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CHANGES IN THE CORPORATE TAX IN SLOVAKIA – TAX LICENSE

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Abstract. The presented paper deals with actual changes in the Slovak tax system, namely with the changes in the area of corporate income tax – tax license for join stock companies and law obliging limited companies and with impacts of these changes on their individual business economy. The tax license, in Slovakia known as a tax from negative profit or minimum corporate income tax, will be firstly paid for the tax period 2014. By the senior officials of the Slovak Government, the tax license represents a tool for dealing with the deficit of the Slovak public finances and a fight against companies which report tax losses unjustly. In the context of the paper, authors also provide brief information on the Slovak tax system and public finances of Slovakia.

Keywords: tax, taxation, tax evasion, tax licence, tax burden, public finance.

JEL classification: H25, H26, H60.

1. Introduction

Taxes, taxation, and tax system as the parts of the tax policy have played an important role in the economy of each country as well in its economic subjects – households (simple individuals), business entities and of course in the case of a state and taxation is associated with almost everything economic from globalization (Owens 1993) to divorce (Cebula, Belton 1995).

In the Dictionary of Economics the term tax is defined as *"a compulsory transfer of money (or occasionally of goods and services) from private individuals, institutions or groups to the government, which may be levied upon wealth or income, or in the form of surcharge on prices"*. In modern economies, the tax duties are exactly defined by the tax legislative and tax payment is exacted by a legislative authority.

The fact that taxes directly or indirectly impact on production, consumption and distribution of wealth has been known since ancient times, although the way of taxation itself, taxes, purposes and ways of tax collection (overall tax system) have historically changed (or developed) as changed state's goals, interests and overall economic environment. State tax policy, as the part of fiscal policy, should not be considered in isolation but as a rule in relation to overall economic policy of given country (Frajtová-Michalíková, Kramárová 2007), which aims to influence economic and social processes in the society. It is common knowledge that well-adjusted and stable tax system with minimum (or acceptable) obstacles to entrepreneurship, willingness to work, savings, firm or individual investments and innovation may be an important driver of competitiveness of the national economy and its economic growth.[1] Otherwise, it could cause distortional behaviour of economic subjects which would take such kind of economic decisions they would not.

[1] Note: The fact that the tax system is considered as the one of the most important components of quality of business environment has been demonstrated through many surveys. This knowledge was supported as well by the results of survey, which took place at our Faculty in cooperation with The Silesian University in Opava, namely with The School of Business Administration. The survey was undertaken within the official Operational Program of Cross-Border Cooperation Slovak Republic-Czech Republic 2007-20013: *"Innovation – the Way of Increasing of Competitiveness and Regional Development"* in 2011. One of the findings was that taxes, structure of taxes, tax and contribution (to health and social security system) burden were after quality of supplier-buyer relationship (especially in connection with payment discipline) and legal protection of rights indicated as the biggest obstacles of entrepreneurship in Slovakia (13,10% of all respondents) (Janošková, Kráľ 2012; Štefániková 2012). Just for comparison, in Czech Republic the area of taxes was not perceived so negatively. Based on the survey, for Czech companies the legislative and legal protection of rights, quality of supplier-buyer relationship, own employees, bureaucracy and haggling with state authorities (institutions), activity of competitors seem to be worse for their business activities than taxes, tax system and their tax burden (8,33% of all respondents). We would like to point out, that the survey had a local character (Žilina Region, Moravian-Silesian Region). But the findings (and thereby also respondents' opinions on "tax matters") of the survey were supported by the findings of many other national surveys, e.g. survey conducted by The National Union of Employers, The Association of Young Entrepreneurs of Slovakia, The Institute For Economic and Social Reforms etc.

However, a setting of optimal tax system in real economic conditions is a difficult task and hence the term "optimal tax system" or "optimal taxation" itself it is difficult to find in "real economic world". The optimal taxation is basically associated with the problems of tax efficiency and tax fairness – if the tax system is efficient, it does not definitely mean that is fair too and vice versa – fair tax system does not mean that is also efficient.

The tax theories – the theories of optimal taxation are relatively able to define criteria, respectively conditions of optimal system but economic events in the world have confirmed existing gaps between theory and practice of policymakers and the question arises here whether policymakers need to learn more from theorists, or the other way round (Mankiw *et al*. 2009).

