



THE TAX REFORM IN SLOVAKIA

Ivan Mikloš

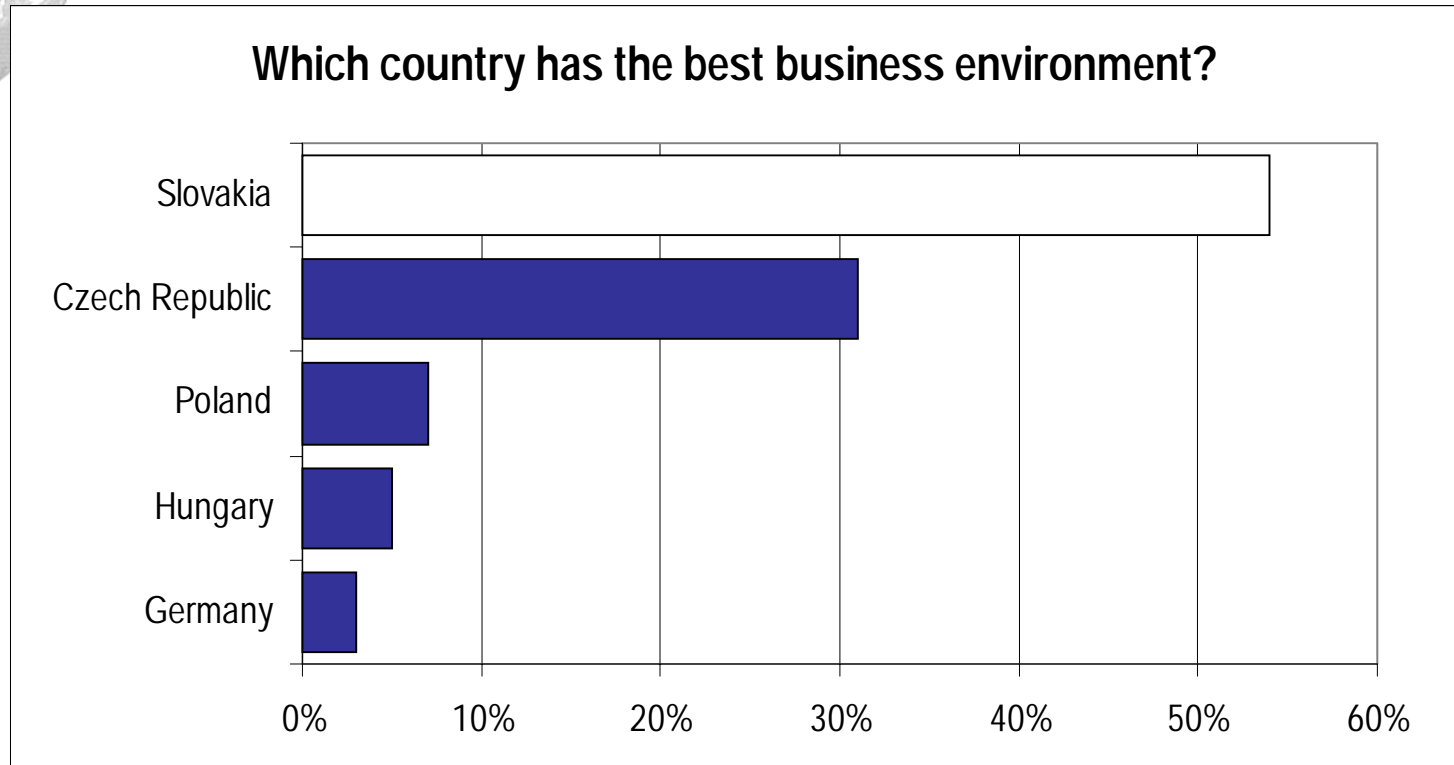
Minister of Finance of the Slovak Republic

