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Corporate and Personal Taxation

Parliamentary changes to the proposed amendment to the Income Tax Act

Recently, the Government’s proposed amendment to the Act No. 595/2003 Coll. on Income tax as amended (“the Amendment”) proceeded to Parliament. We informed you of the original draft wording of the proposal in the July-August issue of our Tax and Legal News. Below you will find a summary of changes that were introduced during the legislative session:

- In relation to the re-introduction of dividend income taxation for individuals, and in some cases also for legal entities, the proposed provisions should be applicable only for dividends from profits achieved for tax periods from 1 January 2017 onwards.

- Dividends from profits achieved for tax periods from 1 January 2017 onwards should no longer be subject to health insurance contributions.

- The dividend income of individuals should be taxed at the rate of 7%, compared to the originally proposed 15% rate.

- The originally proposed Amendment anticipated 15% taxation of dividend income paid to employees without an equity stake. Based on new wording of the Amendment, this should be considered as employment income, which will be taxable at the standard 19% (25%) tax rate. This should apply also to dividends paid from profit for tax periods before 31 December 2003, if they are paid after 31 December 2016.

- The lump sum expenses that self-employed individuals can deduct from their taxable income should be increased from 40% to 60% of taxable income. Consequently, the maximum limit of tax deductible expenses should also be increased from €5,040 to €20,000 per year. Taxpayers who did not carry on business activities during the entire tax period should no longer be restricted to deducting only a proportional amount of expenses from the maximum limit.

- Costs incurred in the form of gifts for the purposes of material humanitarian aid abroad, based on a signed donation contract with the Ministry of Interior of the Slovak Republic, should be considered tax deductible.

As we informed you in the previous issue of EY Tax and Legal News, the corporate income tax rate should decrease from the present 22% to a proposed 21%. The lower tax rate should apply to tax periods beginning from 1 January 2017.

We will monitor the legislative development of the proposed amendment to the Income Tax Act further and inform you of its progress.

If you wish to obtain more information or have any questions regarding this topic, please contact the author of this article or your EY partner or manager.
**Act on the Special Levy for Regulated Industry**

As we informed you in the summer edition of our Tax News, the amendment to the Act on the Special Levy for Regulated Industry introduced an increased rate of the special levy of 0.00726. The levy itself should apply indefinitely, however, the rate should be progressively decreased:

- To 0.00545 from 1 January 2019
- To 0.00363 from 1 January 2021

In the meantime, considerable modifications of this bill were made as it flew through the legislative process:

- Change to the definition of a regulated person, which should be now represented by an entity expecting to carry out business in a regulated industry (e.g., energy, telecommunications, pharmaceutics etc.) for a period of at least a month. Hence, even companies which derive less than 50% of their revenues from regulated activities will be subject to the levy, as long as other conditions are met.

- The new system of calculating the special levy is introduced. Newly, the special levy should reflect the ratio between an entity’s income realized from activities in the regulated industries and its total income.

- Most importantly, entities with gross profit exceeding €3 million should pay the levy on their whole profit and not only on the part exceeding €3 million.

We will be closely following the parliamentary discussion of this proposed draft and will inform you of further developments.

If you wish to obtain more information, or have any questions regarding the above, please contact the author of this article or your partner or manager at EY.

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**Slovak Republic presents first draft of local Country-by-Country Reporting legislation**

As one part of the two separate amendments of Act no. 442/2012 Coll. on International Assistance and Cooperation in Tax Administration, Slovak legislators recently presented draft wording of the proposed Slovak Country-by-Country Reporting (CbCR) legislation.

**Background**

CbCR rules represent the international efforts of tax administrations across OECD Member States to increase the transparency of transfer pricing models applied by the largest MNE Groups. They aim to reveal specific information about particular MNE Group members’ activities, via submission of standardized reports to the competent authorities. These should be freely exchangeable between the various countries of the MNE group’s presence, in order to identify any gaps, indicating artificial tax avoidance via transfer pricing.

