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TAX AUDIT ADVISORY

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As already announced in the previous issue of our BMB Newsfilter, the government has been preparing the main phase of the consolidation of public finances all summer and published its first draft just before the beginning of autumn (17 September). It is certainly to be appreciated that the government proceeded to consolidate the public finances. The government's consolidation package is a surprise both in terms of the total volume of over €2.5 billion and a sharp increase in the standard VAT rate from 20% to 23%. The corporate income tax rate will also be increased, for companies with revenues over €5 million to as much as 24% instead of the planned 22%. The most positive measure for tax residents of Slovakia is the reduction in the withholding tax on dividends back to 7%. Conversely, the most controversial measure is the introduction of a new tax on financial transactions. For the current status of the consolidation package focusing on changes in tax rates, with a brief overview of the rates as approved by the Parliament on 3 October 2024, please see TOP 1. Given the turbulent process, we will inform you about the final changes as of 1 January 2025 in the next quarterly edition of BMB Newsfilter.
Within this brief overview of the proposed changes that will lead to an overall higher tax burden, JUDr. Eliška Macků has prepared for you a summary of changes to the criminal law from tax perspective (TOP 2). In particular, the thresholds at which tax evasion becomes a criminal offence are being raised. Also very interesting is the preliminary decision of the Supreme Administrative Court on the compensation for unjustifiably withheld excess VAT deduction (TOP 3), in which the court asks to take into account not only the interest prescribed by the law, but also inflation. Useful information on the planned technical changes in the field of VAT, in particular as regards the change of the purpose of use of assets or company cars, is provided in TOP 5.
In the second part of BMB Newsfilter you will find, as always, the most interesting news from abroad, including the Annual Report of the European Commission on Taxation published in July or interesting transfer pricing rulings in Italy and France, which were analysed in detail by our German colleagues.

Our BMB Taxand team wishes you relaxed autumn reading.

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TOP 1: Consolidation package from tax perspective

The most controversial measure of the package is definitely the introduction of a new tax on financial transactions, so we will give at least a brief explanation. We have prepared a brief overview focusing on the changes to the rates following their approval by the Parliament on 3 October. Due to the turbulent legislative process, we will inform you about the final shape of the changes to the tax law as of 1 January 2025 in the next quarterly edition of BMB Newsfilter, according to their final wording published in the Collection of Laws.

Financial transaction tax

Unless this tax is suspended by the European Union for the reasons set out below, it will apply from 1 January 2025, following the Hungarian model, to transactions carried out by businesses as defined in the law - whether legal or natural persons.

The new tax will apply to the following transactions:

- debit bank transfers, rate 0.4%, but maximum €40 per transfer,
- cash withdrawals from a bank or ATM, rate 0.8%,
- payments via payment cards, charge of €2/year,
- purchases of securities, interest payments on loans, commissions and fees.

This tax should not apply to payments of taxes and social/health insurance contributions. In the case of accounts in the Slovak Republic, it will be calculated and paid to the state by banks. In the case of accounts abroad it should be calculated and paid by entrepreneurs themselves, according to the explanatory report.
The introduction of a financial transaction tax may impose substantial costs on businesses and, as banking transactions cannot be equated with real value creation, this tax also contradicts the original principles of the tax as proposed by the EU and targeted precisely at the transactions in the last point above (purchase of securities etc.). The practical collection of this tax may also be problematic, as many Slovak companies already have bank accounts in other EU countries. Moreover, legal restrictions of these other accounts within the EU may qualify as a conflict with the free movement of capital guaranteed by the EU Treaty, which may lead to legal disputes.

VAT (amendment to Act No. 222/2004 Coll. on Value Added Tax)

- The standard VAT rate on selected goods and services is being increased from 20% to **23%**.
- A new reduced rate of **19%** will be applicable to the supply of electricity (now 20%), all foodstuffs (exceptions applicable), beverages in restaurants and catering establishments except alcoholic beverages with an alcohol content of more than 0.5% (now 10%).
- A reduced rate of **5%** is being introduced on a selected range of food and medical supplies, medicines, books (now 10%) and state-supported housing.

