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Amendment to the OECD Commentary on Article 5 (Permanent Establishment) of the Model Tax Convention released for public discussion

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The OECD has released of the proposed changes to the OECD Commentary on Article 5 of the Model Tax Convention ("the Commentary") for public discussion.

The document addresses various issues related to the definition of permanent establishment which are not sufficiently covered in the current version of the Commentary.

Below we have provided an overview of the most relevant issues which are dealt with in the discussion draft:

- ▶ definition of the term "at the disposal of" for the purposes of the fixed place permanent establishment concept
- ▶ individual's home office as a fixed place of business for a company
- ▶ time requirements for the existence of a permanent establishment
- ▶ circumstances in which the presence of a foreign enterprise's personnel working for the benefit of a host country's company may create a permanent establishment
- ▶ additional works performed on a construction site after completion of a construction project
- ▶ clarification of the term "to conclude contracts in the name of the enterprise" for the purposes of the dependent agent permanent establishment concept.

The public discussion closes on 10 February 2012 and the respective working party should examine the comments at its next meeting. The approved changes are planned to be included in the Commentary through the next update, which is currently scheduled for 2014. We will inform you of all future developments in this respect.

We would be pleased to discuss with you the potential practical implications of the proposed amendment to the OECD Commentary that may arise for your company. If you would like more information or have any questions regarding this issue, please contact the author of the article or your partner or manager at Ernst & Young.



"Construction" as a permanent establishment concept - Guideline of the Slovak Tax Directorate

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The Slovak Tax Directorate recently published a guideline seeking to unify the approach of the Slovak tax authorities dealing with situations when a "construction" as a permanent establishment of

a foreign entity could be created within the territory of Slovakia.

The wording of the guideline is generally based on and follows the respective provisions of the OECD Model Tax Convention on Income and on Capital and the Commentary thereon. The guideline provides for more detailed definitions of terms relevant for the conclusion on the existence of a "construction" as a permanent establishment in Slovakia and deals with the following:

- ▶ conditions for the creation/termination of the existence of a "construction" permanent establishment in Slovakia;
- ▶ existence of a fixed geographical point for the purposes of the "construction" within the permanent establishment concept;
- ▶ the relation between international treaties, domestic legislation and the guideline.

The guideline also deals with several practical situations such as:

- ▶ production of components by a foreign company on the premises of its Slovak customer using its own mobile production facility;
- ▶ realization of assembly projects by a foreign

company in different places and for different customers in Slovakia;

- ▶ temporary interruption of a construction project;
- It is our belief that the Guideline could have a positive impact, as it should serve as a useful interpretation basis for tax subjects dealing with the presence of

foreign entities within the territory of Slovakia.

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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Amendment of the Income Tax Act in relation to amendment of the Tax Administration Code

On 6 October 2011 the President signed the amendment of the Tax Administration Code, which replaces the current Act on Tax Administration with effect from 1 January 2012. We already informed you of this amendment in our Tax news edition No. 4/2011.

In respect of this, we would like to draw your attention to the most significant changes of the Income Tax Act that were approved in addition to the draft governmental proposal:

- ▶ Employers will be obliged to submit tax withholding reports on a monthly basis. The reports will contain the personal information of employees and they will have to be filed by the end of the calendar month following the applicable calendar month.
- ▶ The annual reports containing the information on the tax reconciliation, total amount of employment income and tax bonuses will contain summary data (without reporting per individual employee), regardless of whether the income for the previous tax period was paid in cash or in kind.
- ▶ Following the upcoming change of the tax settlement system (with anticipated effectiveness from

1 January 2012), the amendment also adjusts the deadline for payment of the tax liability in the event that the tax administrator does not announce to a taxpayer the number of the bank account of the taxpayer within the tax return filing deadline. In such cases, the deadline will be postponed (i.e. the tax is not due within the tax return filing deadline) and the taxpayer will be obliged to pay the tax within eight days after receipt of the announcement.