To a large extent the Slovak CbCR rules reflect the model wording of CbCR legislation presented by the OECD within the BEPS Action 13 Implementation Package released in June 2015, adding some local specifics, such as penalties for non-compliance with Slovak rules. We informed you about the release of the implementation package last year within Issue 7-8/2015 of our EY Tax and Legal News.
Basic definitions and scope of Slovak CbCR rules

The first section of the legislation sets out basic definitions of particular elements necessary for application of CbCR rules such as definition of “(Qualifying) MNE Group”, “Excluded MNE Group”, different types of entities subject to reporting obligations and reporting periods.

Based on the current wording of the proposed legislation, CbCR rules will be applicable only to MNE Groups with total consolidated annual group revenue exceeding €750 million for the financial year preceding the reporting fiscal year (the year for which the CbC Report is to be filed).

Reporting obligations

Generally, the primary obligation to file a CbC Report as set forth by the draft model OECD legislation (as well as Slovak draft legislation) should arise for the ultimate parent entity of the Qualifying MNE Group with the competent authority in the country of its tax residence. Draft Slovak CbCR legislation presupposes primary reporting obligation to Slovak authorities for ultimate parent entities of Qualifying MNE Groups that are Slovak tax residents.

The legislation also defines a secondary obligation to file a CbC Report by a so-called Constituent Entity (de facto any other Qualifying MNE Group member in Slovakia) if one of the following three conditions are met:

- The Ultimate Parent Entity of the Group is not obliged to file a CbC Report in its tax residence jurisdiction.
- The Ultimate Parent Entity’s tax residence jurisdiction has a current International Agreement with Slovakia, but does not have a Qualifying Competent Authority Agreement in effect to which it is a party, at the time the CbC Report is required to be filed.
- There has been a systemic failure of the Ultimate Parent Entity’s tax residence jurisdiction that has been notified to the Constituent Entity by the competent Slovak authority. Systemic failure is a situation in which a certain jurisdiction has a Qualifying Competent Authority Agreement in effect with Slovakia, but has suspended automatic exchange of CbCR reports, or otherwise has persistently failed to automatically provide the CbC Reports of Qualifying MNE Groups with Constituent Entities in Slovakia.

The proposed wording of the Slovak CbCR legislation also contains templates of CbC Reports that are to be filed by the obliged entities, along with the explanatory notes and high level guidance on their completion.

Notification obligations

Apart from reporting obligations as such, the draft legislation also presupposes specific obligations for all constituent entities that are Slovak tax residents to notify Slovak authorities about their status (i.e., whether they qualify for the definition of Ultimate Parent Entity, Surrogate Ultimate Parent Entity or Constituent Entity).

If the Constituent Entities (i.e., any other member of the Qualifying MNE group in Slovakia) qualify for none of the specific CbCR subject definitions, they are obliged to notify the Slovak authorities of the details of the Reporting Entity from its MNE Group.

Both these notification obligations are to be fulfilled by the deadline for submission of the corporate income tax return for the particular reporting period.

Penalties

The draft legislation also presupposes specific penalties for non-compliance, as follows:

- €10,000 for failure to comply with the reporting obligations
- €3,000 for failure to comply with the notification obligations

It should be noted that both of the above penalties may be assessed repeatedly.

Authority of the legislation

The Amendment containing the draft CbCR legislation is still
in the legislative process and is waiting for approval of the relevant bodies (currently in intradepartmental consultation process). Should the Amendment be approved in its current wording, it should come into force as of 1 March 2017. We will keep you updated about all changes in this regard.

Under transitional provisions of the Amendment, the first CbC Reports are expected to be filed with the competent Slovak authorities after 28 February 2017 as follows:

- For fiscal years starting on 1 January 2016 - for situations in which the reporting entities - Slovak tax residents - are Ultimate Parent / Surrogate Parent Entities of the Qualifying MNE Groups.
- For fiscal years starting on 1 January 2017 - for situations in which the reporting entities - Slovak tax residents - are Constituent Entities of the Qualifying MNE Groups.

