News Flash

December 16, 2022

Amendment to the Income Tax Act in Slovakia as from January 1, 2023

Amendment to the Income Tax Act in Slovakia

We would like to inform you about the most significant legislative changes introduced by the **amendment to the Income Tax Act** (ITA) from year 2023.

We would like to draw your attention in particular to the changes in the area of **transfer pricing** and **taxation of bonds** flowing to non-residents and **increased amount of tax bonus for child**, which will be in force from year 2023. The changes regarding the rules for limiting of tax deduction of interest costs have been approved with a postponed effect from year 2024. The amendment to the ITA was approved by the Slovak Parliament on December 6, 2022.

In order for the legislative changes to enter into force, they must be signed by the President of the Slovak Republic and published in the Collection of Laws of the Slovak Republic.

Transfer pricing amendments

The definition of **economic closed persons** is being clarified and the calculation of shares of close persons (e.g., spouses) **for the purpose of determining economic closed persons** is being introduced.

Controlled transactions exclude legal or other similar relationships from which income from dependent activity flows. The definition of a **"significant controlled transaction"** is introduced, which is considered to be a legal relationship or other similar relationship, on the basis of which a related person receives taxable income (revenues) or tax expenditure (cost) in a value exceeding EUR 10,000. A credit or loan with a principal of over **EUR 50,000** will also be considered a significant controlled transaction.

A reference to the OECD Transfer Pricing Guidelines for multinational companies is added to the provision of the ITA. In a situation where the price used by the taxpayer in a transaction with related parties is not set on the arm´s length principle and is outside the range of established independent (market) comparable values, the tax authority will be allowed to determine the transfer pricing adjustment during the tax audit at the level of the mean value (median) **determined based on the benchmark analysis**, unless the taxpayer demonstrates that given specific circumstances, an adjustment to another value within the range of independent values is more appropriate.

It will be possible to submit **transfer pricing documentation t**o the tax administrator initially **in a foreign language**, and subsequently, only if the tax administrator additionally requires the documentation to be submitted in the Slovak language, the taxpayer would have the obligation to submit the documentation **in the Slovak language within 15 days** from date of delivery the request.

Non-resident's bond yields

According to the new rules, **yields of the bonds flowing to a taxpayer with limited tax liability** (tax non-resident) from sources in the territory of the Slovak Republic will represent **income that will be subject to taxation in Slovakia.**

Payment of coupons from bonds held by tax non-residents **will not be taxed** in Slovakia if the conditions for tax exemption are met in the case of related persons (e.g. parent-subsidiary relationship) with ownership of at least 25% of the share capital for at least 24 months or if the relevant Double Taxation Treaty did not grant the right to tax the Slovak Republic.

Interest limitation rules

By transposing the EU Directive 2016/1164 (hereinafter referred to as the "ATAD" Directive), a new rule on the limitation of interest costs in relation to creditors (§17k ITA) is introduced into the Income Tax Act, which is to be effective from January 1, 2024.

The new rule will be applied for the first time to net interest costs arising on the basis of contracts concluded after December 31, 2023, including amendments concluded after December 31, 2023. Therefore, it does not apply to contracts concluded by the end of year 2023.

From year 2024, the new rule will be applied, the thin capitalization rules according to § 21a ITA will not be applied at the same time. The new rule thus takes precedence over the thin capitalization rules and it is valid that if the new rule is not applied, the thin capitalization rules must be tested.

The new rule on the limitation of tax deductibility of interest costs **will be applied only if the amount of net interest costs is higher than EUR 3,000,000 = so-called safe harbor.**

We would like to point out that all interest costs and revenues are considered, not only toward the related parties.

For example, it applies if net interest costs are negative, i.e., taxable interest revenues are higher than tax-deductible expenses, then the taxpayer does not comply with the new rule and all interest costs are treated as tax deductible, unless they are limited by the thin capitalization rules.

Net interest costs are considered as the difference between interest costs and revenues.

Interest costs will be interpreted broadly. They should be understood as interest costs with all types of debt, other costs economically equivalent to interest, expenses incurred in connection with obtaining funds from the debtor. If the amount of net interest costs is higher than EUR 3,000,000, the tax base will increase by the amount by which the net interest costs exceed **30% of tax EBITDA.**

Tax EBITDA =
The tax base before the adjustment according to the new rule, including the tax base when applying the so-called exit tax, the tax base on received dividends (non-cooperating jurisdictions) and the tax base on income from which the tax is withheld and the tax obligation is fulfilled by withholding tax
+ net interest costs
+ tax depreciation of assets

Tax bonus for dependent child

As from January 1, 2023 the amount of tax bonus for dependent child is again amended as well as other conditions for its claim and paid out.

The amount of tax bonus for child as from January 1, 2023 until December 31, 2024 is as follows:

- **EUR 50** per month for dependent child older than **18 years**
- **EUR 140** per month for dependent child younger than **18 years**, if the child is not provided with a subsidy to support education for the child's eating habits according to the Act on Subsidies within the competence of the Ministry of Labour, Social Affairs and Family of the Slovak Republic. Also known as "free school lunches“.