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- The current reduced rate of 10% is being abolished.
- Within services, the reduced rate of 10% is on passenger transport by cable cars and ski lifts, sports facilities, accommodation services, fitness centres, recreational parks, etc. is being abolished.
- With respect to goods, the 10% rate on printed books, brochures, newspapers, etc. is being abolished.

Corporate income tax (amendment to Act No. 595/2003 Coll. on Income Tax)

- The current reduced tax rate for legal entities is being reduced from 15% to **10%**. At the same time, the threshold for the amount of taxable income is being increased from €60 thousand to **€100 thousand**.
- An increased tax rate of **24%** is being introduced for legal entities whose taxable income exceeds **€5 million**.

Personal income tax (amendment to Act No. 595/2003 Coll. on Income Tax)

- The threshold of taxable income for individuals - entrepreneurs (self-employed persons) is being increased from €60 thousand to **€100 thousand**. Thus, a larger number of taxpayers will be able to apply the 15% tax rate.
- Withholding tax on dividends is being reduced from 10% to **7%**. Dividends paid out of the profit reported for the 2025 tax year will be subject to a 7% tax rate.
- The amounts of the tax bonus for children are being adjusted as follows:
  (i) age 0-15: €100/month,
  (ii) age 15-18: €50/month.
  (iii) The tax bonus for dependent children aged 18 and over is being abolished.
  (iv) At the same time, the right to the full amount of the tax bonus arises already at lower income due to the increase of the percentage limit of the partial tax base from 20% - 55% to **29% - 64%** depending on the number of dependent children.
- The possibility to assign a share of the tax paid to parents is being introduced.

Other areas, including sectoral taxes and increased ceilings for social insurance contributions

- Changes to special levies for companies in regulated sectors
- Increase in the ceilings for social insurance contributions from 7 to 11 times the average wage
- Toll increase for trucks
- Increase in the price of vignettes

The above-mentioned measures will take effect from **1 January 2025**.

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TOP 2: Amendment to the criminal law from tax perspective

On 6 August 2024, an extensive amendment to the Criminal Code (Act No. 40/2024 Coll.) came into force, fundamentally changing the State's penal policy. The amendment also brings many changes in the area of tax offences. The key changes are (i) reduction in penal charges, (ii) increase in damage thresholds, (iii) change of in statute of limitations , (iv) change of imposition of suspended sentences and, in the case of tax crimes, also (v) changes in active repentance.
For some of the changes, a simplified comparison of the penal charges for tax offences before and after the amendment is given. In the comparisons outlined, we assume that each of the offences is committed in the scope of €30 thousand and does not harm the financial interests of the EU.

1. Evasion of taxes and insurance contributions (Section 276 of the Criminal Code)

The offender evades taxes in the amount of €30 thousand.

Assessment before the amendment	Assessment after the amendment
Crime of tax evasion on a significant scale (at least €26,600) • the offender may be sentenced to **4 - 10 years** of imprisonment • the court must sentence the offender to imprisonment • the court may impose a suspended sentence, however, only after exceptional reduction of the sentence • **statute of limitations** for prosecution - **20 years**	Offence of tax evasion on a larger scale (over €20 thousand) • the offender may be sentenced to **1 - 5 years** of imprisonment • the court may impose a suspended sentence • the court does not have to sentence the offender to imprisonment, but e.g. only to a fine • the court may refrain from punishing the offender altogether • **statute of limitations** for prosecution - **5 years**

2. Failure to remit tax or insurance contributions (Section 277 of the Criminal Code)

The offender withholds and fails to remit to the tax administrator the tax due in the amount of €30 thousand, which he collects in accordance with the law, with the intention of obtaining an unjustified benefit for himself or another.

