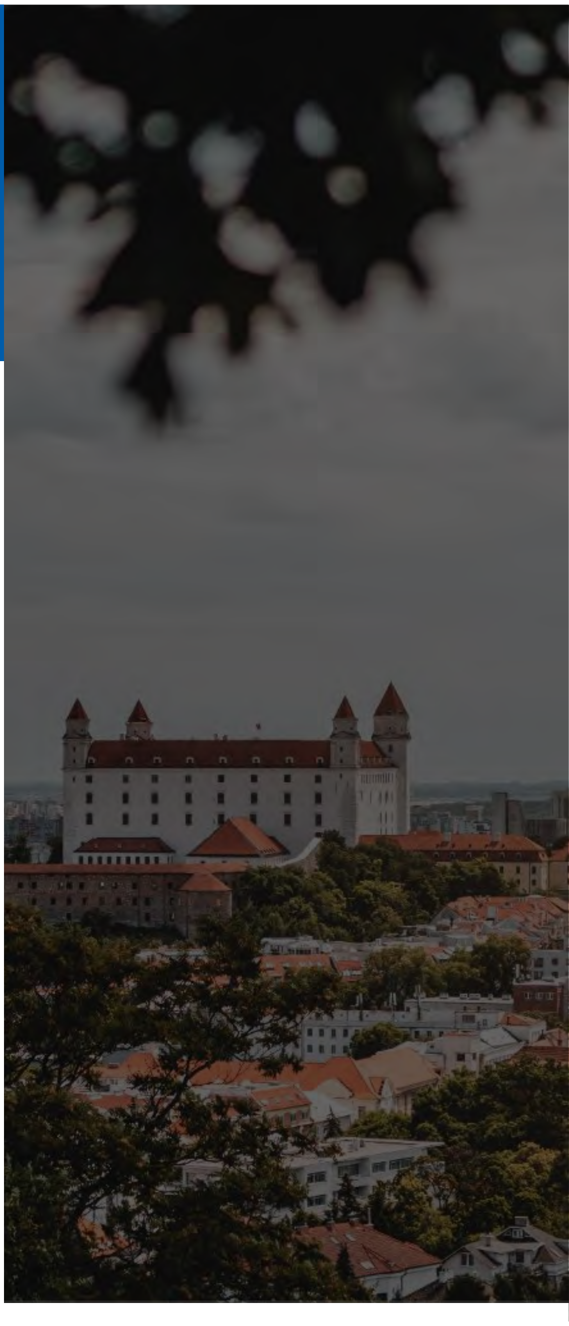
Transfer Pricing Overview

Slovakia | 2023

Introduction



The Transfer Pricing rules regulate for tax purposes the prices charged in the intercompany transactions. The main goal is to maintain the arm's length principle.

General Transfer Pricing rules have been implemented in Slovak legislation even before 2001; however only in 2001 were the specific methods of application of arm's length principle introduced by the Slovak Income Tax Act.

The obligation to keep the Transfer Pricing documentation became effective on January 1, 2009. Starting with January 1, 2015 this obligation applies not only to foreign related parties but to domestic related parties as well.

Pursuant to the Slovak tax legislation, all related parties are obliged to prove the method applied for setting the prices of controlled transactions (domestic or cross-border) between related parties and keep a relevant documentation justifying this method.

In recent years the number of tax inspections on Transfer Pricing rapidly increased, that is why we recommend focusing on this area and especially on preparation of the proper Transfer Pricing documentation.

