

In the autumn edition of our Newsflash we are summarizing selected changes that will be brought about by proposed amendments to the Income Tax Act.

A basic proposal of the amendment to the Income Tax Act was prepared by the government and another proposal was submitted to the parliament by a group of MPs. The amendments are intended to ensure the fulfilment of aims set out in the government manifesto for 2016 to 2020 in several areas:

## I. Improving business environment along with consolidation of public finances

### Decreasing the tax rate for income of legal persons

A proposal to decrease the tax rate for income of legal persons from the existing 22% to 21% is aimed to support the business environment. The new tax rate of 21% would apply in the case of filing a tax return for a tax period that begins on 1 January 2017 at the earliest. A taxpayer whose tax period is a financial year would apply this tax rate for the first time in a tax period that will begin in the course of the calendar year 2017.

### Introducing taxation of dividends and abolishing health insurance contributions from dividends

The proposed changes foresee the abolition of health insurance contributions from dividends along with the introduction of their taxation by a special tax rate of 7%. These new rules should apply to dividends paid out to individuals for a tax period that begins on 1 January 2017 at the earliest.

Pursuant to the proposed transitional provisions, dividends declared for tax periods that begin in a period from 1 January 2004 and until the time when the amendment becomes effective at the latest (the proposed date of effectiveness is 1 January 2017) would not be subject to tax even after 1 January 2017. It means that the rules effective until 31 December 2016 would apply to dividends declared for a business year that begins in the calendar year 2016 even after 1 January 2017, i.e. they would not be subject to tax.

As concerns legal persons, dividends would be taxed by a tax rate of 35% only in the case of income coming from a taxpayer from a non-contracting State or to a taxpayer from a non-contracting State.

Besides the dividends, the changes would also affect shares on business results to be paid out to dormant partners, shares on profits belonging to members of a land association with a legal personality, shares on a liquidation surplus as well as settlement shares.

According to the proposed transitional provisions, health insurance contributions would not be paid only from dividends paid out from profits achieved in an accounting period that begins in a period from 1 January 2017.

Outside the scope of the submitted proposals, the Ministry of Health of the Slovak Republic has declared intention to propose the abolition of a maximum assessment base for the calculation of health insurance contributions. This proposal may potentially affect dividends to be paid out in 2017 (from profits declared for an accounting period of the calendar year 2016 or previous years, as the case may be).

### Increasing the maximum limit for claiming lump sum expenses for individual entrepreneurs

The proposed amendment to the Income Tax Act is intended to increase the limit of lump sum expenses to 60% of income from business activities and other self-employed activities, up to the maximum amount of EUR 20 000. At the same time, besides lump sum expenses there should still be a possibility to claim in a demonstrable amount also paid statutory health insurance and social insurance contributions.

### Abolishing the tax licence

A group of MPs from parties forming the government coalition submitted to the parliament a separate proposal of the amendment of the Income Tax Act. The aim of this proposal was to add to the Income Tax Act provisions abolishing the minimum tax with the effect of 1 January 2018. However, the proposal was revoked by the respective MPs later on.

## II. Increasing legal certainty in the area of transfer pricing

### New definitions for the purpose of transfer pricing

The proposed new definitions and clarifications of the existing definitions of terms relating to the transfer pricing rules are intended to restrict the possibility of interpreting the Income Tax Act in a way that would enable the avoidance of these rules.



The term “**management**” (in Slovak: “*vedenie*”) should now include the management of any legal person and not only a company or cooperative.

It is also proposed to add a definition of the “**controlled transaction**” as a transaction to which the transfer pricing rules apply. The term “controlled transaction” should replace the existing term “mutual commercial relationship”. The reason for the change are different interpretations of the term “**mutual commercial relationship**”, which is not defined in the law for tax purposes and there have been ambiguities as to what this term exactly means in practice.

According to the new provisions, the transfer pricing rules would only apply if at least one of the persons involved in the transaction is a taxpayer with income referred to in Article 6 of the Income Tax Act (income from the lease and self-employed activities) and a legal person which has a taxable income (earnings) from activities or disposition of assets.

### Transfer pricing adjustments of the income tax base

The amendment proposes redefining the obligation to adjust the income tax base in connection with the transfer pricing rules. This obligation should, according to the proposed amendment, apply not only to situations in which prices in controlled transactions differ from prices that would be applied among independent persons in comparably uncontrolled transactions, but also in the case when conditions of the transaction differ. The proposal assumes that not only the price but also (other) conditions of the transaction may affect the tax base.

According to the proposal, the law should enable the taxpayer itself to make the corresponding adjustments to the tax base, if another dependent person (resident in the Slovak Republic) adjusts (increases) its tax base in accordance with the transfer pricing rules – without the obligation to submit an application for approval of this adjustment to the tax authorities.

### Clarifying the process concerning the application for approval of a transfer pricing method

The proposed provisions of the law clarify the process concerning the application for approval of a method of pricing of transactions between dependent persons for tax purposes (Advanced Pricing Agreement – APA).

The submission of the application should be subject to a new fee:

(i) in the amount of EUR 10 000 in the case of adoption of a decision of the tax authorities unilaterally approving the use of a pricing method and

(ii) in the amount of EUR 30 000 in the case of approval of the use of a pricing method on the basis of a treaty for the avoidance of double taxation.

### III. Fight against aggressive tax planning

#### Sanctions for breaching transfer pricing rules

In addition to the existing sanction system laid out in the Tax Procedure Code, there is a proposal of new sanctions applicable to taxpayers who, on the basis of transfer pricing, are intentionally decreasing a tax base or increasing a tax loss by way of actions that do not have economic justification and that result in a tax obligation being purposefully avoided or in a tax benefit, to which the taxpayer would not otherwise be entitled, being purposefully obtained or that result in a tax obligation being purposefully reduced.

A sanction equalling to twice a fine determined on the basis of the Tax Procedure Code would apply to such situations. These more stringent rules should apply to a tax or tax difference assessed on the basis of a tax audit that began after 31 December 2016.

The increased sanction would not apply if the taxpayer does not appeal against the decision of the tax authorities and pays the tax difference within a deadline for filling the appeal.

If the taxpayer applies for the approval of the use of the transfer pricing method (APA) and the tax authorities assess a tax or tax difference for a tax period<sup>\*</sup>, in which the application for the issuance of APA was submitted or for two tax periods preceding this tax period due to the breach of the principle of independent relationship between dependent persons, the tax authorities would impose a fine in the amount of the base annual interest rate of the European Central Bank, however in the minimum amount of 3% per annum.

The reduced sanction (as opposed to the special sanction for the breach of transfer pricing rules referred to above) could only be imposed if the tax authorities, when determining a tax base, has not applied a general anti-abuse rule contained in the Tax Procedure Act or anti-abuse rules contained in the Income Tax Act.

<sup>\*</sup> The provisions concerned would apply to all cases in which a tax or tax difference have not been assessed with a final effect by 31 December 2016.

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