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# A Practical Insight to Cross-Border Corporate Tax Work—Slovakia



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## General: Treaties

### How many income tax treaties are currently in force in your jurisdiction?

After the breakup of the Czech and Slovak Federal Republic (CSFR) in 1993, the Slovak Republic acceded to the tax treaties signed by the former CSFR. Since then, the Slovak Republic has signed a number of new tax treaties. Currently, Slovakia has tax treaties with 58 countries. The tax treaties with France and Germany are currently being renegotiated.

### Do they generally follow the OECD or another model?

The tax treaties signed by the Slovak Republic generally follow the OECD Model Tax Convention. The specific tax treaty is signed with the US, which follows neither the UN nor OECD Model Tax Convention.

### Do treaties have to be incorporated into domestic law before they take effect?

The tax treaty, if signed, also needs to be approved by the Slovak Parliament and subsequently ratified by the Slovak President. Afterwards, upon the counterparty ratifying the tax treaty, the treaties are published in the Collection of Laws and become part of domestic law.

### Do they generally incorporate anti-treaty shopping rules (or “limitation of benefits” articles)?

Slovak tax treaties do not usually include any specific anti-treaty shopping provision, except for those incorporated in the model tax treaties, e.g., principle of limitation of benefits to the “beneficial owners” of income.

### Are treaties overridden by any rules of domestic law (whether existing when the treaty takes effect or introduced subsequently)?

Once the Slovak double tax treaties are ratified in compliance with Slovak legislation and published in the Collection of Laws, they prevail over Slovak law.

## Transaction Taxes

### Are there any documentary taxes in your jurisdiction?

In Slovakia, no documentary taxes have been introduced.

### Do you have Value Added Tax (or a similar tax)? If so, at what rate or rates?

As of May 1, 2004, the Slovak value added tax (“VAT”) system complies with



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the principles of VAT applied within the European Union (the EU) by the Sixth Council Directive 77/388/EC (Recast Council Directive 2006/112/EC) of the common system of VAT.

Generally, a standard 19 percent VAT rate applies on the majority of taxable supplies with the place of the transaction being in Slovakia, unless these supplies are specifically exempt from VAT. As of January 1, 2007, the reduced 10 percent VAT rate applies on certain pharmaceutical products and medical equipment. Currently, the lower rate for books is also being considered.

**Is VAT (or any similar tax) charged on all transactions or are there any relevant exclusions?**

Under the Slovak VAT system, VAT is imposed on: (i) the supply of goods for consideration in Slovakia; (ii) the provision of services for consideration in Slovakia; (iii) intra-Community acquisitions of goods and (iv) the import of goods from countries outside the EU.

VAT-exempt supplies with an input-VAT deduction entitlement include: (i) the supply of goods from Slovakia to another EU Member State and (ii) the export of goods.

VAT-exempt supplies without an input-VAT deduction entitlement include, among others: (i) insurance services; (ii) the transfer and lease of real estate under certain circumstances; (iii) financial services; (iv) lotteries; (v) postal services; (vi) health care services; (vii) social care services; (viii) educational services; and (ix) other activities in the public interest.

**Is it always fully recoverable by all businesses? If not, what are the relevant restrictions?**

In general, the VAT payer is entitled to deduct VAT paid in respect of supplies used for the purposes of its business activities. According to the Slovak VAT Act, input VAT cannot be deducted from the acquisition of personal motor vehicles (unless they are purchased by VAT payers whose scope of business covers the purchasing of vehicles for their further resale or lease), or for entertainment expenses. The VAT payer is also

not able to deduct VAT paid in respect of supplies received to provide VAT-exempt supplies of goods and services (e.g., postal, insurance and financial services, the supply and lease of immovable assets, see the above question regarding VAT relevant exclusions).

If taxable supplies are received to perform taxable supplies where VAT deduction is allowed, as well as taxable supplies exempt without input VAT deduction, input VAT can be deducted proportionately based on the coefficient. The VAT paid in respect of acquired intangible assets or received services which are used for business purposes, as well as for purposes other than business, can generally be deducted only in a proportion reflecting the business use of such assets.

