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BMB Newsfilter

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After more than 3 turbulent years, Slovak citizens voted in very important parliamentary elections on the last September Saturday. The results from a business and tax perspective of most industries in the country are not so bad as it may seem. Most importantly, there is no risk that the state administration and the whole economy will be frozen due to the so called public debt break and no far right party was elected to the parliament. The winner is the party SMER again, however, with only 25% of seats in the parliament and strong liberal opposition. The kingmaker of this election is Mr Peter Pellegrini, whose centre-left party HLAS has promised "tough negotiations" on forming a new government. He has two alternatives: the coalition with the liberal Progressive Slovakia party (PS), and with the winning SMER of his former colleague Robert Fico. Therefore, no radical changes in Slovakia's foreign or business policy are expected. Financial markets have responded calmly so far.

Moreover, all 3 major parties in the 150 seat parliament (Smer 42, PS 32 and Hlas 27 mandates) declared stability as their main priority, including taxation of employment and business income. Fragmented and unpredictable voting from the past few years should be history. The only exceptions in the upcoming months may be windfall taxes in selected industries such as the banking sector, VAT or excise duties. In general, we also believe that the EU law including its directives will be followed. We therefore expect that the draft law on top-up tax in Slovakia as prepared by the Ministry of Finance in September will be approved by the Slovak parliament by the end of this year (TOP 1). Please note that our tax experts took part in important discussions with the Ministry of Finance and shared their knowledge in a few public events, such as the IFA SR Regional Congress in the first week of October.

Last but not least, we believe that the pro-business changes in taxation of cryptocurrencies or exemption of capital gains (TOP 2) approved in June as well as the proposed changes to the VAT Act (TOP 3) will hold.

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TOP 1: DRAFT LAW ON TOP-UP TAX (PILLAR TWO)

As we informed you in the previous BMB Newsfilter, new regulations regarding the minimum level of taxation of 15% will become applicable in Slovakia from 2024. In August, the first proposed version of the Act on top-up tax to ensure the minimum level of taxation was submitted for the inter-ministerial comment procedure. The wording of the law largely copies the directive. In order to be accepted as qualified by the European Commission, the domestic regulation of the top-up tax (officially "qualified domestic minimum top-up tax") needs to be thoroughly implemented.

As the nominal tax rate is 21%, no significant collection of the top-up tax is expected in Slovakia. An exception is the conflict between the new law and the tax relief granted in Slovakia. This includes e.g. tax relief for recipients of investment aid, super-deduction for research and development and deduction of investment expenses (so called Industry 4.0.). According to the Slovak Ministry of Finance, the tax will be assessed in these cases, if the overall effective tax rate falls below 15%. It will be necessary to prove whether the top-up tax applies or not, and the related documentation obligations and processes will apply to hundreds of Slovak subsidiaries of multinational enterprises with a turnover exceeding EUR 750 million.

Starting point for the top-up tax will be the financial statements of the entities or the consolidated financial statements of the parent company before eliminating intra-group transactions, while numerous accounting standards will be accepted (IFRS, local standards of EU countries and many others).

For the purposes of calculating the effective tax rate, the income tax and the special levy for regulated industries will be recognized. Not only the payable income tax, but also the deferred tax will be taken into account. Both will be subject to a number of adjustments. The amount subject to taxation (excess profit) will be based on the economic result after numerous adjustments.

The effective tax rate, the top-up tax rate and the excess profit subject to taxation will be calculated at country level, i.e. in total for entities located in Slovakia. However, the actual top-up tax return must be filed by each taxpayer on its own behalf.

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The Act also introduces an exemption called substance based income exclusion, which is deducted from the included income when determining the excess profit (the basis for taxation). However, this is not a sufficient compensation to solve the above relief problem.

