INEKO

Institute for Economic and Social Reforms

Tax system in the Slovak Republic

Jozef Hajko, fellow worker at INEKO, September 2016

Abstract

Taxes and social contributions represent the most important income flow for the general government budget. In the Slovak Republic they account for up to four fifths of the income of the general government budget.

The tax and social contribution mix of the Slovak Republic has much in common with the tax and social contribution mixes of neighbouring V4 countries. Social security contributions account for 40 per cent of it, production and import related taxes (mainly VAT) cover one third of it and the remaining one fifth is represented by income and property taxes.

This analysis covers two types of direct taxes (personal income tax – PIT and corporate income tax – CIT) and two types of indirect taxes (value-added tax – VAT and excise tax – ET). These four tax types account for 90% of total tax income of the state budget of the cabinet and municipalities.

Chapter 1 describes the regulatory mechanisms applied to the examined taxes and maps the current state of affairs. It unfolds the evolution of the tax system after 2004, the year in which the Slovak Republic launched its most compelling change in the tax domain so far within its contemporary history – the flat tax for both natural and legal persons, including the gradual departure from this policy in recent years and the outlook for the next few years.

Chapter 2 outlines the trends in the collection of the examined taxes in the post-2000 period. It analyses the reasons for lagging behind GDP growth in tax collection in almost all areas and presents the view of the Ministry of Finance explaining the reasons for failing to meet budgetary goals in individual years.

Chapter 3 presents and attempts to interpret gaps in tax collection. The only two tax types for which gap quantification was possible were VAT and excise tax on mineral oil. Otherwise no data or calculations exist, hence providing no other alternative than relying on estimates, working with auxiliary indicators or waiting until data are available in the future. They do not exist because research in this area is financially demanding and there is no relevant methodology.

Chapter 4 maps the main instruments used to combat tax avoidance. In 2012 the government adopted 50 measures to combat tax fraud and topped those up by additional 30 in 2015. The text analyses the impact of these measures and where possible quantifies it. Moreover, it does not shy away from highlighting their negative side effects.

Chapter 5 evaluates the progress achieved in the examined area. It also summarises the key positive and negative features in the field of combatting tax fraud.

1. Tax System in the Slovak Republic

This chapter provides an overview of the key types of taxes according to their collection weight. Its first part describes the current situation, its second part the main changes after 2004 and the tax outlook for future years. Table in Annex contains a more detailed summary.

Personal income tax (PIT). An individual who spends 183 or more days in a calendar year in the Slovak Republic or who has a permanent residence here is considered a tax resident for tax purposes. A tax resident is subject to tax on worldwide income, irrespective of whether the income is remitted to the Slovak Republic.

An individual's tax base is formed by adding income from different sources (such as income from employment, income from entrepreneurial activities, income from other self-employment activities, rental income, and other income).

The tax rates applicable are as follows:

- The tax base of up to 176.8 times the subsistence level (i.e. up to EUR 35,022 annually) is subject to a 19% tax rate. The exceeding part of the tax base is taxed at 25%.
- Income of constitutional authorities (e.g. members of the Government and the Parliament) from dependent activity is, in addition to the tax calculated as listed above, subject to a special tax rate of 5%.
- Income from capital gains is included into specific tax base taxable at 19% rate.

The personal allowance of 19.2 times the minimum subsistence amount announced on 1 January each year is available to all individuals whose annual tax base does not exceed a certain limit. If the tax base of a taxpayer exceeds a certain limit, the personal allowance is reduced to nil progressively, based on a formula. For 2016, the personal allowance is set at EUR 3,803 based on the minimum subsistence amount valid on 1 January 2016.

A tax bonus of EUR 21.41 per month for each dependent child living in an individual's household is available to individuals with taxable income of at least six times the minimum wage. The tax bonus decreases the tax liability and changes always as of 1 January. It also works as a negative tax meaning that should the tax liability be lower than the sum of tax bonuses, the individual would get the difference from the state.

Employees of companies must contribute to the statutory social security and health insurance schemes. Employee's health insurance and social security contributions total 13.4% of the gross wage, but due to caps on the amounts on which these contributions are levied, the total contribution does not exceed EUR 574.86 per month in 2016. Employer's health insurance and social security contributions total 34.4% of the gross wage, but due to caps on the amounts on which these contributions are levied, the total contribution does not exceed EUR 1,475.76 per month in 2016.

Non-cash benefits, dividend income, and income from the sale of shares are subject to health insurance contributions. Dividend income is not subject to tax, but is subject to health insurance contributions at a rate of 14%, up to 60-times the average monthly salary from two years prior (i.e. EUR 51,480 in 2016).

An annual deduction of up to EUR 500 is available from certain types of income from capital, including gains on the sale of shares, and rental income from real estate.

