TAX MANIFESTO 2020

INTRODUCTION AND BASELINE SITUATION

Slovakia has entered a period of unprecedented economic downturn and companies are already experiencing shortfalls in revenues. Furthermore, they are impaired by stuck logistics, an obstacle exacerbated in sectors involving complex products (e.g., automotive), because as one link becomes stuck this paralyzes the entire supply chain. It is therefore necessary to strengthen the domestic economy, principally focusing on radical improvement of the conditions for innovation. Slovakia's innovation potential (according to the the European Innovation Scoreboard) has been stagnant for almost 10 years (only Romania and Slovenia have had worse results) 1.

Returning the economy to a pre COVID-19 state is a long-term undertaking and Slovakia's lag in EU convergence means significant measures are required to increase the competitiveness of Slovak firms.

The EU has committed to providing external funds for individual economies within its recovery plan, which is mainly dedicated to financial reforms. However, it is also essential to adopt legislative measures, particularly in the area of tax policy, to motivate firms' investment of private resources into the economy.

Below we present a summary of selected measures, which would result in many long-term benefits for the business environment. The goal is to stimulate and accelerate professional discussion in the tax area (not including social security and insurance), which initiates legislative action as soon as possible to ensure retroactive effect for 2020.

The proposed measures are partially pro-reform solutions, but do not substitute for complex tax reform. However, they can bring about a rapid and significant improvement to the quality of the Slovak business environment from a tax perspective.

PROPOSED MEASURES – FIVE AREAS

1 Radical tax aid for innovation and investment

- **Super-deduction** Application of the super-deduction should be extended to R&D expenses from (external) services, if it can be proved that they are related to R&D. This would include costs of: services in prototype development, prototype testing, certification, technical documentation, training, education and development of employees working in R&D, software leasing and maintenance.
- **Patent Box** Patent Box exemptions should be extended to revenue from legal relations such as in-app purchases and Software as a Service. The exemption should be granted even when intangible assets do not appear on balance sheets as is often the case in innovation centers around the world (UK, Israel, Ireland, etc.) 2.
- **Super-amortization & super-depreciation** Support should be increased to investments which lead to improvements in labor productivity (even temporarily), improvements in the quality of production and those with high added value (automatization, robotization). In order to maintain the competitiveness of Slovak companies and support the Industry 4.0 concept, it is necessary to capture global trends in intelligent business automation. We would therefore recommend that expenses related to intelligent industry in Slovakia (machines operating on the concept of the Internet of Things, artificial intelligence, 3D printing, machine learning, predictive analysis etc.) are tax deductible from a tax base of 200% as they are for R&D expenses according to Sec. 30c of the Income Tax Act (so called super-deduction).
- **Adaptation of state aid rules** A temporary amendment of state aid rules should be considered, to ensure simpler conditions for a larger number of firms to obtain state aid in the fields of innovation and technological improvement, in line with EU legislation.

2 Tax support for the recapitalization of companies

- **Tax support for reinvestment of individual shareholder's capital gains** back into companies, i.e., deferral of the moment of taxation until the time of consumption by an individual.
- **Shifting the taxation of income from employee shares and options to the actual realization of income** (sale, collection of dividends, etc.). Employee stock option plans increase the involvement of key managers and employees in innovation and are more motivating than a fixed salary. At the same time they are advantageous in terms of the company's cash flow (a key aspect currently in time of crisis).
- **Unification of the tax regime for contributions to capital and contributions to capital funds** Capital funds from contributions represent a faster and less administratively demanding alternative for obtaining funds from shareholders. The current tax regime places contributions to capital funds at a disadvantage compared to contributions to registered capital, although both are economically similar categories. In times of crisis, there is an increased need for swift financing within companies, and such a regime would simplify and speed up the realization of these deposits.

3 Depreciation of assets in line with economic life

- **Tangible assets** The current tax depreciation categories of assets do not take into account their real economic lives (e.g., computers depreciated over four years which actually last no more than two years, office buildings currently depreciated over 40 years 3). This should support preferential areas such as Industry 4.0, digitization and the green economy.
- **Receivables** If a company sells goods/services, the proceeds are fully taxable, even if the customer does not actually pay for them. The company claims costs related to the receivable through provisions, but this takes three years. Several countries (e.g., Germany) have adopted a concept whereby creation of an accounting provision is a fully tax-deductible expense.

