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Tax services

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Information published by the Tax Directorate on the application of Art 43 (6) of the Income Tax Act for taxpayers applying the financial year 2010/2011 as their tax period

With effect from 1 January 2011, the tax withheld from Slovak source income is deemed to be the final settlement of the tax liability for those Slovak tax residents who perform their bookkeeping in accordance with SAS or IFRS. Up to the end of 2010, the tax withheld from Slovak source income for these taxpayers was regarded as a prepayment on the final

tax liability calculated after the end of the respective tax period.

In order to avoid practical problems with the application of Article 43 (6) effective as from 1 January 2011 for those taxpayers applying the 2010/2011 financial year, the Tax Directorate recently published information on this matter.

The information states that, if the taxpayers' financial year started in 2010 and ends in 2011, the tax withheld from the income paid, credited or remitted to the taxpayer

- ▶ Up to and including 31 December 2010 should be regarded as a tax prepayment on the final tax liability calculated after the end of the tax period;

- ▶ As from 1 January 2011 should be deemed to be the final tax settlement. The income taxed by the withholding tax should not be included into the taxpayer's tax base and the respective withholding tax should not be reported in the tax return.

If you are interested in more information or have any questions regarding the above, please contact the author of the article or your partner or manager at Ernst & Young.



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Double Taxation Agreement between the Slovak Republic and Taiwan

The Ministry of Finance of the Slovak Republic has proposed the Agreement for the Avoidance of Double Taxation between the Slovak Republic and Taiwan. Once the Agreement is published in the Collection of Laws of the Slovak Republic, it will take precedence over the provisions of the Slovak Income Tax Act.

If you are interested in more information or have any questions regarding the above, please contact the author of the article or your partner or manager at Ernst & Young.



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OECD releases multi-country analysis of transfer pricing simplification measures

On 10 June 2011, the OECD published the main findings from its analysis of transfer pricing simplification measures existing in 33 OECD and non-OECD countries, as part of its project on the administrative aspects of transfer pricing.

The simplification measures analyzed in the survey were:

- ▶ Exemptions from transfer pricing rules or from transfer pricing adjustments;
- ▶ Simplified transfer pricing methods, safe harbour arm's length ranges and safe harbour interest rates;

- ▶ Exemptions from or simplified documentation requirements;
- ▶ Exemptions from or alleviated penalties;
- ▶ Simplified Advanced Pricing Arrangement ("APA") procedures or reduced APA charges.

Highlights of the survey are summarized below.

More than 70% of the available simplification measures are directed towards small and medium-sized enterprises ("SMEs"), minor transactions and low-value-added services.

Since approval of the OECD Transfer Pricing Guidelines (1995), simplification measures have been introduced almost every year. From 2001 onward, 4.8 simplification measures have been

introduced on average every year by the group of respondent countries.

In 20 out of the 33 respondent countries, transactions between domestic related parties are subject to the arm's length principle.

The results of this survey will help inform the work currently being undertaken by the OECD to improve the administration of transfer pricing, including a possible update of the related guidance included in the OECD Transfer Pricing Guidelines.

If you are interested in more information or have any questions regarding the above, please contact the author of the article or your partner or manager at Ernst & Young.



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Draft amendment to Old-age Pension Savings System Act

At its session on 8 June 2011, the Slovak Government approved with minor changes the draft amendment to the Old-age Pension Savings System Act (2nd pillar of the pensions system). The draft amendment was thus passed to the legislative process in the Slovak Parliament. We list below some of the major proposed changes aimed at stabilization of the old-age pension savings system which should become effective on 1 November 2011 and 1 April 2012:

- ▶ Introduction of mandatory participation in the system, with an exit option that can be used in the subsequent two years;

- ▶ Creation of fourth so-called "index" pension fund (the current conservative, balanced and growth pension funds are to be renamed as bond, mixed and share funds respectively);
- ▶ Introduction of the option to split the savings into two different pension funds, where one of the funds needs to be the bond fund;
- ▶ The guarantees in the mixed and share pension funds should be cancelled (the reviewed period for guarantee purposes in the bond pension fund should be extended from the current 6 months to 60 months);
- ▶ Changes in remuneration of pension funds management companies.

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Amendment to the Act on Illegal Work and Illegal Employment

The Slovak Parliament is currently discussing an amendment to Act No. 82/2005 Coll. on Illegal Work and Illegal Employment ("Act on Illegal Work") as well as amendments to related regulations in the Slovak legislation. The amendment should become effective on 20 July 2011.