Kyjev

May 16, 2005



INVESTORS THINK THAT SLOVAKIA HAS THE BEST INVESTMENT CLIMATE

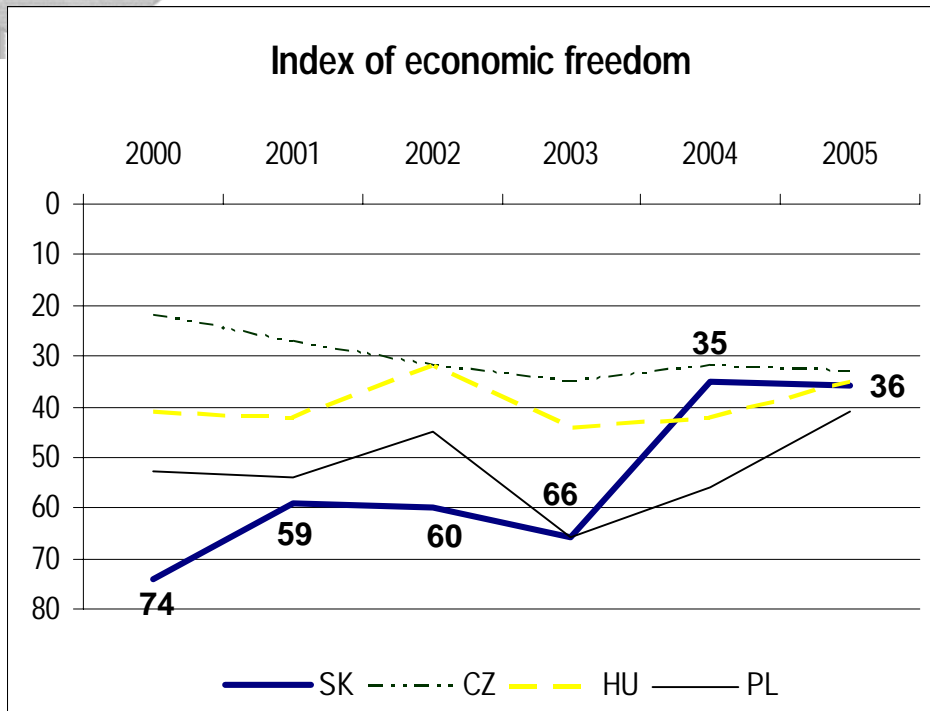


Source: Czech-German Chamber of Commerce and Industry, 2004

91% of current foreign investors in Slovakia intend to expand their local investment!

Source: US Chamber of Commerce in Slovakia, 2003

BUSINESS ENVIRONMENT IS RAPIDLY IMPROVING



- World's best reformer according to the World Bank
 - #1 in *Doing Business 2005*
 - currently among top 20 countries in the world regarding the quality of business environment

Source: Heritage Foundation and Wall Street Journal



FISCAL REFORM: GENERAL CONTEXT

MAIN GOVERNMENT'S OBJECTIVE:

- reduce the general government deficit under 3.0% of GDP by 2006...
- ... while simultaneously decreasing public expenditures as a share of GDP

Fiscal Position of General Government (% of GDP)

	2002	2003	2004	2005	2006
Revenues	38.3	36.0	36.2	37.0	36.6
Expenditures	44.0	39.6	40.0	40.4	39.5
Net borrowing	-5.7	-3.6	-3.8	-3.4	-2.9



THE SLOVAK TAX REFORM: GOALS

BASIC PHILOSOPHY: LIGHT, NONDISTORTIVE, SIMPLE AND TRANSPARENT TAX SYSTEM

- create business and investment friendly environment for both individuals and companies
 - eliminate existing weaknesses and inefficiencies in the tax law
 - eliminate distortive roles of tax policy as instruments for achieving non fiscal goals
 - improve tax fairness by taxing all types and all amounts of income equally
-



FISCAL IMPACT OF THE TAX REFORM

- reform designed to be **revenue neutral in 2004**
 - serious attention paid to fiscal impact quantifications
 - **5 independent estimations** made by following institutions:
 - International Monetary Fund
 - Slovak Ministry of Finance - Institute of Financial Policy
 - special high-level working committee
 - Infostat (Slovakia)
 - Slovak Academy of Sciences
 - conservative estimates adopted for fiscal purposes
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IMPLEMENTATION STRATEGY

Chronology of the changes in the tax laws



1. Changes in indirect taxes:

- **amendment of VAT Act** – introduction of one single rate of 19% (before: 20% and 14%)
- **amendment of Acts on Excise Duties** – increase of certain excise duty rates: mineral oils, beer and tobacco products



2. Changes in direct taxes:

- **new Income Tax Act** – introduction of flat tax
- **abolishment** real estate transfer tax and gift and inheritance tax



3. Changes in indirect taxes in compliance with EU tax legislation

- new VAT Act and new Excise Duties Acts - as of May 1, 2004



THE SLOVAK TAX REFORM: SPECIFIC CHANGES

- radical simplification of the tax system
 - elimination of virtually all exceptions, exemptions, deductions, special rates, and special regimes
 - elimination of dividend, inheritance, gift taxes, and real estate transfer tax
- introduction of low nominal rates
 - 19% flat individual income tax
 - 19% corporate tax
 - 19% unified VAT on all goods and services - without any exceptions
- shift from direct to indirect taxes