Below we summarize other changes approved without significant adjustments, which we already briefly outlined in April's Tax news edition:

- ▶ Income Tax Act introduces definitions of the terms „advance tax payment“ and „taxpayer“.
- ▶ In justified cases, the tax administrator may, upon a taxpayer's request, stipulate the tax advances on an individual basis (up to now this was possible only if the expected final tax liability did not correspond to the tax advances paid).
- ▶ Should the employer fail to prepare the annual tax reconciliation for the employee(s), provided that the employee(s) applied for the reconciliation and all the conditions for annual reconciliation were met, the tax administrator may impose a penalty of a minimum of EUR 15 per employee (however not exceeding EUR 30,000 for all employees).

- ▶ An article dealing with the complaints of taxpayers about incorrectly withheld tax or high tax advance paid by employers was implemented into law.
- ▶ Provisions dealing with the registration and reporting obligations of taxpayers, among them the obligation to announce the creation of a permanent establishment of a foreign entity based on a concluded contract and the obligation of reporting material cash transactions exceeding EUR 5,000 per year were transferred from the Act on Tax Administration to the Income Tax Act.
- ▶ The amendment also introduces procedural details in the area of the submission of corrective tax withholding reports and supplementary annual reports. In this regard, the amendment also stipulates the obligation on a tax administrator to request an additional explanation from the taxpayer in the event of doubt as to the correctness or completeness of the submitted reports.

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



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Tax and social security reform is stopped

In our previous Tax news editions, we informed you of the proposal for extensive tax and social security reform which was to be implemented in Slovakia as of 1 January 2012.

Due to recent political developments, the reform has been stopped and the proposal for the act on the adjustment of the income from dependent activities has been withdrawn from the parliamentary session.

However, simplification, unification and rationalization of the collection of taxes and social security / health insurance contributions still remain a part of a bigger and thriving project. We can, therefore, expect some form of tax and social security reform in the near future, but this is unlikely to come into effect before 2013.

If you would like more information or have any questions regarding this issue, please contact the author of the article or your partner or manager at Ernst & Young.

Value Added Tax



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Proposed Amendment to the Value Added Tax Act

We would like to inform you about a new draft amendment to the VAT Act ("the Amendment") which was recently subject to public discussion. The Amendment aims to introduce provisions against tax evasion in the area of value added tax ("VAT"). In the event of its approval, the Amendment will be effective as of 1 April 2012.

In the following section, we provide an overview of the main changes to be introduced by the Amendment:

- ▶ Obligation to pay a tax guarantee in an amount ranging from EUR 1,000 to 500,000 for taxable persons applying for VAT registration and meeting the conditions listed in the VAT Act (if taxable person or its related persons e. g. statutory representatives or shareholders have tax underpayments exceeding EUR 1,000; persons whose registration was cancelled in the past; newly

established taxable persons performing preparatory activities).

- ▶ Extension of "local reverse charge mechanism" to situations when (i) the VAT payer supplies an immovable property to another VAT payer and decides not to apply the VAT exemption, (ii) the VAT payer supplies an immovable property within enforcement or bankruptcy proceedings.
- ▶ Extension of joint and several liability for output VAT relating to supplies of goods and services which were not remitted by the supplier to the tax authorities. If the customer knew, could have known or should have known that the supplier would not remit the VAT liability to the tax authorities, he becomes jointly and severally liable for the unpaid VAT. The amendment lists the situations when the customer is deemed to have this knowledge: (i) the consideration for the supplied goods or services differs from the fair market value without any business reason; (ii) the customer was notified by the tax authorities that there were no longer any reasons for the supplier's VAT registration; (iii) the supplier and the customer are related parties.
- ▶ The cash register receipt is to be considered a valid invoice for VAT purposes if (i) the price of goods and services including VAT and paid in cash does not exceed EUR 200, (ii) the price of goods and services including VAT and executed by other means (e.g. bank transfer) does not exceed EUR 1,600.
- ▶ A taxable person who supplies an immovable property is obliged to register for VAT prior to making a supply of the immovable property by which he would exceed the mandatory registration threshold (unless the supply is exempt from VAT).
- ▶ Obligation on VAT payers to keep records about a means of transport acquired from a VAT payer established in another EU member state with the intention of subsequent sale. The records should be submitted to the tax authorities together with the respective tax return; otherwise a penalty of up to EUR 10,000 may be imposed by the tax authorities.