The primary aim of the amendment is to transpose into Slovak law EU Directive No. 2009/52/ES which stipulates the minimum sanctions and measures imposed on employers of third country nationals who stay illegitimately in the territory of EU member states and of EU Directive No. 2009/50/ES on the conditions for entry and stay of third country nationals into the EU territory for the purposes of highly-skilled employment.

Below, we summarize the most important changes:

- ▶ The definition of illegal work and illegal employment has been extended - in the new wording, illegally employed persons will also include third country nationals who stay illegitimately within the territory of the Slovak Republic (i.e. without permission to stay in the Slovak Republic for purposes of employment);

- ▶ Inspections of illegal employment are transferred under the sole responsibility of the Labor Inspectorates;
- ▶ Inspections will be performed more frequently in the so-called "risk" sectors, i.e. those sectors which the authorities define as sectors with high rates of illegal employment;
- ▶ The employer who illegally employs third country nationals in the territory of the Slovak Republic will be obliged to settle the respective penalty as well as any additional payments (agreed monthly salary, respective tax liability and social and health insurance contributions, etc.). In the event that these payments are not settled by the employer, the amendment proposes that this obligation may be transferred to other (third) persons who participated in the process of the illegal work/goods or services in some way;
- ▶ The amount of the penalty will be imposed on the employer on the basis of the number of illegally employed persons;
- ▶ Infringements of this law will have a significant impact on those entities that draw state aid or seek to draw state aid. The relevant conditions/sanctions were transferred from Act No. 231/1999 Coll. on State Aid to Act No. 523/2004 Coll. on Budgetary Rules of the Public Administration;
- ▶ Also, in accordance with the Amendment to Act No. 25/2006 on Public Procurement, any infringement of the prohibition on illegal employment will be deemed to be a serious breach of professional duties and, as such, will result in the exclusion of any such entity from participation in any public procurement process.

In addition, the amendment introduces the so-called "Blue Card" for highly skilled third country nationals, which should facilitate the process of them gaining permission to stay in the Slovak Republic for the purposes of employment.

If you are interested in more information or have any questions regarding the above, please contact the author of the article or your partner or manager at Ernst & Young.



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Cancelled supplies - input VAT deduction in respect of factoring services and correction of tax base - judgment of the Slovak Supreme Court

The Slovak Supreme Court (the “Court”) recently published its decision dealing with the VAT implications of cancelled supplies, i.e., with the non-existence of supplies for VAT purposes, the deductibility of input VAT incurred in respect of factoring services and the procedure for correction of the VAT base in similar situations.

Background of the case

The VAT payer issued invoices to the customers in respect of supplies of goods prior to the goods being physically handed over to the customers. The VAT payer transferred his claims towards the customers to a factoring company and claimed input VAT deduction in respect of the factoring fees. The invoices were eventually cancelled (as no goods were ever supplied to the customers) and the VAT payer issued credit notes to the customers. The correction of the VAT base and the amount of VAT were reflected by the customer in the VAT periods of issue of the credit notes.

During the VAT audit, the tax authorities rejected the deduction of input VAT from the factoring fees, arguing that the underlying supplies to customers were never performed; hence, no receivables towards customers which could have been transferred to the factoring company ever existed.

The tax authorities further challenged the correction of the tax base in the periods of issue of the credit notes. According to them, as no supplies occurred, the conditions for correction of the tax base stipulated by the VAT Act were not met. Instead, the VAT payer should have reclaimed the VAT by filing supplementary VAT returns.

Court's decision and relating practical implications

In its ruling, the Court endorsed the reasoning of the tax authorities and the judgment of the Regional Court and rejected the VAT deduction in respect of the factoring services. The Court argued that the conditions for VAT deduction were not met; in particular, no supply existed from the factoring company to the plaintiff. According to the Court, the formal existence of an invoice (not accounted for by a customer) for a supply that was never made is not sufficient for a receivable to be deemed to occur. Subsequently, there was no debt, hence the VAT payer could not have received services from the factoring company in respect of the debt transfer.

The Court further ruled that the VAT payer could not have applied the procedure of VAT correction, reasoning that a VAT payer may correct a VAT base only in the event of a full or partial cancellation/return of a supply.

Practical considerations

VAT payers should be aware that the tax authorities are increasingly taking into consideration the substance of the transactions instead of relying on the paper evidence, i.e. they should be able to substantiate for VAT purposes that supplies were actually performed (the customer acquired the right to dispose of the goods as an owner). VAT payers should review their systems of issuing credit notes and to consider carefully whether the procedure of correction of a VAT base, as stipulated by the Slovak VAT Act, can be applied.