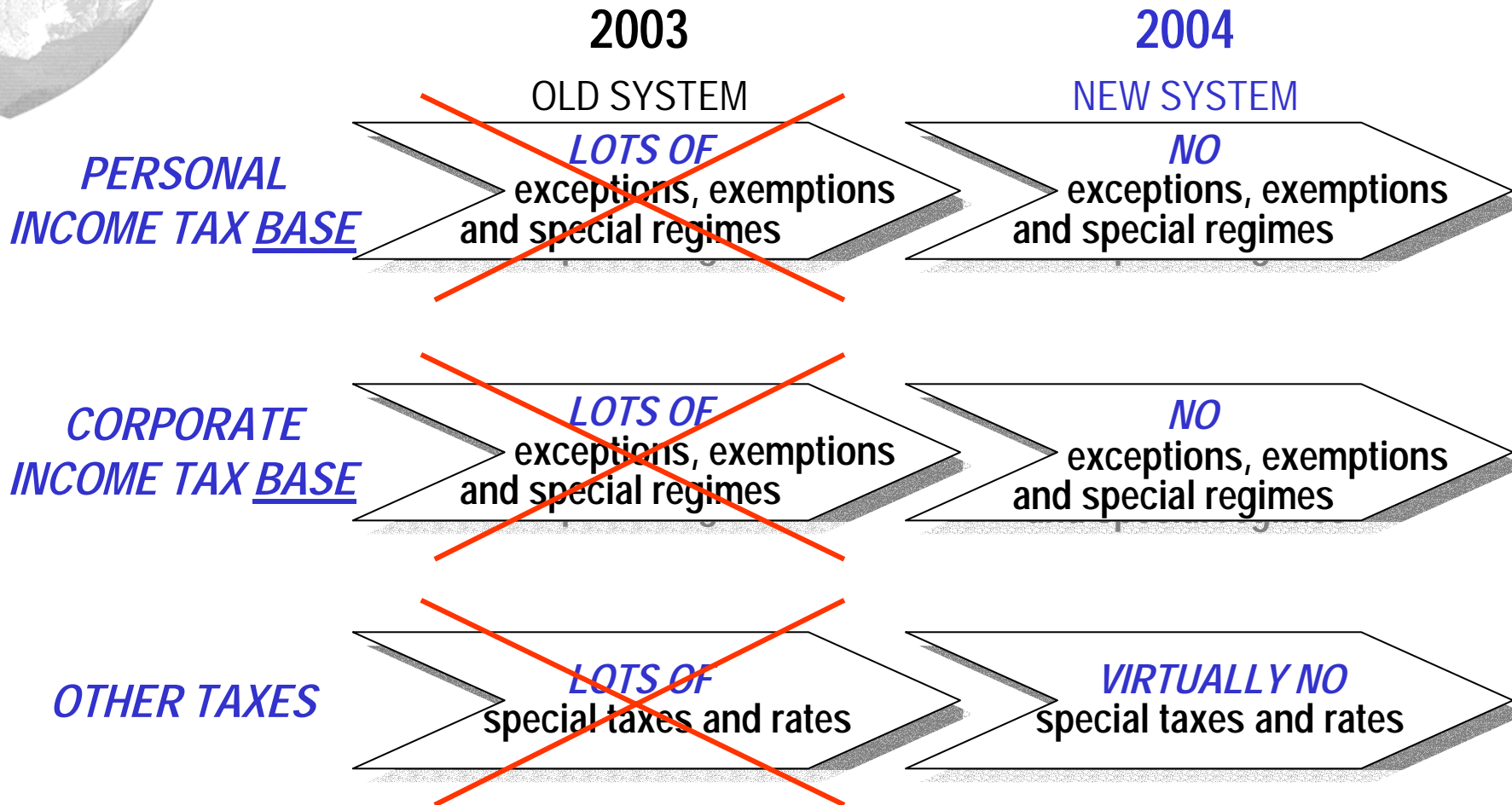


THE REFORM RADICALLY DECREASES ECONOMIC DISTORTIONS CREATED BY THE TAX SYSTEM

	2003	2004
<i>PERSONAL INCOME TAX RATE</i>	OLD SYSTEM 5 tax rates: 10%, 20%, 28%, 35% and 38%	NEW SYSTEM 1 flat rate: 19%
<i>CORPORATE INCOME TAX RATE</i>	25%	19%
<i>VALUE ADDED TAXES</i>	standard rate: 20% lowered rate: 14%	one unified rate: 19%