We will closely monitor the ongoing legislative process of the Proposed Amendment to the Value Added Tax Act and will provide you with any relevant updates and developments.

Indirect amendment to the VAT Act

We already informed you in the Tax news no. 6/2011 about an Amendment to the Tax Administration Act ("the Amendment") which also introduced changes to the VAT Act. This amendment has now been

approved by the Parliament. Below, we summarize the main changes introduced:

- ▶ The import VAT postponed accounting scheme was approved with its effectiveness from 1 January 2013.
- ▶ If the excess VAT is refunded on the basis of a tax return that includes incorrect data, the tax authority may impose a penalty amounting to 1.3 % of the excess VAT refunded.

If you would like more detailed information about the above Amendments, please contact the author of the article or your partner or manager at Ernst & Young.



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CJEU judgment in C-421/10 Finanzamt Deggendorf vs Markus Stoppelkamp - Concept of "taxable person established abroad"

On 6 October 2011 the Court of Justice of the European Union ("CJEU") published its decision in case no. C-421/10 Stoppelkamp, concerning the applicability of reverse-charge procedure on services provided by a supplier residing in the same country as the customer but having established the seat of his economic activities in another country.

In this case, Mr Raab, a resident of Germany having the seat of his economic activities registered in Austria, performed supplies of his own staff to

transport companies established in Germany. Considering the general rule for place of supply of services and taking into account the location of the seat of his economic activities, for the supplies of services to German transport companies Mr Raab applied the reverse-charge procedure and issued invoices under his Austrian VAT registration number, exclusive of VAT.

The German tax authorities, however, took the view that, in the respective case, the conditions for the reverse-charge procedure were not met and issued a VAT assessment notice to Mr Raab's address. They argued that Mr Raab had his personal residence in Germany and, therefore, he could not be deemed to be "a taxable person established abroad". Mr Raab disputed this reasoning and the case ended up in front of the CJEU.

Having reviewed the situation in hand, the CJEU did not support the reasoning of the German tax authorities. Instead, it concluded that, in order to be considered a 'taxable person who is not established within the territory of the country', it is sufficient that the taxable person has established the seat of his economic activity outside of that country. If such a place is genuine, the place of personal residence is not substantial when determining the place of supply of service.

If you would like more information or have any questions regarding this issue, please contact the author of the article or your partner or manager at Ernst & Young.



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CJEU judgment in joint cases C-180/10 Jaroslav Slaby vs Minister Finansów and C-181/10 Emilian Kuć, Halina Jeziorska-Kuć vs Dyrektor Izby Skarbowej w Warszawie regarding exercise of ownership rights

On 15 September 2011 the Court of Justice of the European Union (“CJEU” / “the Court”) published its decision in the joint cases C-180/10 and C-181/10, concerning the issue of whether the disposal of several plots of land purchased as agricultural land and later reclassified to building land must be subject to value added tax (“VAT”).

Background

Mr Slaby, Mr Kuć and Ms Kuć, as natural persons not performing an economic activity, purchased land designated for agricultural purposes. Later on, there was a change in the urban management plan and the land in question was reclassified and designated for a holiday home development. Following that change, they began to sell plots of the land to various

purchasers. According to the Polish authorities, the division of the land into plots indicated the intention to make repeated sales, therefore the transactions constituted an economic activity subject to VAT.

This interpretation was challenged and the CJEU subsequently dealt with the question of whether a natural person who divided land purchased VAT-free which was a part of his private property into smaller parts and began disposing of it is a taxable person for VAT purposes.

Reasoning and decision

According to the ruling, when considering whether the transactions in question represent an economic activity subject to VAT, it is neither decisive that the land was divided into plots in order to obtain a higher overall price of the land, nor is the level of income derived relevant or the period of time over which those transactions take place. The Court further concluded that the number and volume of sales are not in themselves decisive, since a large volume of sales may also be performed by operators acting in a private capacity.

