Tax and Legal News

June 2024

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Safe passage through (un)safe harbours

Pillar 2 is one of the most frequently mentioned tax topics of late (and not only at EY).

Starting this year, the related set of rules ceased to exist in the realm of science fiction and took the form of a very real piece of legislation – the Top-up Taxes Act. The plural is quite appropriate here, because there are two new taxes: the allocated top-up tax (generally to be paid by the top entity in a group) and the Czech top-up tax (to be paid by Czech entities and Czech permanent establishments of the group).

The fact that this is not a simple issue is evidenced by the scope of the related legislation. The recently published OECD Consolidated Commentary is already over 330 pages long, and the Czech law, with its 152 sections, is not far behind.

As expected (and quite logically), a large number of taxpayers took the path of least resistance, which in the terminology of Pillar 2 means the path of "safe harbours".

Compared to the full calculation of the top-up tax, this is indeed a huge simplification. Ideally, the taxpayer should only need two figures from the CbCR report (i.e. total revenue and pre-tax profit for the jurisdiction), plus a total tax expense figure extracted from the financial statements. On the basis of this data alone, it should be possible to verify whether the de minimis condition or the minimum simplified effective tax rate has been met in a given country. If so, the top-up tax for that country is considered to be zero.

If none of the above options works, the taxpayer can still try to calculate whether the profit shown in the CbCR report corresponds to the so-called "profit excluded on the basis of the economic substance of the group" for the country in question. It sounds a bit scary, but in principle it's a question of whether there are adequate assets and personnel (relative to the profits made) in the country under consideration. The volume of required data is slowly increasing, though not beyond a tolerable limit.

But as it happens in life, the devil is in the details. So let's take a closer look at one such calculation (or at least some parts of it).

Before starting any calculations, you need to find out if you have the right CbCR report. A basic requirement is consistency of data. For example, do you know that all data for a country must generally be based on the same type of financial statements? Similarly, all data used for a single entity must come from the same source. Otherwise, you can't use the country's safe harbour rules at all. Relatively detailed guidance in this regard is provided by the OECD Administrative Guidance issued in December 2023, currently embodied in the draft first amendment of the Top-up Taxes Act.

Another issue is the accuracy of the data in the CbCR report. Some may be surprised to find that -based on the methodology for completing this report - the income does not include (mostly exempt) dividends received from subsidiaries. Previously rather uninteresting information becomes extremely important when calculating the simplified effective tax rate. On the other hand, capital gains (including exempt ones) should be included in the CbCR report, which may in practice somewhat affect the resulting effective tax rate.

Also note that for some companies you will need to carry out the calculation completely separately (for example, joint ventures).

Despite the possible pitfalls, it's definitely worth taking this route. At the end of it, you can expect that most jurisdictions will drop out of the obligation to make a full calculation of the top-up tax (and, more importantly, to prove its correctness in future tax audits). And that's well worth a bit of effort.

Moreover, according to unofficial Czech tax administration interpretations, the safe harbours should also apply equally to the Czech top-up tax (though a more specific regulation in the law wouldn't hurt).

In any case, we wish you smooth and safe passage through all harbours (pillar-related or otherwise) in the coming summer holidays.

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Amendments

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Ministry of Finance has published the first version of revolutionary tax changes

The Ministry of Finance has published the first version of a long-awaited bill amending certain laws in connection with the adoption of the (new) Accounting Act. One of these laws is the Income Tax Act (more, in Czech, HERE).

The scale of the proposed changes is impressive. Combined with the proposed accounting changes, it is one of the biggest changes to Czech taxation since the independent tax system was established.

After a first cursory study of the proposed changes, we set out below a brief summary of the top 5 that we've noted so far (the current proposed general effective date is 1 January 2025, which seems [overly] ambitious):

- ***International Accounting Standards*** – Taxpayers ***compulsorily*** applying International Accounting Standards (IFRS) will generally base their tax base calculation on profit or loss determined based on these standards. However, adjustments will have to be made to the profit or loss for (among other things) any permanent differences between the (new) Czech standards and IFRS. The proposal also includes a very specific process for the transition to/from IFRS, or for the first year of application of this new approach.
- ***A revolution in treatment of assets***– There is a complete "recodification" of the approach to assets and their treatment – among other things, all terminology and the approach to leasing, tax depreciation, depreciation groups, or depreciation period, technical (or "subsequent") appreciation, related value limits, the first year of the new rules, etc.
- T***ax allowances and provisions*** – Tax valuation allowances and provisions will generally be made independently of the accounting.
- ***Income tax in euros*** – If the taxpayer's accounting currency is the euro, then from 2027 the calculation and administration of corporate tax is expected to be in euros.