The reports for the particular fiscal years as described above should be filed within 12 months of the last day of the reporting period.

### Recommendations

Given the relatively short time given to comply with the complex new notification and reporting obligations by potential Slovak Constituent Entities in the role of Reporting Entities, it is advisable to begin preparations. For example, the positions of Slovak subsidiaries within Qualifying MNE Groups, in accordance with CbCR definitions should be reviewed as soon as possible.

Even if it becomes apparent that a particular Slovak subsidiary will not be a Reporting Entity, it is still advisable to begin aligning contacts with the relevant Group for the purposes of gathering specific information that will need to be submitted for CbC Report completion abroad.

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

### EU BEPS work plan

The Slovak Presidency of the EU Council published an EU-BEPS Roadmap, which is a plan containing key tasks and priorities of the Slovak Presidency in the area of corporate taxes, particularly in relation to the BEPS initiative.

#### More on individual announced priorities

Key announced short-term tasks included (i.e., a theoretically higher chance of significant progress/change by the 2016 year-end):

- **Interest and royalties** - work on changes related to the Directive on a common system of taxation applicable to interest and royalty payments ("I-R Directive"), primarily an anti-abuse clause like the one found in the Directive on a common system of taxation applicable in the case of parent companies and subsidiaries ("P-S Directive"). It seems contentious discussions are underway on whether to add a minimum taxation requirement to the I-R Directive.

- **Beneficial ownership** - work related to transparency and beneficial ownership of companies - the main goal is to revisit the Directive on Administrative Cooperation to allow tax authorities to access the mechanism, procedures, documents and information of the newly-introduced European Anti-money Laundering Directive.

- **Non-cooperative jurisdictions** - work on a list of non-cooperative jurisdictions outside the EU - the aim will be to set appropriate indicators and criteria for identifying and assessing the compliance of screened third countries and exploring possible common defensive measures.
Hybrid structures - work on inconsistencies arising from hybrid structures - in compliance with what was agreed when the Anti-Tax Avoidance Directive (ATAD) was approved; the main goal will be to establish rules for hybrid structures that include third countries (i.e. non-Members).

Key announced medium-term tasks included (i.e., less likely chance of significant change by the 2016 year-end):

- Patent box regimes - monitoring the legislative process necessary to change existing patent box regimes in Member States.
- Dispute resolution - improving the mechanisms for resolving disputes in tax matters within the EU.
- EU concept of a common corporate tax base (CCTB) - examining the proposals for a renewed CCTB.
- Payments from the EU - identification of potential problems when payments are made from the EU to third countries.
- Mandatory reporting (disclosure) - exchange best practices and adopting guidance on mandatory disclosure rules targeting offshore tax evasion schemes.
- Rules for issuing binding tax rulings - the aim will be to develop rules and recommendations for Member States in this area.

What are the practical implications?

Only time will tell which of the above described areas will undergo major changes in the coming months. However, the key trend in this area seems to be a growing tax authority emphasis on the exchange of information (or access to it) and expanding the scope/range of related tools.

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

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Value Added Tax

Decision of the Court of Justice of the European Union in the ESET case - Recovery of branch support costs

The Court of Justice of the European Union (CJEU) recently issued its decision in the case C-393/15 ESET concerning the business's ability to recover VAT on global and branch support costs. The case was decided by an order, which is usual in cases when the questions placed by the national court seem straightforward and can be answered, based on previous CJEU decisions. Nevertheless, it might be interesting for certain taxpayers with a limited right to input VAT deduction, particularly large financial institutions, which operate via a complex branch network.