However, if the person takes active steps for the purpose of concluding the sales, in ways similar to those deployed by a producer, a trader or a person supplying

services, that person must be regarded as performing an economic activity and, therefore, be regarded as a taxable person for VAT. According to the Court, such steps may consist of, for example, preparatory work on the land to make the further development possible or the deployment of proven marketing measures. Such initiatives are normally not performed in the course of management of personal property, i.e. the supply of land in such a situation cannot be regarded as the mere exercise of ownership rights and constitutes an economic activity for the purposes of VAT.

Conclusions and remarks

It is of interest to note the criteria specified by the Court for distinguishing between the activity of taxable persons and the “mere exercise of ownership rights” by the holder of property. These criteria should be thoroughly considered when encountered in transactions of exploiting property, especially in situations when the property was previously used for other purposes and as a part of private property.

If you would like more information or have any questions regarding this issue, please contact the author of the article or your partner or manager at Ernst & Young.



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Judgments of the Slovak Supreme Court dealing with the right to deduct input VAT

We would like to inform you of two recent judgments of the Slovak Supreme Court (“the Court”) dealing with the right to deduction of input VAT from services conducted on the basis of business contracts.

I. Deduction of input VAT incurred in respect of activities of developers

Background

The Slovak VAT payer concluded a contract of a non-specified character (framework contract) with an investor, based on which he was obliged to develop a shopping centre and arrange for its full occupation by tenants for a period of five years.

The VAT payer incurred input VAT in respect of construction work performed on the request of a future new tenant. The input VAT was deducted by the VAT payer in the VAT return for the respective period.

During a tax audit, the tax authorities challenged the deduction of the input VAT, arguing that the VAT payer was neither the owner nor the lessor or lessee of the premises where the construction work was

performed and, thus, did not use the services for his taxable activities. Instead, the services were used for the business purposes of other individuals (either owner or tenant). In other words, the tax authorities challenged the direct link between the input VAT and the taxable transactions of the VAT payer. Moreover, the tax authorities argued that, according to the contract, the VAT payer was not obliged to conduct any construction or reconstruction work for new tenants.

In appealing this decision, the VAT payer argued that the construction services were used for his business purposes. Although the contract did not explicitly provide for his obligation to conduct construction services for new tenants, this was indirectly implied by his obligation to arrange for full occupation of the shopping centre. Moreover, the remuneration of the VAT payer was dependent on the full occupancy of the shopping centre. The VAT payer additionally argued that, without performing the construction work as required by the new tenant, the tenant would not have concluded the lease agreement.

Decision

The Court's decision confirmed the approach and argumentation of the tax authority (previously confirmed by a Regional Court). According to the Court's reasoning, the VAT payer did not substantiate that he was explicitly acting in the course of his taxable activities when arranging for the construction work, as he did not have any legal relationship to the premises and no such obligation was specifically mentioned in the contract.

II. Deduction of input VAT in the case of lease relationship

Background

In the second case, the tax authorities rejected the input VAT deduction incurred in respect of services received by the VAT payer for reconstruction of the leased object. The tax authorities argued that the VAT payer had not concluded a valid lease agreement as only one statutory representative of the lessor had signed the lease agreement whereas the signatures of two statutory representatives had been required for validating actions on behalf of the lessor. As there was no valid lease agreement, the VAT payer had not received the services for purposes of his taxable activities performed in the leased object.

In its appeal, the VAT payer argued that he was acting in good faith when concluding the lease agreement and both the lessor and the VAT payer considered the lease agreement to be valid. Moreover, this formal omission was later (however, prior to the tax audit) rectified and the lease agreement was signed by two statutory representatives of the lessor.

Decision

The Court cancelled the decision of the tax administrator (confirmed by a Regional Court) and returned the case for further proceedings to ascertain whether circumstances other than the invalid lease agreement could substantiate the rejection of input VAT deduction.

