However, the excess profits levy and the windfall profits tax have one thing in common. Both these bills simply came out wrong. Unfortunately, only time will tell how much more taxpayer money subsequent lawsuits and litigation will cost.

Nevertheless, I would like to wish you a wonderful, successful and prosperous 2023.

At first glance, it might seem that there is no significant difference between the above definition of a tax and a levy on excessive revenue (it certainly seems so to us).

EU

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EU officially approves implementation of Pillar 2 of the BEPS 2.0 initiative

After an arduous negotiation process, the EU formally approved a directive implementing the GloBE rules of Pillar 2 of the BEPS 2.0 initiative (simply put - minimum level of 15% taxation).

Below we provide an initial and simplified overview of our current understanding of selected parameters of these rules.

Top-up tax

- under the Income Inclusion Rule (IIR) - tax is typically calculated and paid by the ultimate parent entity (UPE), but not necessarily by that company.
- under the Undertaxed Profit Rule (UTPR) – this is a top-up tax that has not been levied under the IIR.
- under the Qualified Domestic Top-up Tax (QDTT) rules – individual jurisdictions have the option to levy "their" top-up tax on the excess profits of all low-taxed constituent entities located in that jurisdiction.

Effective date

- IIR from periods starting from 31 December 2023; UTPR generally with a one-year delay.

Who is affected by the rules

- EU entities belonging to a multinational group (or large domestic group) with annual consolidated revenues of at least EUR 750 million (in at least 2 of the last 4 periods).
- Conversely, the rules generally do not apply to excluded entities:
  - Governmental entity;
  - International organisation;
  - Non-profit organisation;

  - Pension fund;
  - Investment fund or real estate investment vehicle, which is a UPE;
  - and selected other entities owned by those entities, subject to certain conditions.

What is it based on?

- Generally, it is based on accounting numbers according to the accounting standard of the consolidated UPE statements before consolidation adjustments.
- The Directive goes on to prescribe a number of adjustments, e.g.:
  - income tax;
  - selected dividends;
  - selected revaluation of ownership interest or the proceeds from the sale of ownership interest;
  - asymmetric exchange rate differences, etc.

How the effective tax rate (ETR) and top-up tax are calculated?

- It is generally calculated for each jurisdiction according to the following steps:
  1. Calculate the jurisdiction's effective tax rate (ETR) (i.e. the ratio of covered taxes to GloBE income);
  2. Determine the top-up tax percentage (15% - ETR of the jurisdiction);
  3. This percentage is applied to the jurisdiction's so-called excess profit (i.e. the difference between the GloBE income and the jurisdiction's substance exclusion);
  4. A jurisdiction's top-up tax is allocated to each entity according to its income ratio.
- Substance exclusion (or substance based income exclusion) – generally % of payroll and tangible assets in the jurisdiction (increased to 10% and 8%, respectively, for a transitional period of 10 years and gradually reduced).

Administration

- Annual top-up tax information return will be filed (either by the entity, UPE or designated entity) generally within 15 months (18 months for the first year) of the end of the accounting period.
- It is necessary to properly record/report the chosen elections.
- Member States shall set penalties for failure to comply with these obligations.

Transitory provisions

- Generally, "input" deferred tax assets/liabilities presented in the financial statements will be taken into account (but generally at a maximum rate of 15% and with certain exceptions).

- For intra-group asset transfers from 1 December 2021 until the beginning of the first year of application of the new rules, increased tax bases of assets (except for inventories) will generally not be recognised.
- Special 5-year exemption for selected groups (operating in up to 6 countries and having a net book value of tangible assets outside the reference jurisdiction of up to EUR 50 million).
- Option for a Member State not to apply IIR/UTPR for 6 years if they have a maximum of 12 UPEs subject to these rules (top-up tax to be collected by other States).

Other

- De minimis exemption (i.e. no top-up taxes apply) in a jurisdiction with
  - revenues below EUR 10 million and
  - profit below EUR 1 million (averages over 3 periods).
- There may be (temporary) simplifications in the application of the GloBE rules – the so-called "safe harbour rules".
- So-called qualified refundable tax credit is booked to income (non-qualified – e.g. tax credit in incentives – is not).
- Special limits exist for certain intra-group financing.
- The profit of a permanent establishment is generally not included in the profit of the head office.
- The rate for calculating deferred tax is generally applied at a maximum rate of 15%.
- European Commission to prepare list of jurisdictions with equivalent rules.

Specific situations

Examples of situations that may typically result in less than 15% ETR per jurisdiction include:

- the use of investment incentives in the form of tax rebates;
- claiming the research and development deduction;
- operating in a jurisdiction with a low nominal corporate tax rate;
- operating in a jurisdiction with a special tax regime (e.g. special type of exemption or "super-write-off/deduction");
- material tax depreciation of an asset acquired in an intra-group sale from 1 December 2021 until the beginning of the first year of application of the new rules (with a significant increase in value compared to the seller's value).