A taxable entity which becomes a VAT payer is entitled to deduct input VAT related to the input price of an asset, including depreciated assets (according to the Income Tax Act), acquired prior to its VAT registration.

Special rules on the adjustment of input VAT that was deducted apply to capital goods. The initial input VAT deduction on acquired capital goods had to be adjusted if certain changes in the use of such goods (e.g. the use of the capital goods for exempt supplies when the input VAT had been fully deducted) occurred during the subsequent five calendar years, including the year of their acquisition (a ten-year period applies to real property).

**Are there any other transaction taxes?**

No real estate transfer, inheritance or gift taxes are levied in Slovakia.

**Are there any other indirect taxes of which we should be aware?**

The applicable legislation for excise duties is effective as of May 1, 2004, implementing the EU Directives. Specified consumer goods produced in Slovakia, supplied to Slovakia from another member state, or imported from countries outside the EU are subject to an excise duty upon various tax events specified in the relevant tax laws. Goods subject to excise

duties include mineral oil, tobacco products, spirits, beer and wine. By 2010, electric energy, coal and natural gas should also be subject to excise duty. Duty is charged according to the volume produced or imported, with varying rates for each category.

## Cross-Border Payments

### **Would there be any WHT on royalties paid by a local company to a non-resident?**

According to the Slovak Income Tax Act, there is a 19 percent withholding tax levied on payments for the use of intellectual property rights (industrial rights, software, copyrights) and know-how made by Slovak companies, unless the respective tax treaty stipulates otherwise.

Based on the provisions implementing the Interest and Royalty Directive, the royalty payments to a related party seated in another EU member state are exempt from WHT if certain conditions are met.

### **Would there be any WHT on interest paid by a local company to a nonresident?**

If the creditor is a nonresident for Slovak tax purposes, interest paid by a Slovak company will generally be subject to 19 percent WHT under the Slovak ITA. The majority of tax treaties signed by the Slovak Republic, however, eliminate the withholding tax on interest. If this is the case, the Slovak company paying the interest may automatically apply the reduced (zero) tax rate under the tax treaty. Taking into consideration the Measure issued by the Ministry of Finance and the practical approach of the tax authorities, we recommend having a tax residence certificate confirming the recipient's tax domicile and eligibility for treaty benefits in the files of the Slovak company for the purposes of a possible tax audit.

Further, as a result of the fact that the Slovak Republic joined the EU, the Interest and Royalty Directive was implemented into Slovak law. Based on these provisions, the loan interest payments to a related party seated in another EU member state are exempt from withholding tax if certain conditions are met.

### **Would relief for interest so paid be restricted by reference to "thin capitalisation" rules?**

The thin capitalisation rules were abolished as of January 1, 2004. Note, however, that an amendment to the Income Tax Act is currently being prepared that should re-introduce these rules as of January 1, 2008.

### **If so, is there a "safe harbour" by reference to which tax relief is assured?**

If the proposed wording of the amendment is approved, the tax deductibility of interest costs on loans provided by foreign related parties will be restricted, if the sum of such loans exceeds four times the recipient company's own equity as reported as of the end of the preceding taxation period (four to one debt-to-equity ratio). Interest on the portion of loans exceeding the said ratio will be considered tax nondeductible. For the newly established entities, the registered capital as of the end of the first taxation period is taken into account.

### **Would any such "thin capitalisation" rules extend to debt advanced by a third party but guaranteed by a parent company?**

No, the proposed thin capitalisation rules only refer to loans provided by foreign related parties.

### **Is any withholding tax imposed on dividends paid by a locally resident company to a nonresident?**

No, under the Slovak Income Tax Act, profit shares (dividends) distributed by an eligible Slovak legal entity are not subject to income tax in Slovakia. This applies for distributions made to the shareholders by the following qualified Slovak legal entities: a limited liability company (s.r.o.), a joint stock company (a.s.) and a limited partnership (k.s.), if distribution is made to limited partners (komanditista). The exemption does not apply to distributions made to partners of a general partnership and general partners of a limited partnership.