A taxpayer can donate 2% (or 3% provided that certain conditions are met) of his tax liability for 2015 to a qualifying entity of his choice.

Corporate income tax (CIT). Any legal entity that has its seat or its management located in the Slovak Republic is a taxpayer with unlimited tax liability (a tax resident). The taxpayer's worldwide income is the subject of tax. In order to avoid double taxation, tax treaties with relevant countries apply.

The corporate tax period can be a calendar year or a fiscal year different from a calendar year (12 consecutive calendar months). Corporate tax returns must be filed by the general filing deadline of three months from the end of the tax period. The tax balance due for a fiscal year is payable by the general or extended tax return filing deadline.

There is a flat CIT rate of 22%. Some income may be subject to a 19% withholding tax rate (e.g. interest, royalties). A specific 35% withholding tax rate applies for payments to taxpayers from non-treaty jurisdictions.

A tax licence is applicable to companies and represents a minimum lump sum tax after deduction of tax relief and credit of taxes paid abroad. The respective amounts range from EUR 480 to EUR 2,880 annually, depending on the entity's turnover and whether the entity is a VAT payer. The tax licence should be paid regardless of the value of the reported tax base or the tax loss incurred; however, it should be possible to deduct it from future tax liability in the subsequent three years.

The tax base is the profit/loss as determined under the Accounting Act, adjusted for tax purposes. Tax-deductible items are those that the taxpayer incurs when generating and maintaining his taxable income.

Tax depreciation (capital allowances) is generally available for expenditure incurred on non-current tangible and intangible assets. Non-current tangible assets are classified into tax depreciation groups to which different tax depreciation periods apply, with depreciation period from 4 to 40 years.

A taxpayer can donate 1.0% (or 2% provided that certain conditions are met) of his tax liability for 2015 to a qualifying entity of his choice.

Investment incentives available under Slovak law are available for projects in manufacturing, technology centres, shared service centres and tourism. Taxpayers involved in research and development are entitled to a super deduction of at least 25% of actual qualifying costs incurred.

Special taxes. There is a special tax from activities of entities in regulated industries (e.g. energy, insurance, public healthcare insurance, electronic communications, etc.) The tax is calculated as a multiple of the tax base (accounting result before tax). The annual rate can be up to 4.356%. A special tax on banks is charged at a rate of up to 0.4% of liabilities net of own equity to the extent that the cumulative amount of special tax collected from all banks by the Tax Office does not reach the EUR 750 mn threshold. The tax rate of 0.2% applies in 2016.

Value–added tax (VAT). A basic VAT rate of 20% applies to all taxable supplies, with certain exceptions. Certain medical products, printed materials and basic foods (e.g. milk, butter, meat) have a VAT rate of 10%. Exempt supplies without credit entitlement include postal services, financial and insurance services, education, public radio and TV broadcasting services, health and social services, the transfer and leasing of real estate (with exceptions), and lottery services.

Excise taxes (ET) are charged on the release to tax-free circulation or import of tobacco products, wine, spirits, beer, mineral oil, electric energy, coal, and natural gas. Rates are fixed in EUR per unit of commodity.

Immovable property tax is divided into land tax, building tax, and tax on apartments. The tax is calculated based on the area of the real estate, its location, and its type, as well as the tax rate of each self-governing region.

Motor vehicle tax applies to vehicles that are registered in the Slovak Republic used for business purposes. The tax rate depends on engine capacity, vehicle size, etc.

The Slovak Republic adopted a fundamental tax reform in 2004 which introduced a single rate of 19% PIT, CIT and VAT. The implementation of a single rate was accompanied by the cancellation of a series of derogations applicable at that time. Moreover, Slovakia repealed certain types of taxes – tax on dividends, gift tax, real estate transfer tax – and road tax was replaced by motor vehicle tax. With this reform, the country became the first in OECD to have a flat PIT. The tax reform succeeded in making the tax system simpler and more transparent.

The main objectives of this reform were to support growth, strengthen work incentives and send positive signals to investors. While this reform has contributed to Slovakia's strong economic performance, less than ten years later, weaknesses in the tax system – especially the low level of tax revenues, the relatively distortive tax mix, the system's limited progressivity, the poor levels of tax compliance and the high tax wedge for low-income workers – became apparent.

To tackle these issues, the Slovak Republic introduced a series of tax reforms in 2012 and 2013. These reforms included the introduction of a second PIT bracket and a rate to increase the progressivity of the PIT system as well as an increase in the statutory CIT rate to raise additional tax revenues.