Practical implications of the decisions

Both decisions again show that the Slovak tax authorities tend to attach greater relevance to the formal aspects of business relationships instead of to their economic substance. In the first case, the formalistic approach was also confirmed by the Court; however, the second decision shows some shift in the approach of the Court in favour of VAT payers.

The first case, however, is of particular practical concern as the court confirmed what appears to be an unreasonably formalistic approach. Indeed, on the face of it, it seems clear that the expenditure was aimed at the purpose of leasing the property which again seems to be the business purpose. The case, however, does not discuss some important details. Specifically, the tax authorities had probably not analysed whether the VAT payer conducted an economic activity for VAT purposes (it is not clear from the wording of the case what the relationship between the developer and the investor was and how the developer was remunerated for his activities).

If you would like more information or have any questions regarding this issue, please contact the author of the article or your partner or manager at Ernst & Young.



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Changes in tax administration from 2012 onwards

We would like to inform you of some of the most important changes in the area of tax administration effective from January 2012.

The changes will be introduced due to a new Tax Procedure Code No. 563/2009 Coll. as amended coming into effect. The most important differences compared to the current rules include the following:

- ▶ All registered VAT taxpayers, tax advisors and attorneys acting on behalf of taxpayers will be obliged to submit all filings addressed to the Slovak tax authorities electronically. This will be done either with an advanced electronic signature or by concluding a written agreement in person with the Slovak tax authorities which should contain conditions for an alternative means of electronic

communication. The tax administrator will deliver the documents electronically to taxpayers from 1 January 2013.

- ▶ The maximum duration of a tax audit will be extended to one year (currently it is six months) and will also be valid for a repeated tax audit. It will also be possible to interrupt the tax audit under specific circumstances (e.g. in case of simultaneous proceeding about a preliminary question relevant for the tax audit).
- ▶ Signatures on powers of attorney authorizing other persons to represent taxpayers will not need to be notarized. The power of attorney for the authorized person will be effective in respect of the tax administrator only after its delivery.
- ▶ Taxpayers will be obliged to file a supplementary tax return in the event of (i) the VAT return not containing correct entries related to taxable

transactions even if these changes do not have any impact on the final tax position or (ii) the tax loss reported in the ordinary tax return needs to be decreased.

- ▶ The penalty for a breach of non-monetary obligations will be reduced from EUR 33,190 to EUR 3,000 and will be unified for all types of taxpayers.

Among other changes, there will be a change in the organizational set-up of the tax authorities, leading to the formal removal of the current assigned tax authority of some of the taxpayers and possibly causing changes to the usual tax authority contacts.

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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- ▶ The Slovak Government has adopted the Regulation by which the **monthly minimum wage in Slovakia will be increased to EUR 327.20 as of 1 January 2012**. The increase in the minimum wage will also affect the minimum contributions for social and health insurance for employees and employers, as well as the taxpayer's entitlement to tax allowances such as child bonus and employee premium.
- ▶ The members of SMER-SD opposition party recently introduced a proposal regarding the implementation of **progressive income tax rates**. To ensure a higher state budget income, it is proposed that the currently applicable flat rate of income tax of 19% is increased (i) to 25% in the case of individuals with annual income exceeding EUR 33,000 (ii) to 22% in the case of companies with a tax base exceeding EUR 30 million and (iii) application of 5% dividend tax rate.
- ▶ According to a press release of 19 September 2011 issued by the Serbian government, it is expected

that Serbia and the Slovak Republic will soon sign the social security agreement (“totalization agreement”) covering the social security and employment area.

- ▶ **“Explanatory Notes” on Council Directive 2010/45/EU on VAT Invoicing** have been published. The Explanatory Notes are not legally binding but serve as an informal guidance tool that can be used to clarify the application of the VAT invoicing rules valid from 1 January 2013. The Notes have been published more than one year prior to the date of implementation of the new invoicing rules and they are expected to allow Member States to transpose new legislation into their national laws in a more uniform way and to provide businesses with the necessary information to adopt the new rules before the date of implementation.

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