- ***Natural persons (individuals)*** – Individuals currently keeping accounts will be taxpayers with a so-called cash tax base (i.e. not accrual tax base) from the entry into force of the new regulation. Furthermore, the new approach to asset evidencing may have a negative impact on certain groups of taxpayers.

We promise this isn't the last time we'll be writing about this topic.

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

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Initial draft Tax Code amendment published

The Ministry of Finance is preparing an amendment to the Tax Code. Its initial draft has been published as part of the comment procedure. The amendment contains a number of modifications that could come into force during 2025 or as of 2026.

Below is a brief selection of the changes that caught our eye:

- Introduction of a fiction of delivery for informal communication with the tax administrator (e.g. e-mail). The effects of delivery would take place on the tenth working day from the date on which the tax administrator sent the message.
- Extension of the information obligation towards the tax administrator to information "needed" for tax administration (until now only for "necessary" information).
- Explicit admission of evidence outside tax proceedings.
- Breaking the time limit for tax assessment even in the case of an offence committed by a person other than the relevant tax entity.
- Allowing the tax administrator to issue a notice to the guarantor within the period for payment of the tax, not only within the period for assessment of the tax.
- New regulation of the transfer of tax liability on the termination of a trust fund (the person who has received assets from the trust fund, up to the amount of the assets so received).
- Explicit prohibition of interest on interest even for that paid by the tax administrator.
- Clarification that the basis for calculating the penalty for late filing of a tax return is the amount of tax determined in the proceedings directly related to the late filing of the tax return.
- Possibility of the full waiver of penalties (now capped at 75%).
- Changes in the regulation of mass waiver of tax (newly by government decree and possible mass postponement).
- Further changes to of the rules on delivery (e.g. for multiple data box situations), split administration and tax execution.

It is likely that during the legislative process some points of the amendment will be changed, others may be deleted or new ones added. We'll keep you informed.

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

The Ministry of Finance is preparing an amendment to the Tax Code with the changes taking effect primarily in 2025. One of the changes is the introduction of a fiction of delivery for informal communication with the tax administrator, such as by e-mail.

VAT

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Liability for VAT not paid by a supplier: What changes from 1 January 2025?

VAT is an important fiscal revenue item of the state budget. Its correct but also timely payment has a significant impact on public finances. One of the mechanisms that should ensure effective collection of VAT from the perspective of the tax administration is the institution of liability of the recipient of the taxable supply. However, for many VAT payers this can be a very complicated set of obligations.

The draft "big" VAT Act amendment prepared by the Ministry of Finance, brings changes that further expand the obligations of taxpayers and regulate the rules of liability. What is being changed and what consequences may it have for taxpayers?

Shifting the burden of proof to the recipient

The amendment significantly affects the position of the recipient of a taxable supply in terms of the allocation and bearing of the burden of proof. The amendment redefines the specific situations where it is *a priori* presumed the recipient had knowledge that the tax would not be paid and is therefore liable for the unpaid tax.

Extension of the range of situations of knowledge of non-payment of tax

These include, for example, transactions with a provider about whom the tax administration has published information about its unreliability, relationships between related parties (see § 36a of the VAT Act), deliveries by a fuel supplier who is not on the statutory list of fuel distributors, or payments that are disproportionate to the usual price.

The knowledge of the recipient that the tax will not be paid should also be newly established in cases where the payment of the transaction is made in an unusual way, such as payments in cryptocurrency, cash in excess of the legal payment limit or transfers to accounts other than officially published.

The amendment introduces liability for an authorised recipient who has incurred an obligation to declare and pay excise duty in connection with the receipt of selected products from another Member State, where the goods are acquired from another Member State by a person who supplies the goods to a third party.

Limits of liability

The Explanatory Memorandum to the amendment specifies that the liability would apply only to the immediate recipient of the supplier and not to multiple payers (recipients), if the supply was made in a chain of payers. Liability is limited to the tax due (not the taxable amount).