Special taxes on activities of entities in regulated industries and banks were introduced in 2012. CIT rate was increased from 19 % to 23 % in 2013, a year later the rate was lowered to 22 %. In 2014, a minimum CIT was introduced (so-called tax licence). In 2014, tax loss carry forward rules were tightened. Under the new rule, tax losses may only be carried forward for a period of up to four years (as opposed to seven previously).

A second tax bracket and PIT rate of 25% was introduced in 2013. As of 2013, the possibility of deducting 40 % of expenses without any bookkeeping for self-employed workers was limited to EUR 5,040 per year.

The reduced VAT rate of 10 % applied to certain medical products and printed materials in 2007 was extended to cover also basic foods in 2016. Many VAT counter-fraud measures were adopted as part of the 2012 – 2016 Action Plan to Combat Tax Fraud. For more read Chapter 4.

The government plans to introduce further changes in 2016. The most important one should be the general taxation of dividends in form of a withholding tax of 15 % effective from 2017 combined with the abolition of the hitherto special health insurance contributions levied on dividend income. In 2017 CIT should fall from 22 to 21 % and the possibility of its further reduction will be analysed in the following years. The so-called tax licences should be repealed in 2018.

Special taxes on the activities of entities in regulated industries, despite originally being introduced as an interim measure until the end 2016, should apply also in 2017 and with a rate twice as high. Special taxes on banks will continue to be in effect in 2017 even though in 2012, when the legislation regulating them was adopted, their gradual down-scaling was envisaged. Next year the rate should have slid from 0.2 to 0.1 % but it will probably remain unchanged.

2. Trends in Tax Collection

All taxes. The common denominator in budgeting and actual collection of all examined taxes is dependence on economic growth. In the period from 2000 to 2015 the constant-price GDP growth index was 2.47 whereby PIT, VAT and ET revenues followed suit, although slightly slower, with index levels 2.04, 2.09 and 2.22, respectively. During the same period of 16 years CIT revenues surprised by a higher growth level (3.12).

The tendency is apparent, yet the calculations should not be evaluated mechanically because the method, scope and rates of taxation in the four tax categories during the defined period were subject to a series of adjustments. Moreover, the 2004 tax reform that introduced a single VAT rate and flat PIT and CIT rates had a significant impact on tax budgeting and collection.

The only period when Slovakia experienced a declining constant-price GDP was 2009-2010, i.e. during the global economic crisis, which was followed by years of less dynamic growth. Tax collection levels, especially of CIT and VAT, mirrored that development. And one more aspect played a role in this process – the euro currency adopted by Slovakia in 2009.

The economic crisis influenced the accuracy of forecasting tax revenues. In fat growth years actual revenues typically surpassed budgeted levels while in years of economic recession actual collection lagged behind expectations. Particularly so in the case of PIT and CIT.

PIT. This tax is comprised of two tax sets – income tax of natural persons from employment and income tax from entrepreneurial activities and other self-employment activities.

Budgetary expectations were not met in 2000, the first year of the reviewed period. According to the Ministry of Finance (hereinafter referred to as the "Ministry") this was caused by an extremely high unemployment rate of almost 19%. Especially lower income levels of small businesses reflected that phenomenon.

The next decrease surfaced in 2003. The Ministry considered that decrease to be the consequence of excessive tax refund claims of businesses that the state had to pay.

The very worst mismatch between actual and budgeted was reported in 2011 through 2013. There were three main reasons: In 2011 and 2012 the Ministry struggled with dissonant revenue reporting because of the Slovak Financial Administration's problems with its information system. Yet again problems with settling tax refunds to small businesses cropped up and as if that was not enough, the rates of social insurance and health insurance contributions, altering the tax base calculation, underwent changes, too. The third reason identified by the Ministry was lower than expected growth of wages and employment.

CIT. Within the reviewed period CIT did not meet expectations for the first time in 2003. The Ministry explained that the tax rate reduction from 29% to 25% introduced at the beginning of 2002, which took its toll in 2003, caused it. It concluded that "in general this tax is considered to be the most difficult one to predict as there are numerous factors, which are hard to quantify, affecting it".

The next fierce plunge of the actual amount against budgeted expectations came in 2010 to 2012. The impact of the economic crisis on the cash tax revenues unfolded in full in 2010. Tax settlements related to the crisis year 2009 were executed in 2010 causing a high level of tax rebates. Concurrently, companies were paying tax prepayments over a lower base (legal entities pay tax prepayments derived from the tax levied on their last known tax liability, i.e. in 2010 from the 2009 taxation period). In 2011 this was caused by failing to meet the expected cash revenues in the last three months. The Ministry admitted that this situation could have been caused also by setting January 2012 as the deadline for paying tax prepayments for December 2011. The reason for not meeting the budgetary target in 2012 was weaker than expected growth of nominal GDP. Which in turn eroded the year-on-year profitability of companies that dropped below expectations. The Ministry also reported "unexpected shrinkage of the share of actually collected tax on GDP (effective tax rate)".