TOP 2: JUNE AMENDMENT TO THE ITA + IMPACT OF THE COMPANY CONVERSIONS ACT ON TAXATION

Amendment to the Income Tax Act

The Act No.315/2023 Coll., approved without a proper legislative process but for the benefit of taxpayers at the last session of the Slovak Parliament on 28 June 2023, brought changes to the Income Tax Act which **come into effect from 1 January 2024**. The changes mostly concern the taxation of virtual currencies, participation in companies and income of individuals from capital gains.

New definitions of virtual currency, stablecoin and staking were introduced and the definition of the term sale of virtual currency as an exchange of virtual currency for stablecoin was changed. Another change is the exemption of income of an individual from the exchange of virtual currency for property or for provision of a service, if the total of such income less expenses does not exceed EUR 2,400 in the tax period. Income from the sale of virtual currency after the lapse of one year from its acquisition will be included in the special tax base by the individual, which will be subject to a tax rate of 7%.

In the case of capital gains of individuals, such as interest and other income from loans and interest on the value of a paid-up deposit in an agreed amount of partners of general partnerships, the possibility was introduced to claim, in addition to the mandatory health and social security contributions paid on this income, the expenditure verifiably incurred for the acquisition of the financial assets used for the purpose of obtaining this income. From 1 January 2024, capital gains are the income arising on the maturity of a security from the difference between the nominal value of the security and the acquisition price of the security.

Further, a tax exemption for income from the payout of share certificates was introduced for individuals, after the lapse of three years from the date of issue of the share certificates. Income from the payout of share certificates which were part of the taxpayer's business assets is not exempt from tax.

Income of individuals from the sale of securities admitted to trading on a regulated market or on a similar foreign regulated market is exempt from tax, after the lapse of one year from the date of acquisition.

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Income of individuals from the sale of securities not admitted to trading on a regulated market or on a similar foreign regulated market shall be tax exempt after a period of three years from the acquisition of such securities. Income from the sale of securities which were part of the taxpayer's business assets is not exempt from tax.

In the area of corporate income tax, special-purpose establishments of churches and religious societies, organisations with an international element, the Slovak Red Cross and research and development entities have been added to the taxpayers who are not established or set up for business purposes.

FS Drive

In September 2023, the tax administration introduced a new feature called FS Drive. This new innovative tool is designed to enable taxpayers to send large files securely and easily, particularly in the case of a tax audit. The new service also allows the tax administration to send files to, or request files from, external entities by creating a temporary account with access valid for 30 days. However, the FS Drive application in no way replaces the mandatory electronic communication with the tax administration, which is also the case of two-way electronic communication, i.e. from the tax administration to the tax subjects. The FS Drive service can only be used in the case of capacity constraints for the submission of large attachments to a filing sent in the statutory way. In such a case, it should be stated in the filing that the attachments were submitted using the FS Drive service.

Impact of the Company Conversions Act on taxation

The new Company Conversions Act (Act No. 309/2023 Coll.) has transposed into Slovak law the EU Directive No. 2019/2121 of 27 November 2019 amending Directive No. 2017/1132 as regards cross-border conversions, mergers and **divisions of companies**. In the Slovak Republic, business conversions have been so far regulated by the Commercial Code. The main objective of this separate act was to create a uniform, coherent and transparent regulation of cross-border business combinations and conversions of companies.

With effect **from 1 March 2024**, the provisions on mergers, divisions and conversions will be deleted from the Commercial Code and the above will be governed exclusively by the new law. The new legal regulations shall apply to business combinations where the **agreement on merger or division is approved by the general assembly on or after 1 March 2024**.

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The Act introduces new terms in the context of business combinations: division of companies in the form of **split-up** and **spin-off**. A split-up means that the company being split up ceases to exist and its business assets are transferred to legal successors. A spin-off, on the contrary, means that the company being divided does not cease to exist and part of its assets is transferred to a legal successor. Further, the new law also defines a cross-border conversion, i.e. the company converts its legal form under which it is registered in the register of the departure state into a legal form of the destination member state and at the same time transfers its registered office.

