TAXAND

bmbpartners TAX AUDIT ADVISORY 25 YEARS

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Despite major turbulences, the end of 2022 turned out relatively well in Slovakia. Pro-European orientation, including the support for Ukraine, has been maintained, and Slovak finances have been stabilized – at least in the short term.

Although the minority government of Eduard Heger lost a no-confidence vote in the parliament on 15 December, the state budget for the next period was approved on 22 December, along with a permanent reduction of VAT for restaurant services and sports venues to 10 % (more on this in TOP 1), minimum health insurance contributions (TOP 4), and, in order to minimize the impact of the energy crisis based on EU regulations, also a special windfall tax for selected companies in the amount of 55 % of the excess profits for 2022, although the original proposal was as high as 70 %.

The interim government led by Mr Heger has time until the end of January for reconstructions and to find a new 76 MP's support in the parliament so that it can rule until the regular date of the next elections in February 2024. If it fails to do so, it is likely that early elections will be held in the autumn of 2023. In any case, it will probably mean that changes in the tax area that failed to be passed until the end of 2022 will be on hold this year. It will be wise to postpone any major changes, as has already happened with e-invoicing, and wait for further development in the EU (TOP 5 and TOP 9).

In 2022, the financial administration not only recorded extraordinary tax revenues, but also managed to shorten the average duration of a tax audit by approximately two months (TOP 3).

Slovak statistical trends in the field of taxes follow the European trends, whether it is in the area of VAT and its share in the total tax revenue (TOP 7) or in the dramatic increase of transfer pricing cases which are subject to the international dispute resolution mechanism (TOP 10), where our tax experts are among the regional leaders in terms of quality.

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## TOP 1: APPROVED AMENDMENTS TO THE INCOME TAX ACT AND VAT ACT

On 06/12/2022, an amendment to the Income Tax Act was approved by the parliament, which brought significant changes primarily in the area of transfer pricing and also in the calculation of the amount of the tax bonus per child.

In the area of transfer pricing, one of the most significant changes is the introduction of a lower threshold for a "material controlled transaction" (€10 thousand per transaction or €50 thousand for the principal in the case of a loan). The amendment introduced many improvements to taxation of permanent establishments. Significant changes also include that the tax administrator may determine the profitability of an entity at the level of the median when reviewing transfer price settings, unless the entity proves another value from a range of comparable values is more appropriate.

The above changes are related to the already announced change to the Guideline on determining the content of transfer pricing documentation, which was published by the Ministry of Finance on its website on 29/12/2022, and which we will discuss in more detail in our next BMB Newsfilter.

Important changes include transposition of further provisions from the ATAD Directive on the limitation of deduction of net interest expenses from the tax base, which will also apply to non-related parties.

During the legislative process, a change was made to the Act No. 564/2004 Coll. on the income of municipalities from the state budget, according to which the share of the taxes transferred to municipalities will increase by the amount of €228 million in 2023 and by €236 million in 2024. The amount will be transferred from the corporate income tax collected. The above measure is intended to eliminate the negative impact of a significant increase in the tax bonus on the budgets of municipalities.

The amendment to the VAT Act, which also brought numerous changes, was approved on the same day. The main issue was the obligation of the customer to correct the deducted tax if 100 days have passed since the due date of the liability. At the same time, more favourable conditions for the possibility of correcting the tax base of an irrecoverable receivable were set out. Through the transposition of the Directive 2020/284, the amendment introduced a number of obligations for payment services providers with the aim to fight transparently against tax evasion in the field of e-commerce.

Another change to the VAT Act which was proposed during the legislative process in the parliament was the introduction of a temporarily **reduced 10 % VAT rate** (until 31/03/2023) applicable to services of transporting people by cable cars and ski lifts, services of admission to indoor and outdoor sports facilities, swimming pools and to restaurant and catering services.

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Together with the approval of the state budget, the parliament finally agreed on **22/12/2022 that the reduction of the VAT rate to 10 % will be permanent instead of temporary.** This last-minute change has already been signed by the President.

Details on the above changes are explained in BMB Newsfilter 3Q2022, accessible on our website.