THE REFORM RADICALLY SIMPLIFIES THE TAX SYSTEM AND INCREASES ITS TRANSPARENCY





THE REFORM ELIMINATES MOST FORMS OF DOUBLE TAXATION OF INCOME

~~INHERITANCE
TAX~~

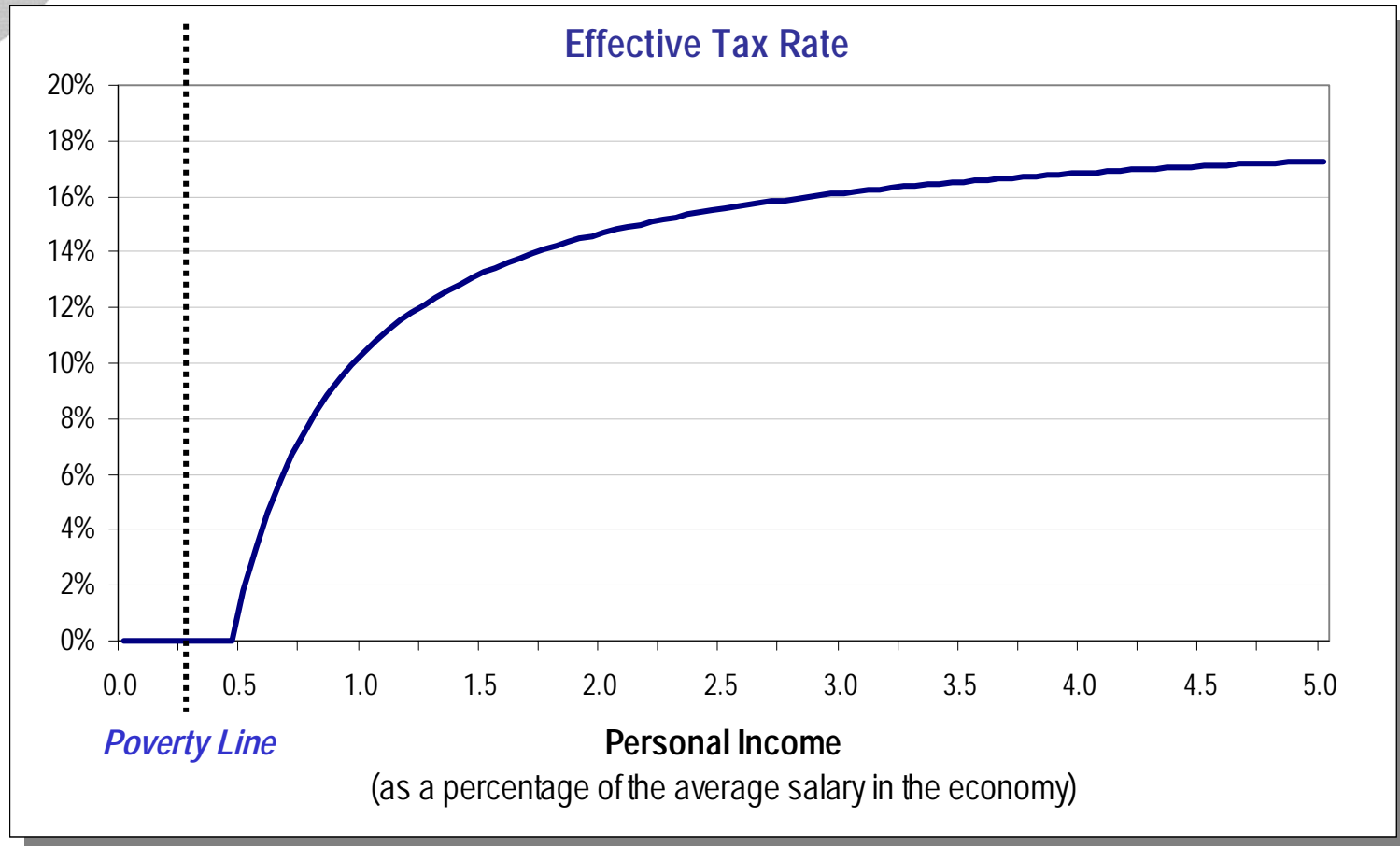
~~DIVIDEND
TAX~~

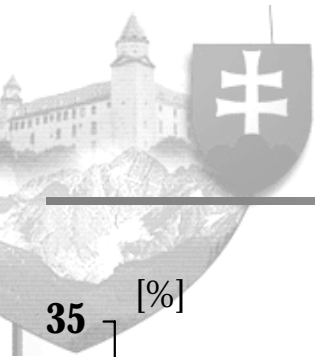
~~GIFT
TAX~~

~~REAL ESTATE
TRANSFER TAX~~

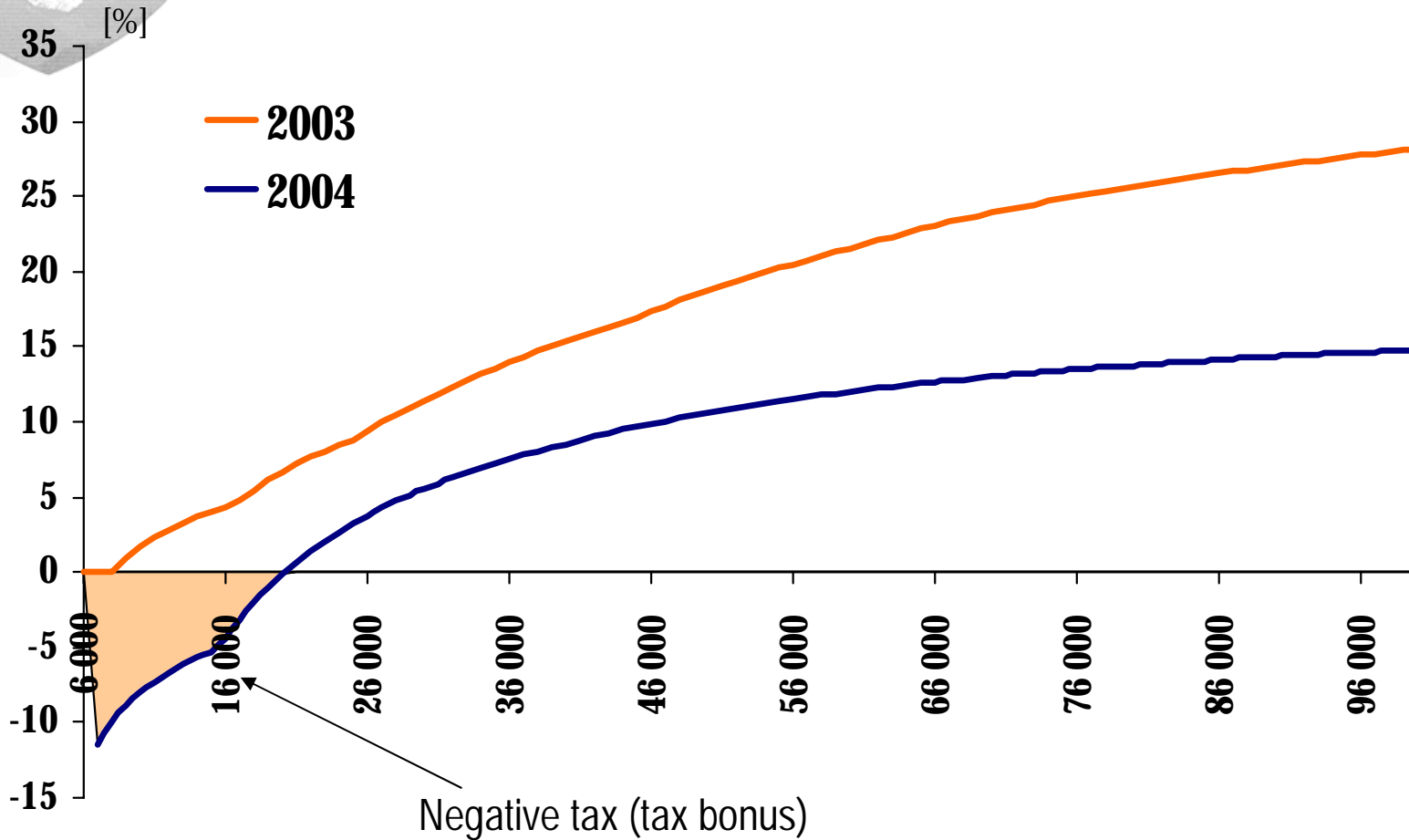