As the terms split-up and spin-off have previously not been used in the Slovak Income Tax Act and Accounting Act, these acts had to be amended, too. **However, the basic principle of the above mentioned changes is that the tax treatment of both split-up and spin-off will be governed by the same rules as mergers, i.e. for example, the same rules will be applied in the option to use historical costs or fair values in the valuation of assets and liabilities of the dissolving company, or in the case of a spin-off, in the valuation of the spun-off part of the company**.

The new act also amends the Accounting Act and changes certain terminology of established terms, e.g. introduces the terms conversion, cross-border conversion etc. At the same time, the separate application of the decisive date remains unchanged.

TOP 3: DRAFT AMENDMENT TO THE VAT ACT

Currently, the comments received during the inter-ministerial comment procedure for the draft amendment to the VAT Act are being evaluated. The amendment introduces many significant changes, of which the most important are described below:

1. Changes in registration duties

Within the transposition of the EU Council Directive 2020/285, which provides for special treatment for small businesses, changes are proposed to the rules for VAT registration of domestic taxable persons liable to register for VAT. In this context, it is being specified when a domestic person becomes liable to register for VAT. Under the new rules, a person is liable to register for VAT when supplying goods or services, while the directive allows for the introduction of a transitional mechanism, i.e. the person is not liable to register for VAT in the year of exceeding the turnover, but as from 1 January of the following calendar year. However, if the person exceeds the turnover by significantly more than 25%, it would be liable to register for VAT as at the date of delivery of the goods which caused the above mentioned excess of turnover. The increase in turnover for compulsory registration is still being evaluated in the light of experience in other Member States. The determination of the starting date of the registration changes, too. Previously, the taxable person was registered for VAT as of the day specified in the decision.

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This amendment intends to introduce declaratory effects of the decision for VAT registration, i.e. through the supply of goods or services when the turnover exceeds a certain threshold. It will not be possible to appeal against the decision. The person liable to register for VAT is obliged to file an application for VAT registration with the tax administrator, stating the date as of which it became liable to register for VAT, **within 5 days** of the latter date.

The effects of voluntary VAT registration remain unchanged.

The declaratory effects of the decision will also apply to VAT registration of foreign persons.

2. Tax liability and input VAT deduction for intra-community supplies in the same period

In accordance with Article 181 of the VAT Directive, it is proposed that a taxable person who has acquired goods in inland from another Member State **should be able to exercise its right of input VAT deduction in the tax period in which this acquisition gives rise to a tax liability**, even if the taxable person does not have an invoice for the supply of those goods from a supplier from another Member State by the time it submits the relevant VAT return. In this case, the taxable person will be able to prove the legitimacy of the claimed right to deduct tax with **other relevant documents** from the commercial correspondence with the supplier, which must prove the actual acquisition of the goods as well as the amount of the tax liability incurred. Further, it is proposed that in this case the taxable person should enter the data from this other document in the recapitulation statement.

3. Change in VAT deduction for the period before VAT registration

The key change compared to the current rules is that **this input VAT will be deductible only in the tax return filed for the first tax period.**

4. Changes to late VAT registration

A new wording of Section 78(9) is proposed, which provides that a domestic taxable person or a foreign taxable person who has not fulfilled its VAT registration obligation or has fulfilled this obligation with a substantial delay, will be obliged to file a VAT return for each tax period in chronological order, starting with the first tax period for which it has not filed a VAT return within the standard filing deadline due to the failure to fulfil this obligation. At the same time, Section 78a(14) proposes that the taxable person should also file, late and in chronological order, starting with the first tax period, any recapitulation statements which it has not filed as a result of the delay.

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Compared to the current situation, a taxable person who has not fulfilled its VAT registration obligation will also be sanctioned for late filing of the VAT return and recapitulation statement for each tax period (or calendar month) for which it was obliged to submit them.