## TOP 2: RULING ON CAPITAL GAINS EXEMPTION REGARDING SHARES

In November 2022, the Slovak Financial Directorate published on its website the long-awaited ruling on the exemption of income (profits) from the sale of shares. Since 01/01/2018, the Slovak Income Tax Act contains a provision on the exemption of income (profits) from the sale of shares in selected legal entities or permanent establishments in the Slovak Republic. The exemption applies to the sale of shares by a shareholder of a joint-stock company, ordinary shares or shares with special rights by a shareholder of a simple joint-stock company and business shares by a shareholder of a limited liability company or a limited partner of a limited partnership.

Section 13c of the Income Tax Act sets out the preconditions for the application of the exemption:

- the time test of holding a minimum share in the share capital (minimum holding period of at least 24 consecutive calendar months),
- the minimum shareholding test (holding of at least 10 % of the share capital),
- performing the functions and bearing the risks associated with the ownership of financial investment.

The greatest legal uncertainty was linked to the fulfilment of the third condition - performing the functions and bearing the risks associated with the ownership of financial investment, as the condition is defined very broadly and in practice there are cases when it is difficult to prove that the test is met, e.g. when the companies are not operating companies but holding structures established for the purpose of management, holding and appreciation of shares and stocks of subsidiaries.

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In the ruling published, the financial administration interpreted the condition and commented on the fulfilment of the test as follows:

The test of performing the functions and bearing the risks associated with the ownership of financial investment means that throughout the entire 24-month-period of the minimum shareholding, the selling legal entity has to perform, in the Slovak Republic, the essential functions (exercise full shareholder and voting rights and functions), manage and bear the risks associated with the ownership of shares, while possessing the necessary personnel and material equipment required to perform these functions and, in determining the tax base, to proceed from double-entry bookkeeping or IFRS. **It cannot be a 'shell company' for the purposes of this condition**.

The person entrusted with these functions **should therefore not be a 'third party'**, but an actual shareholder who **performs these functions at an actual place (e.g. an office**) and the condition of personnel and material equipment should be fulfilled during the whole 24-month-period.

## TOP 3: LATEST INFORMATION ON TAX COLLECTION AND TAX AUDITS

In 2022, the financial administration recorded very positive results in tax collection. At the end of November 2022, the nominal tax revenue of the state amounted to €14.2 billion, which is a year-on-year increase of 17 %, in absolute terms an increase of €2 billion.

The financial administration expects the best ever result also in the area of tax enforcement. Forecasts suggest that the state budget will receive around €300 million in 2023 thanks to efficient enforcement procedures.

A number of measures have also been taken to combat tax evasion. Tax auditing activities have been made more efficient, with the total volume of findings from tax audits reaching €343.4 million. At the same time, more than a third of all tax audits is already carried out in a narrower scope, i.e. mainly risky transactions are examined so that the taxpayer is not unnecessarily burdened. We had the opportunity to discuss this topic also with the Director General of the Anti-Fraud and Risk Analysis Section of the Slovak Financial Directorate at our joint IFA Seminar in September.

Another good news for taxpayers is the fact that the duration of tax audits has been reduced by approximately 2 months. The tax auditors focused more closely on e.g. transfer pricing, international taxation, real estate, e-cash registers and tax bonus.

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Further priorities of the financial administration are pro-client measures and support of voluntary tax compliance in the form of soft-warning reports. An important part of the promotion of voluntary compliance is the letter campaigns of the tax administration, in which taxpayers are alerted to possible errors and given the opportunity to correct them voluntarily. So far, this has secured additional tax collection for the state budget amounting to €13.6 million.

## TOP 4: SOCIAL SECURITY OF TELEWORKERS AND MINIMUM HEALTH INSURANCE CONTRIBUTIONS IN SLOVAKIA

The COVID-19 pandemic has brought situations when a large proportion of cross-border workers carried out their work from home, i.e. from a different location than usual. If the standard EU social security rules had been applied during this period, this would have led to a change in the applicable legislation for a large number of cross-border workers. Therefore, in order to simplify the situation and because it was an exceptional situation, the practice during the pandemic period was that carrying out activities in another country did not lead to a change in the applicable legislation. The application of this special rule was possible until 30/06/2022.

The EU Administrative Commission has issued guidance 125/22REV2, which lays down the rules for determining the applicable legislation. An important piece of information is that a change in the applicable legislation for employees who, for example, continue to work partly in a home office is not immediately necessary. The above-mentioned guidance provides for a transitional period until 30/06/2023, during which the original rules are still in force. The above procedure in the Slovak Republic has been confirmed by the Social Insurance Institution (Sociálna poisťovňa).