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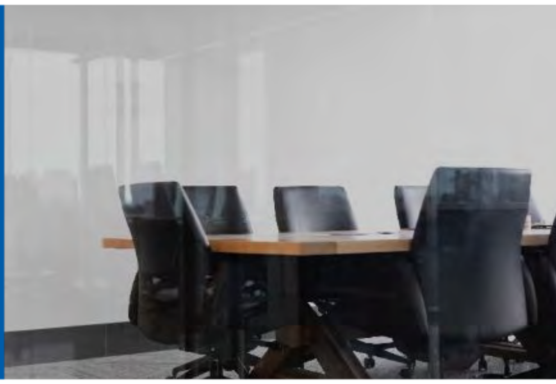


Applicable legislation

- Income Tax Act No. 595/2003 Coll. (Sections 2/n-r, 17/5, 17/6, 17/7, 18, 18a)
- Double Tax Treaties
- Financial Reporters No. 14/1997, 20/1999, 3/2002 where OECD Transfer Pricing Guidelines from 1995 and 1997 were published in Slovak language
- Financial Reporters No. 1/2009, 8/2014, 5/2015, 7/2016, 12/2018 where administrative guidance of the Slovak Ministry of Finance on content of the transfer pricing documentation were published

As an OECD Member State and an EU Member State, Slovakia adheres to the OECD Transfer Pricing Guidelines and to the EU Code of Conduct on transfer pricing documentation for associated enterprises. Slovakia also acceded to the EU Arbitration Convention, which establishes a procedure to resolve disputes where double taxation occurs between enterprises of different Member States as a result of an upward adjustment of profits of an enterprise of one Member State.

Arm’s length principle

Applicability

The arm’s length principle is based on a comparison of the terms which were agreed in any business or financial transactions between related parties and the terms which would have been agreed between unrelated parties in similar business or financial transactions, in comparable circumstances.

The review of comparability of the terms is made by confronting in particular the businesses conducted by the parties, including, but not limited to their production, assembly works, research and development, purchase and sale, the scope of their business risks, the characteristics of the compared property or the service, the terms agreed between the parties to the transaction, the economic environment in the marketplace, and the business strategy. The terms shall be considered comparable if there is no difference at all or if only minor adjustments would compensate such a difference.

If there is a difference between the prices agreed in transactions of related parties, and the prices applied between unrelated parties in comparable business transactions, as long as such difference results in a reduction of the tax base or increase of tax loss, the related party shall increase its income tax base by that difference. As from January 1, 2023, the materiality threshold was introduced for controlled transaction (or group of controlled transactions that may be aggregated), for which such tax base adjustment is required. As qualified controlled transaction is considered a legal relationship or other similar relationship in which one or more related parties achieve taxable income or tax-deductible expense exceeding EUR 10,000. In the case of loan transaction, the qualified transaction is with a principal amount above EUR 50,000.

General terms

The term "***related party***" means – (1) close persons, (2) persons or subjects with economic, personal or other ties, (3) persons or subjects that are members of the consolidated group.[1] By “***close persons***” should be understood close persons pursuant to Civil Code.

[1] The term *subject* was introduced in the Slovak Income Tax Act as from January 1st 2018 and shall have the following meaning: *„legal structure of assets or legal structure of persons, which does not have a legal personality or any other legal structure, which owns assets or performs asset management“.*

By "***economic or personal tie***" should be understood:

- the person's or subject's interest in the property, control or management of another person or subject, or
- the mutual relation between persons or subjects who are under control or management of the same person, his/her close person or subject, or
- where such person, his/her close person or subject has direct or indirect ownership interest

Interest in the "***property***" or "***control***" means at least a 25% direct or indirect interest or indirect derived interest in the registered capital or in voting rights or at least a 25% share on profit; where the indirect derived interest exceeds 50%, all persons or subjects used in the calculation thereof shall be deemed to have economic ties irrespective of the actual amount of their interest. Starting from January 1, 2023, this definition is stricter in the meaning that for purposes of calculation of direct interest, indirect interest and indirect derived interest, the interests of close persons (e.g., spouses) shall be tot up.

The term "***management***" means the relationship between the members of the statutory bodies, the members of the supervisory bodies or the members of some other similar bodies of a legal entity or a subject to that legal entity or subject.

The term "***other ties***" means a legal relationship, or any other similar relationship established particularly for the purposes of tax base decrease or tax loss increase.