### **Does your country have transfer pricing rules?**

Under Slovak tax law, transactions realised between foreign related parties should be subject to Slovak transfer pricing rules. The prices agreed between them should be set on an arm's length basis. The definition of related parties includes those related through personnel (through statutory representatives, members of statutory bodies or supervisory boards), related economically (directly or indirectly holding more than 25 percent of the capital or voting shares), or otherwise related (through a relationship arising with the aim of decreasing the tax base).

The determination of transfer prices between related parties is generally considered to be very sensitive from the tax perspective. According to Slovak tax legislation, if the prices contracted between related parties differ from prices that would be contracted between unrelated parties on the same or similar terms, and this difference decreased a tax payer's tax base, the tax base of the taxpayer should be adjusted by the ascertained difference.

Under Slovak tax legislation, an advance ruling from the tax authority on the transfer pricing method to be used between related parties may be obtained. Slovak transfer pricing legislation stipulates the methods available based on the OECD Transfer Pricing Guidelines.

A new Measure of the Slovak Ministry of Finance concerning transfer pricing documentation (the "Draft") is currently subject to interdepartmental review. Like the EU Code of Conduct on transfer pricing documentation, the Draft specifies that the transfer pricing documentation should consist of the master file and the country (specific) file. If approved, the Draft should take effect as of January 1, 2008.

## **Tax on Business Operations: General**

### **What is the headline rate of tax on corporate profits?**

The corporate income tax flat rate is set at 19 percent.

### **When is that tax generally payable?**

The corporate income tax is generally payable within three months after the end of the tax period (calendar/financial year). In addition, corporate income tax prepayments might be payable monthly or quarterly (pro rata) during the current tax period, depending on the tax liability reported in the previous tax period.

### **What is the tax base for that tax (profits pursuant to commercial accounts subject to adjustments; other tax base)?**

The corporate income tax base is generally based on profit/loss, determined according to the Slovak statutory accounting standards, which is further adjusted for nondeductible expenses and nontaxable income. For specific taxpayers (e.g., banks, insurance companies, mutual fund management companies, etc.), the accounting result is compiled according to IFRS, which is further adjusted for tax base calculation purposes. These adjustments include, among others, various items to exclude the impact of IFRS accounting.

### **If it otherwise differs from the profit shown in commercial accounts, what are the main other differences?**

Nondeductible tax expenses include, among others: (1) entertainment and travel allowances paid in excess of the statutory limits; (2) general accounting reserves and provisions, except for specific tax deductible reserves and provisions (special rules apply for banks and insurance companies); (3) fines and penalties except for contractual penalties; (4) taxes paid on behalf of other taxpayers and (5) shortfalls and losses exceeding compensation received, except for specific losses.

Slovak tax law further specifically sets the rules for the tax deductibility of certain items, e.g., tax depreciation of assets; lease payments.

**Are there any tax grouping rules? Do these allow for relief in your jurisdiction for losses of overseas subsidiaries?**

Tax grouping is not possible in Slovakia. Therefore, if one company is profitable and the other is making losses, the losses may not be credited against the profits.

**Is tax imposed at a different rate upon distributed, as opposed to retained, profits?**

No, both the distributed and retained profits are taxed at the same rate (19 percent).

**What other national taxes (excluding those dealt with in “Transaction Taxes”, above) are there—e.g., property taxes, etc.?**

Municipalities are entitled to assess several municipal taxes, such as real estate tax, tax on dogs, tax on the use of public areas, tax on accommodation, tax on vending machines, tax on non-winning game slot machines, tax on entry and parking of motor vehicles in the historic parts of a city, tax on nuclear devices and a motor vehicle tax. The level of the applicable municipal tax rate is set by the municipalities. The municipal taxes are administered by the respective municipalities, except for the motor vehicle tax, which is the responsibility of the tax authorities. The most significant of these are real estate and motor vehicle tax.