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Assessment before the amendment	Assessment after the amendment
Crime of non-remittance of tax on a significant scale (at least €26,600) • the offender may be sentenced to **4 - 10 years** of imprisonment • the court must sentence the offender to imprisonment • the court may impose a suspended sentence, however, only after exceptional reduction of the sentence • **statute of limitations** for prosecution - **20 years**	Offence of non-remittance of tax on a larger scale (over €20 thousand) • the offender may be sentenced to **1 - 5 years** of imprisonment • the court may impose a suspended sentence • the court does not have to sentence the offender to imprisonment, but e.g. only to a fine • the court may refrain from punishing the offender altogether • **statute of limitations** for prosecution - **5 years**

3. Tax fraud (Section 277a of the Criminal Code)

*The offender unlawfully claims **a refund of value added tax** in the amount of €30 thousand with the intention of obtaining an unjustified advantage for himself or another.*

Assessment before the amendment	Assessment after the amendment
Crime of tax fraud on a significant scale (at least €26,600) • the offender may be sentenced to 4 – 10 years of imprisonment • the court must sentence the offender to imprisonment • the court may impose a suspended sentence, however, only after exceptional reduction of the sentence • statute of limitations for prosecution - 20 years	Offence of tax fraud on a larger scale (over €20 thousand) • the offender may be sentenced to **6 months – 3 years** of imprisonment • the court may impose a **suspended sentence** • the court **does not have to sentence the offender to imprisonment, but e.g. only to a fine** • the court may **refrain from punishing the offender altogether** • statute of limitations for prosecution - 3 years

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	It is not a criminal offence to unlawfully claim a refund of VAT/consumption tax up to €20 thousand!!!

4. Non-payment of tax and insurance contributions (Section 278 of the Criminal Code)

The offender fails to pay the due tax in the amount of €30 thousand.

Assessment before the amendment	Assessment after the amendment
The offence of non-payment of tax on a significant scale (at least €26,600) • the offender may be sentenced to 1 - 5 years of imprisonment • the court may impose a suspended sentence • statute of limitations for prosecution - 5 years	Offence of non-payment of tax on a larger scale (over €20 thousand) • the offender may be sentenced to up to 2 years of imprisonment • the court may impose a **suspended sentence** • the court does not have to sentence the offender to imprisonment, but e.g. **only to a fine** • the court may refrain from punishing the offender altogether • statute of limitations for prosecution - **3 years** **Failure to pay due tax/insurance contributions up to €20 thousand is not a criminal offence!!!**

The amendment also affected the provisions on active repentance.

5. Active repentance (Section 86 of the Criminal Code)

Active repentance is a circumstance that extinguishes the State's right to punish the offender. **The possibility of exercising active repentance in tax offences is strengthened by the amendment**. A crucial change is the extension of the possibility to apply active repentance also to cases of prior sanctioning (not sentencing) of the offender. This means that active repentance will not be excluded if the offender has been previously sanctioned for an administrative offence in tax proceedings.

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Active repentance does not apply to offenders of tax fraud offences even after the amendment.

Active repentance before the amendment	Active repentance after the amendment
The criminality of the offence ceases to exist if the offence is evasion of tax and insurance contributions pursuant to Section 276, non-payment of tax and insurance contributions pursuant to Section 277 or non-remittance of tax and insurance contributions pursuant to Section 278, **unless the offender committed the offence as a member of an organised group or as a member of a criminal group** and the tax and its accessories or insurance contributions due were subsequently paid not later than the day after the day on which the offender, after the completion of the investigation, could have become aware of the results of the investigation. The criminality of the offence shall not cease to exist if the offender has been **sanctioned** for a similar offence **within the preceding 24 months** or if the prosecution of the offender for a similar offence has been discontinued within the preceding twenty-four months on the ground of the extinction of the criminality of the offence.	The criminality of the offence ceases to exist if the offence is evasion of tax and insurance contributions pursuant to Section 276, non-payment of tax and insurance contributions pursuant to Section 277 or non-remittance of tax and insurance contributions pursuant to Section 278, **unless the offender committed the offence as a member of a criminal group** and the tax and its accessories or insurance contributions due were subsequently paid not later than the day after the day on which the offender, after the completion of the investigation, could have become aware of the results of the investigation. The criminality of the offence shall not cease to exist if the offender has been lawfully **sentenced** for a similar offence **within the preceding 24 months** or if the prosecution of the offender for a similar offence has been discontinued within the preceding twenty-four months on the ground of the extinction of the criminality of the offence.