If you would like to receive more detailed information regarding this judgment, please contact the author of this article or your partner or manager at Ernst & Young.



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Import VAT postponed accounting scheme to be introduced from 2013

The Government approved the amendment to Act No. 563/2009 Coll. Tax Administration Act and passed it on to Parliament on 8 June 2011. The amendment also contains changes to the VAT Act. The changes, amongst others, include the provisions introducing the import VAT postponed accounting scheme from 1 January 2013.

Under the scheme, selected VAT payers are to be allowed to postpone the payment of VAT due on the import of goods from outside the EU. Deferral will be

performed by declaring the import VAT on the regular VAT return filed for the tax period in which the import takes place. This will bring cash-flow savings for many VAT payers importing goods, as the import VAT declared can be deducted immediately in the same VAT return (upon meeting the relevant conditions for deduction).

Payment of import VAT may be postponed on condition that the VAT payer can prove that no outstanding liabilities exist towards the customs and tax authorities as of 30 November of the previous year. This entails "zero tolerance" towards any underpayments, including those that are unintentional, resulting from errors or those of minimal value. There are also certain minimum

thresholds concerning the volume of imports applicable in order for the importers to benefit from the scheme.

The amendment will undergo further discussion in Parliament. The import VAT postponed accounting scheme may therefore be subject to further changes with regard to the implementation conditions as well as its scope of application.

If you are interested in more information or have any questions regarding the above, please contact the author of the article or your partner or manager at Ernst & Young.



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Information paper on refund of VAT to foreign entities from third countries

The Slovak Tax Directorate recently published its information paper summarizing the main changes to Articles 56 to 58 of the Slovak VAT Act, applicable for VAT refund requests submitted by foreign entities from third countries for the calendar year 2010 ("Information paper"). The changes addressed are as follows:

- ▶ Requests for VAT refunds should be submitted for the period of the whole calendar year; submission of requests for periods shorter than the calendar year is not permitted;

- ▶ Foreign entities performing transport services in accordance with Article 46 of the Slovak VAT Act are obliged to register for Slovak VAT and are, therefore, no longer entitled to VAT refunds under the VAT refunds procedure;
- ▶ Requests for VAT refunds may be submitted only if the amount requested exceeds EUR 50 (EUR 25 in 2009);
- ▶ If the VAT is refunded on the basis of false information, the tax authorities will charge penalties in accordance with Article 35/1/g of the Slovak Act on Tax Administration; the penalty calculated as 50% of VAT refunded without entitlement will no longer be applied.

Along with these changes and some basic information regarding the VAT refund, the Tax Directorate wishes to state that it holds no list of refundable goods, or any list of third countries and range of refundable goods and services for entities from third countries.

The paper also emphasizes that the deadline for submission of requests for VAT refunds for entities from third countries is 30 June of the subsequent calendar year.

If you are interested in more information or have any questions regarding the above, please contact the author of the article or your partner or manager at Ernst & Young.



Free Trade Agreement between EU and Korea to take effect from 1 July 2011

South Korea's parliament ratified a free trade agreement with the European Union in May this year. This represented the final hurdle before the agreement can take effect from 1 July 2011.

On the part of the European Union, the EU Parliament confirmed the Free Trade Agreement on 17 February 2011. Thanks to this agreement, businesses from both sides will soon be able to trade more freely and easily.

The declaration of origin on the invoice will be the only acceptable proof of preferential origin (EUR 1 certificates will no longer be accepted). Exporters will therefore need to obtain the status of "approved exporter".

The agreement and its significant duty concessions afford Korean exporters significant benefits over other manufacturers from Asia. However, access to the preferential tariff treatment is not automatic, with some requirements (such as "approved exporter" status) necessary for exporters to benefit from the agreement.

The agreement is expected to boost the value of trade in goods between South Korea and the EU, as most tariffs and trade barriers will be lifted within the next five years.

If you are interested in more information or have any questions regarding the above, please contact the author of the article or your partner or manager at Ernst & Young.

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Other



Binding opinions to be issued by Slovak tax authorities

The Slovak Ministry of Finance recently released its Proposal on measures enhancing the provision of information by tax and customs administration. The proposal aims to improve the business environment and to increase legal certainty, as well as to facilitate entrepreneurs' access to relevant information. As from 1 January 2013, taxpayers should be entitled to request a tax authority to issue a binding opinion on a complex issue in respect of any tax area. As a result, this amendment should represent a legal recourse by which taxpayers might confirm the implications of certain transactions in advance.