Procedural changes in proceedings

In liability proceedings initiated otherwise than by notice to the guarantor, the new recipient of the taxable supply (or the authorised recipient) may consult the file in respect of the tax arrears. The tax administration may, in certain circumstances, exclude the suspensive effect of an appeal against a demand to a guarantor.

At the same time, we recommend monitoring the currently prepared Tax Code amendment, which could, among other things, extend the period within which the tax administrator can demand payment from guarantors.

Special method of securing tax

The amendment still allows the recipient to pay the tax on behalf of the supplier. This special method of securing the tax has procedural rules that must be followed.

Conclusion

The wider responsibility of the recipient for the correct payment of VAT should contribute to the prevention of tax evasion. On the other hand, it will place great demands on recipients to have a good overview of their business partners and to be able to prove that they did not and could not have had knowledge that the tax would not be paid.

VAT payers should carefully consider the impact of these changes on their business and adapt their business and accounting processes to avoid unwanted liability.

The EY team is ready to assist you in assessing existing measures, designing new and appropriate processes to verify the trustworthiness of business partners, and developing a strategy for disputes.

The amended wording of the VAT Act in the area of liability for unpaid tax represents a significant shift in practice. The recipient will have to be much more proactive in checking its business partners and the circumstances in which a business transaction takes place.

Sustainability

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European Corporate Sustainability Due Diligence Directive (CSDDD)

On 24 April 2024, the European Parliament adopted a new directive on corporate sustainability due diligence (the "Directive").

The adopted Directive is the result of extensive political negotiations between EU Member States and the EU Council. Compared to the original proposal, this is a compromise text that significantly limits the proposed scope of the Directive and extends the deadline for its adoption through national legislation to ensure its implementation in the legal systems of EU Member States.

What will the new Directive introduce?

The Directive will have major implications *in relation to corporate environmental and human rights due diligence*.

The Directive lays down rules concerning:

a) the obligations of companies with regard to actual and potential adverse human rights impacts and adverse environmental impacts in relation to their own activities, those of their subsidiaries and those of their business partners in the companies' chains of activities, i.e. business partners in the production and distribution chain;

b) liability for breach of the above obligations; and

c) the obligation to adopt and put into effect a climate change mitigation transition plan.

The Directive seeks to comprehensively cover a wide range of human rights and environmental areas, such as the right to fair and satisfactory working conditions, prohibition of child labour, prohibition of unequal treatment in employment, pollution of land, water or air, harmful emissions, protection of the ozone layer and more.

Who should be covered by the Directive?

One of the main points discussed in the original draft of the Directive was its broad scope and the associated concerns about excessive bureaucracy. In order to reach agreement, the Directive now applies to a smaller number of companies (groups) and the thresholds have also been significantly increased compared to the original proposal.

The Directive will apply to companies (groups) incorporated under the laws of an EU Member State that employ more than **1,000 people** (compared to the originally proposed 500 people) and whose worldwide turnover in the last financial year exceeds **EUR 450 million** (compared to the originally proposed EUR 150 million). It also affects the ultimate parent companies of groups that meet the set thresholds.

Importantly, the Directive also applies to large **companies outside the EU** if they have a turnover of **EUR 450 million** in the EU in the last financial year. There is no limit on the number of employees for these companies.

How will companies exercise due diligence?

Companies affected by this Directive will be required to carry out human rights and environmental due diligence, in particular through the following measures:

- integrating due diligence into internal risk management policies and systems (in particular a description of the company's approach to due diligence, a code of conduct describing the rules and principles to be followed throughout the company and its subsidiaries and by the company's direct or indirect business partners, and a description of the procedures put in place to exercise due diligence, including measures taken to verify compliance with the code of conduct and to extend its application to established business relationships);

- identification and assessment of actual or potential adverse impacts, avoidance and mitigation of potential adverse impacts, and elimination and minimisation of the extent of actual adverse impacts;

- implementing meaningful stakeholder engagement (employees of the company, employees of its subsidiaries and other persons whose rights or interests may be affected), establishing and maintaining a reporting mechanism and complaints procedure, monitoring the effectiveness of its own due diligence policy and communicating publicly about due diligence.