We will continue to monitor this initiative and everything related to it.

If you are interested in this area, please contact the author of the article or your usual EY team.

After an arduous negotiation process, the EU formally approved a directive implementing the GloBE rules of Pillar 2 of the BEPS 2.0 initiative (simply put - minimum level of 15% taxation).

Transfer pricing

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Tax Administration: How to deal with transfer pricing in the energy crisis

The General Financial Directorate (GFD) has just published a brief statement on the question of how to reflect the jump in energy prices in intra-group transactions and, in particular, the question of whether or not to take these rising costs into account in the transfer price set-up of low-risk entities (available HERE).

We understand the gist of the GFD's communication to be that the current situation - similar to the covid crisis - does not generally warrant a departure from past practice and established principles (in particular, the emphasis on the functions actually performed and the associated risks borne). In this context, we are reminded of the memorable statement by representatives of the tax administration that *"covid is not a risk - it just 'activates' a lot of risks that someone carries"*.

In this context, the GFD notes that for manufacturing companies with a limited functional profile, their remuneration is usually determined based on the cost-plus method, with energy costs being one of the costs that enter into the basis for applying the normal profit mark-up. According to the GFD, an increase or decrease in this cost item plays no role in assessing whether or not these costs should enter the cost base.

According to the GFD, the actual increase or, in the future, decrease in energy prices will be reflected in the remuneration of these undertakings in the mark-up that is established for comparable independent undertakings, since these independent undertakings are also subject to fluctuations in energy prices. A significant increase in prices will consequently be reflected in a decrease in the profitability of the independents and hence in the mark-up obtained from the market, which is used by related parties in the application of transfer pricing methods in the pricing framework.

This is the view of the GFD. We add that, as always, it is the detail that determines the most appropriate practical approach to assessing the proper setting of transfer pricing. We would be happy to discuss it with you if you wish.

If you are interested in this area, please contact the author of the article or your usual EY team.

We understand the gist of the GFD's communication to be that the current situation - similar to the covid crisis - does not generally warrant a departure from past practice and established principles (in particular, the emphasis on the functions actually performed and the associated risks borne). In this context, we are reminded of the memorable statement by representatives of the tax administration that *"covid is not arisk - it just 'activates' a lot of risks that someone carries"*.

VAT

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Requirements for simplification in triangular trade

We informed you about the rules governing VAT application to "triangular" transactions and the common problems and ambiguities encountered in tax practice in our Tax and Legal News in October 2021 (HERE). The article is still relevant today. If triangular transactions apply to you, we recommend reading the article again. This will also make it easier for you to understand the following content.

In the article, we draw your attention, among other things, to the Austrian request for preliminary ruling submitted to the CJEU in Case C-247/21 Luxury Trust Automobil GmbH. This case was expected to bring a new perspective on the option to subsequently remedy triangular trade conditions. The CJEU has now decided the case.

Judgment of the Court of Justice of the EU in Case C-247/21 Luxury Trust Automobil GmbH

The CJEU confirmed the formalistic approach already expressed by the Advocate General (we informed you about the Advocate General's opinion (HERE). An incomplete reference in the invoice provided by the intermediary results in a failure to comply with one of the substantive requirements for simplification which cannot be met retrospectively.

The case concerned a situation where the intermediary based in Austria bought luxury cars from the UK (before Brexit) and resold them to a Czech company. Meanwhile, the Czech company became non-contactable and did not pay VAT on the acquisition in the Czech Republic. According to the Austrian tax authority, one of the requirements for a triangular transaction was not met because the invoice of the Austrian intermediary company did not explicitly state that the obligation to pay VAT was transferred to the buyer (reverse charge). The invoice merely stated that it was an exempt intra-community triangular transaction. The Austrian tax authority therefore charged Austrian VAT to the intermediary as the Austrian VAT number was used for the purchase of the goods from the UK.

The CJEU has confirmed that if the intermediary's invoice does not contain the words "reverse-charge", one of the conditions for applying the simplification to a triangular transaction has not been met. In other words, it is a substantive condition. The Court further held that that condition could not be remedied with retrospective effect by correcting the document already issued. The judgement has the following practical implications for the intermediary who issued an incorrect tax document:

- Obligation to register for VAT in the state where the transport ends (the state of the final customer) on account of acquisition of goods from another Member State and the subsequent local taxable supply of goods to the final customer and the associated potential VAT payment in the state where the transport ends[1].

- At the same time, however, VAT on the acquisition of goods from another Member State is also due and payable in the state whose VAT number was used for the acquisition in the triangular transaction; this was Austria in the above-mentioned example[2]. In this case, the intermediary company is not entitled to deduct input VAT on the acquisition of goods[3]. The intermediary company may only correct the amount of VAT (claim a VAT refund) after it has fulfilled its obligations pursuant to the previous bullet point in the Member State where the transport ends[4].