VAT. The Ministry reported notable slumps in VAT collection twice. And such situations are always painful as VAT is the key contributor to tax revenues in the state budget.

In 2003 only 84% of the budgeted level was actually collected. The Ministry conceded that the budget estimates were unrealistic. It came by surprise that an increase of the standard rate from 10% to 14% and simultaneous decrease of the increased rate from 23% to 20% would result in quite the opposite than expected. New legislation defined a new method of input tax calculation. As a result the tax liability level for January plummeted and excessive refunds of monthly payers leaped upwards (in total reaching EUR 400 mn whereby the total annual VAT collected stood at EUR 2730 mn).

In 2012 only 89% of the budgeted level was actually collected. The Ministry identified two reasons. Despite the growing final consumption of households the actual tax liability according to tax returns showed a year-on-year decline, hence illustrating a discord of tax liability with macroeconomic development. Problems in the implementation of a new information system in late 2011 caused significant delays in excessive refund claims in turn having a negative impact on the 2012 cash revenues. Under standard circumstances the mentioned excessive refunds would impact the 2011 cash revenues and the year-on-year decrease in VAT revenues would not have been as dramatic.

Apart from the above, a minor downwards slide against expectations was reported in 2008. Its underlying cause was the negative impact of a legislative amendment applying the decreased tax rate of 10% to medical products.

ET. A small shortfall relative to the forecast was reported already in 2001 whereby less than expected ended in the state treasury mainly in the category of wine tax. More significant shortfalls occurred in 2008 through 2013 (with the exception of 2009).

2008: Mineral oil tax revenues were negatively affected by the practice of adding favourably taxed biofuels to petrol and diesel fuels. According to the Ministry the low level of tobacco tax revenues resulted from the negative impact of consumers' stockpiling in late 2007 when they became aware of the tax rate increase planned for the upcoming year.

2010: Lower mineral oil tax revenues reflected the negative influence of the reduced excise tax rate on diesel. Less beer tax was collected due to a drop in beer consumption. 2011: The tax collection reaching 95% of the budgeted amount was not explained by the Ministry in the state final account. In financial terms the most significant shortfalls in collection concerned mineral oil tax as well as alcohol tax. 2012: The tax collection reaching 96% of the budgeted amount was not explained by the Ministry. The most significant shortfall in collection concerned mineral oil tax and tobacco tax. 2013: The tax collection reaching 98% of the budgeted amount was not explained by the Ministry. The most significant shortfall in collection concerned mineral oil tax and tobacco tax.

3. Magnitude of Tax Gaps

PIT gap. There are no PIT gap calculations, nevertheless the Ministry aspires to quantify it on the basis of statistically gathered information. This gap has three main sources: illegal work, expense optimisation of self-employed persons and undeclared income of natural persons (for example rental income). Nowadays economists only refer to the growth of the effective tax rate (related to the insufficient indexation of non-taxable elements of the tax base and tax tiers for income from employment which contributes to effective growth of taxable income every year). Whereby this indicator highlights the fact that the government should pursue consistent indexation of items reducing the tax base in order to ensure fair tax collection. It cannot be used as an indicator of the success in tax collection.

CIT gap. There are no CIT gap calculations, but in this case the Ministry in cooperation with the International Monetary Fund intends to draw up a methodology. Economists refer to the effective tax rate which stands for the share of paid tax in the created added value of companies in macroeconomic terms. However, it cannot serve as the ultimate indicator of the success in corporate tax collection as it might be skewed by a number of factors (such as deduction of losses from previous years, analysis of companies with differently set financial years). It may be used as an indicator of the success in tax collection on a short-term basis provided that there had been no major structural changes in the methods of depreciation and accounting for losses from previous years. The fact that after the adoption of measures described in Chapter 4 the rate of success of CIT collection increased by EUR 0.4 bn (0.5% of GDP) in 2014 may be used as a secondary indicator.

VAT gap. The efficiency of VAT collection has been consistently falling, with only a few short breaks. In 2000 the gap percentage (representing the share of uncollected tax in the total potential VAT) stood at 20%, while in 2012 it escalated to almost 40%. That fact relegated the Slovak Republic into the ranks of EU Member States that were less successful in VAT collection. After the Slovak government put more effort into the matter this percentage gradually declined to below 30% in 2014 and 2015. Additional resources that could have been gained by full collection of the potential VAT in 2014 are estimated at the level of EUR 2.5 bn (3.3% of GDP). The core part of the VAT gap is attributed to unidentified VAT defined as the difference between tax liability according to tax returns and potential VAT. The remaining part relates to the gap in tax collection which in 2008 through 2010 hovered at the level of 5.0% of potential VAT.

