Amendments to the Slovak legislation and other topics

Welcome to our March issue of Tax & Legal News. In this issue we outline information on the following topics:

- **Methodical guideline to the application of transfer pricing methods,**
- **Guideline of the Financial Directorate to the interpretation of double taxation avoidance treaties,**
- **Electronic filing and signing of financial statements,**
- **"White list" and a special withholding and security tax of 35%.**

We wish you a pleasant read.

Methodical guideline on application of transfer pricing methods

The Slovak Financial Directorate issued a methodical guideline which outlines the application of transfer pricing methods (further only "the Guideline"). The Guideline determined in more detail the methods which are based on comparison of prices (traditional transaction methods) and methods which are based on comparing profits (transactional profit methods).

The Guideline directly stipulates, that besides the definition of the transfer pricing methods in Article 18.2 and Article 18.3 of the Act No. 595/2003 Coll. on income tax as amended (further only "the ITA"), the substance and use of transfer pricing methods are determined also by the OECD transfer pricing guidelines for businesses and tax administration (further only "the guidelines"). The guidelines are in line with the Vienna convention on contractual law considered to be a generally accepted tool for explaining the meaning of Article 9 of double taxation avoidance treaties. The original wording of the guidelines was published in the Financial Bulletin No. 14/1997 (Part 1), Financial Bulletin No. 20/1999 (Part 2) and Financial Bulleting No. 3/2002 (Part 3). Based on the guideline, the Slovak Republic acknowledged the arm's length principle as the generally accepted norm by publishing the guidelines.

The methodical Guideline explains the key terminology, as well as the use of the respective methods. It stipulates that it is not necessary to prove that the use of some methods is not appropriate at the respective circumstances and conditions. It is sufficient if based on the analysis of comparability factors the methods whose use is inappropriate are excluded.

The ITA in its wording effective as of 1 January 2014 removes the previously preferred preference of traditional transactional methods over transactional profit methods. However, based on the methodical Guideline, if the use of traditional and profit methods is equally trustworthy, the traditional transactional methods continue to be preferred.

The traditional transactional methods are:

- comparable uncontrolled price – direct, unilateral method, used especially in transactions with tangible assets (e.g. material) and intangible assets (e.g. license fees), financial transactions (e.g. interest rates),
- resale minus method – indirect, unilateral method, used in the case of distribution of products,
- cost plus method – indirect, unilateral method, used especially in the case of production and sale of semi-finished goods, goods and services with low added value, e.g. in the case of contract manufacturing.

Transactional profit methods include:

- profit split method – bilateral method, used especially in the case of highly integrated transactions, when the contractual parties contribute to the transaction in a unique way or they own valuable intangible assets,
- transactional net margin method – unilateral method with various profit level indicators in the case of various transactions depending from availability of data; use of this method is limited e.g. if the contractual parties own valuable intangible property or their contribution to the transaction is of unique nature.

The use of the selected transfer pricing method must be proved to the tax authorities and the transfer pricing documentation must contain reasoning why the respective transfer pricing method was chosen.

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Guideline of the Financial Directorate on interpretation of international double taxation avoidance treaties

The Slovak Financial Directorate issued a guideline on interpretation of international double taxation avoidance treaties and avoidance of tax evasion in the area of taxes on income and property (further only "the Guideline"). The aim of the Guideline is to ensure common approach of the tax authorities to the interpretation of double taxation avoidance treaties (further only "DTTs").

The main connection between the local rules and an international treaty is mentioned in Article 1.2 of the Act No. 595/2003 Coll. on income tax as amended (further only "the income tax act") and in Article 162 of the Act No. 563/2009 Coll. on tax administration (tax procedural code) as amended.

According to Article 1.2 of the income tax act an international treaty, which was approved, ratified and published in the manner stipulated by law (i.e. published in the Collection of Laws), or an agreement which governs the taxation and connected legal relationships in relation to dependent territories which act in international matters independently, has precedence over the income tax act. This means that the provisions of the income tax act will not be used, if the international treaty, which binds the Slovak republic, stipulates otherwise.

