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Slovak Republic

Introduction

The Slovak tax system was established in 1993. Tax legislation attempted, in basic terms, to prevent deviations from arm's-length prices in related party transactions. One of the major milestones in Slovak transfer pricing history was December 2000, when Slovakia joined the Organisation for Economic Co-operation and Development (OECD). Thus, taxpayers could adopt the OECD Guidelines with some degree of certainty that the treatment would be acceptable to the Slovak tax authorities. Furthermore, the Slovak Ministry of Finance has issued an official translation of the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, published by the OECD. Slovak tax authorities' practical experience with transfer pricing principles are that of an under-developed countries' level, although they have increased significantly in the last few years.

Corporate income tax

The Slovak Income Tax Act and Slovak transfer pricing regulations cover transactions with foreign related parties. Generally, the prices in transactions between foreign related parties are required to be at arm's length. Foreign related parties are defined as a Slovak tax resident and/or a non-Slovak tax resident that are one of the following:

- Relatives.
- Entities that are economically or personally related.
- Entities with certain other relationships.

Economically or personally related means one of the following:

- When one entity directly or indirectly holds more than 25% of the share capital or voting rights of the other.
- An entity and its statutory representative or a member of its supervisory board.
- Two or more entities in which a third entity directly or indirectly holds more than 25% of the share capital or voting rights.
- Entities having the same person as their statutory representative or a member of their supervisory board.

However, according to the full extensive definition set in the Slovak Income Tax Act, all companies within the company group likely qualify as related parties.

Entities with certain other relationships are parties connected solely for the purpose of reducing the tax base. Furthermore, a Slovak permanent establishment (PE) and its foreign headquarters, as well as foreign PEs and their Slovak headquarters, are also considered foreign related parties for transfer pricing purposes.

Slovak Republic

In 2001, the transfer pricing legislation introduced a number of methods to determine the arm's-length price for cross-border transactions between related parties. These methods broadly equate to the transaction-based methods and profit-based methods according to the OECD Guidelines. The transaction-based methods listed include: comparable uncontrolled price, resale price, and cost plus methods. The profit-based methods listed include: the transactional net margin and profit split methods.

The Slovak taxpayer can also use a combination of these methods, or choose any other method, provided the method used is in accordance with the arm's-length principle. However, in general, taxpayers should primarily use transaction-based methods. The Slovak tax legislation has not yet adopted the latest OECD Guideline version, which removed the hierarchy of transfer pricing methods.

There are no formal advance pricing agreements (APAs) in Slovakia. However, the Slovak tax authorities can, in advance, approve a particular method of setting the price in transactions with foreign-related parties. They are obliged to issue a decision on a particular method to be used if requested by a taxpayer. However, they do not confirm prices used or publish any benchmarks.

The approved method can be used for up to five tax periods, and can be extended for another five tax periods if certain conditions are met. The tax authorities can cancel or amend their decision if the method was approved based on false or inaccurate information provided by the taxpayer, or if the relevant conditions had changed. The tax authorities may also cancel or amend their decision based on the request of the taxpayer proving that conditions have changed.

In addition, the tax authorities can approve a method for determining the corporate income tax base of a Slovak PE of a foreign taxpayer per the taxpayer's request. This method is usually based on one of the OECD transfer pricing methods.

For certain related party transactions the Slovak tax authorities generally accept as the arm's-length price value as appraised by an independent valuation expert.

From 2009, all Slovak taxpayers have to report a value of intragroup transactions performed in each particular tax year in their corporate income tax return forms.

Burden of proof

Generally, the burden of proof rests with the taxpayer.

At the beginning of 2009, the Slovak Ministry of Finance issued a guideline which set out the content of obligatory transfer pricing documentation (the Guideline). Under the Guideline, a Slovak company's obligatory transfer pricing documentation should include information that explains how the prices applied in material transactions with foreign related parties have been set, and justifies their arm's-length nature.

The transfer pricing documentation is required for all tax periods during which the Slovak taxpayer carries out material transactions with its foreign related parties. It must be in Slovak, unless the tax authorities agree to accept documentation in a different language.