FLAT TAX STILL ENSURES PROGRESSIVE TAXATION OF INCOMES



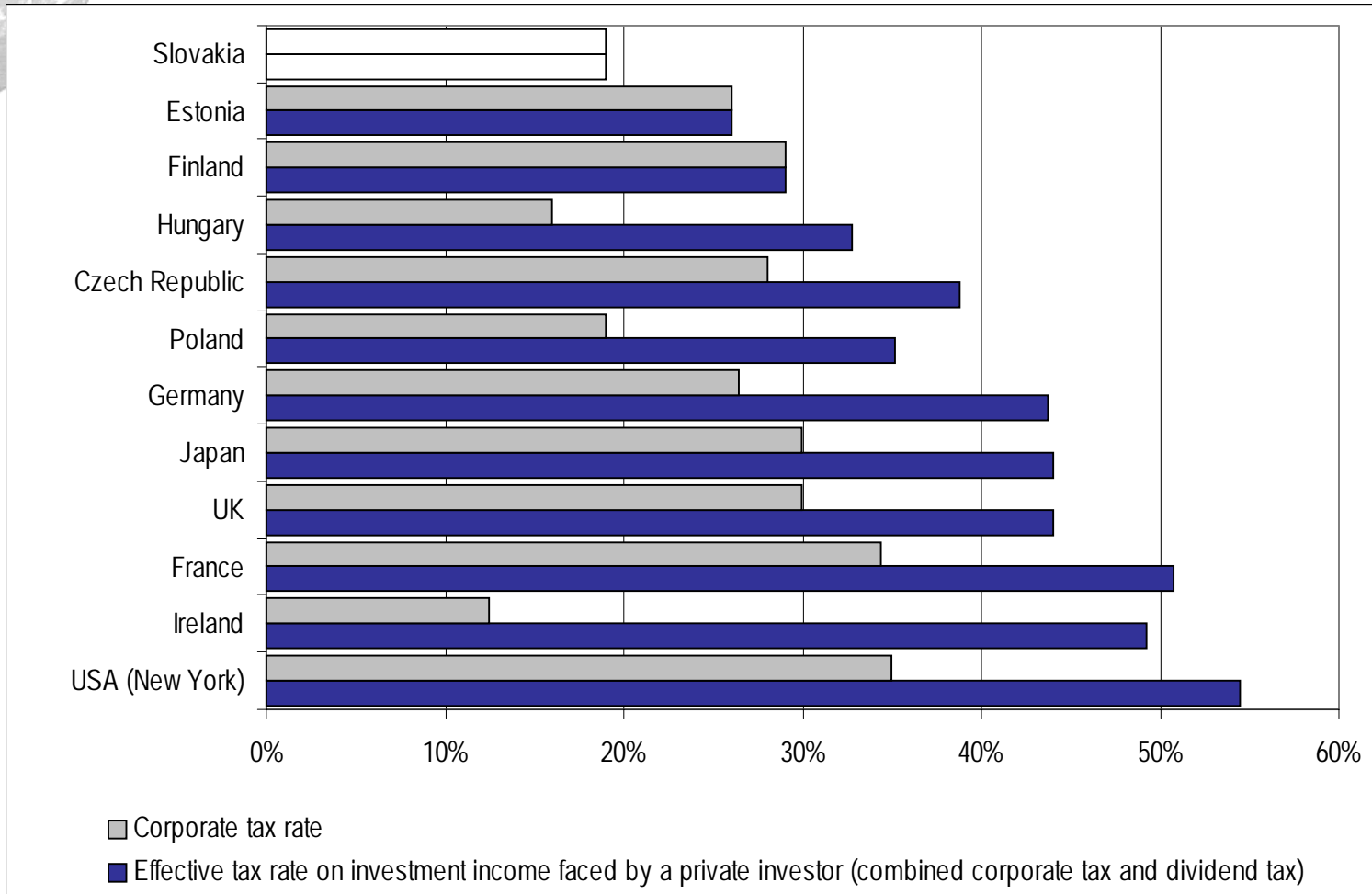


INFLUENCE OF FLAT TAX ON INCOME (person with unworking wife and 2 children)

