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TAX AUDIT ADVISORY

BMB Newsfilter

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Our Christmas issue of BMB Newsfilter provides you with information on the latest changes to Slovak tax law, in particular on the adopted amendments to the Income Tax Act (ITA, TOP 1 + TOP 5) and to the Value Added Tax Act (TOP 2, VAT Act), as well as on the legislative changes being currently prepared by the Slovak Finance Ministry (Amendment to the Tax Administration Code, TOP 8). Further, we bring information on the new COVID Aid Measures PLUS (TOP 3), changes to the Labour Code (TOP 6), impact of the COVID-19 crisis on transfer prices (TOP 4) as well as on the new "Kurzarbeit" concept to be introduced in the future (TOP 7).

This year's Taxparency® report contains again interesting financial data on the biggest taxpayers in Slovakia (TOP 9). The survey among TOP 50 taxpayers reveals information on the estimated impacts of the COVID-19 crisis on economic situation of companies (TOP 10).

In the previous months, we could have witnessed the first transparent selection process for the post of the President of the Financial Administration. 12 candidates took part. Our partner Renáta Bláhová was shortlisted among the final three candidates.

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TOP 1: APPROVED CHANGES TO THE ITA

In December 2020, the Parliament adopted the Amendment to the ITA, which introduces numerous changes. We have informed you about the planned changes in BMB Newsfilter 3Q in detail. Some changes were approved in the planned wording, some were revised during the legislative process. As there were a number of revisions to the **CFC rules** for individuals, we deal with this topic separately (TOP 5). An overview of other important approved changes to the ITA can be found below:

- **Exemption of COVID contributions and concurrence of super-deduction und contributions under 3B scheme**

The exemption refers to individuals as well as legal entities. In this relation it is necessary to exclude from tax-deductible expenses the expenses incurred for income not included into the tax base. The exemption can be first applied for the year ending 31/12/2020.

It is also eligible to include into the super-deduction of R&D costs the salaries which were supported in form of lump-sum COVID contributions under the Measure 3B. The provision enters into force from 01/01/2021 and will be first applied when filing tax returns after 31/12/2020.

- **Change in the definition of a micro-taxpayer from 01/01/2021**

Individuals – entrepreneurs – and legal entities with income up to EUR 100,000 will be able to apply the reduced tax rate of 15% for 2020. From 2021, the reduced rate will be applicable only to micro-taxpayers, while the definition of a micro-taxpayer was revised to include taxpayers with taxable income up to EUR 49,790.

- **Regulation of hybrid and transparent entities from 01/01/2022**

This measure is related to the implementation of ATAD 2, based on which the term "*reverse hybrid entity*" has been defined by the ITA. The income of non-resident majority partners (at least 50% in registered capital, voting or profit) will be taxed at the level of this transparent entity applying the corporate income tax rate of 21%, if it cannot be taxed at the level of a permanent establishment in Slovakia or if it is not taxed at the level of this non-resident partner in its residency state. A new reporting obligation of foreign partners has been introduced, too. To be able to apply correct tax treatment, the foreign partner is obliged to declare how it treats the Slovak transparent entity from tax point of view.

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- **Specification of the definition of place of effective management from 01/01/2021**

According to the new wording, the place of effective management of a legal entity with its registered office in Slovakia (according to the Slovak Commercial Register) is considered the place where key management and business decisions for the legal entity as a whole are structured or taken.

- **Changes to tax-exempt income and tax-free allowances from 01/01/2021**

The exemption of the 13th and 14th salary up to EUR 500 has been abolished (last application in 2020). The exemption of recreation and sports vouchers remained unchanged. The tax-free allowance for spa visits has been abolished, too (last application in 2020).

- **Taxation of non-resident sportsmen and artists from 01/01/2021**

The new provision is applicable in cases when the income of non-resident artists and sportsmen for their activities in Slovakia is paid out through an agent. If the actual amount of income of the artist is not documented in the payment to the agent, the whole amount of the payment is considered the income of this person.

- **Changes to tax bonus from 01/01/2021 and 01/01/2022**

Children up to 6 years of age are still entitled to the double amount of the tax bonus. Children between 6 – 15 are entitled to 1.7-times the basic tax bonus from 01/07/2021 and to 1.8-times the basic tax bonus from 01/01/2022. Children between 15 – 25 (full-time) are entitled to the basic tax bonus.

- **Sending information on due tax advances from 01/01/2022**

The tax administrator will notify taxpayers – both individuals and legal entities – on the amount of the due tax advance payment no later than 5 days prior to its maturity date.