Background

ESET, a company established in Slovakia, had a branch in Poland (ESET Poland) which provided software services to its head office. The software services were incorporated in the final products which were supplied to the customers of ESET in Slovakia. In addition to this, ESET Poland occasionally performed taxable supplies (with full right to input VAT deduction) in Poland. ESET Poland sought full input VAT deduction on costs incurred locally, for the
purposes of the supplies made to its head office, as well as for the purposes of its own taxable supplies.

The Polish Tax Authorities rejected ESET Poland’s claim on the ground that no taxable supplies were performed in the Polish territory. They pointed out the fact that the intra-entity flows were disregarded for VAT purposes (based on the FCE Bank case). The occasional VAT-able supplies made in Poland were considered as irrelevant. The local court referred the case to the CJEU with the question of whether a branch, which mainly performs internal operations and occasionally also local VAT-able supplies, should be entitled to recover input VAT attributable to the supplies made to its foreign head office.

Decision

The CJEU held that a branch of a company established in another Member State can recover input VAT incurred locally if they are related to taxable supplies effected by the company abroad (despite the branch mainly carrying out internal operations not subject to VAT). This right exists where those supplies, if carried out locally, would have given rise to input VAT deduction.

The CJEU also confirmed that the VAT Directive takes a fairly broad approach to the concept of “economic activity” and does not restrict its scope on the basis of the activity’s place of performance.

Considering that the branch and the head office form one taxable person, the ESET decision logically follows Article 169 a) of the VAT Directive (implemented in Article 49 Section 6 of the Slovak VAT Act), which grants the right of input VAT deduction for costs attributable to activities abroad, provided that the activities would be eligible for VAT deduction if carried out locally.

Practical considerations

In view of its decision in the ESET case, the logic of the VAT Directive was followed by the CJEU and the decision itself should not be a surprise generally. From the perspective of this case, however, the previous CJEU decision in the Le Credit Lyonnais, the CJEU ruled that the turnover of foreign branches should be excluded from the pro rata calculation of the general costs for a head office. The court specifically argued that the method of pro rata calculation lies within the scope of the national VAT legislation and the supplies made through other establishments should not be taken into account.

On the other hand, in the ESET case the court ruled that the supplies made through another establishment should be taken into account to determine the right to deduct VAT. However, the level of input VAT recovery in the country where the branch is established was not discussed in ESET. It is, therefore, not clear whether the level of recovery would be based on:

- A ‘look through’ to the head office’s or another foreign branch’s rate (which would contradict Le Credit Lyonnaise).
- The general recovery rate of the branch where it makes supplies in its own name (which may be problematic if it makes no supplies at all).
- Some combination of both.

Nevertheless, companies carrying out activities with limited VAT recovery, which operate via a branch network, might want to reconsider their current approach to pro rata calculation methods applied in various countries, particularly in those where the local establishments make only taxable or non-EU supplies.

Should you have any questions or would like obtain more information regarding this topic, please contact the author of the article or your usual contacts within EY.
Legal news

The Act on Expropriation of Land and Buildings and on Forced Limitation of the Ownership Right to them

The new Act No. 282/2015 Coll. on Expropriation of Land and Buildings and on Forced Limitation of the Ownership Right to them ("the New Act") came into effect on 1 July 2016.

According to the New Act, expropriation will follow four basic conditions:

1. The inevitable extent of expropriation

   The extent of expropriation shall be adequate to its purpose. This principle is reflected in practice in such a way that the expropriation authorities are not entitled to decide on transfer of ownership in situations when its limitation is sufficient. Also, they are not entitled to decide on the expropriation of the whole land or the building, if the purpose can be achieved by its partial expropriation.

   The New Act provides for the person against whose property the expropriation is directed ("the Expropriated Person") the possibility of enforcing by objection (i) the transfer of ownership instead of just its limitation or (ii) expropriation of the whole real estate if the partial expropriation would lead to inappropriate difficulties in use of its remaining part. The expropriation authorities shall be always obliged to comply with an objection in the former case and in the latter case to consider the usability of the remaining part of the real estate based on expert opinion.