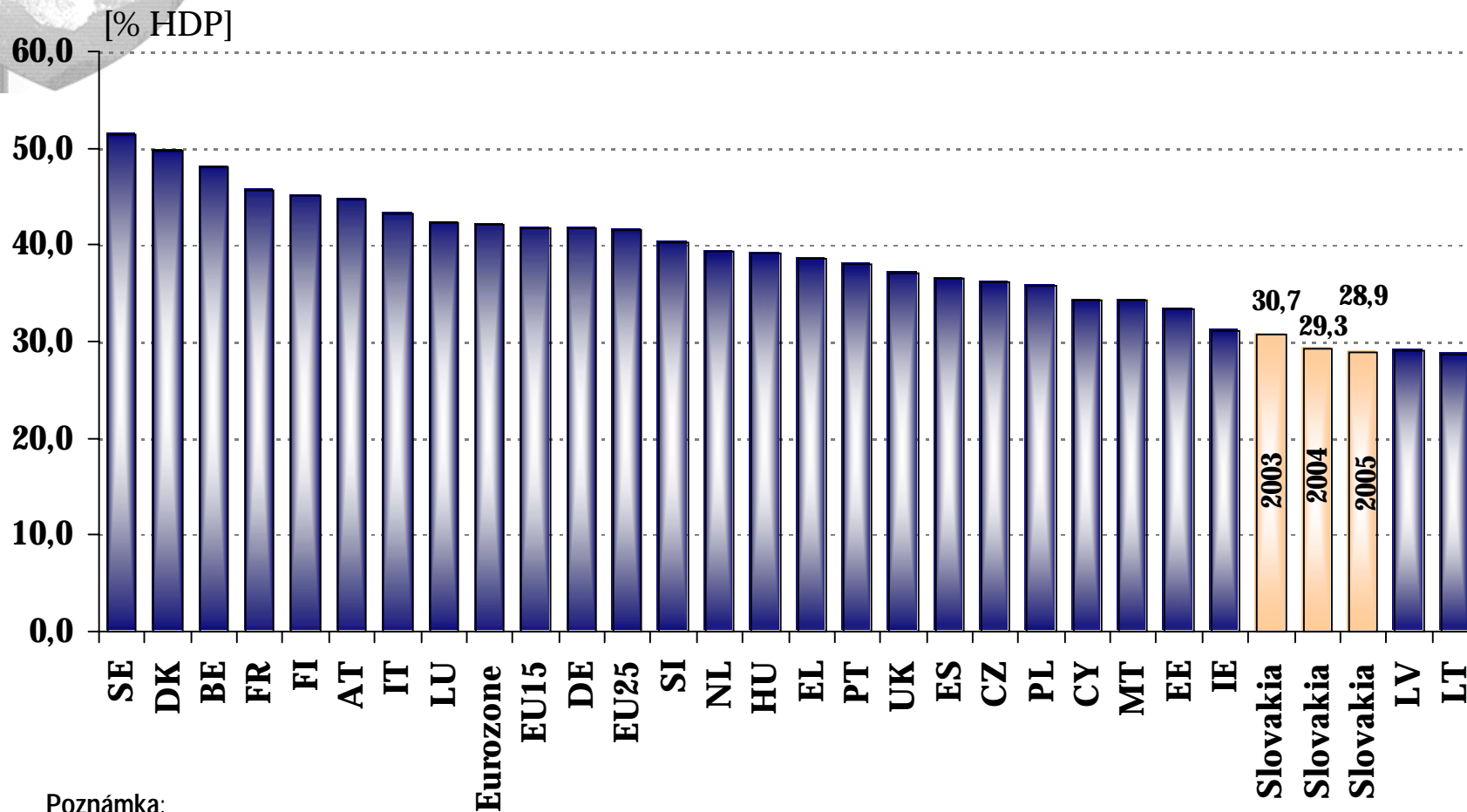




TAX RATES FACED BY INVESTORS IN SLOVAKIA



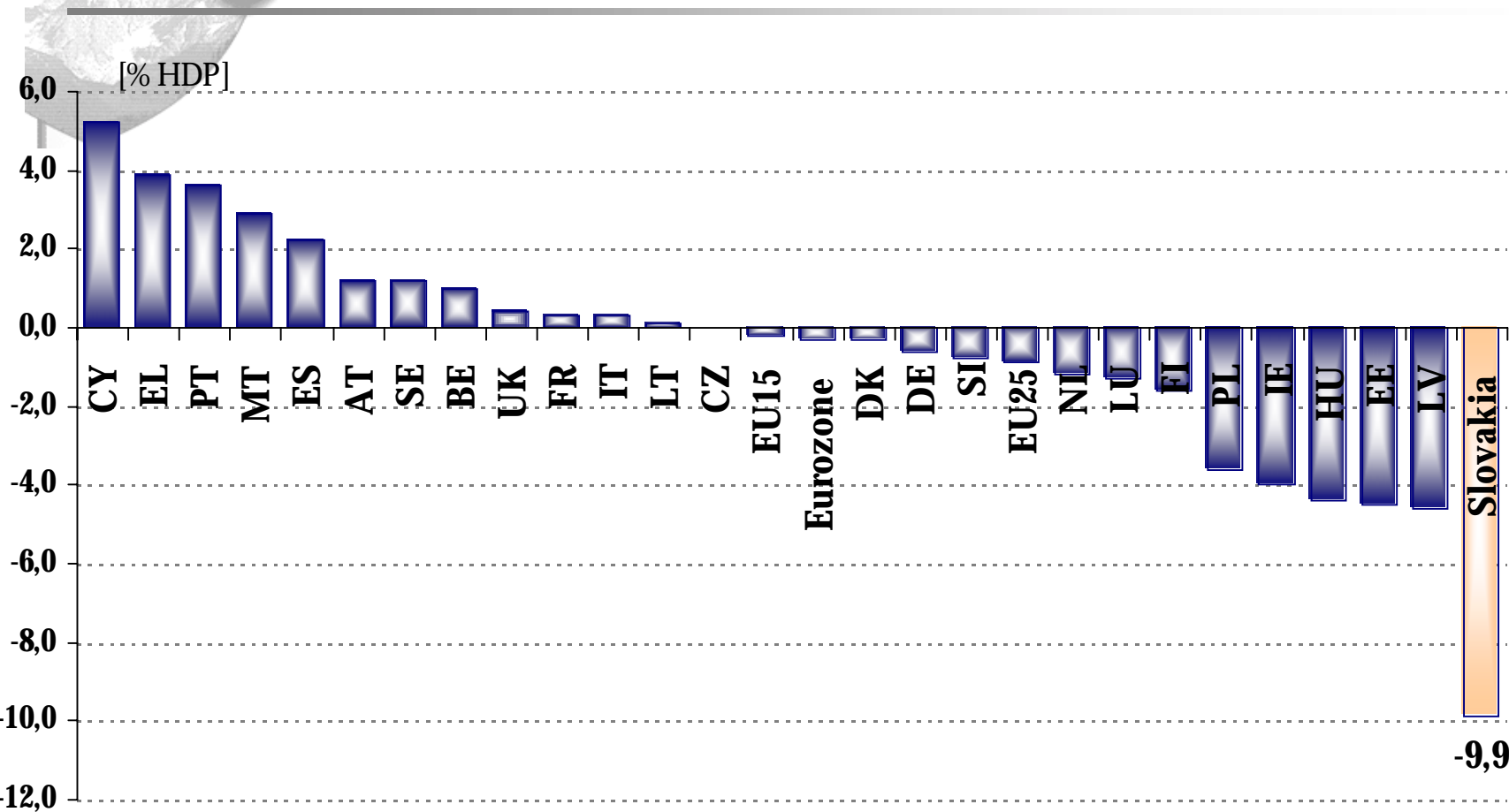
TAXATION II IN EU 25, (year 2003)



