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Proposed Amendment to the Income Tax Act

The Slovak Government recently approved a Proposal to amend the Income Tax Act which should come into effect on 1 January 2012. A similar proposal was submitted earlier this year within the proposed Act implementing the Tax and Social Security Reform. The proposed Amendment should now go for discussion by Parliament. Further modifications may be adopted in the course of the parliamentary proceedings.

Here we provide an overview of the main changes introduced by the Amendment:

a) Financial lease

- ▶ Unifying the tax depreciation of tangible assets acquired through financial lease with assets acquired in other ways. Tangible assets acquired through financial lease are to be depreciated over

the standard period stipulated by the ITA, rather than over the period of the lease.

- ▶ The draft amendment introduces specific provisions covering adjustments to the tax base in the event of:
 - ▶ Breach of the conditions of the financial lease
 - ▶ Purchasing a leased asset for less than the net book value of the asset

These provisions should apply to tangible assets acquired under financial lease agreements concluded after 31 December 2011. Under the proposed transitional provisions of the ITA, existing financial lease agreements should continue to be governed by the current rules. Provided that due commercial reasons apply, taxpayers may consider acquiring assets through financial leases prior to the year-end, so as to benefit from the accelerated tax depreciation.

b) Depreciation of tangible assets

Tax depreciation charges would no longer apply in the full yearly amount for tangible assets acquired during the tax year. The Amendment introduces proportional tax depreciation charges to commence in the month in which the asset is put into use. This should apply to tangible assets put into use after 31 December 2011.

c) Carry-forward of tax losses generated by individuals

Only tax losses generated from business income and income from independent activities would be eligible to be carried forward. The Amendment puts an end to the option by which individuals could carry forward tax losses generated from rental income.

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 C-126/10 Foggia - Sociedade Gestora de Participações Sociais SA

The Court of Justice of the European Union ("CJEU") recently released its judgment in the case of Foggia - Sociedade Gestora de Participações Sociais SA ("Foggia"), concerning a transfer of tax losses following an operation to merge companies belonging to the same group.

Through a merger operation, Foggia, a Portuguese holding company, acquired three other holding companies belonging to the same group. The Portuguese Ministry of Finance subsequently rejected the transfer of tax losses carried forward by one of the holding companies on the basis that Foggia had no commercial interest in acquiring that company. The Portuguese Ministry of Finance argued that the company so acquired had ceased to have a portfolio of holdings, it had practically no revenue from its

activity, it had invested only in securities while it declared enormous tax losses of undetermined origin. Although the Ministry accepted that the restructuring might clearly lead to a reduction in administrative and management costs, it could not even start to be considered as being of commercial interest.

The case was subsequently brought before the CJEU, seeking clarification on whether such a transaction might be considered as having valid commercial reasons.

According to the CJEU there is nothing to prevent a merger operation from having valid commercial reasons where it performs the restructuring or rationalization of a group allowing its administrative and management costs to be reduced. However, this would not pertain for an acquisition operation, where it is clear that, with regard to the magnitude of the anticipated tax benefit, the saving made by the group concerned in terms of cost structure is quite marginal.

The Court added that the competent national authorities, in determining whether a transaction might have valid commercial reasons, need to examine the specifics of each individual case and must not confine themselves to applying predetermined general criteria.

Taxpayers need to pay close attention to structuring their transactions as a result of this judgment, as the tax authorities might not consider some of them as

having valid commercial reasons in the event that the tax advantage gained by the transaction significantly exceeds further cost savings achieved.

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.

Personal Taxation



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Reclassification of gift to taxable income - Decision of the Czech Supreme Administrative Court

The Czech Supreme Administrative Court (the "Court") has published its judgment (No. 8 Afs 45/2011) dealing with the classification of income from a trust.

Situation

The case involved the payment of a share from a trust to a shareholder (individual) of Harvard Industrial Holding ("HIP"). The funds were transferred to the trust by HIP Cayman Limited. Withdrawal of funds from the trust was conditioned upon ownership of shares in HIP. The taxpayer deemed the payment from the trust to be a gift not subject to income tax, while the tax authority reclassified the income as taxable and levied additional personal income tax. The

taxpayer argued that HIP Cayman Limited transferred the funds to the trust on a voluntary basis and also defined the conditions and method of payment from the trust to the HIP shareholders without requiring any consideration.