This judgment is yet another proof that it is not a good idea to underestimate the application of VAT in international transactions. Every trader should carefully map all its cross-border transactions in terms of correct VAT application, including a review of the invoicing rules.

Incorrect implementation of the EU rules

Pursuant to the VAT Directive[5] and the CJEU case law, the simplification for triangular trade is as follows: the intermediary acquires goods from one Member State to the Member State where the transport ends and, subject to the fulfilment of specific requirements, such acquisition is not subject to tax. The reverse charge regime should apply to the subsequent local supply of the goods to the final customer.

The domestic transposition of the VAT Directive is not entirely accurate, as it states that the buyer is obliged to declare tax on the supply of goods by an intermediary similarly to the acquisition of goods from another Member State. This is also reflected in the Czech VAT return, where the reporting of such transactions is misleading; while the last buyer reports the purchase of goods from the intermediary as a standard acquisition of goods from the EU (lines 3, 4 and 43 of the VAT return and section A.2 of the control statement), it should rather be reported as a local purchase of goods subject to the reverse charge regime (lines 12, 13 and 43 of the VAT return).

Invoice by the intermediary

The conclusions of the CJEU also raise the question of invoicing requirements imposed upon the intermediary by the Czech VAT Act. Section 17 of the VAT Act does not stipulate an obligation to include the words "reverse-charge" ("tax to be paid by the customer"). The above provision, read in isolation,

1 If the Czech Republic is the country where the transport ends, the intermediate company will typically not be established in the Czech Republic; as a result, the customer shall be obliged to pay VAT on the domestic supply under the reverse charge regime, if the customer is registered as a Czech payer. The intermediary can therefore only register in the Czech Republic as an identified person due to acquisition of goods from another Member State.

2 If the intermediary uses a Czech VAT number, the place of acquisition of the goods will be the Czech Republic pursuant to the provision of Section 11(2) of the VAT Act. According to this provision, for the acquisition of goods from the EU, the place of supply shall also be the Member State whose VAT number was used, unless the acquirer proves that the acquisition was taxed in the state where the transport ended according to the basic rule, or unless the acquirer proves that the conditions for triangulation were met. This is the implementation of Article 41 of the VAT Directive.

3 The VAT Directive did not clearly imply impossibility of claiming a VAT deduction for VAT paid because of the use of the intermediary's VAT number. Prohibition of a VAT input deduction was not clearly established until the decision of the CJEU in case C-539/08 - Facet Trading BV. The prohibition of VAT input deduction was implemented in the Czech VAT Act through Section 11(2) with effect from 1 July 2017.

4 This rule is reflected in Section 11(3) of the Czech VAT Act.

5 Article 141 of the VAT Directive.

may lead to the conclusion that it is sufficient for the intermediary company's invoice to state that the transaction is part of a triangle transaction. However, the law stipulates such a requirement in the general provisions on the issue of tax documents (Section 29(2)(c) of the VAT Act), the obligation to combine the two sections is not obvious at first sight. Let's hope that after the publication of the CJEU judgment the legislators will amend the VAT Act accordingly.

The referring Austrian court was obviously also in doubt about the invoicing rules contained in the Czech legislation; one of the court's questions was whether the invoicing rules of the country of the final customer (here, the Czech Republic) applied to the intermediary entity. According to the Austrian court, the Czech legislation does not require invoices to contain reference to the reverse charge regime, i.e., transfer of the tax liability to the customer. Unfortunately, the CJEU did not address this issue, stating that the answer to this question would not affect the outcome of the dispute.

In any case, we advise our clients, as intermediaries in triangular transactions, to include in their invoices to the final customer not only the information that the transactions is part of a triangular trade, but also an explicit reference to the reverse-charge regime, i.e. that the buyer is liable to pay VAT on the goods supplied.

If you have any questions on the above topics, please contact the authors of the article or your regular EY advisory team.

According to the CJEU, the consequence of an incorrect invoice issued by the intermediary in a triangular transaction is a failure to meet the requirements for simplification and the error cannot be remedied retrospectively.

Exchange of information

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in

New DAC7 reporting - Questions and Answers

We keep you informed about the new reporting obligations for digital platform operators. The Czech implementation of this initiative can be found HERE.

General information

The main objective of this initiative is to extend the automatic exchange of information framework to a new range of information reported by digital platform operators. Simplistically, a platform is a software that allows a seller to connect with another user in order to carry out defined reportable activities for consideration. These activities are broadly 4 sets of activities:

- the provision of immovable property, by all means of provision of the property for use by another, e.g. by leasing or providing accommodation, where immovable property includes e.g. housing units, houses, agricultural land, parking spaces.
- the provision of a means of transport, e.g. cars, motorcycles, bicycles or scooters.
- personal service, which means an activity of an individual based on time or a task at the request of the user of the platform (e.g., the activity of cleaning, performing craft work, etc.).
- sale of goods, which in practice may be e.g. various web-based marketplaces or e-shops that broker the sale of goods from other sellers.