TOP 2: APPROVED CHANGES TO THE VAT ACT

The Amendment to the VAT Act focuses on two key topics: **adjustment of the tax base from uncollectible receivables** from 01/01/2021 and **new regulation of distance selling of goods and services** from 01/07/2021.

One of the basic principles of VAT is that the taxable amount is the consideration actually received. The valid Slovak rules on the adjustment of the tax base did not include a solution for uncollectible receivables. However, according to the ECJ case law, such rules are not compatible with EU law.

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The question is not whether adjustment may be made and VAT refunded if no payment is received, but when the non-payment is final. The new Slovak law copies the Czech model.

The law defines an uncollectible receivable as well as deadlines in various circumstances and procedures, e.g. bankruptcy, enforcement proceedings, debt relief, death of the debtor or winding-up of a company without a legal successor. A solution for unregistered receivables was introduced, too. The supplier may adjust the tax base no sooner than in the tax period in which the receivable became uncollectible, however, no later than 3 years since the supply. The 3-year period is interrupted during the proceedings (court, arbitration, enforcement).

A limitation for related parties has been introduced, too. A threshold of 10% share is applicable, personnel connection as well as possible knowledge of non-payment for the supply.

A document on the adjustment of the tax base is to be issued and sent to the customer. Reporting duties apply, too.

Entrepreneurs as well as professional public welcome this regulation and discussions run whether it is possible, once the law comes into effect, to adjust the tax base also with respect to supplies conducted in the past. As there are no transitory provisions, this is a question for a tax advisor.

Another big change is the **regulation of "distance selling of goods and services"**, which replaces the current rules of mail order sale. It concerns supplies for non-taxable persons – final consumers - and ensures taxation at the place of final consumption. This affects the goods sent from another member state or from a third country and online provision of services to the final consumer. The regulation will affect not only e-shops, but also online platforms, electronic market places and portals, defined as "persons simplifying the supply", if goods are supplied within the EU, if the supplier is from a third country or if goods up to 150 EUR are imported in consignments.

The law introduces "special regimes" and the entities will be able to meet duties through a single contact point (one stop shop). They will file VAT returns for all EU supplies in the country where they apply for the special regime. VAT will be distributed to the country of final consumption by the states. The country of this special registration of EU entities will be the residence country of the entity. Non-EU entities will follow special rules for registration. This will be a new type of registration (VAT ID will start with "EU") and will exist besides eventual standard VAT registration.

If the entity does not apply for the special regime, it will be obliged to register for VAT in Slovakia and charge the Slovak VAT on distance selling of goods and services to Slovak customers once it exceeds the threshold of EUR 10 thousand. The threshold is checked for the current as well as previous year.

Entities that wish to apply the special regime through a registration in Slovakia from 01/07/2021 have to apply in advance – in the period 01/04/2021 – 10/06/2021, i.e. before the law comes into effect.

TOP 3: APPROVED CHANGES TO THE COVID AID MEASURES PLUS AND TO OTHER CONTRIBUTIONS

A) Approved FIRST AID PLUS since October 2020:

In October 2020, the government approved an instant increase in the financial contributions to be granted by the Ministry of Labour.

Comparison of contributions during the 1st and 2nd pandemic wave:

Measure	Contributions March – September 2020	Contributions since October 20020
Measure 1	max. 1.100 € (80 % of gross salary)	max. 1.100 € (80 % of labour costs)
Measure 3A	max. 880 € (80 % of gross salary)	max. 1.100 € (80 % of labour costs)
Measure 3B	Decrease in revenues	Decrease in revenues
	from 20 % - 180 €	from 20 % - 270 €
	from 40 % - 300 €	from 40 % - 450 €
	from 60 % - 420 €	from 60 % - 630 €
	80 % and more – 540 €	80 % and more – 810 €

With regard to Measures 1 and 3A, the contributions equalling salary compensation paid to the employee for obstacles on the part of the employer were increased to 80 % of the labour costs compared to the original 80 % of the employee gross salary. Accordingly, the state will finance also part of social/health insurance contributions of the employer.

With regard to Measure 3A, the maximum possible contribution increased from 880 EUR to 1.100 EUR per employee and month.

As regards the most widely used Measure 3B, the maximum contribution was increased to 80 % of the labour costs of the employee.

Contributions may be granted also to employers and self-employed that were established after 01/02/2020, however, no later than 02/09/2020. Further, contributions may be granted also for employees who started employment after 01/03/2020, however, no later than 02/09/2020.

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At the same time, the condition regarding the period for which the job has to be preserved was loosened from two to one month following the month for which the employer claims the contribution. This is applicable only during the emergency state in the country.