DTTs cannot impose higher taxation than the local rules. The list of applicable DTTs is mentioned on the web-page of the Financial Directorate in the part "Legislatíva" (https://www.financnasprava.sk/sk/legislativa/dane/priame-dane/dan-z-prijmov/medzinarodne-zdanenie)

The DTTs have historically a routine structure, which has its source in internationally agreed models. The most frequently used model is the OECD Model Tax Convention on Income and Capital (further only the "OECD Model Treaty"). The OECD Model Treaty is accompanied by a commentary which serves as a tool for interpretation of the individual provisions of the OECD Model Treaty.

The Financial Directorate interprets the use of the commentary to the OECD Model Treaty as follows:

The commentary can be used as an additional means to the interpretation of DTTs, in line with Article 32 of the Vienna convention on treaty law No. 15/1988 Coll. (further only the "Convention"). It is possible to use the commentary for the confirmation of a meaning of specific provisions of the DTTs, which follows the general interpretation rules stipulated in Article 31 of the Convention (i.e. interpretation of DTTs with a good intention, in line with the usual meaning, which is attached to the terms used by DTTs in their entire context, and as well in regard to the substance and purpose of the DTTs) or it can be used as a supplementary tool where the meaning based on Article 31 of the Convention is not definite, is not clear, is presumably contradictory or unreasonable.

In general, the commentary can be used for the interpretation of DTTs, if the differences between the OECD Model Treaty and the wording of the respective DTT are not substantial and the provisions, which were amended or added to the commentary after the DTT was signed were published within, or during the period of realisation of the transaction.

The OECD member states, which do not agree with the interpretation of individual articles of the OECD Model Treaty stipulated in the commentary, may express their position to the interpretation of the commentary. These comments (Observations) to the commentary are not regarded as a disagreement with the wording of the OECD Model Treaty, but stipulate how the member state, which raised the observation to the commentary, interprets the respective article of the OECD Model Treaty.

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Electronic filing and signing of financial statements

According to Art. 49 Sect. 11 of the Income Tax Act, for purposes of filing the income tax return, the taxpayer is obliged to prepare financial statements as at the end of the tax period.

In addition, financial statements must be filed by the deadline for filing the tax return with the Register of Financial Statements ("Register").

Methodical Ordinance of the Ministry of Finance to filing and publishing of documents in the Register of Financial Statements.

Ministry of Finance (MoF) published in the first half of March 2014 methodical ordinance to filing and publishing of documents in the Register of Financial Statements which describes *inter alia* procedures upon electronic filing of financial statements.

Financial statements must be filed in an electronic form by those entities who are obliged to communicate electronically with the tax authorities, i.e. in particular registered VAT payers.

According to the published ordinance of MoF documents of corporate entities, such as financial statements, are not to be filed with the Register directly. Depending on the type of document, they should be filed via the electronic registry of the Finance Directorate (i) either as enclosure to a general filing (ii) or directly via completing designated electronic forms.

Based on the amendment to the Commercial Code the obligation to file documents with Collection of Deeds is deemed to be fulfilled by filing documents with the Register of Financial Statements. These documents need not be filed with the Collection of Deeds separately.

Methodical ordinance of MoF is available in the internet website of MoF: http://www.finance.gov.sk/Default.aspx?CatId=84&NewsID=672

Signature of the accounting entity's statutory body

According to Accounting Act one of compulsory content elements of financial statements is the signature record of the accounting entity's statutory body (or a member of its statutory body in the case of collective statutory bodies).

A signature record is defined as an accounting record containing an autograph [handwritten] or a similar supportable accounting record in a technical form substituting the autograph.

In this respect one of the topics subject to debate and polemic among professional public is the question whether the content requirement for signature of statutory body is met if financial statements are signed and filed electronically by a person who is not a statutory body but is authorized to communicate electronically with the tax authorities one behalf of the taxpayer.

It is expected that the tax authorities will publish instructions as to how the requirement for signature of statutory body upon electronic filing of financial statements should be met.