The rules contain a number of exemptions from reporting platform operators or reportable sellers. As with other reporting obligations, the amended Act also introduces additional registration or notification obligations in this context, detailed due diligence procedures to identify and verify sellers, and penalties for breaches of related obligations, for example.

Selected platform operators will be obliged to report information to the tax authorities once a year (always by 31 January) regarding the income generated by selected users of these platforms (sellers).

The year 2023 will be the first reporting period (i.e. in 2024).

Questions and answers

In this context, the General Financial Directorate (GFD) has published questions and answers on this new obligation (more details HERE). Below we briefly summarise selected observations.

DAC7 application

- The Financial Administration will operate the so-called Authenticated Zone DAC7 (or DAC7 application), which is to be an environment on the MY Taxes portal, where the platform operator logs in and from where it can notify a change in registration data, report the termination of the reporting obligation, report the fulfilment of a condition for exclusion from the reporting obligation, etc.

Notification of the Czech reporting platform operator

- The notification of the Czech reporting platform operator for the reporting obligation can only be submitted electronically via the MY Tax portal. After processing the notification, the Czech reporting platform operator will receive a notification on the granting of access to the DAC7 application.
- The Czech reporting platform operator's notification form is bilingual - the tax administrator accepts completion in Czech or English. However, it is possible that situations may arise where the tax administrator may additionally require a translation into Czech.
- A platform operator who has become a Czech reporting platform operator no later than 75 days after the date of entry into effect of the Act in question (i.e. 1 January 2023) shall submit the notification no later than 3 months after the date of entry into effect of the Act in question, i.e. by 3 April 2023.

Registration of a non-established reporting operator

- In case the non-established reporting operator does not have the possibility of authentication, the non-established platform operator will submit an application for registration (generally accepted to be completed in English) without authentication. The SFO, after processing the non-established platform operator's registration application, will issue a registration decision whereby the non-established reporting platform operator will be assigned a platform identification number (IIN) and will also be assigned a password to log into the DAC7 application.

Practical examples

- As an example of what is not in the scope of the DAC7 notification obligation, the GFD gives the following examples:
  - Advertisement sites that only allow promotion (advertisement in the form of a so-called "bulletin board" only without the provision of other functions by the platform operator), e.g. rental property, where the advertisement offers a connection with the seller only by direct contact, e.g. by providing a telephone or email contact directly to the seller. The connection between the seller and the user is thus made directly, not through the advertising platform.
  - An e-shop where products are offered to end consumers only on behalf of the e-shop operator - selling their own products on behalf and for the account of the e-shop operator without further intervention by a third party.

  - The platform operator has included on its website the reportable activity of the seller, including the contact details of that seller. The buyer contacts the seller directly. The conclusion of a contract between the buyer and the seller is not facilitated via the platform, nor is the value of the consideration for the notified activity collected via the platform.

- As an example of what the reporting obligation under DAC7 instead applies to, the GFD gives the following examples:

  - The platform operator has listed the seller's reportable activity on its website, including the contact details of that seller and the price for the notifiable activity. The platform operator facilitates the conclusion of a contract between the buyer and the seller through the platform, e.g. by allowing an order to be placed. However, the consideration for the notified activity is not collected through the platform and the final amount of consideration paid to the seller may be higher, equal to or lower than the amount listed on the platform operator's website.

  - The platform operator has listed the vendor's reportable activity on its website, including the contact details of that vendor and the price for the reported activity. The platform operator facilitates the conclusion of the contract between the buyer and the seller through the platform and collects the consideration for the reportable activity through the platform.

  - An e-shop offering goods from other sellers, if other sellers whose products are offered on the e-shop also enter into a contractual relationship with the buyer when selling the products.

- As regards lessors of software - e-shop solutions, i.e. merely leasing space and software to the operator of an e-shop, the GFD indicates that it is unlikely to be a reporting platform operator, adding that if the e-shop or website operated in the leased space would meet the characteristics of a platform under the Act, then the lessee/operator of the e-shop or website would be the reporting platform operator, acting vis-à-vis the users of the platform.

If you have any questions on the above topics, please contact the authors of the article or your regular EY advisory team.

The Financial Administration will operate the so-called Authenticated Zone DAC7, which is to be an environment on the MY Taxes portal, where the platform operator logs in and from where it can notify a change in registration data, report the termination of the reporting obligation, report the fulfilment of a condition for exclusion from the reporting obligation, etc.