Since October 2020, applications/statements have to be filed by employers electronically through the slovensko.sk. electronic portal. It is not necessary to sign the documents by an electronic signature.

B) Possibility of higher contributions for self-employed with voluntary social insurance

Until 30/11/2020, only those self-employed with voluntary social insurance could receive contributions under Measure 2 who were registered for voluntary social insurance as at 01/07/2020 and their voluntary insurance lasted also after this date.

Since 01/12/2020, contributions under the Measure 2 for December 2020 and the following months may be received by self-employed with voluntary social insurance who are registered for the voluntary social insurance at least for half the calendar month for which they wish to receive the contribution.

By paying the voluntary social insurance, self-employed are able to receive increased contributions (from 315 EUR to 810 EUR), depending on the decrease of their income.

C) Rent subsidies also during the second pandemic wave

The government approved rent subsidies also during the second pandemic wave in shortened legislative procedure. The law was adopted on 01/12/2020.

The rules are the same as in the first wave. The state will provide a rent subsidy in the amount of the price reduction provided by the lessor, however, max. up to 50 % of rent. The subsidy may be granted to all persons whose rental contracts started before 01/08/2020.

Lessees must start repaying the debt amount starting with the month following the end of pandemic. However, no later than in April 2021. This deadline is binding irrespective of whether the pandemic is over or not.

Details will be published on the website https://najmy.mhsr.sk/.

D) Financial contributions for the tourism industry

Businesses in the tourism industry will be eligible for financial contributions if their sales revenues fall by over 40 % compared to the previous period.

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The amount of the contribution is calculated as 4 % – 10 % of sales revenues for each month in which the businesses reported a drop of sales revenues of over 40 %.

The amount of the contribution is calculated as follows:

The taxpayer calculates the decrease in the net turnover for the eligible period compared to the reference month. Subsequently, the decrease in the net turnover is multiplied by the net turnover in the reference month and by the eligible ratio of fixed costs for a particular business type.
The eligible ratio of fixed costs on the amount of the total net turnover:

Travel agencies 6%
Travel services agencies 3.6%
Other activities 10%

Entities in the tourism industry may apply for the financial contribution also subsequently for the first pandemic wave from 01/04/2020 until 30/12/2021.

The Ministry of Transport published all details regarding the state aid on its website:

https://www.mindop.sk/cestovnyruch.

Besides the above measures, the government approved this month another payment deferral for social insurance contributions for employers and entrepreneurs until 30/06/2021 (originally 31/12/2020).

TOP 4: TRANSFER PRICES DURING THE PANDEMIC

During the pandemic, the long-term settings of transfer prices of particular companies but also of the whole industry sectors may become inappropriate. On 18/12/2020, supporting guidance was published also by the OECD. A few practical recommendations can be found below.

Whether the problems concern the whole industry sector (e.g. tourism) or a particular company (loss of a big customer), the key recommendation is updating the comparability analysis as well as reviewing the profile of functions and risks in the specific circumstances. For both fields we state several tips and helpful questions. When taking a final decision on the adjustment of a transfer price we recommend a more detailed expert analysis.

A) Comparability analysis including benchmark

- Perform a review of the preliminary result of the company for 2020.
- Estimate development for 2021 based on the data for Q3 and Q4 2020.

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- Implement a simulation of impact in a particular industry.
- Consider a revision of the statistical method and of the selection of comparable entities.
- Evaluate contributions to preserve jobs and profitability of the company.
- Analyse the impacts of increased financing on the total profitability of the company.
- Consider the use of the total range, not just the interquartile range.

B) Function and risk profile

- How are routine companies with a low profile of functions and risks to be treated?
- Are one-time losses acceptable?
- Does the allocation of pandemic-related costs to subsidiaries meet the benefit test?
- Should royalties be reduced / eliminated during the downturn?
- What is the impact of the change of the business model or of distribution structures?
- Is the adjustment of contractual relationships within the group necessary?

Disregarding whether you decide to prepare a new analysis or not, we recommend documenting the impact of Covid-19, either separately or when updating the transfer pricing documentation.

We strongly recommend a separate analysis if you plan to conclude a pricing agreement (APA, MAP etc.) with the tax administrator or if you already have one.

Last but not least we would like to point out that several court decisions in favour of taxpayers in relation to the application of the OECD transfer pricing guidelines were taken last year, including the dismissal of a formalistic approach of the tax office when auditing transfer prices. We will inform you on these judgements in our next issue of BMB Newsfilter in more detail.