Moreover, the Guideline introduces two types of transfer pricing documentation:

- Full transfer pricing documentation.
- Simplified transfer pricing documentation.

The full transfer pricing documentation is required only for material transactions undertaken by entities that prepare their financial statements under the International Financial Reporting Standards (IFRS) for Slovak statutory purposes. Other entities should maintain simplified transfer pricing documentation in order to justify prices applied in their material foreign-related-party transactions.

The full transfer pricing documentation under the Guideline is based in the EU recommendations, and should include general transfer pricing documentation (a master file) and specific transfer pricing documentation (a local file).

The master file includes the following information about the pricing policy within the entire group or related entities (Slovak and foreign):

- The identification of group members.
- The group ownership structure.
- A business description.
- Industry identification.
- The business strategy of the group.
- A description of the functions undertaken and the risks assumed by individual entities within the group.

The local transfer pricing documentation should contain the following specific information about the Slovak entity and its transactions with its foreign related parties:

- The identification of the entity and its ownership.
- A description of the company's business and industry.
- The company's organisational structure and a list of foreign related parties.
- The company's planned business strategy and business plan.
- A list and description of transactions or services provided to foreign related parties.
- An overview of the company's intangible assets.
- A description of the functions undertaken and the risks assumed by the Slovak company.
- Information on the choice and application of transfer pricing methods.
- Information on comparable data (benchmarking study).

Taxpayers are obliged to provide the transfer pricing documentation within 60 days of the tax authorities' request. Therefore, it is recommended to prepare the documentation at the same time the foreign-related-party transactions are carried out.

Value added tax

On 1 January 2010, an amendment to the Slovak VAT Act which introduced transfer-pricing rules for VAT was introduced. According to the amendment, if the actual price that a Slovak VAT payer charges for supplies of goods and services to an entity which is a related party, as defined in Slovak VAT law, is lower than the market value, then the tax base shall be the market value if the recipient is either:

- not registered for Slovak VAT, and
- a Slovak VAT payer (registered for Slovak VAT as a domestic or foreign entity) but does not have the right to claim the full input VAT for these goods and services.

Under the amendment, a related party to the VAT payer is, for example, a statutory body or statutory representative of the VAT payer, an entity who directly or indirectly owns or controls 10% or more of shares of the VAT payer supplying the goods or services, or one that is directly owned or controlled by 10% or more of shares of this VAT payer or employees of the VAT payer.

Other taxes

With respect to real estate tax, the value of the real estate, based on which the tax base is determined, should generally be set according to the appendix to the Real Estate Tax Act. In specific cases, it should be based on the arm's-length price, determined by an independent, court-approved valuation expert who must value the real estate under specific regulations.

Customs

Since its accession to the EU on 1 May 2004, Slovakia has followed the EU Customs Code, based on the transaction value. For sales between related parties, the price applied in any particular case should approximate the transaction value in sales of identical or similar goods between buyers and sellers who are not related.

Tax inspection procedures

The transfer pricing inspection and potential additional tax charges on the grounds of transfer pricing could be assessed for 11 years following the year or tax period concerned. Thus, the standard six or eight year statute of limitation period does not apply in case of transfer pricing.

According to the Slovak Act on Tax Administration, the tax administrator should impose a fixed penalty equal to three times the European Central Bank's interest rate on the difference in tax between that shown in the tax return and that determined by the tax administrator (but not less than 10%).

In the event of late payment of the tax liability declared in the tax return, the tax administrator can impose interest of four times the European Central Bank of Slovakia's interest rate on overdue tax. This applies to each day of late payment, up to a maximum period of four years.

Anticipated developments

As the tax authorities become more familiar with transfer pricing principles and begin to understand the background to transactions between related parties, the importance of having sufficient and technically sound documentation increases. The tax authorities started to make special transfer pricing tax inspections and have formed a specialised group of transfer pricing experts.

The tax office continues to train a specialised group of staff to handle transfer pricing audits and has already performed a number of transfer pricing tax inspections of multinational companies, resulting in significant additional tax charges.

As communicated by tax authorities, the number of tax inspections focused on transfer pricing area should significantly increase in 2012 in comparison to previous tax periods.