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European Union package on data governance, sharing and use in the digital environment

Last month, we informed you about the adoption of the long-awaited EU regulations package to reform the online environment in which companies offer and use digital services in the EU internal market (Digital Services Act[6] and Digital Markets Act[7]). In this issue, we follow up on last month's edition. This time, we present EU legislation focusing on data management and data sharing in the digital environment.

Draft Data Act

At the beginning of last year, the European Commission already proposed the Data Act[8], a regulation which, if adopted, should ensure a more competitive data market in the EU across all sectors of the economy. The reason for this step is the current insufficient use of data in the EU, which has a negative impact on consumers and SMEs in particular. Such use is hampered by several factors, namely the lack of protection for SMEs, which are not in a position to negotiate fairer data sharing terms with larger market players, and the lack of harmonised regulation allowing companies to access data generated by connected devices, as the data is often collected exclusively by the device manufacturers.

There is currently no uniform regulation in the EU stipulating who can use the data of smart devices that, when used, receive information from the external environment, i.e. products that are connected to the Internet and collect and process the data they receive when interacting with the environment - either with people or with other external stimuli. In most

6 Regulation (EU) No 2022/2065 of the European Parliament and of the Council of 19 October 2022 on a single market for digital services and amending Directive 2000/31/EC (Digital Services Act).
7 Regulation (EU) No 2022/1925 of the European Parliament and of the Council of 14 September 2022 on contestable and fair markets in the digital sector and amending Directives (EU) 2019/1937 and (EU) 2020/1828 (Digital Markets Act).
8 Proposal for a Regulation of the European Parliament and of the Council on harmonised rules on fair access to and use of data (Data Act); available HERE.

cases, only the manufacturers of these products are entitled (either de facto or by contract) to handle the data, although, in a large number of cases, this is the data of individuals who have purchased or use the product.

The Data Act should allow both consumers and individual businesses more control over the data collected by these smart products. For smart device users, the regulation will allow fairer access to data, data portability and interoperability between systems. E.g., smart vehicle users will be able to transmit driving data to an insurance company, making it easier to raise insurance claims and to prove certain facts concerning a potential car accident. In the event of a vehicle breakdown, on the other hand, they can use the services of car repair shops other than those authorised by the vehicle manufacturer, as the users can provide the repair shop with access to vehicle data necessary to restore the vehicle's original condition.

Freer access to data should also encourage SMEs to engage more in the digital sphere, which should promote their competitiveness. Concerning businesses using smart machines, on the other hand, the newly acquired data could help them optimise their production processes, and the "smart factory" concept could take centre stage.[9]

Although entities will have much greater access to the data generated by the products they use, manufacturers of these products will not lose their ability to use the data from their products. This option will remain unchanged. In addition, the regulation proposal provides for safeguards to prevent the use of data in a way that could negatively affect the manufacturer's business opportunities, including cases where the data could be used to develop a competing product or service.

In order to protect the position of SMEs in negotiating data sharing contract terms, the regulation contains a so-called "fairness clause" for fair data sharing practice, according to which unfair contract terms relating to (i) access to and use of data, or (ii) the liability and remedies in case of breach, or (iii) termination of data-related obligations imposed on a micro, small or medium-sized enterprise are not binding when they have been unilaterally imposed and the other party did not have a realistic opportunity to negotiate their content. Contractual terms are unfair if they are of such a nature that their use grossly deviates from good commercial practice in data access and use, or if they are contrary to good faith and fair dealing.

The proposal also explicitly indicates which specific terms are considered to be unfair. These include, e.g., terms the object or effect of which is to:

- exclude or limit the liability of the party that unilaterally imposed the term for intentional acts or gross negligence;
- inappropriately limit the remedies in case of non-performance of contractual obligations;
- inappropriately limit liability in case of breach of contractual obligations;
- give the party that unilaterally imposed the term the exclusive right to determine whether the data supplied are in conformity with the contract or to interpret any term of the contract; or
- exclude the remedies available to the party upon whom the term has been unilaterally imposed in case of a breach of contractual obligations

9 A "smart factory" offers digital interconnection of the production system, including machines, production lines, warehouses and the supply chain.

The regulation is not intended to interfere with the contractual freedom of the parties. Contract terms defining the main subject-matter of the contract, as well as price arrangements, will be exempt from the assessment of unfairness. In addition, the Commission should draw up non-binding model contract terms for SMEs to rely on in negotiating contracts.

Data Governance Act

EU Member States have approved the European Data Governance Act[10], which aims to improve the conditions for data sharing in the internal market, allowing for wider sharing of personal and non-personal data within the EU. The Regulation will apply from 24 September 2023. The aim of the regulation should be reached particularly by the following:

- providing access to data held by the public sector to citizens and businesses;
- prohibiting exclusivity agreements, i.e. exclusive agreements on the repeated use of public administration data;
- creating a legal framework for data intermediaries; and
- creating a framework for voluntary provision of personal data for altruistic purposes.