TOP 5: FINAL WORDING OF CFC RULES AFTER CHANGES IN PARLIAMENT

The Parliament has succeeded to close the 2017 loophole in the Income Tax Act and to adopt rules for the taxation of controlled foreign companies (CFC) also in relation to individuals. Compared to the original proposal, there were several compromises and **the entry into force was postponed until 01/01/2022.**
Accordingly, the rules will be first applied when filing the tax returns in 2023 for the previous year. However, the principles remain unchanged.

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Compared to CFC rules for legal entities, CFC rules for individuals are stricter. They apply the "entity approach" unlike the transaction-based approach applicable to Slovak legal entities. Below you will find a 5-step-test to find out whether CFC rules are applicable to an individual residing in Slovakia. Unlike the original proposal submitted in the Summer, the list of countries where also actual business activities may be subject to tax was narrowed from "third countries" to "non-cooperating countries". According to our current legislation, these countries are "negatively enumerated" in the White list updated by the Finance Ministry annually as at 1 January. Starting next year, the list should include also the countries applying a zero tax rate (e.g. Jersey, UAE) or the countries where no income tax is applicable (e.g. Bahamas).

CFC taxation test in a simplified form:

1. **Tax residence** – only if the individual is a tax resident of Slovakia (hereafter SK individual)

2. **Definition of a CFC**

   i. Only if SK individual has **> 10%** share in CFC (direct or indirect, in share capital, voting rights or profit)
   ii. Only if effective taxation **< 10%** (tax actually due /profit of CFC)

3. **Exceptions**

   i. Income from all CFC **≤ 100 TEUR**
   ii. CFC **actually performs economic activity** except for countries outside the White List
   iii. Income of this CFC was included into the tax base of the legal entity under section 17h ITA

4. Inclusion into **the tax base and tax rate**

   i. The accounting profit of CFC is included in the tax base without further adjustments under Slovak ITA
   ii. **Tax rate 25% or 35%** for countries outside the White List

5. **Tax credit, deduction or refund**

   i. The tax verifiably paid by CFC is credited
   ii. Deduction of tax upon actual distribution of dividends (tax rate 7%, overpayment is refunded)
   iii. Deduction of tax upon sale of financial investment to CFC

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TOP 6: PLANNED CHANGES TO THE LABOUR CODE AT A GLANCE

The amendment to the Labour Code should introduce several changes as from **01/03/2021**:

- Regulation of home office work and telework is a response to new situations in relation to the COVID-19 pandemic. A written agreement between the employee and the employer is necessary, while the employee will perform work from an agreed place (place of residence or another place) other than the office of the employer. The amendment provides the option to agree upon the reimbursement of increased costs of the employee (internet etc.).
- No operational reasons will be necessary for temporary assignment of employees between related parties. A pre-condition is free assignment, meaning that only the expenses (salaries and thereto related costs) without a profit margin will be allocated.
- Meal contribution: Where the employer does not provide meals in its own premises, it can provide either meal vouchers or a meal contribution in the same amount in which it contributes other employees to meal vouchers, min. 55% of the meal voucher value.
- Permanent childcare – definition of the term includes both parents, also alternating childcare and also persons to whom custody of the child was granted by the court.

TOP 7: NEW KURZARBEIT CONCEPT NEXT YEAR

The COVID-19 pandemic and the thereto related economic downturn have brough a number of new staff-related topics. The countries take numerous measures to keep the job, such as the broadly discussed short-time work concept, which has a green light at the EU level, as several countries have already positive experience in this field. The draft concept should be discussed by the government by the end of this year and should be submitted to the Parliament at the beginning of 2021. It is planned that the new law comes into effect from 01/01/2022. The concept should be financed through a separate insurance fund in the Social Insurance Agency without the need to increase the insurance contributions.

Criteria for payments from the short-time work scheme – simplified overview:

- Limitation of operations
- Exhaustion of own possibilities of the employer (consumed vacation and overtime)
- Keeping the jobs
- Paid insurance contributions
- Approved application

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TOP 8: CHANGES TO THE TAX ADMINISTRATION CODE

Within the December Amendment to the ITA, a provision of the Tax Code was changed regarding the interest rate applicable to the approved tax payment deferral and to payment of tax in instalments. This interest rate decreases from 10 % to 3 % p.a. The new rate is applicable to decisions issued after 31/12/2020.