**Real Estate Tax**

Only real estate located within the territory of the Slovak Republic is subject to real estate tax. In general, the owner of real property is obliged to submit a tax return for the calendar year and to pay real estate tax, which is levied on buildings, land and apartments. The real estate tax base is calculated according to the area in square meters on buildings and apartments or the value of land. The basic tax rates for buildings, land and apartments are stipulated in the Act on Municipal Taxes. However, the rates can be changed by the respective municipality.

**Motor Vehicle Tax**

The motor vehicle tax is payable by both individuals and legal entities for all vehicles used for business purposes. The tax rate is based on engine capacity for passenger cars and weight and size for other vehicles. The level of the tax rate is determined by the municipalities, without any maximum limitation.

**Are there any local taxes not dealt with in answers to other questions?**

There are no other local taxes than those dealt with in the above question.

**Capital Gains**

**Is there a special set of rules for taxing capital gains and losses?**

No, there are no special rules for taxing capital gains and losses in Slovakia. Any capital gains and losses are included in the tax base of the Slovak company and taxed at the standard corporate tax rate of 19 percent.

**If so, is the rate of tax imposed upon capital gains different from the rate imposed upon business profits?**

No, the same 19 percent corporate income tax rate applies to all profits realised by the Slovak company.

**Is there a participation exemption or relief for reinvestment?**

Slovakia has neither participation exemption rules nor relief for reinvestment incorporated in its income tax law.

In respect of state aid, individual tax relief can be granted. Such relief, however, is not necessarily linked to reinvestment.

## Branch or Subsidiary?

### What taxes (e.g., capital duty) would be imposed upon the formation of a subsidiary?

The setting up of a Slovak company (and the subsequent increase of registered capital) will not trigger any Slovak capital duty, transfer taxes or other similar implications for its shareholders or the Slovak company.

### Are there any other significant taxes or fees that would be incurred by a locally formed subsidiary but not by a branch of a nonresident company?

Generally, the rules for taxation of a subsidiary and a branch are the same (Profit/Loss Statement).

### How would the taxable profits of a local branch be determined?

Generally, a permanent establishment is taxed on a profit and loss basis ("P/L basis") in Slovakia. If it is impossible to determine the tax base on a P/L basis, another method to determine the tax base can be used, e.g., percentage from annual turnover generated in Slovakia, cost plus method, etc.

### Would such a branch be subject to a branch profits tax (or other tax limited to branches of nonresident companies)?

The tax base of a branch is taxed at the same corporate tax rate as the tax base of other Slovak legal entities, i.e., at 19 percent. However, according to the Slovak Income Tax Act, Slovak legal entities are required to withhold 19 percent tax, securing from payments made to foreign entities having a tax presence in Slovakia (including branches). The guarantee tax is then offset against the corporate income tax liability of the branch. This obligation does not apply to branches of entities seated in an EU country or for branches paying tax prepayments in Slovakia.

### Would a branch benefit from tax treaty provisions, or some of them?

As a branch is considered to be a nonresident, the majority of tax treaty benefits cannot be applied to the branch, but the tax treaty may eliminate or decrease the application of tax securing as mentioned in the question above.

### Would any withholding tax or other tax be imposed as the result of a remittance of profits by the branch?

The profits of a branch are first taxed in Slovakia. Subsequently, the remittance of after-tax profits to the headquarters is not subject to further taxation in Slovakia.

## Anti-avoidance

### How does your jurisdiction address the issue of preventing tax avoidance? For example, is there a general anti-avoidance rule or a disclosure rule imposing a requirement to disclose avoidance schemes in advance of the company's tax return being submitted?

A general anti-avoidance principle has been incorporated to Slovak tax law. To prevent abuse, the tax authorities are obligated to take into account the substance of a transaction, and to disregard the formal structuring (Substance-Over-Form Principle). Tax authorities can use their own assessment for the determination of the tax base of a taxpayer who performed operations that, in substance or purpose, were aimed at circumventing the tax law and which resulted in a reduction in the tax base. In addition, any business relation established solely for the purpose of the decrease of tax base/increase of tax loss should be subject to transfer pricing rules.

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