5. Reverse charge on import of goods

This simplification will be available to VAT registered persons if they are established in inland and have been granted the **status of an approved economic entity** at the time the tax liability arises and intend to use the imported goods for the performance of their economic activity. A VAT registered person who meets the above conditions for reverse charge will be obliged to calculate the VAT on import of goods by itself and enter it in the VAT return for the tax period in which the tax liability arises. **The advantage of this proposed arrangement for the VAT registered person is that it will have the right to claim the input VAT deduction in the same tax period**, provided that the conditions under Sections 49 and 51 of the VAT Act are met. This system will give businesses a cash flow advantage and influence their decision on which Member State to choose as the country of import of goods into the EU.

TOP 4: TAX DIRECTORATE GUIDANCE ON BENEFICIAL OWNER

This summer, the tax administration published Information on how and when to prove the beneficial owner of income. The guidance was prepared in cooperation with the Ministry of Finance of the Slovak Republic and the Slovak Chamber of Tax Advisors. The guidance is only of a recommendatory nature and includes 3 annexes (statement, questionnaire and a list of additional evidence) serving as a model for the recommended proof of the beneficial owner of income.

The concept of the beneficial owner of income was incorporated into the Slovak Income Tax Act (hereinafter "ITA") from the OECD with effect from 01/01/2018, but in a somewhat "unfortunate" way. While the OECD states that the beneficial owner only needs to be examined and proved for passive cross-border income – such as dividends, interest and royalties, the Slovak ITA requires proof of the beneficial owner for a wide range of Slovak-sourced active and passive income of non-residents.

The main objective of the introduction of the concept of the beneficial owner of income was to avoid and prevent cross-border practices, in particular tax avoidance, undue application of tax advantages and increased tax security in relation to taxpayers from non-cooperating jurisdictions. However, it is not necessary to prove the beneficial owner of income if a double tax treaty is applied to the income. If the applicable treaty does not require the proof of a beneficial owner of the income in question, the beneficial owner does not need to be proved.

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Closer attention is to be paid particularly in the case of passive cross-border income, income paid to non-contracting states and income where the treaties specifies who the beneficial owner of the income is.

As it has not been, until now, prescribed how the beneficial owner of income should be proved, a lot of questions have been raised by taxpayers.

According to the guidance, the key factor in proving the beneficial owner of income is the risk level of the transaction, which is left to the taxpayer to determine. The Tax Directorate recommends analysing the risk level by looking at possible risk indicators, such as the absence of actual economic activity of the income recipient, dependence of the income payer and income recipient, dependence of income recipient on another person in decision-making and disposition of income, large amounts of passive income, unusual contracts relating to income, non-taxation of income in the recipient's state of residence, and many others. The risk level of individual cross-border cases then determines the manner, form, extent and even frequency of proof.

Failure to prove the identity of the beneficial owner of income results in an obligation to apply withholding tax or a tax security of 35%, without the possibility of any relief and exemptions. The income payer (i.e. Slovak entity) is as financially liable for the correct withholding and remittance of the tax as if it was its own tax.

TOP 5: PLANNED CHANGES TO THE ACCOUNTING ACT IN RELATION TO ESG REPORTING

Currently, there is an inter-ministerial comment procedure underway on the amendment to the Accounting Act No. 431/2002 Coll., which aims to transpose the Directive 2022/2464 of 14 December 2022 into Slovak law. The directive regulates the conditions for reporting sustainability information (commonly known as "ESG reporting").

The aim of the proposed changes is to improve the quality, comparability and reliability of the information on environmental, social and governance issues (**sustainability information**) to be reported in a **separate section of the annual report.** This is to help investors and other users of this information to better understand the risks and opportunities of the entity in its transition to a green economy.

Currently, the Accounting Act reflects the requirements of the Directive 2014/95/EU on the disclosure of non-financial information in the annual report, which, however, represent only a minimum level of harmonisation.

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In this context, it is proposed to introduce requirements for the presentation of information in line with the European Sustainability Reporting Standards (ESRS), thus ensuring a **uniform way of presenting this information**, which has not been regulated within the EU so far. At the same time, a **uniform electronic format** for the annual report will be introduced, thus facilitating the processing of information and allowing for comparisons.