In order to support companies and EU Member State authorities in putting the above obligations into practice, the European Commission should provide a range of guidance, including, for example, model contractual clauses, guides, guidelines, dedicated websites, platforms or portals, or helpdesks.

Liability and sanctions

Under the Directive, EU Member States will designate one or more national supervisory authorities which will have investigative powers and can impose sanctions for breaches of obligations under the Directive including financial penalties **up to 5% of the company's worldwide net turnover**. In addition, the Commission will establish a European Network of Supervisory Authorities composed of representatives of supervisory authorities to facilitate cooperation and coordination between national supervisory authorities.

The Directive also introduces civil liability for companies for damages caused by breaches of the due diligence obligations set out in the Directive and the right to full compensation. However, a company cannot be held liable if the damage is caused solely by its business partners in its chain of activities.

Transposition of the Directive into national law and its entry into force

The Directive will be implemented gradually. The transition periods for each group of companies are set according to the thresholds as follows:

- for companies with more than **5,000** employees and a turnover of **EUR 1,500 million – 3 years** after the entry into force of the Directive (also applies to non-EU companies with a turnover of EUR 1,500 million in the EU);

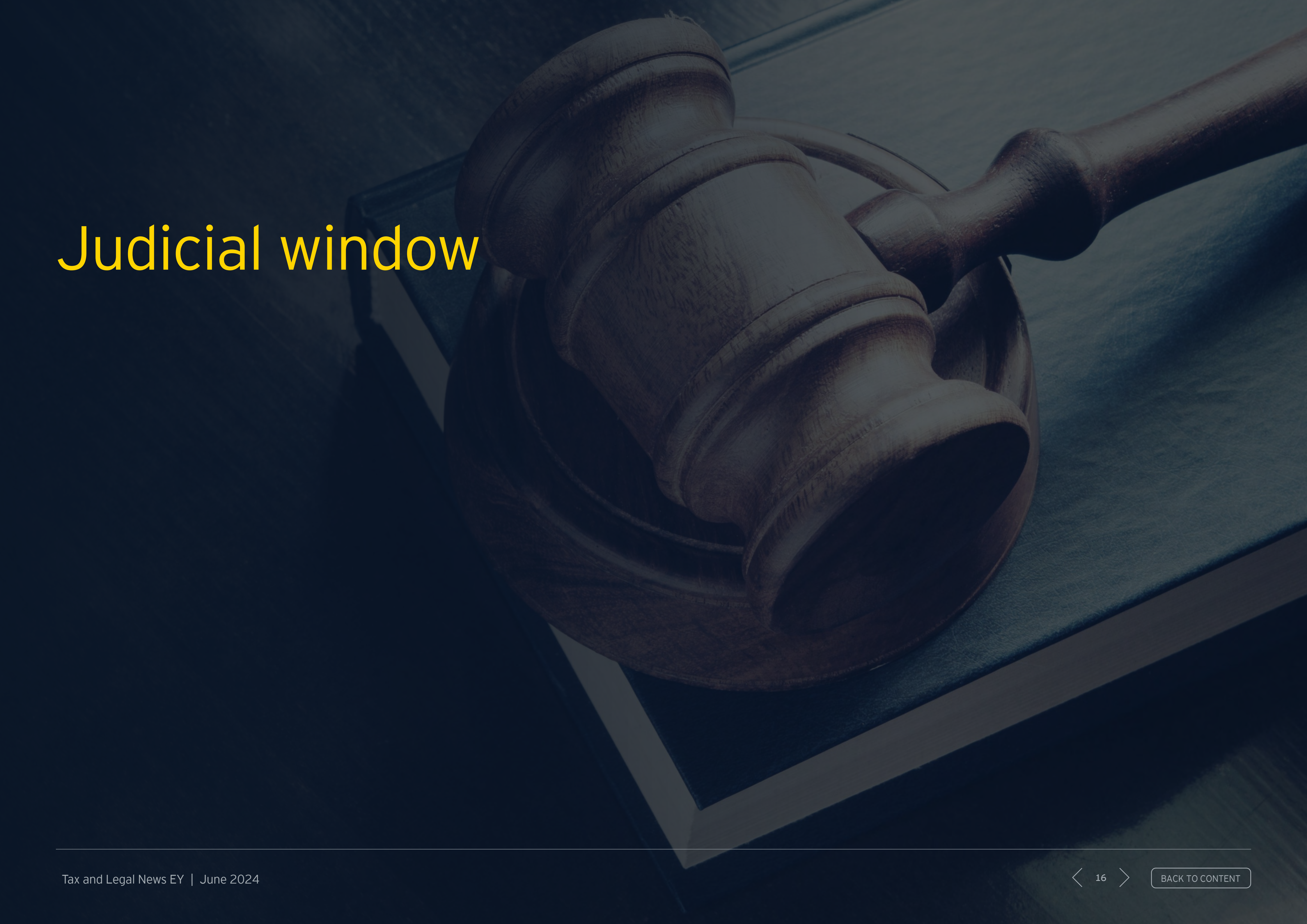
- for companies with more than **3,000** employees and a turnover of **EUR 900 million - 4 years** after the Directive enters into force (also applies to non-EU companies with a turnover of EUR 900 million in the EU);
- for companies with more than **1,000** employees and a turnover of **EUR 450 million – 5 years** (also applies to non-EU companies with a turnover of EUR 450 million in the EU).