ET gap. It is quantified only for one case in the following text, no other calculation or data exist. Economists maintain that mainly the absence of indexation for these taxes causes a drop of effective tax rate to GDP.

Mineral oil tax gap. This tax represents more than one half of all ET. The Ministry defines it as the difference between the estimated potential and actual collected petrol and diesel tax. In 2014 the gap was estimated to be at the level of EUR 397 mn, which equals 37% of the potential revenues from this tax (0.5% of GDP). That accommodates a sum of the following three items – cross-border purchases, tax evasion and additionally levied tax.

The Ministry plans to draw up a methodology for the gap related to excise tax on tobacco which stands for one third of the total excise tax revenues.

Since 2000 the share of the examined taxes PIT, CIT, VAT and ET in GDP has been around 15% (highest in 2005 – 16.8 %, lowest in 2010 – 13.5 %; in 2015 at 15.8 %). This sum does not include revenues from withholding tax which is a special way of PIT and CIT collection in the case of which the taxpayer is responsible for withholding tax (such as interest tax). The annual overviews do not specify the breakdown between natural and legal persons. Even if it was added to the sum of examined taxes, its revenues size would have a minimum impact on the previous calculations.

The development of the shares of individual taxes in GDP after 2000 begs the following conclusions. Up to the tax reform in 2004, the development of tax collection corresponded with GDP development, only CIT was slightly lagging behind. After 2004 when the government significantly cut both PIT and CIT rates, while natural persons enjoyed flat tax, trends started to change. CIT outran GDP development while PIT significantly lagged behind GDP. CIT development was crucial because the strident reduction of its rate incentivised companies to report profit. The development of VAT and ET collection moderately outperformed the other taxes at a time when VAT underwent a major change merging its two rates a single one.

This development was sustained until being hit by the global economic crisis. After 2008 (in the case of CIT delayed until post 2010) all taxes started to lag behind GDP. This was mainly caused by increased unemployment, weaker consumption and probably the general growth of the tax gap. The performance of public administration deteriorated dramatically and so the decision was made to increase the VAT rate by one percentage point in 2011. Today VAT continues to lag behind GDP development but it appears to be slowly catching up mainly as the result of more effective tax collection in the recent years.

CIT collection is gradually improving and now it is actually exceeding GDP development. There is more than one reason behind it. Europe’s economic recovery brought prosperity to companies.

CIT rate climbed up in 2013 but it was still too low to incentivise companies to put more effort in tax base optimisation. By introducing a novelty, tax licenses, the government forced hitherto loss-making companies to pay a minimum tax which fuelled the willingness of companies to declare profits. CIT collection was influenced by tax incentives provided to selected companies. Up to 2007 they ranged from 7.6% to 17.4% of total CIT collection while after 2008 they dropped to 2% and annually represent EUR 30 mn to EUR 50 mn.

PIT has been falling behind GDP growth the most and the disparity remains almost unchanged. Better results had been anticipated after the abolition of flat tax and heavier taxation of higher income groups.

As of 2012 the Financial Administration of the Slovak Republic (merged tax and customs administration) became in charge of tax administration. It performs its function of administering taxes and rendering support services including financing independently, although it reports to the Minister of Finance. It has 170 employees serving 100 thousand citizens, which is at par with the V4 average. Over 15% of employees work in directorates and almost 80% in regional offices thus ranking the Slovak Republic at the very bottom among the V4 countries as regards the proportion of its employees distributed in regions. Tax Administration spends almost 20% of its money on information technologies which is the highest level among V4 countries. On the other hand, the administrative costs of the tax administrator relative to the GDP are the lowest, standing at 0.2%. Costs of tax collection consume 1.5% of net tax collection revenues which is a regional average. The most telling indicator would be the proportion of actually collected taxes to potential revenues but as the latter parameter does not exist such indicator cannot be determined (possible only for VAT and ET on mineral oil). The tax administration should be strengthened to better detect all forms of non-compliance, particularly in relation to VAT and CIT because VAT and CIT non-compliances are significant issues. Strengthening the tax administration’s capacity is critical for the effective pursuit of non-compliance.

4. Methods Used to Combat Tax Avoidance

In 2012 the Slovak government approved its Action Plan to Combat Tax Fraud in 2012 – 2016 containing 50 measures which were topped up by 30 more in 2015. The Ministry estimated that the implementation of the Plan's measures in 2013 through 2015 triggered additional VAT revenues of EUR 1.6 bn. This had a positive impact on CIT revenues, the effective tax rate of which leaped in 2014 and accounted for additional EUR 0.4 bn. The general improvement of tax collection brought around EUR 2 bn representing 2.7% of GDP. This success should be applauded with a pinch of salt as there were also some other factors (e.g. more favourable economic environment) behind the improved tax collection.