"The minimum", which an optimal tax system should contain, is usually defined using (well-known) taxation canons[2] but the current state tax policy must consider actual economic situation and try to give the best trade-of between state's requirements on one side and other economic subjects as taxpayers on the other. This divergence is given by the fact that taxation and taxes represent the main part of state budget revenues used to finance mainly a production of public goods, operation of the government itself and state institutions. On the other side, the tax tolerance of taxpayers (their willingness and ability to pay taxes as well willingness and ability to support especially increasing levels of their individual taxation) plays important role. However, from their point of view taxes are (mostly) perceived as a reduction of their individual income, wealth or consumption. Therefore, any partial change in the existing tax system or reformation of the system as a whole must have an adequate justification and policymakers will have to balance objectives of tax reform, efficiency and its distributional impact – mainly impact on budget revenues, tax burden, tax evasion, tax avoidance, tax compliance, next different distortionary effects of various kinds of taxes and potential enforcement costs.

The main aim of this paper is to present one of the newest changes in the Slovak tax system – the introduction of tax licenses for specific kinds of legal entities. We would like to present a basic concept of tax licences from the legislative and taxation point of view using the analysis of the newest amendment of The Income Tax Act and its comparison with the previous Income Tax Act; as well we will try to investigate anticipated effects of the licence introduction on business economy of concerned legal entities including the quantification of hypothetical tax burden. The anticipated effects we will analyse from the poinf of view of the Slovak state budged and public finance (in economics, the main direct contribution to tax research is based in the general subject area of public finance (James 2007)) based on official analyses presented by the representatives of current Governmet and from the point of view of concerned companies. The methodology of investigating of expected efects on the activities of enterprises consists from questionaire surveys and the presentation of choosen results is supported by adequate graphic processing. We would like to note, that all information on functioning of tax licences presented in our paper are in the plane of assumptions.

2. The Slovak tax system

Since establishment of Slovakia in 1993, its tax system has passed through several fundamental reforms or partial corrections. In the following text the major changes in the area of income taxation are briefly presented.[3]

Among the most important changes relating to business entities and changes of corporate income tax rate belongs its gradual reduction from 45% (in 1993) to 40% (in 1994), then to 29% (in 2000) and to 25% (in 2002). In the case of personal income tax, the progressive way of taxation had been applied until 2004.

The year 2004 was generally one of the most important consolidating and reform-oriented period in history of Slovakia. In this year, the next important reform was made – overall reform of taxation and welfare system – towards to simplification of tax system and growth-oriented economic aims. Specific aims of the tax reform were following:

- create a business and investment friendly environment for both individual and companies,
- eliminate existing weaknesses and inefficiencies in the tax law,
- achieve the highest possible degree of tax fairness by taxing all types and all amounts of income equally,

[2] Note: Main canons of taxation were firstly defined by Smith, A. in 1776 as follows: *canon of equity*, *canon of certainty*, *canon of convenience*, and *canon of economy* (economy in tax administration) (Smith et al. 2001). In 1980 Stiglitz, J. E. presented his own characteristics of "good taxes", very similar to Smith´s: *economic efficiency*, *administrative simplicity*, *flexibility*, *transparency*, and *fairness (Stiglitz 1987; Stiglitz, 2000)*. When reforming the tax system, besides the principles listed previously, currently the *principle of benefit* and *ability-to-pay principle* are considered (Medveď et al. 2009).

[3] Note: Based on The Income Tax Act No. 286/1992 Coll., The Income Tax Act No. 366/1999 Coll., and The Income Tax Act No. 595/2003 Coll. effective till 2013.

– shift the tax burden from direct to indirect taxes.

The introduction of a single tax rate at 19% (flat-rate income tax, single-rate VAT) was the core of this reform. The single rate was levied on main tax categories – personal income, corporate income and goods or services from primary production to final consumption (VAT)[4] (Moore 2005).

The single-rate for VAT was changed in 2011 when the initial 19% increased to 20%. The increasing of VAT rate was in response to global economic crisis and fiscal crisis of the Slovak state budget. This measure is still of temporary nature while the budget deficit does not get below 3% of Slovak GDP.

One year later in 2012, also the flat-rate income tax changed – the corporate income tax increased to 23%, the personal income tax remained still at 19% and a special tax for bank was introduced – the bank contribution with the rate 0,4%[5]. The reason for those changes kept the same – efforts to increase the revenues of the state budget (by increasing the tax revenues) and support consolidation process of public finances in Slovakia.