The Data Governance Act lays down the rules for the repeated use of publicly available data held by public authorities by natural or legal persons, both for commercial purposes and for personal use. The regulation also establishes a mechanism whereby certain categories of data held by the public sector bodies that cannot be considered freely accessible due to third party rights, such as the protection of commercial secret, the protection of third-party intellectual property rights or the protection of personal data, can also be made available. The regulation is based on the presumption that valuable insight can be gained from such data without compromising its protected nature.

In addition, public authorities should provide assistance to users in seeking an individual's consent to the repeated use of his/her personal data or the data of a person whose rights may be affected by the repeated use. Public authorities will be entitled to charge fees for allowing the repeated use of data. However, such fees shall not exceed the necessary public administration costs involved. The regulation also provides for the obligation for each Member State to establish a single information point to receive queries or requests for the repeated use of data.

The regulation further prohibits exclusive arrangements, which means, in principle, no entering into exclusive agreements or engaging in other practices that have as their objective or effect to grant exclusive rights or to restrict the availability of data for repeated use by other entities. The conclusion of an exclusive agreement on the repeated use of public sector data will be possible to the extent necessary for the provision of a service or the supply of a product in the general interest that would not otherwise be possible.

Many companies are currently concerned that sharing their data would involve a loss of competitive advantage and a risk of abuse. The Data Governance Act therefore regulates the terms and conditions for data intermediation services providers to ensure greater security for individuals and companies who share their data. Data intermediation services providers are to act as neutral providers whose role will be limited to intermediation of transactions. The use of the exchanged data for other purposes is prohibited.

10 Regulation (EU) 2022/868 of the European Parliament and of the Council of 30 May 2022 on European Data Governance and amending Regulation (EU) 2018/1724 (Data Governance Act).

The Data Governance Act will also make it easier for individuals and businesses to share data on the basis of their consent for objectives of general interest, such as scientific research or improving public services (e.g., sharing smartwatch users' health data for health research). The Act will also allow organisations wishing to collect data for general interest purposes to register as an EU "recognised data altruism organisation" in order to increase confidence in their activities.

The Regulation does not explicitly provide for penalties and refers to the role of Member States to adopt national provisions on penalties for infringements as well as all necessary measures to ensure their enforcement.

Conclusion

While the Data Governance Act establishes procedures and structures to facilitate the sharing of data between companies, individuals and the public sector, the Data Act clarifies which entities are entitled to generate specific value from data, or to use data for their own use or for business purposes, and the terms governing such use. The EU hopes, through these regulations, to create a single common market for data based on a harmonised legal framework, which should lead to the dynamic development of new technologies.

If you have any questions on the above topics, please contact the authors of the article or your regular EY Law or EY advisory team.

The EU has presented two acts with the intention to create a single common market for data based on a harmonised legal framework. The draft Data Act clarifies which entities are entitled to create specific value, or products and services, from data. The already adopted Data Governance Regulation lays down procedures and structures to facilitate data sharing between companies, individuals and the public sector.

Judicial window

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SAC's view on the transfer pricing methodology in companies with a limited functional and risk profile

The Supreme Administrative Court (SAC) recently issued an interesting judgment containing a detailed opinion on the methodology used to determine transfer prices by companies with a limited functional and risk profile.

Background

- In 2013, the Company concerned manufactured and sold most of its products to other group companies. The Company was classified as a contract manufacturer, i.e., a company with limited functions and risks. The Company's remuneration was determined on the basis of the transactional net margin method ("TNMM") to allow the Company to receive the required operating margin.
- The operating margin was determined by the Company within an interquartile range of average operating margins achieved by comparable independent entities in the period 2011-2013 and determined based on a benchmarking analysis performed using the AMADEUS database.
- The tax administrator found the comparability of the sample of independent companies and the Company's method of calculating the interquartile range to be incorrect and carried out its own analysis. On the basis of its analysis, the tax administrator assessed and imposed upon the Company additional corporate income tax.
- The Regional Court generally upheld the tax authority's conclusions.

Subject of the Dispute

- In its appeal, the Company argued in particular the following:
  - For the purposes of the price comparability analysis, the tax administrator used a commercial database (TP Catalyst) other than the Company (AMADEUS). Also, the tax administrator's analysis was

performed as at a date different from that used in the Company's analysis.

- The tax administrator excluded from the sample of comparables companies with negative margins, without any detailed analysis.

- The tax administrator used a different method than the Company for calculating the weighted average operating margin and did not provide any justification for disregarding the Company's choice of method (although the law does not provide for a binding method for this calculation).

- The tax administrator failed to properly justify sufficiency for the purposes of a comparative analysis of the sample of comparable companies used by the tax administrator. Moreover, the Regional Court did not address this objection at all.

