

Amendment to the Income Tax Act

On 22 October 2009 the National Council of the Slovak Republic approved the amendment to Act no. 595/2003 Coll. on Income Tax ("Income Tax Act" or "ITA") which was signed by the President on 11 November 2009 and published in the collection of law on 8 December 2009 (hereinafter "the amendment"). The amendment is scheduled to become effective on 1 January 2010. We highlight below selected changes introduced by the amendment:

Taxation of employee stock options

The tax point for the taxation of employee stock options is postponed from the vesting date to the exercise date. According to the existing rules the tax point for the taxation of the difference between the market value of the shares and the price of the share guaranteed by the stock option occurred on the vesting date no matter whether the stock option was actually exercised on this date or not. Under transitional provisions the new rules apply to employee stock options granted by the employer after 31 December 2009.

Tax base of a non-resident taxpayer

Tax non-residents who do not maintain bookkeeping according to the Slovak Accounting Act will determine their tax base on the basis of the difference between their income and expenses, unless otherwise stated by law.

This change was, according to the explanatory memorandum to the draft amendment, directed:

- particularly at non-residents:
 - who are legal entities
 - and who do not use bookkeeping according to Slovak law

- and also at kinds of income
 - that are not part of the tax base of a permanent establishment
 - that are not subject to withholding tax according to Art. 43 ITA, and
 - where the withholding tax does not lead to the fulfilment of the tax liability.

Differences from setting off the receivables against liabilities upon merger or amalgamation

According to the amendment, the difference from setting off receivables against liabilities upon the merger or amalgamation of companies or cooperatives, recorded to the account of retained earnings or retained losses of previous years should be included into the tax base of the successor to the taxpayer wound up without liquidation. This difference should be included into the successor's tax base in the tax period which starts with the decisive date of the merger or amalgamation (i.e. date from which the acts of the wound-up entity are considered as being executed on the account of the successor entity for accounting purposes).

Business combinations

The amendment introduces a new tax treatment of business combinations, i.e. transactions involving mergers, amalgamations and demergers of companies. This also includes

transactions involving the sale of a business or part of a business as well as a contribution in kind of individual assets, a business or part of a business.

The new provisions of the Income Tax Act introduce a dual regime for the tax treatment of contributions in kind, mergers, amalgamations and demergers: taxpayers should be allowed to apply the selected tax treatment of such business combinations at their own discretion.

Under the first tax regime (hereinafter also "Regime 1"), the legal successor (upon merger, amalgamation or demerger) or the recipient of the contribution in-kind (upon contribution in-kind of a business) would be allowed to take over assets and liabilities at the revaluated fair value amounts also for tax purposes.

The second tax regime introduced by the amended tax law (hereinafter also "Regime 2") foresees the possibility for the legal successor (or for the recipient of the in-kind contribution) to preserve the tax values of assets and liabilities recorded at the wound-up company (or at the contributor of the in-kind contribution).

Under Regime 1 the legal successor (upon merger, amalgamation or demerger) or the contributor (upon contribution in-kind) will include into the tax base the revaluation difference

resulting from the revaluation of transferred assets and liabilities to fair value over a maximum of seven consecutive tax periods. The revaluation difference under Regime 2 is not included into the tax base.

A significant change occurs in the tax treatment of goodwill and negative goodwill. According to new rules, goodwill or negative goodwill should become tax efficient in the case of purchasing a business and the contribution in kind of a business under Regime 1. Goodwill or negative goodwill reported at the purchaser of a business or at the recipient of the in-kind contribution of a business under Regime 1 should be included in the tax base over a maximum of seven consecutive tax periods.

The law amendment also partially covers cross-border business combinations including cross-border mergers and contributions in-kind. Depending on the tax treatment applied in the other involved country the amended tax law should allow to opt for a corresponding tax treatment on the Slovak side which should be in compliance with the principles of Council Directive 90/434/EEC of 23 July 1990 on the common system of taxation applicable to mergers, divisions, partial divisions, transfers of assets and exchanges of shares concerning companies of different member states ("EU Merger Directive").

The law amendments are complex from the perspective of tax consequences which the respective tax regimes may produce on the taxpayers involved in a business combination. You can find more detailed information in our Tax Alert dated August 2009 in which we have summarized the selected points and basic ideas of the ministerial proposal.

Tax loss of a foreign permanent establishment

According to new rules, the tax loss of a foreign permanent establishment of a Slovak resident taxpayer will form part of its tax base. This will apply regardless to the fact of whether the permanent establishment would be permitted to carry forward the tax loss under the respective foreign law.

The amended law similarly treats foreign tax losses for taxpayers who have transferred their registered seat, or place from which the company or cooperative is effectively managed, from abroad to the Slovak Republic while the taxpayer's permanent establishment remains outside Slovakia.

Write-off of a receivable vis-à-vis the Slovak Republic

The amended law recognizes the tax payer's write-offs of the nominal value of the receivable (or unpaid part thereof without accessories), vis-à-vis the Slovak Republic, as a tax deductible expense.

The taxpayer includes the write-off of such a receivable into its deductible expenses in the tax period in which it abandoned collecting the receivable.

Under this provision the tax deductible write-off of the receivable is only permissible if the receivable is recognized by the Slovak Republic as its liability.

Provisions against receivables that are not time barred

The creation of provisions against receivables will be considered as a tax deductible expense up to the stated percentage (20%, 50%, or up to 100%) of the nominal value of the receivable or its unpaid part without accessories depending on the number of days which elapsed from the due date of the receivable (360, 720, 1080 days).