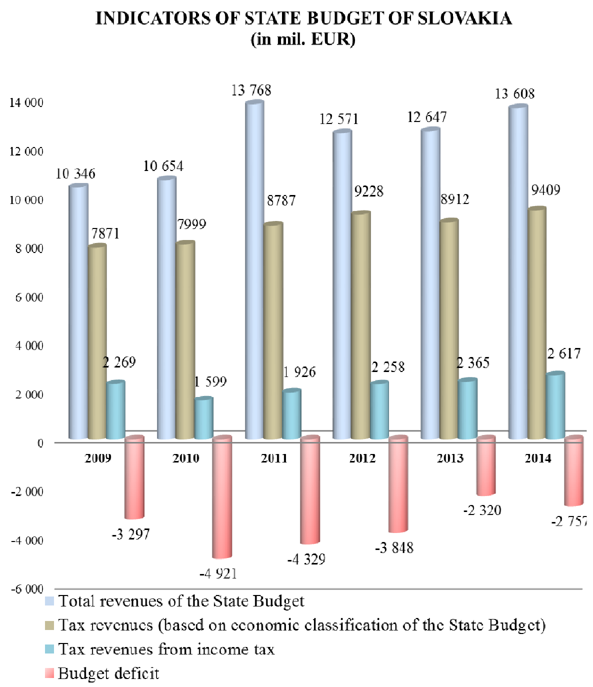

Fig. 1. The State Budget Indicators Overview I. 2009–2014 (predicted data)
(Source: compiled by authors based on: MF SR)

In 2013, then new personal income tax came into force which parallelly exists with the previous rates. It is dubbed as "millionaires' tax" which is applied when taxpayer´s income reaches a level at which he/she does not have right to deduct personal tax allowance[6] (Paliderová, Vilim 2013).

Generally, the tax revenues are very important sources of Slovak public finance. In the following charts, we present an overview of selected indicators (items) of Slovak state budget, including data on tax revenues, budget deficit, deficit ratio and their development since 2009. The data on the budget deficit of Slovakia are in accordance with the ESA95 methodology.

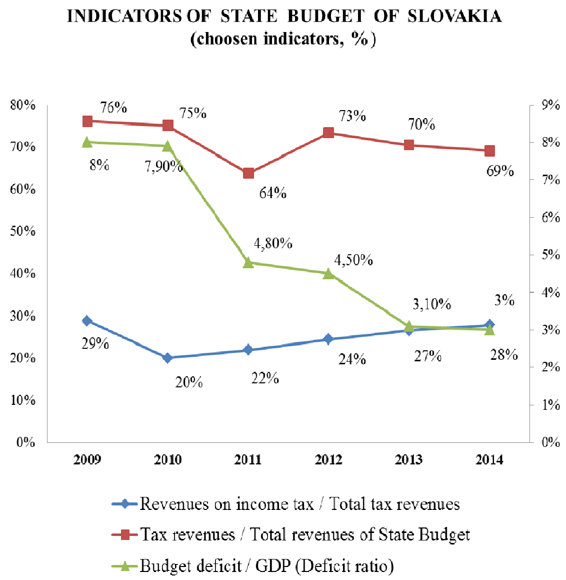

Fig. 2. The State Budget Indicators Overview II. 2009 – 2014 (predicted data) (Source: compiled by authors based on: MF SR, ŠÚ SR, Eurostat, NBS)

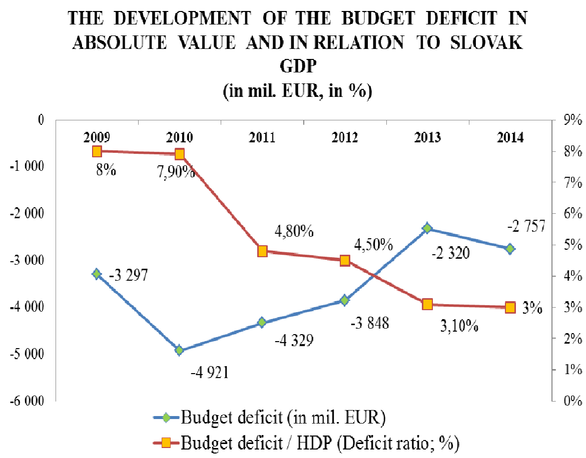

Fig. 3. The State Budget Indicators Overview III. 2009-2014 (predicted data) (Source: compiled by authors based on: MF SR, ŠÚ SR, Eurostat, NBS)

[4] Note: Slovakia was the first country within the countries of the OECD, which applied the conception of single rate tax on personal, corporate incomes and consumption (VAT).