View of the SAC

- The SAC found that the Regional Court had not dealt with the above objection and annulled the contested judgment on the grounds of unreviewability. In addition, the SAC also addressed the Company's other objections.

    - From the tax perspective, the version of the database used by the Company for the purposes of an analysis is completely irrelevant. Independent prices in comparable transactions can be determined objectively, and therefore the degree of prudence or effort of the taxpayer cannot be taken into account. The Company must therefore bear the consequences of having used a database which did not contain all the necessary information.

    - It was incorrect to exclude in general all companies with negative operating margins from the benchmarking exercise. The conclusion that a company designated as a contract manufacturer should always make a reasonable profit was deemed pure speculation, without any basis in the administrative file, and therefore unreviewable. In seeking such a conclusion, the tax administrator should have analysed the operating margins of independent companies operating as contract manufacturers (i.e. entities with a limited functional and risk profile). The tax administrator did not assess the selected independent companies from this perspective at all. At the same time, the Supreme Administrative Court stated that the tax administrator did not explain in a reviewable manner the reasons for choosing particular criteria (e.g., the NACE code) for selecting comparable entities.

    - It is not for the SAC to determine which of the methods used to calculate the weighted average operating margin is more accurate. Neither the Company, nor the tax administrator explained, why they believed that the method they had used was more accurate and providing more representative information.

- Furthermore, the SAC specifically stated that the tax administrator's analysis did not clearly explain why it chose the TNM method rather than other methods. It is also not clear why the tax administrator chose the reference period 2011-2013 and not, for example, a period of five years or, conversely, only the year corresponding to the fiscal year.

- Last but not least, the SAC challenged the use of the interquartile range for determining the arm's-length range of the operating margins of comparable entities, arguing that the tax authority did not provide any reasons for concluding that there was a trend in these values and for designating certain margins as outliers (i.e. the values represented by the first and last 25% of the sample values), and other margins not. Further, the tax administrator did not provide any reasoning as to why the resulting sample of operating margins needed to be "trimmed" and why all values could not be accepted.

Conclusion

- The SAC concluded that the tax administrator had adjusted the Company's tax liability on the basis of a completely unreviewable analysis, which procedure cannot be deemed acceptable. Therefore, the SAC ordered the tax administrator to conduct an analysis of the above aspects for determining the transfer prices in a way that is reviewable, i.e., based on rational grounds.

- The SAC requests that the tax administrator justify a number of procedures that are routinely used in the current tax practice and that are generally considered to be correct and undisputed by both tax administrators and taxpayers. Finding their substantiation in the law might, however, be rather difficult.

- The text of the judgment per se provides some guidance to both the tax administrator and the taxpayers on how to proceed in the given case. Carrying out an analysis in the extent required by the SAC may involve considerable difficulties, particularly in terms of availability of the information needed to carry out the required analyses and to provide rational justifications.

- It will be interesting to see whether the decision will prove to be an impulse for a less routine, more detailed and more individualised approach to the transfer pricing documentation - both on the part of the tax administration and the taxpayers.

If you have any questions, please contact the author of the article or your regular EY team.

The SAC challenged significant aspects of the methodology widely used in practice to determine transfer prices for companies with a limited functional and risk profile (referred to as "contract manufacturers") on the grounds of nonreviewability. According to the Supreme Administrative Court, the tax administrator did not provide sufficient economic and rational reasons to justify the various steps constituting the adopted procedure.

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SAC on abuse of rights concerning financing expenses

It has been obvious for some time now that the tax administration and the courts are not in favour of one-crown bonds. Judgment 7 Afs 175/2022 - 37 of 21 December 2022 might seem to be just another unsurprising decision. In my opinion, it is quite the opposite; it is a fundamental decision, as the reasoning of the tax administration and of the courts effectively changes the rules for claiming abuse of rights, obviously to the detriment of taxpayers.

Background

- A limited liability company was established in 2012, the sole shareholders and, at the same time, executive officers were husband and wife – both medical doctors.
- In November 2012, the shareholders decided to issue company bonds to finance the purchase of a part of an enterprise (dental practice) from one of the shareholders.
- In December 2012, the company issued a total of 10,000,000 registered book-entered bonds with the nominal value of CZK 1 (one-crown bonds), with a fixed interest rate of 9.9% p.a., with the final maturity in 25 years (with possible early redemption at the discretion of the issuer). The shareholders were the sole underwriters of the bonds.
- The issue price and the purchase price were paid in December 2012; the purchase price was covered from the funds raised by the bond issue and, to a lesser extent, from the company's equity.
- The company claimed interest on the bonds as a tax-deductible expense.

View of the tax administrator

- In the subsequent tax audit, the tax administrator concluded that the company had abused its rights.
- The method chosen by the company to finance the transfer of a part of the enterprise, i.e., through the issue of one-crown bonds, did not have a reasonable economic justification. The main purpose was to obtain a tax advantage in contradiction with the Income Taxes Act.
- The tax administrator therefore disregarded the interest expense claimed and assessed additional corporate income tax.