The Directive will enter into force 20 days after its publication in the Official Journal of the European Union. Member States should adopt the laws, regulations and administrative provisions necessary to comply with this Directive no later than 2 years after its entry into force.

We will keep you informed of further developments in this area. If you would like more detailed information, please contact the authors of this article or other members of EY Law or your usual EY team.

Companies affected by the Directive will be required to carry out human rights and environmental due diligence. Member States should adopt the laws, regulations and administrative provisions necessary to comply with this Directive no later than 2 years after the entry into force of the Directive. Under the Directive, EU Member States will designate one or more national supervisory authorities which will have investigatory powers and will be able to impose penalties, including fines of up to 5% of a company's worldwide net turnover, for breaches of its obligations under the Directive.

Judicial window



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Supreme Administrative Court on proving receipt of services – supplier and scope

A number of cases currently before the Supreme Administrative Court concern the issue of proving the supplier and the scope of services received (especially advertising services or auxiliary services in production). In them, the tax administrator questions the recipient's entitlement to deduct VAT[1], but sometimes also the tax deductibility of the related costs for income tax purposes[2].

Neither the performance of the services themselves nor their significance for the economic activity of the customer is in dispute in these particular cases. There are doubts as to whether the actual supplier and the scope of the services provided correspond to the information declared on the tax documents.

The initial problem and trigger of tax administrator doubts usually arise from various irregularities on the part of the service provider. Often, the number of employees registered with the relevant state administration authorities is low, and, according to the tax administrator, does not correspond to the scope of the provided services. In other words, according to the tax administrator, the declared supplier does not have the capacity to provide the services.

Customers generally argue that at the time they received the requested services, they had no reason to investigate further exactly how and by which specific persons the services were provided. It is in practice irrelevant for the purchaser whether the supplier provides the performance by its own employees or by subcontracting.

1 See, e.g., SAC judgment of 20 May 2024, ref. 9 Afs 25/2023 - 48, and of 13 May 2024, ref. 10 Afs 7/2024 – 47.
2 See, e.g., SAC judgment of 15 February 2024, ref. 3 Afs 399/2021-99.

In this context, the SAC in a recent judgment[3] reiterated its earlier view on subcontracting services. It deduced[4] that *"it is not sufficient to prove only the actual provision of the supply/advertising, but the relationship between the taxpayer and the supplier of the supply, which is declared on the submitted documents, must be clearly established, and it must also be shown that the declared supplier's performance for the taxable person consisted at least in ensuring that the subcontractor provided the supply (i.e. <u>the relationship between the declared supplier and the subcontractor who provided the claimed supply to the taxable person must be proven</u>)"* (emphasis added).

In theory, therefore, the customer is faced with the task of proving not only the relationship with its direct supplier, but also the circumstances of the cooperation between its supplier and the subcontractor. In practice, it is often difficult to remove doubts about one's own supplier after a number of years. This can be doubly true for a business relationship in which the end customer was not at all involved.

The conclusions of the case law may be perceived by business practitioners as very strict. However, it should be noted that the courts formulate their conclusions in particular cases in the light of the individual (often more or less suspect) facts and it is possible that in the vast majority of commercial cases there will be no reason to apply them.