Decision

The case was referred to the Czech Supreme Administrative Court which dismissed the taxpayer's claim. The Court only examined the question of the subject of gift tax and ruled that, in order to be treated as a gift, it would have to meet the criteria for a donation under the Czech Civil Code, namely (i) the subject of the gift, (ii) its provision for free, and (iii) its voluntary nature. The Court concluded, without, unfortunately, providing a more detailed analysis, that these criteria had not been met and that no gift, therefore, was entailed.

In its conclusion, the Court stated that neither the legal character of a trust nor the reasons for the distribution of monetary assets were pertinent in the

case in question, and that they could not affect the conclusion that the criteria for a donation had not been met.

Practical implications

This Court decision does not provide an answer as to how the payment from a trust under similar circumstances should be treated for tax purposes. Similarly, for Slovak taxpayers, it is not clear whether such a payment should be considered as a gift, a dividend payment or other taxable income. It appears, from the interpretation applied by the Slovak Ministry of Finance and tax administration, that a dividend payment is to be understood quite strictly, i.e. such a payment is only not subject to tax when it is paid out of post-tax profits.

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.



CJEU judgment in C-225/10 and C-503/09 - social security benefits for migrant workers

The Court of Justice of the European Union ("CJEU") considered two cases dealing with the entitlement of individuals to payments from the social security system in the case of migrant workers.

In the first case, the CJEU considered whether Spanish residents with handicapped children are entitled to social security benefits from the German system if they (1) as migrant workers, contributed to the German social security system in the past

and (2) they were already receiving Spanish non-contributory benefit for handicapped persons.

In this respect, the CJEU gave consideration to the meaning of the term "family allowances" for the purposes of the European social security legislation.

In the second case, the CJEU was considering whether the UK can refuse to grant "a short-term incapacity benefit in youth" to a person with Down's syndrome solely due to the fact that she did not have "ordinary residence", "past presence" and "presence in Great Britain on the date on which the claim was made".

The CJEU also considered the nature of the respective social security benefit, i.e. whether it falls within the definition of invalidity benefit or sickness benefit.

Basically, the respective cases demonstrate that EU social security legislation affords migrant workers some scope for claiming social security benefits in countries other than their country of residence.

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

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New Act on Residency of Foreigners

A new Act on Residency of Foreigners was recently published in the Collection of Laws and will enter into effect as of 1 January 2012.

We summarize some of the important provisions below:

- ▶ The new Act retains such existing concepts of residence as temporary residence, permanent residence and tolerated stay. However, it no longer uses the terms „temporary residency permit“, "permanent residency permit" and the "permit for tolerated stay".
- ▶ The Act introduces new concepts of permanent residency
 - ▶ Permanent residency for five years
 - ▶ Permanent residency for an unlimited period
 - ▶ Long-stay residency
- ▶ Third-country nationals can obtain ten different

types of temporary residency. One of the types of temporary residence is residence on the basis of the European Union Blue Card. A third-country national may be granted temporary stay for one sole purpose at a time. If the purpose changes, the third-country national has to apply for the new permit for temporary stay due to the new purpose.

- ▶ An EU citizen who holds a valid identification card or passport or any other document proving identity is entitled, without any conditions or formalities, to stay in the Slovak Republic for three months from the date of entry into the territory of the Slovak Republic. The obligation to inform the police department on the commencement of the stay in Slovakia within ten working days remains unchanged.
- ▶ The EU citizen who stays in the territory of the Slovak Republic for more than three months has to apply for registration of residency. The application for registration is to be submitted to the police department within thirty days of the lapse of the three months' stay period.

- ▶ If an EU citizen meets the conditions for entitlement of permanent residency, the police department will issue (upon request) an „EU citizen residence card“ valid for ten years.
- ▶ The Act introduces the entitlement for temporary residence for third country nationals with the status of Slovaks living abroad and the entitlement of temporary residence for third-country nationals who have been granted the status of long-term resident in another EU Member State

The new law is important for all Slovak employers with non-Slovak employees or assignees. As Slovak tax, social security and health insurance legislation also refers to individuals with a permanent residency permit, it is also necessary to take the respective provisions into account when determining the tax, social security and health insurance position of the foreign individuals staying/working in Slovakia.