4 More efficient tax regime for offsetting profit and loss in real time and space. Elimination of tax obstacles to business reorganization

- **Loss carry back** The concept of transferring a tax loss to previous periods exists in several countries and should be joined shortly by the Czech Republic. Taxpayers will be able to deduct a tax loss for 2020 from previous profits taxed in 2018 and 2019. The resulting difference will be a tax overpayment (positive cash tax inflow of c. €210,000).
- **Loss carry forward** Improving the tax loss carry forward in comparison with the EU (this would involve extending the maximum transfer period and increasing the maximum annual deduction in relation to the tax base).
- **Group taxation** This occurs in two main models – offsetting profit and loss between group members, or eliminating intercompany transactions – and is currently highly relevant to family businesses. This concept is currently applied by more than two thirds of EU Member States and within the V4 countries a similar concept is applied by Poland and Hungary.
- **Tax-neutral business combinations** (mergers, fusions and divestitures). Within these transactions, real income is generally not realized, while unrealized income is taxed in the form of the increased value of acquired assets. As a result of the crisis, entrepreneurs will be looking for cost-effective solutions through restructuring or lean business management and this measure would enhance implementation of such restructuring without tax obstacles. Furthermore, it would not represent a major departure from the Income Tax Act, rather a return to the regulatory framework valid before 2018.

5 Elimination of Slovakia's comparative VAT disadvantages

- **Introduction of reverse-charge VAT on imports of goods from outside the EU** This measure , which has been postponed since 20134, should lead to greater collection of customs and import tax at the expense of other European jurisdictions (mainly Slovenia, the Czech Republic, Hungary and Germany). Currently producers and traders import their goods preferentially to these countries to avoid paying Slovak import VAT and refinancing the VAT until it is refunded. The measure should also have other associated benefits, such as the development of logistics services and warehousing.
- **Bad debt relief** It is not worth registering low-value receivables in bankruptcy proceedings or filing petitions for court / execution, in terms of direct and indirect costs and time. For this reason, we propose extending the currently submitted amendment to the VAT Act to allow taxpayers to correct the tax base in cases of low-value receivables (i.e., up to €100), even if they have not acquired uncollectible status, and for selected fraudulent receivables.

IMPACT ON THE STATE BUDGET AND EU INCENTIVES

The proposed measures differ in their potential influence on the state budget - some would have little or no impact (reinvestment of capital gains of a natural person, employee stocks), while others would have a more significant effect (acceleration of depreciation/amortization, group taxation). All of them should be adopted as soon as possible and sequenced over time when operating with a higher risk of budgetary dropout (e.g., alignment of accounting / tax amortization of accounts receivable over a three year spread, setting an absolute limit on covered/eliminated transactions within group taxation).

Currently there is ongoing discussion at EU level of necessary reforms and meaningful allocation of European resources, with the goal of revitalizing the European economy. Slovakia should consider European instruments supporting reform and stability, in the case of these partially pro-reform measures, and even more so in the context of broad tax reform.

1 European Innovation Scoreboard 2020, https://ec.europa.eu/commission/presscorner/detail/en/qanda_20_1150

2 Protection of state budget interests is possible e.g., through limitation of exempt profits on inactivated assets with a set sum (e.g., €500 thousand per annum) or use the control function of the Slovak Office for Intellectual Property (e.g., positions on patentability outside of the very time-consuming patent granting process)

3 According to a study carried out for the European Commission, several Member States apply a shorter depreciation period for office buildings https://ec.europa.eu/taxation_customs/sites/taxation/files/taxation_paper_75.pdf

4 The reason for the reluctance to adopt this measure is the accounting, not the economic view of the costs of implementing the measure in the sense of the Constitutional Act on Budgetary Responsibility. In our view, the cost of implementing this measure should be considered as the cost of financing the temporary cash flow of the state budget failure and not the amount of the temporary failure itself.