The effective VAT rate rose from its minimum 12.3% to 14% in 2014. The VAT gap dropped from its maximum of almost 40% in 2012 to less than 36% in 2013 (and 30% in 2014) but even this level is too high. The main contributor to this improvement is the tax collection part of the VAT gap, in other words the difference between tax liability and actual tax collection (in 2008-2010 it was 5%, in 2013 it was slashed to 0.7% of potential VAT). Nevertheless, unidentified VAT, which is the difference between potential VAT and tax liability and in 2013 exceeded 30%, remains far too high. It manifests that there is still much leeway for combating tax evasion.

The PIT, CIT and ET (excluding mineral oil) gaps have not been scrutinised yet. There are recommendations but limited to automatic ET indexation – rates would not be fixed but would automatically be adjusted to match inflation flows. Such approach would have quite the opposite affect for PIT – indexation of non-taxable elements of the tax base would reduce the volume of collected PIT.

The text below presents a selection of the most important state measures to combat tax fraud.

Mandatory submission of electronic recapitulative statements. As of 2014 VAT payers are obliged to include in their recapitulative statements details of their tax liability and tax refunds based on invoices for supplied goods and services. In 2014 alone fraudulent schemes of over 7 thousand entities accounting for EUR 213 mn in VAT were identified based on data in recapitulative statements. For more see box in Annex.

Cleaning up the VAT registry, i.e. purging the registration of VAT payers that cannot be contacted or communicated with. By the end of 2014 the tax authorities identified 12 thousand VAT payers who defaulted, could not be contacted and in most cases acted as mere front men. The VAT registration of these entities was cancelled and they lost their tax fraud avenue.

A public list of high-risk entities. Joint and several liability for tax in a chain. The Slovak Financial Administration publishes on its website an updated list of VAT payers whose VAT registration was cancelled for plausible reasons. The latter measure is closely connected to the first one. There had been cases in which VAT payers did not pay their business partners' invoices because of being afraid that in the future they would have to shoulder the VAT guarantee if their partner was included in the list of high-risk entities. Now VAT can be paid directly to the business partner's personal account kept with the state treasury, thus eliminating any risk of future tax guarantee imposed on businesses.

Establishment of specialised tripartite teams (so-called Tax Cobra). Specialised tripartite teams (tax specialist, investigator, prosecutor) were set up to deal with serious tax crimes. By mid-2015 these teams managed to block EUR 45 mn representing unjustified claims of fraudsters from the state budget. For more see box in Annex.

Use of virtual cash registers. In 2015 the government extended the list of entities obliged to register their sales by means of electronic cash registers to include those providing services previously untapped by such obligation (e.g. medical doctors, taxi drivers, consulting agencies). In order to curtail the economic burden of this requirement virtual cash registers were introduced. These are accessible to everyone as a web application. By mid-2015 over 16 thousand entities registered for a virtual cash register.

Establishment of a state printing house for excise stamps. Aimed at combating tax evasion related to excise tax on alcohol products and excise tax on tobacco products. As of 2014 excise stamps are printed in a single state printing house, no other printing suppliers are permitted. The upgrading of security features and data eliminated the counterfeiting of excise stamps. By mid-2015 the printing house produced 167 million excise stamps.

VAT receipt lottery. In 2013 the government launched a VAT receipt lottery through which citizens could win prizes if they registered valid cash receipts. The lottery was supported by a motivation campaign which initially stirred great public interest but has been gradually declining ever since. By mid-2015 almost 120 million cash receipts were registered in the lottery system. The state does not gain much financially from the system but it definitely raised public awareness on VAT matters. Data from cash receipts registered in the lottery system continue to be used for tax inspections. For more see box in Annex.

Minimum corporate income tax (so-called tax licence). A minimum tax for the incorporated sector was introduced in 2014. The minimum CIT aims at tackling the relatively high level of CIT non-compliance and at increasing tax revenues. The measure is expected to raise CIT revenues by EUR 112 mn (0.2% GDP) in the first year. This new tax was detested by businesses. For more see box in Annex.

Mandatory non-cash payments in commercial transactions above a set limit. As of 2013 according to applicable legislation no cash transactions over EUR 15,000 can be made between natural persons and over EUR 5,000 between businesses. Just before the legislation came in force a businessman with business tied to the members of the government paid for residential apartments up to EUR 12 million in cash and he is suspected of fraud involving excessive VAT refunds. After information about this case was published the Minister of Interior, himself involved in business transactions with this businessman, refused to resign. The investigation of the case, albeit hampered by many complications, has not been closed yet and indirectly falls under the Minister of Interior.