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



Guideline of the Slovak Tax Directorate - deduction of VAT on immovable property used also for non-business purposes

On its web page, the Slovak Tax Directorate recently published a Guideline on the application of Articles 49a and 54a of Act No. 222/2004 Coll. on Value Added Tax (VAT Act). The respective Articles, the provisions of which are effective from 1 January 2011, transpose Article 1 Section 12 of EU Council Directive 2009/162/EU into national legislation.

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The Guideline summarizes in detail the provisions governing the deduction of VAT on purchases of immovable property intended for use for both business and non-business purposes. The Guideline also deals with the adjustment of VAT deducted in the event of a change in the extent of use of immovable property for business and non-business purposes in accordance with Article 54a of the Slovak VAT Act. This mirrors Article 54, which is used to track changes in the use of immovable property for exempt and taxable purposes.

The Guideline provides brief comments and explanations and basic examples on the application of the respective legal provisions. Explanations to more complex situations are not included in the Guidance (e.g. what methods to use in the calculation of mixed use - square metres of floor space, actual/potential revenues, etc.).

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.



CJEU judgment in C-93/10 Finanzamt Essen-NordOst v GFKL Financial Services AG - VAT analysis of the sale of defaulted debts to a third party

The Court of Justice of the European Union ("CJEU") issued its Judgment on 27 October 2011 in Case no. C-93/10 GFKL concerning the correct VAT analysis of the sale of defaulted debts to a third party assuming responsibility for recovery of the debts and the risk of loss.

The background to this dispute is the assignment of defaulted debts by a bank to GFKL, for a price below the face value of the debts. GFKL acquired a portfolio of defaulted debts, comprising mortgages

on immovable property and debts arising from a mix of terminated and matured loan agreements with a face value of EUR 15.5m. In the purchase agreement, the parties stated that the anticipated collection value was EUR 8.9m, which was discounted to EUR 8.4m. The purchase price was EUR 8.035m, which afforded GFKL the opportunity to make a profit from purchase of the debts. Thereafter, GFKL was entitled to all payments attributable to those debts, but also assumed the risk of default without any right of recourse.

GFKL was of the view that it did not supply to the seller (the bank) any service that was liable to VAT. However, GFKL paid an amount of VAT on the basis of an assumed consideration of the difference between the discounted economic value of the debt portfolio and the purchase price. GFKL subsequently appealed against this VAT liability. The Finanzgericht (Finance

Court) allowed GFKL's appeal but ultimately decided to refer the case to the CJEU.

Having reviewed the situation in question, the CJEU concluded that an operator who, at his own risk, purchases defaulted debts at a price below their face value, unlike in cases of the provision of factoring services to the assignor in return for a payment, does not effect a supply of services for a consideration within the scope of VAT when the difference between the face value of those debts and their purchase price reflects the actual economic value of the debts at the time of their assignment.

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 C-444/10 Finanzamt Lüdenscheid vs Christel Schriever - concept of a "transfer of a totality of assets or part thereof"

On 10 November 2011, the Court of Justice of the European Union ("CJEU") published its decision in Case C-444/10 Finanzamt Lüdenscheid vs Christel Schriever, concerning the concept of the transfer of a totality of assets or part thereof.

Background

Ms Schriever ran a retail business, selling sports equipment from premises in her possession. In 1996, Ms Schriever transferred the stock and fittings of the shop to Sport S. GmbH with no reference to VAT on the related invoice. At the same time, she leased the premises on which the business was performed to

Sport S. GmbH for an indefinite period but with the option of termination at short notice.

The German tax authorities took the view that the conditions for the transfer of a business in its entirety were not met because the premises, which constituted an essential component of the business, were not sold to Sport S. GmbH. In addition, the tax authorities argued that a lease contract operating on the basis of a short notice termination period cannot secure continuation of the business. Consequently, the German tax authorities concluded that the transfer of business should, in such a case, be subject to VAT and assessed output VAT accordingly.