   Similar provisions were included in the previous legislation; however, the expropriation authorities were entitled to decide in both cases exclusively based on their sole discretion.

2. Expropriation in the public interest for the purpose laid down by an Act

   The purpose of the expropriation may be determined only by an Act. This means that the expropriation cannot be effective unless such an option is incorporated within corresponding acts. The public interest is an indefinite legal term which can be interpreted, for example, as an interest approved by the Government of the Slovak Republic or by competent local authorities.

3. Expropriation for adequate compensation

   According to the New Act, adequacy of compensation is assessed, based on the general value of the expropriated right, determined by expert opinion. The compensation also reflects reasonably incurred expenses in relation to the expropriation (such as costs incurred in relation to relocation, change of the registered seat or permanent address).

   In compliance with the new legislation, primarily, in-kind compensation in the form of substitute real estate will be offered to the Expropriated Person. If the Expropriated Person does not accept the in-kind compensation, monetary compensation will be used.

   Provision of compensation is regulated specifically in the case of expropriation for the construction of motorways, railroads, airports and public ports as defined by specific Acts. In such cases, in order to facilitate the construction process, compensation is provided exclusively in monetary form. This exception ignores the legitimate interests
of the Expropriated Person. The new legislation does not guarantee that the Expropriated Person will be able to acquire comparable real estate for the provided monetary compensation.

4. The purpose of expropriation cannot be determined by an agreement or other method

With the exception of several statutory cases, a necessary condition of expropriation is the attempt of the person, in favor of whom the expropriation is executed, to reach an agreement with the Expropriated Person. Unlike the present legislation, the New Act stipulates the required contents of a proposal for conclusion of an agreement.

A positive development is an extension of the period in which the Expropriated Person can accept or refuse a proposal.

Transfer of personal data from the EU to the USA

In the 04/2016 issue, we informed you that the European Commission and the USA had reached political agreement on a new mechanism, enabling simplified personal data transfer from the EU to the USA, called the Privacy Shield.

On 12 July 2016, the Commission decided that the Privacy Shield ensures an adequate level of protection for personal data and it entered into force. Personal data transfer to American companies taking part in the Privacy Shield will be possible without the contractual clauses or binding corporate rules which are otherwise necessary for personal data transfer to third countries outside the EU. The list of American companies taking part in the Privacy Shield is available on the website of the US Department of Commerce.

The Privacy Shield reflects the requirements set out by the EU Court of Justice in its ruling dated 6 October 2015, which declared invalid the old framework for personal data transfer from the EU to the USA, called the Safe Harbor.

If you wish to obtain further information or have any questions regarding the above, please contact your partner or manager at EY.
New rules on posting of workers within the EU

As of 18 June 2016, the law concerning posting of workers in the framework of provision of services within the EU has significantly changed.

In the 9/2015 issue, we informed you about this new law (at that time in the form of a proposal) in more detail.

As a reminder, the main changes include:

- New forms of posting of workers.
- New obligations of the employer posting employees to Slovakia, including a duty to notify the National Labor Inspectorate, to maintain work-related documentation at the employee’s work place and to appoint a contact person in Slovakia.
- New obligations of the employer posting employees from Slovakia, including a duty to conclude a posting agreement with the employee and to notify them of the terms and conditions of employment applicable in the state of posting.
- Liability of a Slovak entrepreneur for illegal employment of workers by their subcontractor.

Breaching the rules on posting of workers and failure to pay social security contributions may lead to illegal employment and result in a fine of €2,000 to €200,000, as well as exclusion from public tenders and prohibition from applying for state aid (or obligation to return granted state aid) for several years.

If you wish to obtain more information about the impact of the ruling on your organization, please do not hesitate to contact your partner or manager at EY.