The existing wording of the tax law deals with the tax deductibility of provisions against receivables according to the number of months elapsed from the due date. If the receivable was 12, 24, or 36 months overdue the taxpayer could, depending on the elapsed period, claim as a tax deductible expense provisions against the receivables in the amount of 20%, 50%, or up to 100% respectively of the nominal value of the receivable or its unpaid part without accessories.

The new wording of the tax law thereby eliminates a discrepancy which has existed between provisions of Art. 20 Sect. 4 ITA (treatment applicable to banks) and Art.20 Sect. 14 ITA (treatment applicable to other taxpayers except for banks).

According to transitional provisions, the new treatment of receivables is applied obligatorily to receivables arising after 31 December 2009; however the taxpayer could, at his own discretion, also apply the new rules to receivables arising by 31 December 2009.

Promotional items

With effect from 1 January 2010 promotional items, which are not marked with the trade name or trademark of the provider in the amount of 16.60 euros per object, are to be considered as a tax deductible expense. Provisions of the ITA were amended to be aligned

with the definitions of promotional items in the Slovak VAT Act.

Thin capitalization

The amendment includes a provision which cancels the thin capitalisation rule. The purpose of the thin capitalization rule is to restrict the tax deductibility of interest on loans and credits received from related parties if the volume of such loans and credits exceeds a certain level specified by the law – according to the existing wording of the ITA: six times equity. According to the wording of the Income Tax Act the thin capitalization rule would become effective on 1 January 2010. Thin capitalization rule, however, will be deleted from the act, and thus will never become effective.

The period for tax loss carry forward

Tax losses declared after 31 December 2009 will be available for carry forward for seven tax periods. This is an extension of the tax loss carry forward period, as the existing rules apply a five-year carry forward period.

Income and expenses after the termination of business of an individual

The amendment introduces a specific tax treatment for when an individual, after termination of business, self-employment or rental, receives additional taxable income relating to these activities or pays in connection with these activities expenses that would be recognized as tax deductible expenses.

The amendment grants the taxpayer the option to settle the tax liability by a supplementary tax return filing for the tax period in which business, self-employment or rental were terminated. In such cases, penalties under the Act on Administration of Taxes and Levies will not apply.

However, if it is more favourable for the taxpayer to include those amounts received or paid into the tax base for the tax period in which such amounts are received or paid, the taxpayer will be allowed to apply the more favourable approach at his own discretion.

Corporate income tax prepayments during the utilization of the tax relief

Provisions of Art. 42 Sect.6 ITA were amended to the effect that now the Income Tax Act allows the taxpayers using a tax relief arrangement to calculate their corporate income tax prepayments from the previous year's tax liability decreased by the tax relief.

Settlement of withholding tax applied to income paid to residents of the EU and EEA

Under the amended provisions of Art. 43 Sect. 6 ITA the residents of EU Member States and residents of other States which constitute the European Economic Area ("EEA," i.e. Norway, Liechtenstein and Iceland) who derived income sourced in the Slovak Republic pursuant to Art. 16 Sect. 1 Let. e) first to fourth indent of the ITA, i.e. royalties, interest and rent, will be allowed to settle their Slovak tax in the same manner as it is settled in the case of such income by the Slovak resident taxpayers, i.e. by filing tax returns.

The amendment was made following a warning that Slovakia received from the European Commission regarding a possible incompatibility of the provisions of the Income Tax Act with the law of the European Union because of discrimination of non-residents.

While it is expected that the amended provision should allow taxation of specified types of Slovak sourced income generated by the residents of other EU Member States and EEA on a net basis, several practical questions remain open, e.g. registration of the concerned non-residents with the Slovak tax authorities, retrospective application of the amended provision, etc.

Deadlines for submission of income tax returns

Based on the amended provisions of the ITA, the deadlines for submission of income tax returns will be, in general (with certain exceptions), extended automatically based on a simple announcement made by the taxpayer to the respective tax authorities.

The extension of deadline will thus in general no longer be subject to the discretionary power of the tax authorities. According to new rules the taxpayer will be in general, by filing the announcement, allowed to extend the deadline by up to three entire calendar months. A taxpayer who generates income sourced outside of Slovakia can, by filing the announcement, extend the deadline by up to six entire calendar months.

Legal entities may use the new rules and extend the deadline for filing corporate tax returns for the first time by a simple announcement made to the tax authorities in respect of the tax period ending 31 December 2009. Individuals may extend the deadline for submitting personal tax returns for the first time by a simple announcement in respect of the tax period ending 31 December 2010.

Tax return upon winding-up of the taxpayer without liquidation and upon closing of a permanent establishment

The ITA amendment introduces new special rules for deadlines and administrative procedures for filing tax returns:

- in the case of taxpayers, who are wound up without liquidation; and
- in the case of taxpayers who close their permanent establishments in the Slovak Republic.

Personal tax-free allowance

Under the amendment personal tax allowances for the year 2010 shall be calculated using the subsistence level valid as at 1 January 2009 amounting to EUR 178.92.

Assignment of 2% tax liability

The amount of tax paid (currently 2%) that may be assigned by legal entities to eligible organizations, e.g. charities, will be gradually reduced to 0.5% by 2018.

During a transitional period from 2010 to 2018 the transfer of a specified percentage of paid tax would be conditional on making additional financial donations: legal entities would be required to donate a certain amount of funds to an eligible organization with the donated amount being determined as a certain specified percentage of the tax paid.

If this condition is not met, the percentage of tax paid which could be transferred to an eligible organization would be decreased by an additional 0.5%.

From 2019 the assignable percentage of tax paid by a legal entity could be a maximum 0.5% of paid tax without, however, the requirement to make additional financial gifts.

Provisions concerning the assignment of 2% of tax paid are scheduled to become effective on 1 January 2011; however based on the transitional provisions they should start to be enforced as early as with the tax return filing for the tax period ending no later than 31 December 2010.

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