As already mentioned in the introductory part, an amendment to the Health Insurance Companies Act was approved on 22/12/2022 together with the state budget. The amendment introduces minimum health insurance contributions for low-income employees from 01/01/2023, with the aim to limit speculative part-time employment. The minimum health insurance contribution must reach the level of the contribution calculated from the minimum subsistence amount, which is €32.81 per month for 2023. If the calculated health insurance contribution does not reach the required minimum amount, the difference shall be paid by the employee; the employer's obligation will not change.

However, due to the complications expected in both the calculation and reporting of wages, we recommend that each employer commissions an independent review.

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## TOP 5: INDEFINITE POSTPONEMENT OF E-INVOICING

The long-awaited launch of online transmission of electronic invoices, which was originally planned to be mandatory as of 01/01/2023 and which we reported about in more detail in our BMB Newsfilter 2Q2022, has been postponed indefinitely. In late November, the financial administration announced that it would not be able to implement this project during the current legislative term. Therefore, it will be up to the next government to decide on the introduction of the obligation for businesses to send selected information to the financial administration as early as when issuing invoices to customers.

However, the financial administration stresses that it is by no means cancelling the plans for the introduction of electronic invoicing, only postponing its launch to a later period, as the state expects a significant reduction of the VAT collection gap as well as an improvement in the payment of income taxes once this measure is implemented. In this context, we also draw attention to the extensive VAT reform at EU level, which we discuss in more detail in TOP 9.

## TOP 6: CJEU DECISION ON RESTRICTED DISCLOSURE OF BENEFICIAL OWNERS

According to the CJEU judgment of November 2022, the provision of the EU Anti-Money Laundering Directive that requires information about beneficial owners of companies registered in EU Member States to be made available to the general public is invalid. This provision has since been implemented into national legislation by Member States, including Slovakia.

In its judgment, the CJEU declared the provision of the directive in question invalid. According to the Court of Justice, access by the general public to information on beneficial owners constitutes a serious interference with the fundamental rights to private life and protection of personal data, which are guaranteed by Articles 7 and 8 of the Charter. The information made available enables an unlimited number of persons to be informed of the material and financial situation of the beneficial owner. The Court of Justice has recognised that the objective of the provision of the directive is to prevent money laundering and the financing of terrorism, but that the interference which that provision constitutes is neither limited to what is strictly necessary nor proportionate to the objective pursued.

As a consequence, it is expected that access to the registers of beneficial owners will be limited and will only be granted to obliged persons in each Member State.

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## TOP 7: CONSUMPTION TAX TRENDS 2022

In November 2022, the OECD published Consumption Tax Trends 2022, which provide summary information on VAT and excise duty rates in OECD member countries. It also informs on the developments and efficiency of the collection of these taxes.

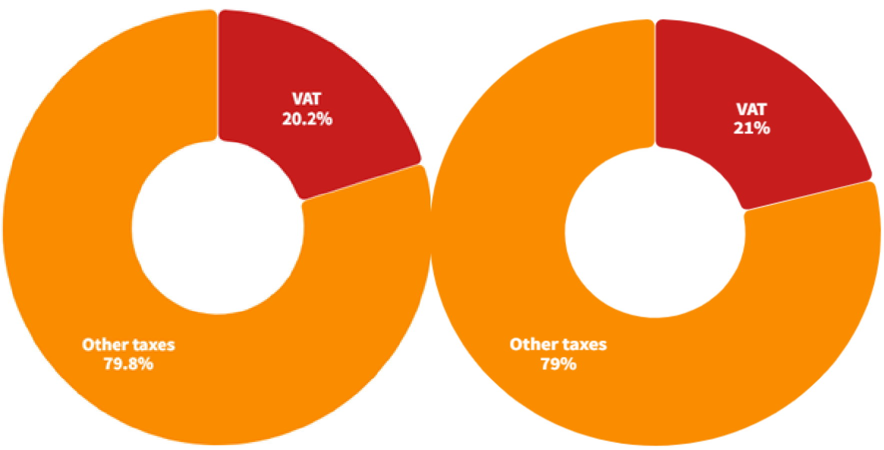
In OECD countries, revenues from excise duties have been averaging around 10 % of GDP over the long term, although this percentage has been declining slightly in recent years (9.9 % of GDP in 2020, 10.0 % in 2019, 10.2 % in 2018).