The following table summarises the applicability of the amendment with the step-by-step introduction of the obligation for each group of entities:

Applicable from (in the annual report for this period)	Entities covered
2024	Public-interest entities (individual reporting) and parent companies that are public-interest entities (consolidated reporting)
2025	Large companies
2026	Small companies

Small entities will not be required to include sustainability information in the annual report for the financial year beginning ***before 1 January 2028,*** *if they provide a justification for not including that information in the relevant annual report.*

Sustainability information will be subject to external assurance **by an auditor within one year** after the lapse of the accounting period to which it relates. This will increase the reliability of the information reported. This assurance may be performed also by an auditor other than the one carrying out the statutory audit. However, also this auditor has to be approved by the **general meeting**.

The draft amendment also lists numerous exemption options. A subsidiary may benefit from an exemption from the obligation to individually report sustainability information if certain conditions are met, e.g. this exemption will be available to any subsidiary whose parent company is established in another EU Member State if that subsidiary is included in the consolidated annual report of its parent company. However, please note that the exemption does not completely remove all reporting obligations of the subsidiaries. For example, in order to qualify for the exemption, the subsidiary must include in its annual report specific details, e.g. a link to the website where the consolidated annual report of the parent company can be accessed and the assurance provided by the auditor.

If the parent company resides **outside the EU**, the subsidiary must deposit the consolidated sustainability report relating to its **foreign** ultimate parent company and the auditor's assurance with the Register of Financial Statements and with the Register of Deeds of the Commercial Register. In order to avoid duplicate filings, the filing with the Commercial Register will be met by filing the document with the Register of Financial Statements.

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TOP 6: TAXATION OF LABOUR VS. CAPITAL INCOME ACCORDING TO OECD

In August 2023, the OECD published a working paper comparing the taxation of labour and capital income. The comparison is made on the basis of effective tax rates (ETRs), distinguishing between two ETRs: an ETR that takes into account only taxation of individuals and an ETR that takes into account, in the case of capital income, both taxation at the level of individuals and at the level of the company paying out the capital income. The material compares taxation for different levels of income.

The aim of the study is to make a detailed comparison of the taxation of labour and capital income. The OECD concludes that **in most OECD countries, the taxation of labour is significantly higher than the taxation of capital income**. Very often progressive rates are used in labour taxation, and social security is also a factor that increases the burden on labour. In the case of capital income, there is predominantly one rate, and, in addition, various tax advantages are often applicable.

This working paper comes to the conclusion that, given the potential negative impacts of higher labour taxation (fairness and efficiency pressure), the OECD will continue working on this issue **to identify options for possible reforms.**

TOP 7: CZECH JUDGEMENT IN A TRANSFER PRICING CASE

In the Czech Republic, a judgment No. 31 Af 21/2022 - 99 was published, concerning transfer prices and the question whether the depreciation of the valuation difference should be included in the cost base for the calculation of the market price on the basis of TNMM (transactional net margin method), or whether such depreciation should be excluded from the base. The Regional Court agreed with the conclusion of the Czech Financial Directorate that the **cost of the valuation differences** should also be included in the cost base, and dismissed the action.

The plaintiff whose transfer pricing was examined had the profile of a contract manufacturer. The plaintiff has not included the valuation difference into the base for the profitability calculation based on the NCP (net cost plus) method, and therefore, in the recalculation performed by the tax authorities which included the valuation difference, the plaintiff was not within the profitability range determined on the basis of a comparable analysis, and was assessed tax. The tax was assessed **at the lower quartile of the interquartile range** (not the median or the minimum). The comparative analysis itself was not disputed.

During the proceedings, the plaintiff (the contract manufacturer) tried to point out that there was a settled decision-making practice of the tax authorities, which, through binding opinions, considered it to be correct to exclude valuation differences. Since the binding opinions were not issued directly to the plaintiff, the latter could not use them in the proceedings and they were therefore not available to the Regional Court (tax secrecy).