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TOP 3: Landmark decision on compensation for withholding excess VAT deduction during a tax audit

The decision relates to Section 79a of the VAT Act and a situation where a tax audit was opened within the period for refunding an excess VAT deduction, after which the excess deduction was refunded. In such a case, the taxpayer is entitled to interest on the excess deduction amounting to 2 times the ECB base rate, min. 1.5% per annum, for each day following the lapse of 6 months since the day after the lapse of the period for the excess deduction refund on the basis of the filed VAT return until the date of the excess deduction refund.

The interesting thing about the judgment is that the chamber of the Supreme Administrative Court came to a legal opinion differing from the previous decision-making practice.

The chamber has not yet ruled on the case, but in its decision it summarised its reasoning and conclusions and referred the case to the Grand Chamber for consideration, which is to decide which legal opinion will be applied in further decision-making practice. This case focused on a tax audit that had not been closed as of 1 January 2017, and thus Section 79a of the VAT Act applied to it.

It can be summarised that the court dealt with two crucial issues:

a) Adequate compensation for the unjustified withholding of the excess deduction, where it expressed the view that the compensation should be **at the rate of inflation** or, where the taxpayer has compensated for the loss of financial resources by taking a loan, **at the rate of interest on the loan**. Thus, it did not consider the statutory compensation of min. 1.5% to be sufficient.
b) The period for which interest is to be awarded, where the court is of the view that **interest should not be awarded to the taxpayer for the period considered to be the reasonable duration of the tax audit** (6 months is considered to be a reasonable period) because the right of the State to audit must be preserved. The current wording of the law grants interest for the period from the first day on which the excess deduction should have been refunded at the latest on the basis of the VAT return filed if the tax audit had not been opened until the date of the refund.

In short, the conclusion a) is for the benefit of the taxpayers and the conclusion b) is for the benefit of the tax administrator.

The decision of the Grand Chamber has not yet been published. We will therefore wait anxiously to see whether there will be a change in the decision-making practice.

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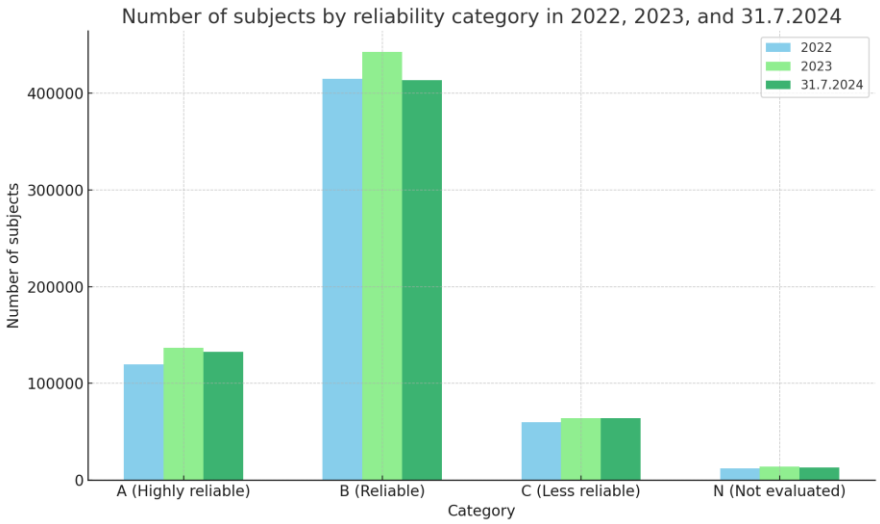
Note: The adequacy of the compensation for unjustified withholding of an excess VAT deduction has been resonating with the professional public for a long time, not only in the Slovak Republic but also in Czechia. This topic was also the subject of the Slovak-Czech conference in 5/2023. Several judgments of the European Court of Justice have been released on this issue, which have been applied also in the Slovak decision-making practice.