The overall share of excise duties on consumption in total tax revenue decreased to 30.0 % in 2020, compared to 30.6 % in 2019 and 30.8 % in 2018. This decline is mainly attributable to the steadily declining importance of excise duties (mainly on tobacco, alcoholic beverages and fuel, as well as some environment-related taxes) as a share of total taxation in OECD countries.

Value added tax (VAT) accounted for an average of 20.2 % of total taxes in OECD countries in 2020. VAT is thus by far the main category of taxes on consumption, generating almost three times more tax revenue than excise duties, which accounted for an average of 6.9 % of total tax revenue in 2020.

**Share of VAT in total tax revenues (2020)**

**OECD Average** **Slovak Republic**




Source: OECD

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## TOP 8: DIVIDING TAX LIABILITY AND THE RIGHT TO DEDUCT VAT ON I/C ACQUISITIONS OF GOODS VIOLATES THE VAT NEUTRALITY RULE

With respect to intra-community acquisitions of goods, the Polish VAT law required, under certain circumstances, that the tax liability and the right to deduct input VAT on the same transaction (invoice) are reported in different tax periods. Such an arrangement has a negative impact on the cash flow of the taxable person, as the liability arises in an earlier tax period than the right to deduct.

In its judgment in the case C-895/19 of 18/03/2021, the CJEU held that such a division of the tax liability and the right to deduct the tax solely due to formal requirements (e.g. failure to have an invoice from the supplier), while complying with the substantive conditions and taking into account the good faith of the taxable person, violates the principle of VAT neutrality, because it temporarily burdens the taxable person with the VAT, even though no VAT is paid between the acquirer and the supplier on an intra-community acquisition of goods and no VAT is payable to the tax authority.

The Slovak VAT Act, too, contains provisions that divide the tax liability and the right to deduct input VAT on intra-community acquisitions of goods into different tax periods. They are most often applied when the liability arises before the supplier has received an invoice or when the tax liability arises on the basis of a late invoice issued by the supplier.

Currently, a commission has been formed within the Methodological-Legislative Commission on VAT, Excise and Customs, which opened a discussion with the Slovak Finance Ministry in December 2022 with the aim of eliminating the provisions of the VAT Act that divide the tax liability and the right to deduct the input VAT on intra-community acquisitions of goods into different tax periods.

## TOP 9: EU PRESENTS A REVOLUTIONARY VAT REFORM

The European Commission has published a package of reforms under the title "VAT in the Digital Age" ("ViDA") aimed at preventing VAT fraud. In brief, it consists of 3 parts:

- ⇒ e-invoicing and real-time digital reporting
- ⇒ platform economy
- ⇒ single VAT registration

According to estimates, EU Member States could collect up to €18 billion more in VAT annually once the proposed reforms are implemented.

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The European Commission said the new rules would require companies operating in multiple Member States to comply with real-time digital reporting standards. This will help eliminate fraud in cross-border transactions, often referred to as carousel fraud. The principle of the fraud is that companies import goods from another Member State without VAT, sell them with VAT added and keep the difference.

The Commission expects that these changes could generate up to €110 billion over ten years that would otherwise go to fraudsters. A further €6.5 billion a year would be raised by requiring short-term accommodation and travel platforms such as Airbnb and Uber to collect and remit VAT on the full price of all bookings.

It is assumed that the proposals, which must be agreed by all Member States, will be adopted. Implementation is expected to take place over the coming decade. Within the EU, VAT brings in the most revenue of all tax types. According to Commission figures, a total of €1 trillion was collected in VAT in 2020. However, the Commission has also quantified the VAT gap at €93 billion in the same year, at least a quarter of which is related to fraud involving cross-border transactions within the EU.

According to tax experts, the forthcoming reforms are the most significant modernisation of VAT in Europe since the creation of the single market in 1993. The Commission calculates that the measures would cut costs for businesses by more than €4 billion a year over the next ten years. On the other hand, the measures will require an initial investment of €11 billion for accounting and IT modernisation and further €2.2 billion investments for tax administrations.

## TOP 10: MUTUAL AGREEMENT PROCEDURE STATISTICS FOR 2021

Under BEPS Action 14 (Making Dispute Resolution Mechanisms More Effective), participating countries have committed to implement a minimum standard to ensure timely, effective and efficient resolution of disputes related to double taxation treaties. All members of the OECD/G20 Inclusive Framework on BEPS have committed to the implementation of the Action 14 minimum standard, which includes timely and complete reporting of mutual agreement procedure (MAP) statistics. The OECD has recently published statistics for 2021.