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This is another reason why we recommend our clients to request a binding opinion for their own unclear tax position in Slovakia if there is no publicly available interpretation of the tax administrator (e.g. methodological instruction, guidance) on the matter.

Note: The valuation difference resulted from the revaluation of the spun-off part of the business under the Company Conversions Act, which was valued at market value by an expert's opinion. Under Czech accounting rules, such a valuation difference is to be depreciated for the period of 15 years. According to the court's conclusion, the valuation difference related to the assets associated with the transaction of the contract manufacturer. The comparable analysis was prepared and submitted by the taxpayer.

TOP 8: CURRENT PILLAR ONE DEVELOPMENTS

In mid-July, the OECD published a Public consultation document seeking public comment on the technical aspects of Amount B under Pillar One, which is intended to help simplify transfer pricing for certain core marketing and distribution activities. Comments were due by 1 September 2023.

TOP 9: DRAFT DIRECTIVE ON FASTER AND SAFER RELIEF OF EXCESS WITHHOLDING TAXES

In June 20d23, the European Commission proposed a new directive (Council Directive on Faster and Safer Relief of Excess Withholding Taxes) with the aim to make withholding tax procedures in the EU more efficient and secure for investors, financial intermediaries and tax administrations. The directive applies to dividends on publicly traded securities and interest on publicly traded bonds paid to their registered holders. In August 2023, the draft directive was subject to an inter-ministerial comment procedure in Slovakia.

Currently, in case of cross-border investments, many Member States levy withholding taxes on dividends and on the interest paid to investors who reside abroad. However, investors also have to pay income tax on the same income in their country of residence. To avoid double taxation, many countries have signed double tax treaties.

The problem is that **refund procedures are often lengthy and costly**, discouraging cross-border investment within and into the EU. Currently, the withholding tax procedures applied in each Member State are very different. Investors have to deal with more than 450 different forms across the EU, most of which are only available in national languages. Moreover, past experience has shown that refund procedures can be also abused.

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The new directive proposed by the Commission will make life easier for investors, financial intermediaries and national tax authorities. A **common EU digital tax residence certificate** will be introduced to make withholding tax relief procedures faster and more efficient. One digital tax residence certificate will be sufficient to reclaim several refunds during the calendar year. The digital tax residence certificate should be issued within one working day. Further, **two fast-track procedures will be introduced: a "relief at source" procedure and a "quick refund" system**, which will make the relief process faster and more harmonised across the EU. Member States will be able to choose which one to use – including a combination of both. A **standardised reporting obligation** for certified financial intermediaries will provide national tax administrations with the necessary tools to check eligibility for the reduced rate and to detect potential abuse.

Once adopted by Member States, the directive should come into force on 1 January 2027.

TOP 10: NEW VERSION OF BEPS MLI MATCHING DATABASE

OECD has released a new and improved version of the database supporting the application of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (the "Matching Database"). The Matching Database allows tax authorities and other interested parties to see on how the Multilateral Instrument ("BEPS MLI") modifies a specific double tax treaty.

The Matching Database was first published in 2017 and is a key tool in the implementation and application of the BEPS MLI. The updated database includes significant improvements that will enhance user experience and provide additional features to support the implementation and application of the BEPS MLI. One of the key updates is the inclusion of historical data, which allows users to view the application of the BEPS MLI at specific points in time. The upgrade also offers a more intuitive interface that makes it easier for users to search for and access information.

The BEPS MLI entered into force on 1 July 2018. To date, 100 jurisdictions have joined the BEPS MLI, out of which 81 jurisdictions have ratified, accepted, or approved the **BEPS MLI**. This **covers around 1850 bilateral tax treaties**. Around 650 additional treaties will be modified once the BEPS MLI will have been ratified by all signatories. Further jurisdictions are also actively working towards signature.

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Information on how and when to prove the beneficial owner of income (SK)
Working paper OECD: Taxation of labour vs. capital income (EN)
Public consultation document: Pillar One – Amount B (EN)
Proposal for a Council Directive on Faster and Safer Relief of Excess Withholding Taxes (EN)
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