TOP 4: Update of the Tax Reliability Index as of 31 July

The financial administration has recently published an update of the Tax Reliability Index based on data as of 31 July 2024. The assessment covers approx. 625 thousand taxpayers. The statistics for the three assessment periods since 2022 show a stable trend. Most entities, ca. 67%, are in category B "reliable". Only about 20% of entities are considered "highly reliable" (A) by the tax administration and 10% of entities are in the less reliable category.



TOP 5: Upcoming amendment to the VAT Act

In September, an amendment to the VAT Act was subject to an **inter-ministerial comment procedure.** The amendment introduces many changes, **focusing mainly on the adjustment and correction of deducted VAT.**

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In particular, the proposed amendment addresses the following key areas:

- Change in the way of determining the tax base upon the supply of goods for personal consumption or supply without consideration or for other than business purposes in that the possibility to calculate the tax base for the purpose of refunding the deducted VAT from the amount of the tax residual price is abolished, while the amendment regulates the linking of the tax base to the so-called **purchase price of the goods at the time of their delivery, i.e. basically linking it to the current market value of the goods at the time of delivery**.
- The amendment proposes **to delete the possibility for the taxpayer to deduct VAT on the purchase of fuel up to the amount of flat-rate expenses** (80% vs. 20%) and **it will be necessary to prove the actual extent of the use** of fuel on the basis of relevant documentation (e.g. the logbook).
- Change of the adjustment of the deducted tax for investment assets, namely linking the provisions of Section 49(5) of the VAT Act not only to the depreciated property, but also to the total movable investment assets or also to intangible investment assets.
- Introduction of the definition of **initial use** - first actual use as a new criterion for the beginning of the period for adjusting the tax deducted.
- Extension of the situations in which there is an obligation to correct or adjust the tax deducted (e.g. in the case of advance payments).
- In accordance with Article 187 of Directive 2006/112/EC and in line with the settled case law of the CJEU (e.g. Stichting Schoonzicht, C-791/18), it is proposed to move away from the current technique of making adjustments to the deduction under Sections 54, 54a and 54d, whereby investment assets are presumed to be used in an appropriate manner until the end of the period for adjusting the deduction. **The adjustment of the deducted tax should be spread over a number of years, with the adjustment of the deducted tax being made only up to the amount of tax corresponding to the portion of the total deducted tax attributable to the calendar year in question.**
- **Change in the definition of investment assets** (addition of intangible assets, exclusion of inventories and impairment for movable assets to €1,700).

The upcoming amendment contains a number of other clarifications and minor adjustments of an administrative nature. We will keep you informed about the details as well as about the progress in the legislative process.

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TOP 6: Annual report of the European Commission on Taxation

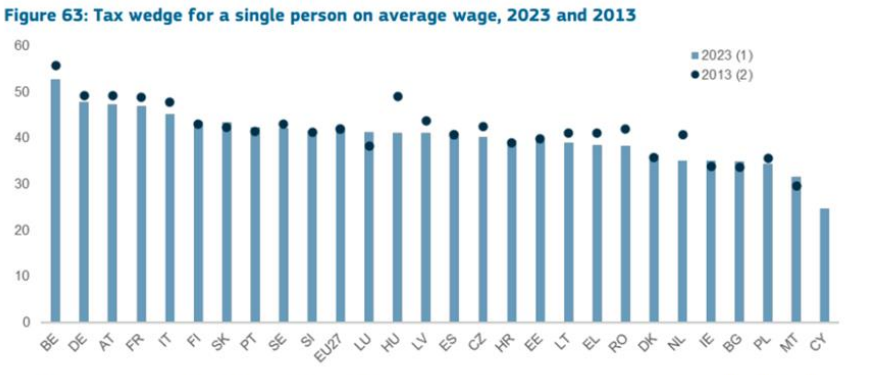
In July, the European Commission published its Annual Report on Taxation 2024 focusing on the latest trends in EU tax systems. The report aims, among other things, to help the EU stand as an attractive market in the global competition for investors. Despite all the challenges Europe has faced in recent years, it has managed to keep e.g. its effective corporate tax burden low. On the contrary, the report remains critical of a too high tax burden on labour.