Pursuant to the Proposal, the tax authority should have a 30-day period for preparation of the respective response. The binding opinions should be subject to a flat fee of EUR 2,000 in order to cover the costs for the tax authorities and to mitigate the risk of taxpayers' making excessive use of this mechanism for routine tax questions.

The Government discussed and accepted the Proposal during the last June week. We will monitor the developments closely and inform you of any significant changes in our future issues of Tax news.

Ernst & Young has recently prepared a publication comparing various concepts in the area of Alternative Dispute Resolution, which covers the concept of Binding Rulings.

[The document can be accessed by clicking here.](#)

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Reform of the tax administration

As we informed you briefly in a previous Tax news (April issue), the Ministry of Finance has prepared an extensive amendment to the Tax Administration Code as part of the wider reform of the Slovak tax administration system.

The Government has already approved the proposed amendment and it is expected to be passed by the Slovak Parliament in the autumn. We will continue to monitor the ongoing legislative process and will inform you of any significant developments.

On a related note, the reform of the tax administration will also mean a change in the structure of the Slovak tax authorities which may have an impact on taxpayers.

The following major changes are expected:

- ▶ The Customs Directorate and Tax Directorate will be merged to form the Financial Directorate as of 1 January 2012. The tax and customs authorities will be merged in the subsequent stage (1 January 2013).
- ▶ Only eight ordinary tax authorities will remain as from 1 January 2012.
- ▶ The competency of the Tax Authority for Selected Taxable Persons will be extended to cover the whole territory of the Slovak Republic. Amongst others, this change will affect taxpayers with their registered seat outside of the Bratislava region and with accounting revenues exceeding EUR 40,000,000, which are currently not subject to control from the Tax Authority for Selected Taxable Persons.

- ▶ The Criminal Office for the Customs Administration will be renamed as the Criminal Office for the Financial Administration and will also have authority in tax matters from 2012.
- ▶ The Financial Authority for the Eastern Border should be established as of 2013.

If you are interested in more information or have any questions regarding the above, please contact the author of the article or your partner or manager at Ernst & Young.



Singapore Project - Proposal for reform of the business environment

The Ministry of the Economy recently analyzed the administrative burden imposed on the business sector.

The Ministry quantified the total administrative burden imposed on the business sector at EUR 1.98 bn per year, which represents almost 3% of Slovak GDP.

As a result of this analysis, the Ministry prepared a proposal of Government policy for improvement of the business environment in Slovakia (the so-called "Singapore Project").

The aim of the new policy is to decrease the administrative costs for the business sector by EUR 100 million per year. The Ministry identified 100 short-term and medium-term measures, relating also to changes in the Commercial Code and tax legislation. Some of the measures should be implemented in 2012.

In the tax area, the changes are to include, for example, the abolition of various notification obligations and simplification of the tax reporting process (user-friendly format of tax returns, electronic tax filing, etc.).

We will inform you of further developments in this respect.

[Please click here if you would like to read more about the Singapore project.](#)

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Proposed amendment to the Slovak Bankruptcy Act to be discussed in the Slovak Parliament

The amendment to Act No. 7/2005 Coll. on Bankruptcy and Restructuring ("Bankruptcy Act") proposed by the Ministry of Justice of the Slovak Republic has progressed through the early stages of the legislative process and is currently undergoing its first reading in the Slovak Parliament.

As we informed you in a previous issue of Tax news, the proposal introduces an important change with regard to the conditions under which companies and entrepreneurs are required to file for bankruptcy. At the same time, it modifies the liability of members of the statutory bodies for not complying with the obligation to initiate bankruptcy proceedings when the conditions as stipulated by the law were met.

The current wording of the proposal also addresses more specifically the amount up to which the members of the statutory bodies may be held liable for failing to file a motion for bankruptcy proceedings within the due period. In accordance with the current wording, the statutory representatives should be held liable up to the amount of the company's registered capital at the time when the bankruptcy proceedings should have been initiated, but not exceeding the amount of two times the minimum registered capital, as stipulated by the Slovak Commercial Code.

The amendment should become effective from 1 January 2012. We will monitor the development closely and inform you of any significant changes in our future issues of Tax news.

If you are interested in more information or have any questions regarding the above, please contact the author of the article or your partner or manager at Ernst & Young.

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