Solving the problem of a lack of drugs in the Slovak Republic

Negotiations on the amendment to the Act on Drugs and Medical Devices are currently in progress in Parliament. The intention of the amendment is to eliminate the long-term problem of a lack of drugs classified in the list of categorized drugs, through new provisions which will restrict export of categorized drugs and at the same time ensure their availability for those who really need them.

The aim of the amendment is to establish new obligations for marketing authorization holders and holders of authorization for the wholesale distribution of drugs, in relation to subjects to whom they can supply categorized drugs, and in relation to maintaining detailed documentation on the flow of categorized drugs. The marketing authorization holders shall be at the same time obliged to create an information system allowing the holders of authorization for medical care to order drugs in extraordinarily short supply. Pursuant to the planned amendment, any breach of the newly-incorporated provisions will lead to penalties of up to €1,000,000.

The legislation is proposed to be effective as of 1 January 2017. We will keep you informed about any important changes.

If you would like to obtain more information or have any questions regarding this issue, please contact the author of this article or the appropriate EY partner or manager.
Brief news

Treaty between Malaysia and Slovak Republic enters into force
On 11 April 2016, the double tax treaty for avoidance of double taxation and prevention of fiscal evasion with respect to income taxes, signed between the Slovak Republic and Malaysia, entered into force. The treaty is applicable:

- For Malaysia from 1 January 2016 with respect to taxes other than petroleum income tax and from 1 January 2017 for petroleum income tax
- For Slovakia from 1 January 2017, for withholding and other taxes

Anti-Tax Avoidance Directive
On 19 July 2016 the Council of the European Union officially published the text of the Council Directive. This directive, also known as Anti-Tax Avoidance Directive, lays down key measures against tax avoidance practices which affect the internal market. The final version of the Directive excludes the previously proposed switch-over rule. A more detailed overview of the directive can be also found in our EY Tax and Legal News 2/2016.

Treaty signed between Slovak Republic and Ethiopia
On 30 September 2016, the Slovak Republic and Ethiopia signed a double taxation treaty for avoidance of double taxation and prevention of fiscal evasion with respect to income taxes, which is currently in the process of ratification at the contracting parties level. The treaty applies to persons who are residents of one or both of the contracting parties and subject to income tax which is imposed by the Contracting States.

New Guidance on transfer pricing (TP) documentation contents issued by the Slovak Ministry of Finance
On 14 July 2016, the Slovak Ministry of Finance issued new Guidance no. MF/014283/2016-724 on the contents of TP documentation. The new Guidance de facto replaces the previous guidance, containing mostly additional specification of the documentation requirements for related parties due to their economic relatedness, based on direct or indirect participation of the state or municipalities in their assets, control or management.

EY office news

EY launches the eleventh EY Entrepreneur Of The Year contest in Slovakia. The nominated entrepreneurs will compete in three categories:

- EY Entrepreneur Of The Year in the Slovak Republic
- EY Technology Entrepreneur Of The Year

EY Emerging Entrepreneur Of The Year
Apply personally, or nominate an entrepreneur you are aware of, with vision, courage and who has built a successful company, thanks to their hard work and determination. Nominations are now open until the
On 22 November 2016, we are organizing a Tax Seminar in Košice, covering various tax topics such as VAT, corporate and personal taxation. A similar seminar is planned for 13 December in Prague. If you are interested, please contact us at: slavomira.popjakova@sk.ey.com.

On 24 November 2016, we are holding a seminar in Bratislava on the Posting of Workers. During the seminar, we will discuss recent legislative changes in this area. For more information, please contact: erika.vidova@sk.ey.com.

We are also organizing a seminar entitled „Specifics of the pharmaceutical industry – Current changes in the act on drugs and tax legislation”, which will take place on 29 November in Bratislava. For more information, please contact: slavomira.popjakova@sk.ey.com.

deadline of 30 November 2016. The 2016 EY Entrepreneur Of The Year contest has the patronage of the President of the Slovak Republic. For more information visit www.podnikatelroka.sk.

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