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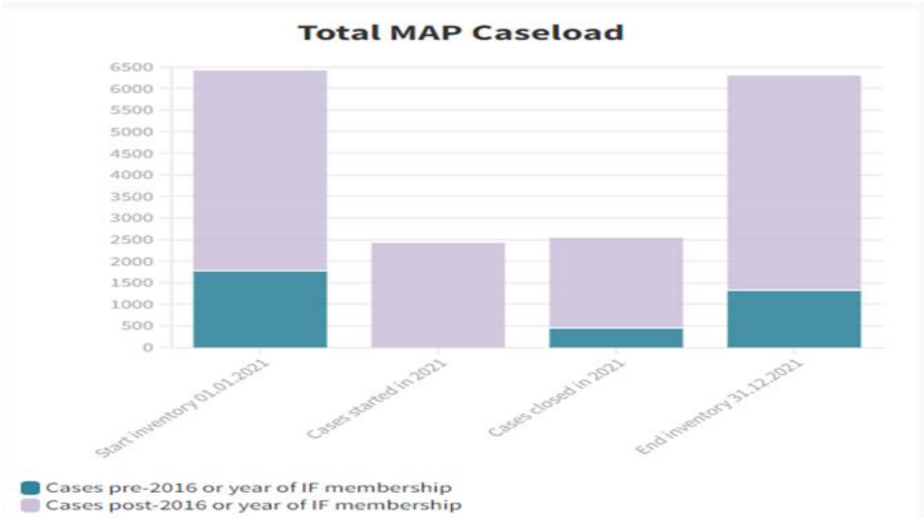
**2021 MAP Statistics at a Glance**

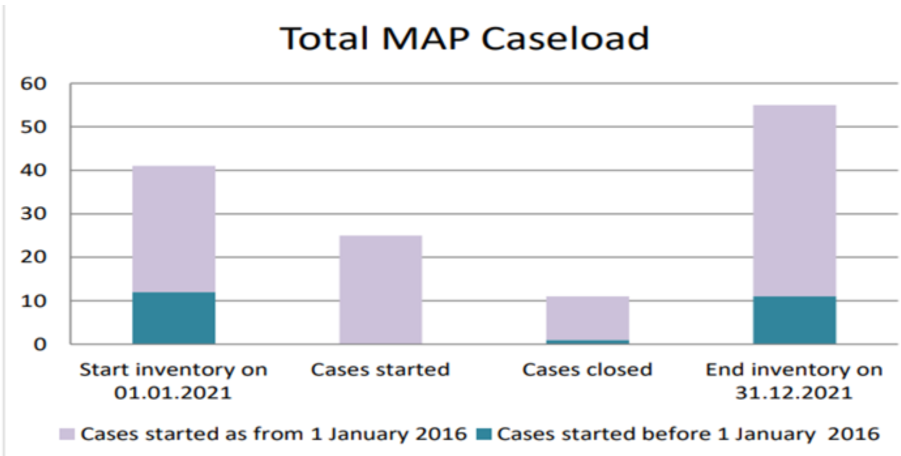



Source: OECD

In 2021, 2,423 new MAP cases were opened, of which 1,051 were transfer pricing cases. 2,543 cases were closed, of which 1,179 were transfer pricing cases. At the end of 2021, 6,301 MAP cases remain pending globally, of which 3,340 are transfer pricing cases. The average length of MAP transfer pricing proceeding is 32.3 months, compared to 20.7 months for other proceedings.

OECD statistics also include statistics for the Slovak Republic.

**MAP Statistics – Slovak Republic**




Source: OECD

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In the Slovak Republic, 25 new MAP cases were opened in 2021, of which 21 were transfer pricing cases. 11 cases were closed, of which 6 were transfer pricing cases. At the end of 2021, 55 proceedings remained pending, of which 34 were transfer pricing proceedings.

## USEFUL LINKS

Slovak windfall tax (EN)
State budget data (SK)
Preliminary Slovak Financial Administration Statistics for 2022 (SK)
Minimum health insurance contributions (SK)
CJEU judgment of November 2022 (EN)
Consumption Tax Trends 2022 (EN)
CJEU judgement of March 2021 (EN)
VAT in the digital age (EN)
2021 MAP Statistics – worldwide (EN)
2021 MAP Statistics – Slovak Republic (EN)

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