As from January 1, 2023, it is also extended that by economic tie shall be understood along:

- the relation between tax resident taxpayer and his permanent establishments abroad,
- the relation between tax non-resident and his permanent establishments in Slovakia,
- the relation among permanent establishments of taxpayers that are considered as related parties in the sense of the abovementioned, and the relation between such permanent establishment and such taxpayer
- also the relation among permanent establishments of the taxpayer.

Documentation

Content

The transfer pricing documentation represents a set of information, data and facts which demonstrate and explain the method of taxpayer's price formation in controlled transactions.

Transfer pricing documentation in general consists of general and of specific part.

The general part contains a set of information giving an overall picture of the group of related parties

The specific part contains specific information related to the taxpayer and to the controlled transactions in which the taxpayer is engaged

General rules

Transfer pricing documentation shall be prepared for each controlled transaction separately or for each group of aggregated controlled transactions.

The documentation should be prepared in Slovak language. However, as from January 1, 2023, it can be filed with the tax administrator also in a foreign language. If the latter occurs, the tax authority may upon request ask for translation to Slovak within 15 days from the delivery of the request.

Transfer pricing documentation shall be kept for the respective tax period. If no new facts occur - facts that would affect the valuation method for controlled transactions, when preparing documentation for the next period - a taxpayer may refer to information stated in documentation for the previous taxation periods.

Deadlines

15 days

The taxpayer shall submit the transfer pricing documentation within 15 days from delivery of the tax administration's or financial directorate's request. Such request may be for the transfer pricing documentation for the relevant tax period, sent no earlier than on the first day following expiry of the period for tax return filing for that particular tax period. Due to short 15-day period it is recommended having the documentation prepared in advance.

Documentation types

There are three different types of transfer pricing documentation in terms of the required minimum scope:

Complete documentation

Basic documentation (simplified documentation)

Shortened documentation (extra simplified documentation)

Obligation to keep the documentation

Starting with the tax period, which begins after December 31, 2017, complete documentation has to be kept by the following taxpayers:

- taxpayers who follow for statutory purposes the IFRS in booking or closing of booking - the obligation to keep a complete documentation is with respect to significant cross-border controlled transactions;
- taxpayers that are engaged in the cross-border controlled transaction with value exceeding 10 million EUR per tax period;
- taxpayers who perform significant business transactions with a related party seated in a state which Slovakia has no double tax treaty or international tax information exchange agreement with;
- taxpayers who are engaged in the controlled transactions with respect to which they opt for an APA (Advance Pricing Agreement)
- taxpayers who asks for secondary adjustments for the controlled transaction according to double tax treaties
- taxpayers who are engaged in the controlled transactions with respect to which there was a request filed for a mutual agreement procedure according to a tax treaty;

- taxpayers who claim a tax relief - the obligation to keep a complete documentation is with respect to significant cross-border controlled transactions.

In other cases, the taxpayer is obliged to keep a basic documentation for the following transactions:

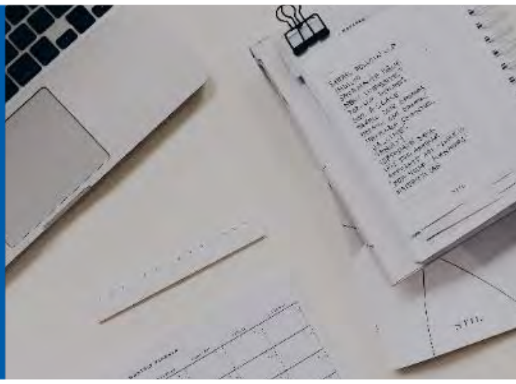
- cross-border controlled transactions with annual value exceeding 1 million EUR;
- non-significant transactions with a related party seated in a state which Slovakia has no double tax treaty or international tax information exchange agreement with;
- significant cross-border controlled transactions, if the taxpayer's total operating and financial revenues per tax period exceed 8 million EUR;
- significant domestic controlled transactions, if the taxpayer claims a tax relief.