[5] Note: The tax base of bank contribution is equal to net bank liabilities (liabilities minus bank equity).

[6] Note: When calculating tax liability, the personal tax allowance is deductible item. Its amount depends on the living minimum in force as of 1 January of the relevant tax period considered (i.e. 337.70 EUR in 2013; 352 EUR in 2014 – allowance represents 19.2 times of the living minimum) and tax base. For instance, if the tax base exceeds 34 401.74 EUR in 2013, the taxpayer is not eligible for personal tax allowance. In this case, the personal income to 34 401 EUR is taxed at the rate 19%, the remaining amount exceed 34 401 EUR is taxed at the rate 25%.

Regarding the structure of taxes, no one can possibly meet the requirements of every country. The best system for any country should be determined taking into account its economic structure, its capacity to administer taxes, its public service needs, and many other factors (Bird, Zolt 2003). Concerning these requirements the current conception of tax system in Slovakia is based on the spheres of direct and indirect taxation, as it is listed in the *Table 1* hereinbelow.

Table 1. The Current Classification of Taxes in Slovakia (source: authors)

DIRECT TAXES	INDIRECT TAXES
• ***Personal income tax***	• ***VAT***
• ***Corporate income tax***	• ***Environmental contribution***
• ***Special contribution for regulated businesses***	• ***Excise taxes (duties):*** - on tobacco and tobacco products, - on alcoholic drinks, - on mineral oils, on electricity, coal and natural gas
• ***Bank contribution***	
• ***Local taxes:*** - motor vehicle tax, - tax for municipal waste and small construction waste, - real estate tax, - dog tax, - tax on the use of public space, - accommodation tax, - vending machine tax, - non-gainful (entertaining) slot-machine tax, - tax on the entry into and parking of a motor vehicle in a historical part of the city, - nuclear facility tax	

We would like to note, that many other important changes there have taken place in the Slovak tax system, whether in the value of tax allowances, in tax deductible and non-deductible expenses, taxable incomes, tax depreciation/amortization, some kinds of taxes have been abolished (dividend tax, gift tax, inheritance tax, real estate transfer tax), in terminology of identification entities as taxpayers, in the process of tax collection, registration, in communication with tax authorities (electronization of communication), legislative changes in the field of taxation of nonresidents, overall changes in the VAT Act and in other tax legislative etc.

One of the newest changes in the area of the corporate taxation the introduction of tax license within the amendment of The Income Tax Act represents.

2.1. Actual changes in the Slovak tax system – the introduction of tax license

Important correction with impacts on taxation on legal entities was adopted at the end of last year with effectualness since 1 January 2014. The amendment of *The Income Tax Act (No. 595/2003 Coll.)*, the basic Slovak tax law governing taxes from various kind of income, in *section 1, §46b* has introduced (besides others) the tax license on income of legal entities, which can be considered as a new kind of direct taxation of corporate incomes. *The tax license is the minimal corporate income tax after deduction of all reliefs* (defined in *§30a* – reliefs for beneficiaries of investment incentives and in *§30b* – reliefs for beneficiaries of incentives in the area of research and development or in *§52*) *and after crediting the tax paid abroad* (in accordance with *§45*). In other word, it is the minimum “fee or lump sum tax” paid into the state coffer, which is obliged to pay limited liability companies (law obliging limited companies) and joint stock companies. The conception of tax license is built in such a way that license must be paid by any legal entity:

– which reports a tax loss for given taxation period,
– which tax liability for given taxation period after overall deduction of any allowed relief and crediting the tax paid abroad is lower than the relevant tax license.

In the past (in comparsion to the previous Income Tax Acts), the corporate taxpayers named above would not be obliged to pay any income taxes or their tax would be queal to calculated tax liability in the tax return and therefore the tax license is rightfully called as “tax from negative profit” and new relevant cost burden (Poniščiaková 2010). The self-employed companies, newly established companies, companies under legal bankruptcy proceedings or in a process of liquidation, sheltered workshop companies, not-for-profit established companies (organization), the National Property Fund, and the National Bank of Slovakia are the only exception, which are exempt from tax license paying (in accordance with *section 6, §46b*).

The policymakers have approved three different rates of tax license that companies will pay in accordance with their license classification. Rates, listed in the following table, applicable to companies that employ at least 20% employees with disabilities of the total amount, are decreased to 50%. The tax license classification is introduced in the following table.

