

News Flash

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Adjustment of the transfer price to the median in Slovakia

Adjustment of the transfer price to the median is already possible during the tax audit for TY 2023 in Slovakia

In December 2022, the National Council of the Slovak Republic approved an amendment to the Income Tax Act, the provisions of which also brought **changes in cross-border tax relations, namely clarification, additions and amendments to the rules in domestic and cross-border transfer pricing.**

The effect of the amendment from 01.01.2023 means that these changes will be applied for the first time for FY 2023. The tax auditor can send to tax subjects a notice about the opening of the tax audit for FY 2023 as early as April 2024. That is why this topic is actual.

What was one of the biggest changes?

One of the biggest changes in the field of transfer pricing was the enactment of the **possibility for the tax administration to use a statistical method, which is the determination of the mean value (median) from the established independent comparable values after a tax audit focused on transfer pricing.**

What is the intention of this adjustment in the Income Tax Act?

The intention of this adjustment in the Income Tax Act was to **ensure legal certainty both on the part of the tax administration and on the part of the taxpayer.** The Income Tax Act added the procedure of the tax administration in situations where the prices used by the tax subject in a transaction with a related person do not correspond to the arm's length principle, especially when the value used by the tax subject is outside the interquartile range. The tax auditor will determine this difference during the tax audit according to the mean value (median) of the independent comparable values found.

Who is amendment in question to the Income Tax Act?

The amendment in question to the Income Tax Act **mainly concerns taxpayers who transfer prices (or profit indicators) do not have determined in accordance with the arm's length principle and prices are outside the**

interval of comparable independent values, or interquartile range.

However, the **taxpayer still could convince the tax auditor that, given the circumstances of the audited transaction, it is more appropriate to use a different value within the interquartile range.**

How to arrive at an interval of comparable independent values?

Transfer pricing deals with prices between related persons who carry out transactions with each other. If these prices are not determined at the market level, the income tax base must be adjusted for the difference. This difference is determined by comparing controlled transactions with comparable uncontrolled transactions.

The comparability of controlled and uncontrolled transactions is ensured in practice through **comparability analysis**, or benchmarking study.

What does this amendment of the law mean in practice?

We have prepared for you an example and three model situations that explain the effects of this amendment to the law.

The taxpayer (Slovak company A) is a contract manufacturer of food products for its parent company in Austria (Austrian company B).

For this transaction, the taxpayer chose the transactional net margin method applied on

costs, and the transfer price was determined using a net mark-up indicator of **2.5%**, which is added to the total costs attributable to this transaction.

Pursuant to the Guidance of the Ministry of Finance of the Slovak Republic on transfer pricing documentation, Slovak company A is obliged to prepare full documentation, i.e., prepares and submits a comparability analysis to prove the correctness of the transfer price setting.

The Slovak company is undergoing a tax audit for FY 2023 focused on transfer pricing. Taxpayer – company A was requested to submit transfer pricing documentation, which also includes a comparability analysis.

First situation:

The taxpayer did not submit a comparability analysis to the tax auditor during tax audit. To determine the correct amount of the profit mark-up, the tax auditor prepared his own comparability analysis, on the basis of which he calculated an interquartile range of profit mark-up from 3% to 6.5% with a median of 4.5%.

The profit mark-up calculated by the taxpayer in the value of 2.5% is not within the interquartile range. The tax auditor based on § 18 par. 1 and § 17 par. 5 letters a) of the Income Tax Act adjusted the taxpayer's profit mark-up to the value of 4.5%, i.e., on the median.

The second situation:

During the tax audit, the taxpayer submitted a comparability analysis to the tax auditor, based on which he calculated the interquartile range of profit mark-up from 2.1% to 7% with a median of 5%.

The tax auditor checked the taxpayer's analysis. He did not find significant errors and mistakes in the analysis, and he accepted the taxpayer's analysis.

In this case, the tax auditor based on § 18 par. 1 and § 17 par. 5 letters a) of the Income Tax Act accepted the taxpayer's profit mark-up in the

value of 2.5%, as it falls within interquartile range of profit mark-ups determined by him (2.1% - 7%).

Third situation:

During the tax audit, the taxpayer submitted a comparability analysis to the tax auditor, based on which he calculated the interquartile range of profit mark-up from 2.1% to 7% with a median of 5%.

The tax auditor checked the taxpayer's analysis. He found significant errors and mistakes in the analysis and did not accept the taxpayer's analysis. He prepared his own analysis with results ranging from 3.1% to 6.5% with a median of 5%.

The taxpayer submitted the relevant economic arguments to the tax auditor, on the basis of which he adjusted the transfer pricing. The profit markup after adjustment represented a value of 3.1%.

The tax auditor based on § 18 par. 1 and § 17 par. 5 letters a) of the Income Tax Act in this case did not adjust the profit mark-up to a median of 5%, but he adjusted the profit mark-up to 3.1%, because he accepted the economic arguments of the taxpayer.

In the event of the tax difference being collected due to the violation of the arm's length principle between related persons, it is also necessary to expect higher sanctions, the mentioned offense is subject to sanctions in the amount of 6 times the basic interest rate of the ECB (min. 20%) p.a. calculated from the amount of the tax difference.

If you suppose that your company may be subject to the obligation to process transfer documentation, including a comparability analysis, or you have doubts about how to set the transfer price correctly so that it falls within the interquartile range and you would like to obtain additional information, our experts in the field of transfer pricing will be happy to advise you on this area.

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About Accace Slovakia

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