The Annual Report on Taxation 2024 is based on a survey in EU Member States and focuses on reforms, but also on the so-called tax mix, which has a significant impact on the behaviour of players on the European market.

Why high burden on labour is a problem

Even though the tax and social security burden on labour has been falling slightly in the EU over the last 10 years (with the exception of Slovakia and a few other countries), it remains very high compared to other economies. In the competition for global investments, this factor plays a key role. According to the annual report, the average difference between total labour costs from the employer's perspective and the net income of an employee is 34.6% in the OECD, but as high as 41.6% in the EU.

Tax wedge (difference between the total labour costs and net wages) in %



Source: European Commission, DG Taxation and Customs Union, based on DG Economic and Financial Affairs, Tax and Benefits database, and OECD tax/benefit model (updated April 2023).
Notes: (1) 2022 figure for SI, HR, BG, MT and CY. (2) 2013 data missing for Cyprus.

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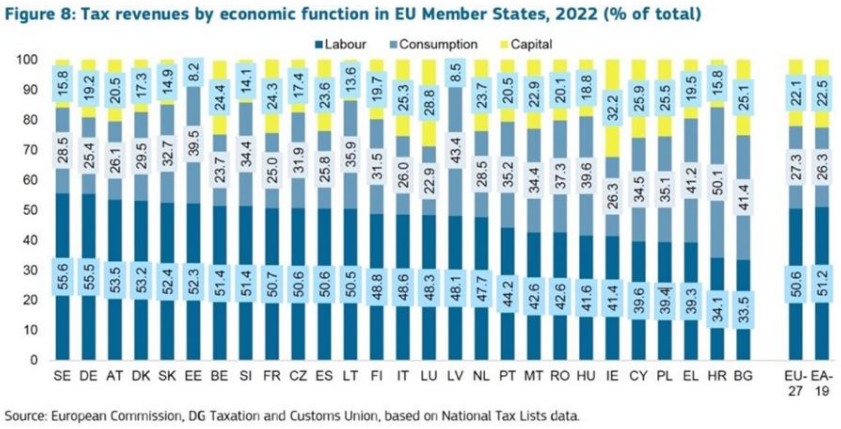
Tax mix comparison EU versus Slovakia

- In EU countries, the share of revenues from tax and social security burden on labour is too high, 50.6% on average in 2022 (compared to 52.4% in Slovakia).
- The burden on labour is followed by excise duties, including VAT, with a share of 27.3% (32.7% in Slovakia).
- Next in order are property taxes, including real estate taxes, referred to as capital taxes; their share in the EU-wide tax mix was 22.1% and in Slovakia only 14.9%.

Tax revenue split by economic function in EU countries (%)
(Labour taxes are shown in blue, consumption taxes in grey and property taxes in yellow.)



TOP 7: DAC6 legislation in Poland is unconstitutional

Poland was the first EU country to transpose the EU DAC6 Directive which implements across the EU the mandatory disclosure rules (MDR) recommendations by requiring intermediaries (and clients in specified circumstances) to disclose tax planning schemes. The Polish National Council of Tax Advisors disputed the reporting obligation based on several grounds, and the Constitutional Tribunal issued its ruling on the claim in July 2024.