Currently, the Finance Ministry is working also on an Amendment to the Tax Code (Act No. 563/2009 Coll.). According to the information available, significant changes to the tax reliability index are expected. With the aim to increase transparency, the criteria for attribution of taxpayers to the particular groups (reliable/less reliable/unreliable), which are currently unknown to taxpayers, should be made public. The list of benefits provided to reliable taxpayers should be extended. In contrast, unreliable taxpayers will not have access to the benefits and will be listed in the register of disqualifications.

Further important proposed changes include the introduction of simultaneous and joint tax audits, introduction of the register of disqualifications and extension of the deadline for comments and submission of documents to the tax audit protocol from 15 to 30 days.

TOP 9: TAXPARENCY® TOP 50 TAXPAYERS IN SLOVAKIA

Also in 2020, our advisory company prepared the Taxparency® report, the aim of which is to inform on which companies pay the most taxes to the Slovak state budget. For 2019, TOP 200 non-financial companies paid EUR 991,429 thousand in corporate income tax (compared to 2018: +10.21%) and EUR 758,046 thousand in payroll tax (compared to 2018: +7.47%). The share of direct taxes of TOP 200 non-financial companies in the total tax revenue from direct taxes amounted to 58% for 2019.

Also this year, the award Taxpayer of the year went to Volkswagen Slovakia, a.s., which paid EUR 272.02 million in direct taxes and social/health insurance contributions for 2019. The second place was taken by Eustream, a.s. (EUR 183.82 million), followed by U. S. Steel Košice, s.r.o. (EUR 133.19 million).

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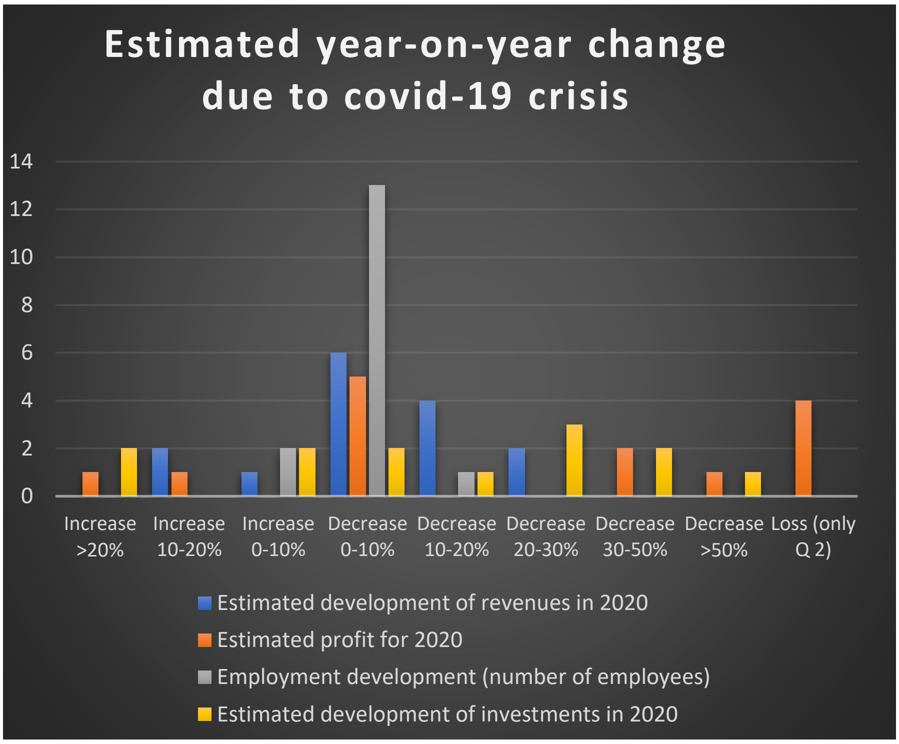
TOP 10: TAXPARENCY® SURVEY AMONG TOP 50 TAXPAYERS

In September 2020, TOP 50 taxpayers from the Taxparency® list received a survey with 4 questions about the estimated impact of the COVID-19 crisis on the economic situation of their company. Out of 50 companies, 30% have replied. The results for all questions are summarized in the graph below.



Based on the answers received it can be concluded that in 2020, compared to the previous year, most respondents expect a decrease in revenues of up to 10%, a decrease in profit of up to 10%, a decrease in the number of employees of up to 10% and a decrease in investments of 20 – 30%. Almost 30% of respondents expect losses for 2020.

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USEFUL LINKS

Žežulka, Bláhová and Pavlovič shortlisted as top candidates for the boss of financial administration

Collection of taxes in Slovakia to be managed by a Czech

Taxparency® report

Biggest taxpayers in Slovakia

OECD Guidance on the transfer pricing implications of the pandemic

Individuals with shell companies in tax havens received the stop sign

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