View of the courts

Both courts upheld the opinion of the tax administrator. Here are the main arguments of the Supreme Administrative Court (SAC):

- The intention to change the way of doing business from a natural person to a legal entity and the form of transition, i.e., transfer of the enterprise for a consideration, can be reasonably economically justified in the given situation and do not contribute negatively to the abuse of rights analysis. Nevertheless, the chosen method of financing the transaction may constitute an abuse of rights.
- According to the SAC, the important thing is that there were other options to allow the company to have at its disposal a part of the shareholder's enterprise and to finance the transaction, which observed the economic rationality principle. According to the SAC, such options included, in particular, contributing the enterprise to the company's equity, taking the enterprise from the shareholder on a loan under standard market conditions or arranging for payment of the transfer price in regular instalments. According to the SAC, these options were economically more advantageous for the company than the transfer for a consideration, which, according to the SAC, disproportionately burdened the company with interest costs for a period of 25 years.
- The transfer for a consideration was between related parties. The funds used to finance the transaction also came from persons related to the company and were raised through the issue of one-crown bonds. Although the payment of the transfer price was made, the seller did not actually receive any consideration for the transfer of the enterprise, since he only received from the company what he had previously paid to the company in respect of the underwriting of the bonds (or, in fact, his consideration amounted to half the amount, corresponding to the funds provided for the underwriting of the bonds by his wife, who was also a related party, and who effectively shared the property with him). As a result, the payment of the transfer price was effectively postponed for 25 years. According to the SAC, there was no actual need to pay the transfer price to the shareholder at the time of the transfer.
- According to the SAC, the provision of funds by the shareholder - the company's executive officer – in order to satisfy his own receivable does not serve the purpose of external financing or any other legitimate economic purpose. According to the SAC, the transaction yields "economic benefit" to the shareholders of the bond issuer in the form of interest income that is not subject to tax. According to the SAC, gaining a tax benefit in the form of reduction of the income tax base by the interest expense on bonds contradicts the meaning and purpose of the relevant provisions of the Income Taxes Act, and as such, according to the SAC, constitutes an abuse of rights.
- According to the SAC, the fact that the company did not intend to use external sources to finance the transfer is evidenced by the fact that the bonds issued in 2012 were not offered for subscription to third parties. According to the SAC, this fact is of key importance for the assessment of the principal purpose of the transaction under review

and casts significant doubt on the alleged purpose of the bond issue, i.e., securing funds for the payment of the transfer of the enterprise. The SAC concluded that, if the one-crown bonds had been subscribed by third parties, the transaction would have had an obvious economic purpose other than merely obtaining a tax benefit associated with the one-crown bonds; namely, the real purpose would have been to actually finance the one-off payment of the price of transfer of the enterprise.

- The SAC does not further elaborate on the above considerations in relation to the other options of carrying out the transaction proposed by the SAC, namely a loan by the shareholder or an instalment scheme.

The main takeaway

Caution must be exercised in an attempt to generalise the opinions of the SAC. The details and context of a particular transaction must always be taken into account. However, in reading the above reasoning of the SAC, the following practical considerations come to mind:

- Each individual step of the overall transaction must be considered. A reasonable economic objective of the entire transaction may not save you from the abuse of rights, but a weak objective of the entire transaction may bury everything.
- Caution must be exercised regarding the simplistic idea that, given the same number of steps, a taxpayer may also choose according to the tax treatment.
- The absence of "outside money" in the transaction can be a big negative aspect depending on the context.
- Using an instrument that is unreasonably complex or otherwise unusual given the situation is a big negative aspect.
- The ability to quantify the non-taxable benefit is important, even compared to other available options.
- Correct transfer pricing scheme is a necessary condition but, on its own, it solves nothing.
- Depending on the context, a reduction of profitability of an entity by more than a little compared to other available options can be a big negative aspect.

If you have any questions, please contact the author of the article or your regular EY team.

According to the SAC, the existence of other - economically rational - ways to allow a company to have at its disposal a part of its shareholder's enterprise and to finance the transaction is of key importance.

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

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Did you know:

- According to the Ministry of Industry and Trade, large companies that wish to reach an energy price cap already for January 2023 need to submit a declaration to their energy supplier by 15 January 2023?
- The Ministry of Finance has published Instruction GFD-D-58 on the remittance of tax accessories?
- Major amendment to the Significant Market Power Act came into force on New Year's Day 2023?
- What is the moment of delivery if the legal fiction of delivery of a data message falls upon a Saturday, Sunday or public holiday?
- The General Financial Directorate has issued Instruction D-59 on the uniform procedure for the application of certain provisions of the Income Taxes Act (replacing GFD Instruction D-22)?