Table 2. The Amount of Tax License in Slovakia for the Tax Period 2014
(source: compiled by authors based on: *The Amendment of the Income Tax Act No. 595/2003 Coll., section 2, §46b*)

CLASSIFICATION CRITERIA	AMOUNT OF TAX LICENSE (EUR)		
	480	960	2 880[7]
• *taxpayer is not registered for VAT*	Yes		
• *taxpayer is registered for VAT*		yes	
• *annual turnover does not excess 500 000 EUR*	Yes	yes	
• *annual turnover excess 500 000 EUR*			yes

The companies are going to pay tax license firstly for the taxation period 2014. The tax license is payable within the deadline for filing tax returns in 2015 (31 March) (PWC 2013). If the company pays tax license, the actual Income Tax Act allows companies to offset their paid license against their future income tax liability before claiming the advances, however within the subsequent three years and of course, if a company's economic results allow it.

2.2. Presumptive influences of the tax license and their assessment

The tax license is considered as a new conception of taxation of legal entities in Slovakia, and therefore its final impacts from the state's point of view or from the point of view of injured companies may be just assumed right now. The representatives of current Slovak Government, who are responsible for actual tax reform, have come to believe that the reform will have just positive benefits. They have emphasized especially its positive effect on tax dodging companies and the Slovak shadow economy[8] (in cooperation with other arrangements of current government) (Balogová 2013). The revenues from income tax, after VAT, are the second most important source of tax revenues of Slovak public finance.[9] The real tax collection generally lags behind the projected budget tax revenues deu to tax frauds. The biggest problems are with VAT, following by evasions on corporate income tax, personal income tax and by other taxes. The Tax Direcorate of Slovak Republic estimated that tax evasion on corporate income tax was approximately 19,3% in 2012 (VAT 73,1%, personal income tax 4,8% other 2,8%).

Based on the own survey of The Ministry of Finance actually approximately 60% of all registered companies in Slovakia do not pay any income tax and much as 25% of companies have reported zero tax liability over the last four years despite the fact that most of them do active business. In the absolute figures since the year 2006 its number has increased from 52 000 to almost 92 000 companies. Thereby the introduction of tax license should help to eliminate illegal taxation activities of companies, which generate tax losses artificially and are suspicious from tax evasion on income tax. In this connection, as well, the assumption on extra tax income to state budget is important to mention – the government concludes that it would be possible to collect 112 million EUR on the tax license annually.

The other fact supporting the introduction of tax license is a cleaning up of The Business Register of Slovak Republic from business entities which have not participated in business activities actively. Currently, there are approximately 10 000 companies that have not responded and the conception of tax license should force them to terminate their business existence legally, or in the other case they are obliged to pay tax license.

It is generally known that any significant change of tax system should be underpinned by appropriate analysis which could enhance prospects for its adoption within injured taxpayers. The introduction of tax license has been advocated by a relatively higher number of companies, which have not paid taxes levied on their income, as we mentioned in the previous text. Nevertheless, it is not exactly known how many companies have reported zero tax duty because of their not good business situation and thereby rightfully. On the other side, we do not have exact figures how many of them have reported tax losses unjustly. Based on this fact, the conception of tax license may be considered as an unsystematic solution of existing lacks of the Slovak tax system (particularly in connection with the tax evasions) – it is assumed that the tax license could have negative and in some cases also liquidation impacts on injured companies, especially on SMEs (as well on the employment in these companies). In case of such kind of companies, the tax license represents just a new type of tax burden, which usually has a negative impact on business environment. There also exists an assumption that expenses on tax license could affect their cash flows in a higher measure

[7] Note: In this case, the classification criterion referring to VAT registration is not relevant to take into account.
[8] Note: The Slovak shadow economy size (in relation to GDP) was 15% in 2013. In comparison to 2012 it dropped by 0.5% (A.T.Kearney).
[9] Note: Authors mean overall tax revenues from corporate income tax and personal income tax (cumulative item in the State Budget based on economic classification).

than cash flows of bigger enterprises. Thereby, the better and rational way how to solve problems with tax evasion but as well with tax avoidance seems to be solving still persistent tax-accounting imperfection of our system with emphasis on the transparency of accounting, simplification of existing tax system and tax inspections of injured entities etc. The tax avasion as the legal possibility to reduce the amount of tax (Orviská, Hudsun 2003) that is payable is other huge problem of Slovak economy due existing legal loopholes. In the case of income tax and legal but in many cases amoral dodging of tax duties especially bigger MNCs play important role in our economy. This concerns in particular transfer pricing. Thereby the appropriate tax control system is the important tool that supports to reveal illegal tax activities (or unmoral legall activities at the adge of the Act) – in this case reveal companies, which do not pay taxes due to their tax speculations and not because worsening business or overall economic situation in the markets. Properly working tax administration should be also able to support fight against the shadow economy and bring back "lost" economic resources into the economy.