Further, the bonus for child is limited up to the amount of set percentage of tax base (partial tax base) and based on the number of dependent children of the taxpayer.

Number of dependent children	Percentage of tax base (partial tax base)
1	20 %
2	27 %
3	34 %
4	41 %
5	48 %
6 and more	55 %

A taxpayer who does not have a sufficient partial tax base to claim the full tax bonus will be able to offset the partial tax base of the second eligible person (e.g. second parent). Additional application of the tax bonus will be possible exclusively through the tax return.

If, during the tax period, the employer granted the taxpayer a higher claim to a tax bonus than he would have after recalculating the claim to a tax bonus for children after the end of the tax period, he will not lose the already granted tax bonus.

Exemption from non-monetary payment for doctors

In order to support future doctors, the amendment of the provision concerning health care providers was reflected in the ITA through the amending proposal of the deputies.

Non-monetary benefits provided to the health care provider in the form of **transportation** and **accommodation** in connection with the required continuing education will also be exempt from income tax.

Preventive restructuring

In connection with the adopted law **on the solution of impending bankruptcy in preventive proceedings** through a set of restructuring measures, the ITA adds the possibility of **creation of tax provisions** for receivables and the write-off of receivables in the case of preventive restructuring.

Tax deductibility of technical reserves in the insurance industry

Due to the adoption of **the new international financial reporting standar**d (IFRS 17), **insurance companies** will no longer report technical reserves as future expected estimated liabilities, but will report liabilities from insurance contracts **continuously** during the duration of the insurance contract based on cash-flow discounting to the present value.

Registration for income tax purposes

The method of registering taxpayers for income tax purposes is being amended. The tax authority will register taxpayers **ex officio** for income tax registered in the register of legal entities, entrepreneurs and public authorities.

The tax authority will register taxpayers for income tax registered in other registers than the commercial and trade registers, **based on a notice** that will be **published** on the website of the Financial Directorate of the Slovak Republic.

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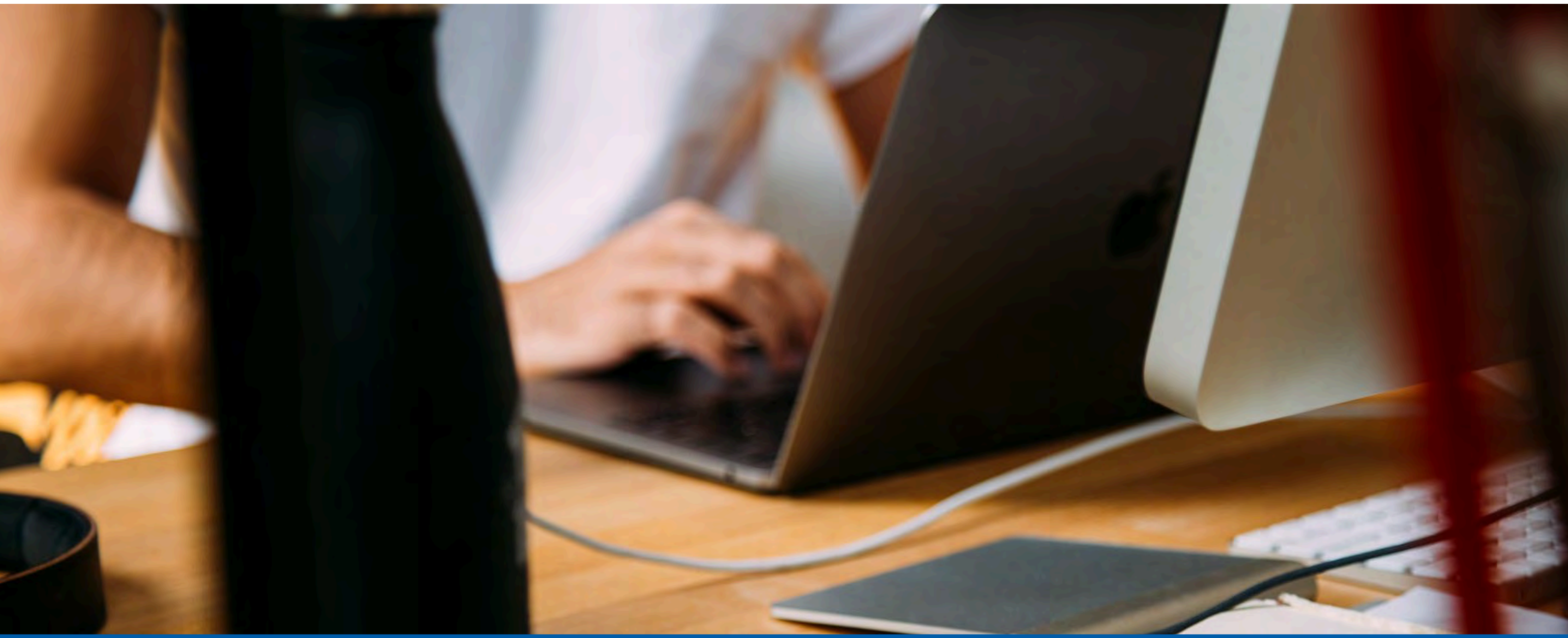

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