The Tribunal ruled that the Polish MDR are unconstitutional in so far as they:

- Impose on tax advisors covered by the attorney-client confidentiality privilege the obligation to disclose information on tax schemes, without sufficiently clarifying the circumstances in which advisors are released from this obligation in order to protect the attorney-client privilege; and

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- Expand on the EU DAC6 Directive by requiring the disclosure of tax planning schemes lacking any cross-border element.

It is at this stage unsure what action the Polish government would take to remedy the situation. It would appear from EU and Belgian case law on the matter that requiring the tax advisor, when constrained by confidentiality obligations, to inform the next intermediary in the chain would itself breach the attorney-client privilege. Other alternatives would be to shift the disclosure requirement to the client or to provide a possibility for the client to release the advisor from its confidentiality obligation.

TOP 8: New electronic VAT exemption certificate

The European Commission proposes to amend the VAT Directive to allow for a digital VAT exemption certificate. The proposal aims to amend Council Directive 2006/112/EC (the VAT Directive) by introducing an electronic exemption certificate to confirm that a transaction qualifies for specific exemptions. Currently, the VAT and/or Excise Duty exemption certificate is paper-based and requires a handwritten signature. This move to an electronic certificate aligns with the EU's broader digitalization efforts, reduces administrative burdens, and allows Member States to meet EU legislation requirements for processing electronically signed documents.

The proposal suggests using a PDF e-form accompanied by a fully electronic process.

To facilitate the transition, Member States can continue using the paper version of the exemption certificate until June 30, 2030. This transitional period allows flexibility and ease in switching to the electronic procedure on a transaction-by-transaction basis.
The new rules are set to be **applied from July 1, 2026**, giving Member States adequate time to implement the new electronic VAT exemption certificate and procedure.

TOP 9: French transfer pricing case on profit splits

A transfer pricing dispute arose between the French company Itron France SAS and the tax authorities, with the tax authorities claiming that the profit margin applied by the taxpayer to invoice the supplies of goods was too low. The taxpayer calculated its margin using the cost plus method and applied a profit mark-up ranging from 14% to 35%. However, in the tax authority's opinion, the market value of the profit margin was around 50%. In order to achieve this target value, it was necessary to apply the profit split method to determine the relevant revenue adjustments.

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The French court of appeal, the Court Administrative d'Appel, upheld the lower court and ruled in favour of the taxpayer. The tax authorities had wrongly compared the gross profit margins of distribution companies with the net profit margins of manufacturers. Therefore, the tax authorities could not even prove that the net profit margin of the taxpayer achieved when using the cost plus method was in fact lower than the net profit margin potentially achieved by the hypothetical use of the profit split method. The court of appeal also clarified that an adjustment to the taxpayer's transfer prices is not necessary where the tax authority has found deviations from the 'target margin', as, according to the taxpayer's argumentation, the tax authority did not even submit a comparative study to show that the margins actually realized were unusually low.

TOP 10: Italian case on transactional net margin method

The Italian company Terexlift (taxpayer) sold machinery to a UK distribution company within the group. The UK distribution company was remunerated on the basis of the TNMM (transactional net margin method). In the years at issue, 2009 and 2010, the taxpayer issued a credit note to the UK company by way of a year-end price adjustment. After taking account of this adjustment, the transfer price at which the taxpayer sold the machinery to the UK distribution company was lower than its own costs.

During the course of the tax audit, the tax authorities declared the application of the TNMM inappropriate and determined higher supplier prices for the taxpayer based on the comparable uncontrolled price method, even though the TNMM had been recognised in previous years and also resulted in year-end adjustments to the detriment of the taxpayer.

The Italian Supreme Court ruled in favour of the taxpayer, stating that the tax authority had wrongly rejected the possibility of applying the TNMM and the resulting year-end adjustments. This was contrary to the principle of continuity.

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USEFUL LINKS

Leading economists on the consolidation package (SK)
Annual Report on Taxation 2024 (EN)
Proposal for a COUNCIL DIRECTIVE amending Directive 2006/112/EC (EN)
International case law on transfer prices (DE)

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