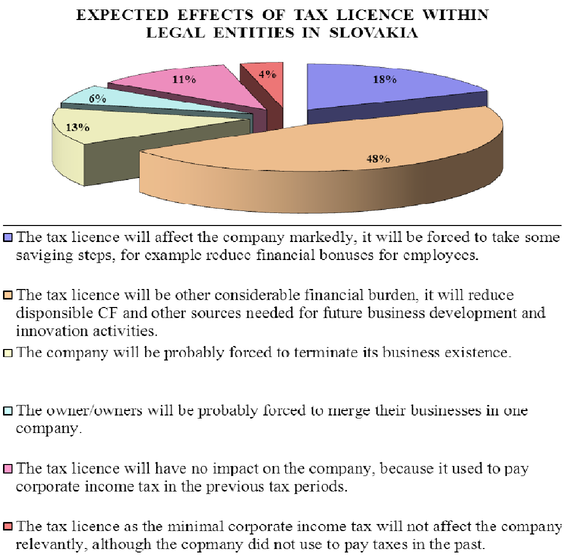

Fig. 4. Expected Effects of Tax Licence Introducion within Legal Entities in Slovakia I. (source: compiled by authors based on: *http://zmps.sk/others/articles/2804621423_2013-danove-licencie-prieskum-vysledky.pdf*)

The survey of The Association of Young Entrepreneurs of Slovakia has confirmed the similar views on the introduction of tax license; The Association has asked on opinions 404 existing entrepreneurs what would cause the tax license introduction in their individual case. The survey was conducted in October 2013, when the Amendment was passed by Slovak Parliament. The findings of the Association are presented in the following chart.

If we consider classification criteria for identification the final amount of tax license – *annual turnover* and *registration for VAT* – and using the data from the survey and principles of segmentation, the presented assumption about the impact of tax license on routine business activities of SMEs (in the worst case on their individual business existence) can be confirmed.

Approximately 74% of all responded companies not registered for VAT with the annual turnover below 500 000 EUR stated that the tax license would hurt them largely and force them to take saving measures (reallocation of finance for bonuses, research and development). Even 17% of companies from this group indicated that they would be thinking about the termination of their businesses. Almost the same opinion stated companies with the same level of turnover but registered for VAT – 70% would be forced to take saving measures and 12% would be thinking about the termination of businesses. The neutral stance (they used to pay taxes in the previous years, the tax license would not have any impact on their business, even they did not use to pay taxes in the past) took only 15% of them. Companies whose annual turnover is higher than 500 000 EUR would expect the least harmful impact of tax license on their individual business economics based on the figures approximately 50% from that group. The next 13% would be thinking about the termination of business and 37% stated that they would be forced to take saving measures.

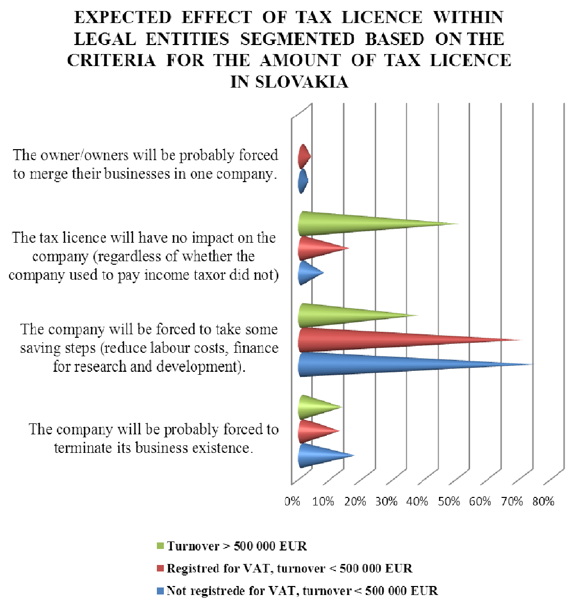

Fig. 5. Expected Effects of Tax Licence within Legal Entities in Slovakia II. (source: compiled by authors based on: *http://zmps.sk/others/articles/2804621423_2013-danove-licencie-prieskum-vysledky.pdf*)