If neither complete documentation nor basic documentation is prepared on controlled transaction, taxpayer is obliged to keep on such transaction a shortened documentation (following the template prepared by the Slovak Ministry of Finance), except for some cases, when it is sufficient to properly report controlled transactions in income tax return only.

Also, some Slovak public entities may qualify for keeping of shortened documentation.

In that respect it has to be mentioned that simplified types of documentation may in the listed cases be sufficient from administrative point of view but will not help a taxpayer to prove the application of the arm's length principle, unless a comparability analysis is made. Therefore, any material transaction from the perspective taxpayer is recommended to be followed by functional and risk analysis and benchmarking.

Methods



Any traditional and other transfer pricing methods according to OECD Transfer Pricing Guidelines can be used while the principle of the best method shall be applied. Also, combination of more methods is possible if necessary. If appropriate, other methods may be used by Slovak taxpayers, too.

Methods based on comparison of prices

Comparable uncontrolled price method - used mainly for transactions with tangible and intangible assets and financial transactions

Resale minus method - used mainly for distributors of products

Cost plus method - used mainly for transactions related to manufacturing and sale of semi- finished products/ finished products which do not include high added value

Methods based on comparison of profits

Net trading margin method - mainly for comparable transactions that significantly differs in functions

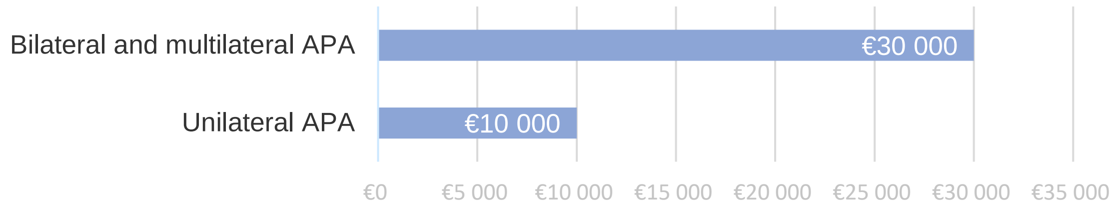
Profit split method - suitable for very integrated transactions when the parties contribute in a unique way or they possess valuable tangible asset

Advance Pricing Agreements (APA)

Taxpayers in Slovakia can ask the tax authority for an Advance Pricing Agreement (APA) - an approval of a particular method of transfer pricing - at least 60 days before the beginning of the tax period during which the approved method shall apply. By this way they can approve the chosen methodology and avoid potential disputes as far as the method is concerned. Only the method can be approved with the APA, not the used transfer prices itself.

The tax administration shall issue a decision on the approval of the valuation method valid for no more than five tax periods. Extension for next five years is possible if the taxpayer demonstrates that no change has occurred in the conditions upon which the decision was issued.

The fee for applying for the APA as from January 1, 2017 does no longer depend on the value of the business case, but is to be set as follows:



From January 1, 2022, the statutory fee is half for a taxpayer who is considered highly reliable at the time of application based on the evaluation of the tax reliability index. For further information regarding the tax reliability index of taxpayers valid from January 1, 2022 please see our News Flash.

The reduced amount of the fee for the APA for highly reliable taxpayers will be applicable only after the first delivery of the notification of the index of tax reliability.

Penalties

EUR 3,000

is the maximum penalty for non-compliance with the transfer pricing documentation obligations, for a breach of a non-monetary obligation can be levied. Moreover, the tax base may be adjusted, and additional tax may be levied by Slovak tax authorities during the tax inspection.

10 years

is the period up to which the tax authority can assess a tax difference after the end of year, in which the obligation to submit a tax return has arisen, i.e. tax return can be a subject of tax inspection for 11 years.

20% p.a.

is the penalty rate from the tax difference instead of 10% p.a. As from January 1, 2017 stricter penalties apply for intentional breach of the arm's length principle. Doubled penalties will apply to taxpayers who decrease their tax base or increase their tax loss intentionally with the help of transfer pricing.

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