Exchange of tax information with other countries. In 2014 the Financial Administration processed almost 10 thousand international cases concerning VAT and direct taxes. The majority of information was exchanged with Germany, Czech Republic, Hungary and Poland. Financial institutions in the Slovak Republic provide information on financial accounts to the Financial Administration for tax administration purposes. Automatic exchange of information is an instrument for combatting tax evasion the aim of which is to eliminate unreported and untaxed income at a supranational level.

Stricter criminal sanctions for tax fraud. Respective legislation was amended in 2013 and introduced a new constituting element of criminal act – tax fraud and frustration of the execution of tax administration. Sanctions for tax crimes became stricter. In 2015 the government adopted legislation on the criminal liability of legal persons that imposes sanctions on companies for tax fraud such as fines, forfeiture of assets or even dissolution of company. A limited liability company cannot be established by a person with tax arrears. Any transfer of a majority interest in a company is subject to approval of the tax administrator. A company cannot be erased from the Company Register before having settled its dues.

5. Conclusions

The Slovak Republic is somewhat special in being positioned at two opposite ends of rankings of the most developed countries worldwide – as regards tax burden and even more so tax collection levels it is among countries with low levels but when it comes to levels of social security contributions it sits among countries with high levels. Its Tax-to-GDP ratio lags behind V4 countries and hovers significantly below the OECD average.

Contributions have not been scrutinised in this analytical paper despite the fact that often they have tax-like features. If the Slovak Republic is to implement radical tax changes then two lines of action must be taken – it must modify the structure of the tax system to promote higher taxation of property and hand-in-hand with increasing indirect taxes it must alleviate the contributions burden.

No government has dared to make this step in this century because of the political risk it carries. So the remaining space for action entailed minor rate adjustments and more efficient collection of existing taxes. The scale of potential gains from more efficient collection of PIT, CIT and ET (excluding mineral oil tax) could not be quantified as there are no data or calculations. The potential additional VAT revenues were massive, reaching a double-digit percentage. So it was no surprise that the government concentrated on this area.

Since 2012 the government adopted 80 measures combatting tax evasion. They were more or less VAT-related and some of them are described in this paper. Many of the measures merely reacted to chronic flaws and inconsistency which motivated fraudsters to steal from the state. An example of such measures was the cancellation of registration of non-communicating VAT payers.

The second set of measures only intensified the motivation of existing institutions to fulfil their obligations. Setting up the Tax Cobra amounts to nothing more than activating the performance of the police and/or prosecutor's office to more rigorously tackle economic crime which they should have done long ago.

The third set of measures targets directly those from whom the government intends to collect the missing amounts. This set includes the introduction of tax licences, i.e. obligation to pay taxes also by those who are without profit, or, obligation of untraditional tax entities such as medical doctors to use cash registers.

Implemented marketing tools appealing to the broad public deserve to be mentioned as well. The receipt lottery contributed to an awareness campaign on the need to pay VAT; on the other hand, no one could have expected that this measure might pour fat revenues in the state coffers. It came as no surprise that in its second phase it was transformed into a TV show.

To summarise the key benefits of these measures:
- Raised awareness of the public on the need to pay taxes;
- Increased tax revenues flowing into the state budget;
- Curbed tax evasion.

Main negative aspects of these measures:
- Double standards still apply when dealing with tax fraudsters (just one big fraudster has been sentenced);
- Increased administrative burden for entrepreneurs;
- Unpredictability of legislative changes even higher than before.

Annex

Chapter 1 (In Excel)

Table, graph: Tax revenues in the Slovak Republic (2014)

Chapter 2 (In Excel)

Table, graph: Gross domestic product in current prices (bn EUR)

Table: Implementation of budgeted tax revenues

Table, graph: Tax-to-GDP (%)

Table, graph: Tax revenues and GDP growth, share of PIT+CIT+VAT+ET in GDP

Table, graph: Personal Income Tax - budgeted vs actual collection (thous. EUR)

Table, graph: Personal Income Tax - implementation of budgeted collection (%)

Table, graph: Corporate Income Tax - budgeted vs actual collection (thous. EUR)

Table, graph: Corporate Income Tax - implementation of budgeted collection (%)

Table, graph: Value Added Tax - budgeted vs actual collection (thous. EUR)

Table, graph: Value Added Tax - implementation of budgeted collection (%)

Table, graph: Excise Taxes - budgeted vs actual collection (thous. EUR)

Table, graph: Excise Taxes - implementation of budgeted collection (%)

Chapter 3 (In Excel)

Table, graph: Effective personal income tax rate

Table, graph: Effective corporate income tax rate

Table, graph: Investment and R&D tax relief

Table, graph: VAT-to-GDP and VAT Gap (%)

Table, graph: Estimated tax gap for excise tax on petrol and diesel

Chapter 4

Selected measures adopted within the framework of the Action Plan to Combat Tax Fraud

Mandatory submission of electronic recapitulative VAT statements

VAT payers are obliged to include in their recapitulative statements details of their tax liability and tax refunds based on invoices for supplied goods and services. Each invoice from which data are entered into the recapitulative statements is identified by its number and contains data on the supplier, customer, type of goods or service, tax base, tax rate and actual tax amount.