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As of 1 March 2014 the Slovak Republic introduces a new withholding tax rate of 35 % and special security tax of 35%, publishes a "white list" of non-affected countries.

The latest amendment to the Slovak Income Tax Act (further referred to as "SITA") introduced a qualified withholding tax rate of 35% that entered into force as of 1 March 2014. According to the new provision, the new special tax rate shall apply to certain payments (such as e.g. interest and royalties) made by Slovak tax residents to taxpayers of non-treaty countries. With respect to other taxpayers, the standard local withholding tax rate of 19% (or a reduced rate if an international treaty is in place) continues to apply.

Further, according to this amendment a new security tax rate of 35% was also introduced that shall apply to other payments to taxpayers of non-treaty countries. The security tax, however, shall not apply at all to payments remitted to EU and EEA tax residents.

A taxpayer of a non-treaty country is defined as an individual who does not have a permanent abode, or as a legal entity which does not have its seat in one of the treaty countries. A treaty country is defined as a country that is included in the list (so called "white list") published on the official web page of the Ministry of Finance. The white list shall include all countries that have concluded a double tax treaty or a treaty on exchange of information in tax matters with the Slovak Republic. The list shall also include countries who are parties to an international treaty providing for similar provisions on exchange of information as the above mentioned treaties, provided it is binding on both such a country and the Slovak Republic.

The "white list" currently includes only countries that have concluded a double tax treaty with the Slovak Republic. However, based on the definition of the White list in the SITA, it should also contain other countries that have concluded treaties on exchange of information and other similar treaties. Therefore, an update can be expected in the near future.

Further, as outlined above the security tax shall not apply to payments remitted to EU and EEA tax residents. Practically, we have experienced that the status of certain territories (e.g. Gibraltar) or other dependant territories of EU members may be misinterpreted by taxpayers, which could lead to potential tax risks or increased tax burden.

Finally, we would like to add that payments flowing from the Slovak Republic to non-EU and non-EEA countries need to be scrutinized as well, as particular provisions of EU law on fundamental freedoms may still be applicable.

In view of the above we recommend that taxpayers pay increased attention to the tax treatment of cross-border payments to be made after 1 March 2014. Internal audit of such payments is highly recommended. We can assist you in this respect and minimize potential risks or/and point out potential tax savings.

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The Ministry of Finance of the Slovak Republic issued a „white list“ which currently includes the following countries:

1	Australia	17	The Netherlands	33	Macedonia	49	The United Kingdom
2	Belgium	18	Croatia	34	Hungary	50	Serbia
3	Belarus	19	India	35	Malta	51	Sri Lanka
4	Bosnia and Herzegovina	20	Indonesia	36	Mexico	52	Syria
5	Brazil	21	Ireland	37	Moldavia	53	Spain
6	Bulgaria	22	Iceland	38	Mongolia	54	Switzerland
7	Cyprus	23	Israel	39	Germany	55	Sweden
8	Czech Republic	24	Japan	40	Nigeria	56	Taiwan
9	Montenegro	25	Republic of South Africa	41	Norway	57	Italy
10	China	26	Canada	42	Poland	58	Tunisia
11	Denmark	27	Kazakhstan	43	Portugal	59	Turkey
12	Estonia	28	Korea	44	Austria	60	Turkmenistan
13	Finland	29	Libya	45	Romania	61	Ukraine
14	France	30	Lithuania	46	Russia	62	USA
15	Greece	31	Latvia	47	Singapore	63	Uzbekistan
16	Georgia	32	Luxemburg	48	Slovenia	64	Vietnam

In one sentence …

- The Slovak Financial Directorate released the following guidelines and notifications:
  - Guideline on application of VAT by VAT group,
  - Guideline on tax guarantee,
  - Guideline on VAT Ledger Statement,
  - Manual containing practical information on filing the VAT Ledger Statement including Executive summary in English,
  - Guideline – persons not obliged to file the VAT Ledger Statement,
  - Guideline on VAT incurred with respect to goods and services purchased abroad and its impact on tax base,
  - Guideline on the taxation of rental income and related tax deductible expenses.

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