Decision

The CJEU ruled that the condition for treating the transfer of a totality of the assets or part thereof as not subject to VAT is that the whole of the elements transferred must, together, be sufficient to allow the performance of an independent economic activity

on a lasting basis. Provided that the nature of the economic activity does not require the use of specific premises, or if the business premises are leased to the transferee, or if the transferee itself has appropriate premises where he can continue to perform the economic activity, the conditions for treating the transfer of a totality of the assets or part thereof as not subject to VAT are also fulfilled. Furthermore, the CJEU concluded that the option of termination of the contract at short notice does not, in itself, decisively support the inference that the continuing performance of the business may not be secured.

Practical implications of the decision

It appears that this ruling could have an impact on Slovak taxpayers who decide to transfer their businesses with the exclusion of specific components.

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.

Tax Administration



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Judgment of the Trenčín County Court dealing with electronic filing

We would like to inform you of a recent judgment of the Trenčín County Court ("the Court") dealing with submissions made to the tax authorities by electronic means.

Background

The taxpayer used the advanced electronic signature ("AES") to file EC sales lists electronically. Generally, when filings are submitted to the tax authorities

electronically, the taxpayer is sent a system-generated receipt. As a second step, the validity of the AES used is verified in the tax authority's database. The whole process is then completed by the issue of an electronic receipt on acceptance or rejection of the filing.

In the case in question, the taxpayer obtained an updated AES shortly prior to filing and filed the EC Sales List for VAT purposes within the statutory deadline, using the new AES. The tax authority's system assigned a filing number. However, as the new AES had not been recorded in the taxpayer's profile, the filing was assessed as invalid. The taxpayer did not discover this until the seventh day after the actual filing, at which time he filed the EC sales list again.

Subsequently, the tax authority assessed a penalty for late filing.

Decision

In its decision, the Court ruled that the fact that the new AES had not been activated in the taxpayer's profile should not have been considered as an administrative offence.

Moreover, the mere fact of using an invalid AES in the case in question may not be considered as non-fulfillment of the taxpayer's filing obligations. The tax authority should have dealt with the invalid filing by inviting the taxpayer to rectify the original filing within a given deadline, without imposing a sanction.

Practical implications of the decision

With the introduction of obligatory electronic communication with tax authorities from 2012 onwards (for all VAT payers, tax consultants and attorneys representing taxpayers before the tax authorities), it is likely that similar issues with the system of

electronic filing will arise. This ruling of the Court may support the position of taxpayers in situations where electronic filing is impeded by the tax authorities' systems.

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.

Other



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Regulation of the Ministry of Justice relating to obligatory publication of court decision

As we previously informed you in Tax news, the approved Amendment to Act no. 385/2000 on Judges ("the Act") introduces the obligatory internet publication of the decisions of the Regional Courts and the Supreme Court of the Slovak Republic with effect from 1 January 2012. This obligation is also to apply to court decisions on tax matters.

The Ministry of Justice recently released for public discussion a draft Regulation on the publication of court decisions ("the Regulation"), which is to be a declaratory statute to the respective provisions of the Act.

In accordance with the Act, from 2012 the courts will

be obliged to publish their final decision on the official website of the Ministry of Justice in the period of fifteen working days from the date that they become final

The proposed Regulation stipulates the particulars for publication of the decisions, as well as the range of data which are to be anonymized prior to publication of the decisions. The Regulation also specifies which decisions are to be subject to publication. By virtue of this provision, only valid decisions of trial courts issued after 1 January 2012 and the valid decisions of courts of appeal pertaining to the trial courts' decisions issued after 1 January 2012 are to be published.

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.

Short news

- ▶ The **double taxation treaty** has been signed **between the Slovak Republic and Georgia**. Further approval is required from the Parliament to complete the process of ratification.
- ▶ **A new form of the VAT return** has been issued by the Ministry of Finance. The new form reflects the changes in the VAT Act effective from 1 January 2012. New rows are to be added, showing the correction of VAT due to credit notes or debit notes. For the

purposes of the December 2011 VAT return, the form currently in use will be applicable.

- ▶ The Parliament has repeatedly approved the amendment of the **Act on Local Taxes and Local Charges** and thereby has overridden the veto of the President. However, the proposed change of the President has been accepted and the date of coming into effect has been postponed to 1 December 2012.

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