However, based on current case law, service purchasers cannot but be advised to thoroughly vet their suppliers, set up contractual relationships with sufficient precision, and properly document the course of cooperation, including the possible involvement of subcontractors. If your supplier is not diligent enough in fulfilling its obligations, it is possible that the tax authorities will knock on your door.

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

However, based on current case law, service purchasers cannot but be advised to thoroughly vet their suppliers, set up contractual relationships with sufficient precision, and properly document the course of cooperation, including the possible involvement of subcontractors.

3 See judgment of 13 March 2024, ref. 10 Afs 153/2022 – 90.
4 See SAC judgment of 11 February 2021, ref. 8 Afs 24/2019 - 44, and of 4 May 2017, ref. 10 Afs 235/2015 – 75.

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Regional Court in Prague on the liability of the organizer of VAT fraud for tax arrears

The Regional Court in Prague considered the question of whether the organizer of VAT fraud can be held liable for unpaid tax by the corporation that carried out the fraud.[5]

Background

The plaintiff was an organizer of VAT fraud who had been convicted by a criminal court. The VAT fraud was perpetrated by a corporation which was an influenced person in relation to the plaintiff under the Corporations Act.[6] The tax administrator asked the claimant, as the alleged guarantor, to pay the arrears arising from the corporation's unjustified claim for VAT deductions.

The applicant's arguments

The applicant's arguments can be divided into three headings:

1) The applicant argued that the limitation period for the assessment of tax on his person had expired because the decision seeking to discharge the guarantee obligation was issued almost six years after the assessment of tax on the affected company.

2) He argued that the creation of a tax liability is not an injurious event and therefore does not give rise to liability. The influencing person is liable to the influencer's creditors for the injuries caused to them, which the influenced person cannot reimburse as a result of the influence.

3) Finally, he argued that the principle of *ne bis in idem*, i.e. the same act cannot be punished twice, had been infringed.

5 No. j. 51 Af 6/2023 – 69
6 Pursuant to § 71(1) of Act No. 90/2012 on business companies and cooperatives

Findings of the court

Expiry of the limitation period

The court addressed the issue of the expiry of the limitation period and agreed with the applicant's earlier case-law, which stated that a guarantee notice can only be issued within the period for the assessment of tax. It added, however, the need to take into account § 148(6) of the Tax Code, i.e. that the time limit for the defendant was broken by a final court decision that a tax offence had been committed. It stated that, despite the accessory nature of the guarantee, the time-limits for the guarantee notice and the tax assessment are independent of each other, starting at the same time, and that the guarantee notice is also a decision on the tax assessment. It confirmed that the tax was assessed on the taxable person in due time.

Origin of the damage

The court pointed out that the plaintiff established the tax entity with the intention of using it to engage in unlawful conduct leading to the imposition of tax. It rejected as unfounded the argument that the tax liability did not constitute damage, stating that damage must be assessed on a case-by-case basis. It stated that had it not been for the applicant's unlawful conduct, the tax would not have been assessed. Therefore, in the court's view, in the present case, the assessment of tax constituted damage.

Violation of the principle of *ne bis in idem*

The court dealt with the objection of violation of the principle of *ne bis in idem* and found that the additional tax liability and interest on late payment were not criminal in nature. It noted that the tax administrator did not impose a penalty which could constitute a criminal sanction.

Conclusion

On the basis of all the above conclusions, the court found the action unfounded and dismissed it.

This judgment is interesting because it endorses the possibility for the tax administrator to recover unpaid VAT directly from the organizer of the tax fraud who, despite his informal relationship with the company involved in the fraud, influenced the behaviour of that company and at the same time profited from it.

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

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

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Did you know:

- The Ministry of Finance published an updated draft of the new Accounting Act as well as a draft of the basic content of related decrees?
- A new Double Tax Treaty between the Czech Republic and the United Arab Emirates has entered into force?
- The TOP20 taxpayers for 2023 have been awarded?
- A tax administration representative has commented on the accounting aspects of non-cash liquidation?
- The Court of Justice of the European Union has examined the question of whether the restriction contained in § 29(4) of the Capital Undertakings Act, i.e. that investment intermediaries also transmit instructions concerning investment instruments to foreign securities dealers, is contrary to EU law?