An automated system, which controls and reviews defined data in the recapitulative statements as well as in aggregate databases, facilitates for example the detection of carousel and chain fraud, detection of issued invoices that were nor filed in the accounting books, detection of manipulated accounting books, detection of replaced invoices in accounting books, detection of unissued invoices, detection of taxpayers who claimed twice refunds for one and the same invoice in two different tax periods.

The market responded to the mandatory recapitulative statements. The Financial Administration noticed changes in the behaviour of taxpayers such as the rapid move from excessive refunds to optimisation of tax liability, increased number of entities in schemes, accelerated processes of company dissolution and novel, difficult to trap, excessive refund claims particularly associated with receipts from electronic cash registers.

Operation of Tax Cobra

The Tax Cobra originated in 2012 and teams up the Financial Administration, General Prosecutor's Office, Police Presidium and National Criminal Agency. The role of specialised teams comprised of tax specialists, police investigators and prosecutors is to tackle serious tax crimes. By mid-2015 they prevented the payment of unjustified excessive VAT refunds in the amount of EUR 45 mn. At the same time they identified fraudulent VAT of nearly EUR 190 mn. Most of the cases concerned commodity fraud such as stone, diesel, reinforcing steel, non-ferrous metals, toners, wheat, sugar, meat, timber, wine. Admittedly, it is highly probable that these special investigation teams targeting crimes against property are exposed to political pressure. Media and politicians in opposition uncovered a number of cases in which members of the government and connected businessmen where suspected of tax fraud. The unwillingness to investigate such sensitive cases remains strong as proven by instances of dismissed impartial police investigators. Whereby in one such case a carousel chain was revealed that allegedly siphoned EUR 75 mn from the state budget, which is three times as much as the amount tracked down by the Tax Cobra within a three-year period.

VAT receipt lottery

The lottery was launched in September 2013. In its first version the lottery took place every two weeks and winners could win cash prizes between EUR 10,000 and EUR 100 (first chance). And the holder of the winning receipt won a car. Later the material prize was replaced by a financial prize of EUR 10,000 and later on a prize of EUR 5,000. There was even a so-called third chance the winners of which took part in a TV contest. The second lottery version as of September 2014 had 100 winners instead of the only ten winners previously. The first winner won a cumulative jackpot the size of which depended on the number of participants. The next 100 winners received a financial prize of EUR 100. Advertising and smart motivation instruments stirred great public interest in the lottery immediately after its launch. In the first week its webpage www.narodnablockovaloteria.sk had more than 9 million visitors – a record number in Slovakia. It may be assumed that the positive effect of the lottery on customers would be mostly in areas where the benefit of non-compliance is not distributed to customers (e.g. restaurants, small groceries). The lottery may have a more limited impact when the benefit of non-compliance is distributed between both sellers and consumers (e.g. services such as cars repairs, additional furnishing services). Nevertheless, the lottery has the potential to make all citizens aware that VAT evasion is illegal.

Minimum corporate income tax (so-called tax licence)

As of 2014 there are three levels of minimum corporate income tax in the Slovak Republic, depending on turnover and VAT registration. Minimum annual CIT applies as follows:

- small companies without VAT registration: EUR 480
- small companies with VAT registration: EUR 960
- large companies (turnover over EUR 500,000): EUR 2,880.

These amounts have to be paid even if the tax calculated based on the actual taxable income using the 22% rate is below them. The minimum tax is paid when the CIT tax return is filed. The difference between the minimum tax and the tax calculated based on taxable income may be carried forward and credited to tax liability up to 3 years. The minimum tax is reduced by half if at least 20% of taxpayer's employees are disabled. The minimum tax does not apply to new companies in their first year of operation. Non-profit organisations as well as social enterprises specialising in employing disabled workers are exempt from minimum corporate income tax.

The aim was to prompt companies to report their profits. This measure was detested by businesses and a number of political parties that referred to it as a tax on losses. Companies are obliged to pay the minimum tax even if they are not profitable which means a burden for companies in the startup phase of their business. As a result, in 2015 out of 7 thousand companies that were closed three thirds were loss-making companies. In the same year only 13 thousand companies were established which has been the lowest number since 2012. In the recently created new government some of the coalition partners negotiated a promise of tax licence abolition as of 2018.