We allow also presume that the tax license may have a negative impact on the establishment of new enterprises (mainly SMs) – probably one-year period during which they are exempted from paying the tax license, will not be long enough to succeed in the market. Indirectly the findings of already mentioned survey have confirmed our opinion. Indirectly because the fact that the opinion on one-year license payment postponement the Association has found out among the potential entrepreneurs who did not have any practical business experience.

Since 1 January 2014, besides the tax license, the *new tax rate on corporate income tax* has come into force – *22%* instead previous 23%. Hence, many opponents perceive the introduction of tax license for nothing less than compensation of income tax drop and potentially missing revenues on income taxes in the state budget. The introduction of tax license, regardless of the tax rate reduction, has partially undermined the tax fairness. It is mathematically provable (using sensitivity analysis) that any company, which reports zero tax base or tax liability lower than the appropriate amount of tax license, will bear larger tax burden than other companies. In the following table, we demonstrate the minimal thresholds of tax base – if the reported tax base of individual corporate taxpayers is below value of the thresholds, company´s tax rate will be higher than 22%. For instance, if the company as taxpayer (belonging into first tax license group) reported in the tax return the tax base at 2 000 EUR, the company´s tax burden due the corporate income tax would be 480 EUR. In comparison to its tax liability, assuming the tax rate from 2013 – 23%, the paid tax would be just 460 EUR that is less than the actual amount of its tax license liability and the real tax rate after recalculating would be 24%.

Table 3. The Recalculated Hypothetical Tax Rate (source: authors)

CLASSIFICATION CRITERIA	THE TAX LICENCE	THE THRESHOLD OF TAX BASE	THE REPORTED TAX BASE, RECALCULATED TAX BASE RATE (HYPOTHETICALLY, EUR)
Taxpayer not registered for VAT, turnover < 500 000 EUR	480 EUR	2 182 EUR	2 000 EUR - 24%
Taxpayer registered for VAT, turnover < 500 000 EUR	960 EUR	4 364 EUR	2 000 EUR - 48%
Taxpayer with the turnover > 500 000 EUR	2280 EUR	13 901 EUR	2 000 EUR - 114 %

The other thing that should be seen as unfair taxation and unfair tax burden to legal entities obliged to pay the tax license is a discrimination of companies registered for VAT compared to self-employed persons also registered as the VAT taxpayers. Considering the recent amendment of Tax Law Act, the income of self-employed persons is taxed at 19% tax rate; regardless of he/she is a VAT taxpayer. Except that, the self-employed person is exempt from tax license paying, as we have mentioned before. Now, considering just the self-employed persons registered for VAT, "are able" to report zero tax duty thanks to "accounting possibilities" that is unfair to the companies obliged to pay licenses at 960 EUR.

Many debates may be also focused on the length of period in which companies are allowed to deduct licenses (if they had paid them) from their future tax liability also on a mutual relationship between the economic possibility of license deduction and utilization of tax losses in Slovakia[10]. Everything will strongly depend on the final economic position of each company, individually.

3. Conclusions

The evaluation of changes in the tax system before the introduction is relatively difficult. Whether, the modifications made, in terms of the objectives of tax reforms and economic objectives, were successful, would be possible to assess objectively after their effectiveness in practice. "Real economic world" and "behaviour of economic subjects in real conditions"might make the tax reform successful, unfortunately it makes it flop, too. In terms of the latest amendment of the Income Tax Law and introduction a new conception of taxation of chosen companies in Slovakia – the tax license – the adequate assessment of its impact will be possible to make in the next year after the current tax period finishing. Its launching will have an individual impact on each company obliged to pay license and its business economics.

Irrespective of it, we have tried to present both sides of opinion on the introduction of tax license. As independent bodies, we do not consider the conception of tax license as completely wrong, it makes sense, but it is questionable if its setting is a good whip on tax defaulters or just measure that will punish only honest entrepreneurs.

[10] Note: The utilitazion period of tax losses reported after tax period 2013 (it means starting 01/2014) is maximal 4 years (Mráziková 2014; Kollárová 2013). It has been shorten from 7 years by the actual Amandment of the Income Tax Act.

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