Poznámka:

Eurostat uvádza pre SR 30,9% z HDP, avšak medzitým sa revidovali údaje HDP v SR za rok 2003 smerom nahor.

TAXATION II IN EU 25, change 1995- 2003



Poznámka:

Eurostat uvádza pre SR pokles o 9,7% z HDP, avšak medzitým sa revidovali údaje HDP v SR za rok 2003 smerom nahor; pokles medzi rokmi 1995 až 2005 sa odhaduje až na 11,7% z HDP



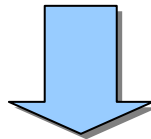
PRELIMINARY RESULTS OF TAX REFORM

- Tax revenue development in 2004 shows that the **estimates** of the Ministry of Finance **have been correct** and collected tax revenues should be in line with the estimates
- Simplified administration and lower total tax burden have lead to **improved incentives for entrepreneurship and investment**
- **Positive impact on employment** is expected in a medium term
- From a macroeconomic and budgetary point of view it is **too early to evaluate** the overall impact of the tax reform
- Reform contributed to **better rating** of the Slovak Republic (A)



THE SLOVAK TAX REFORM: RESULTS

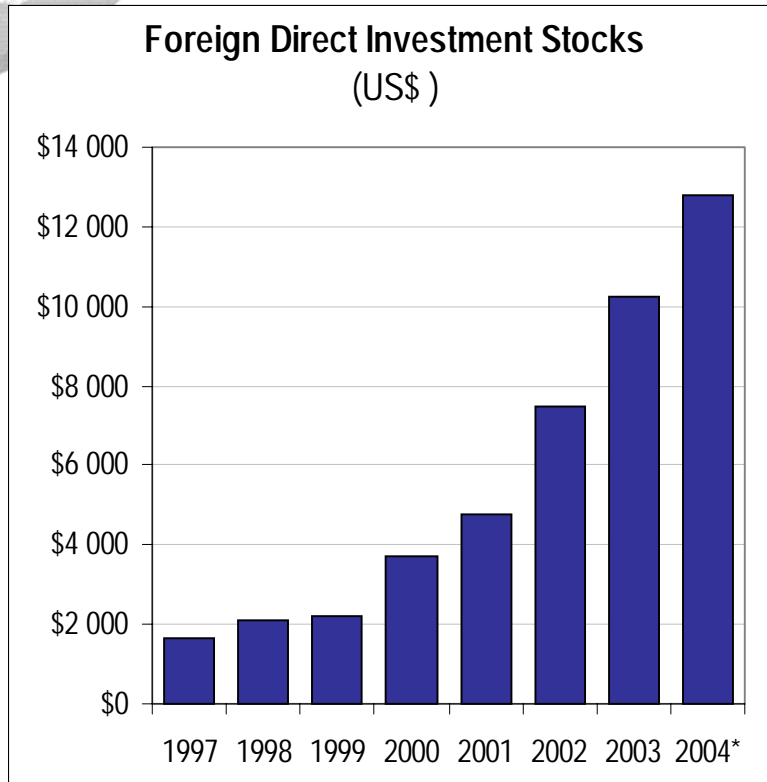
- no decrease in tax revenues
 - increased revenues from indirect taxes
 - less scope for tax evasion and tax avoidance
 - more motivation to pay taxes
- better incentives for investment and work
 - thanks to lower marginal rates
 - thanks to more transparent and equitable taxation



FASTER CATCH UP= LESS REVENUES FROM EU FUNDS!

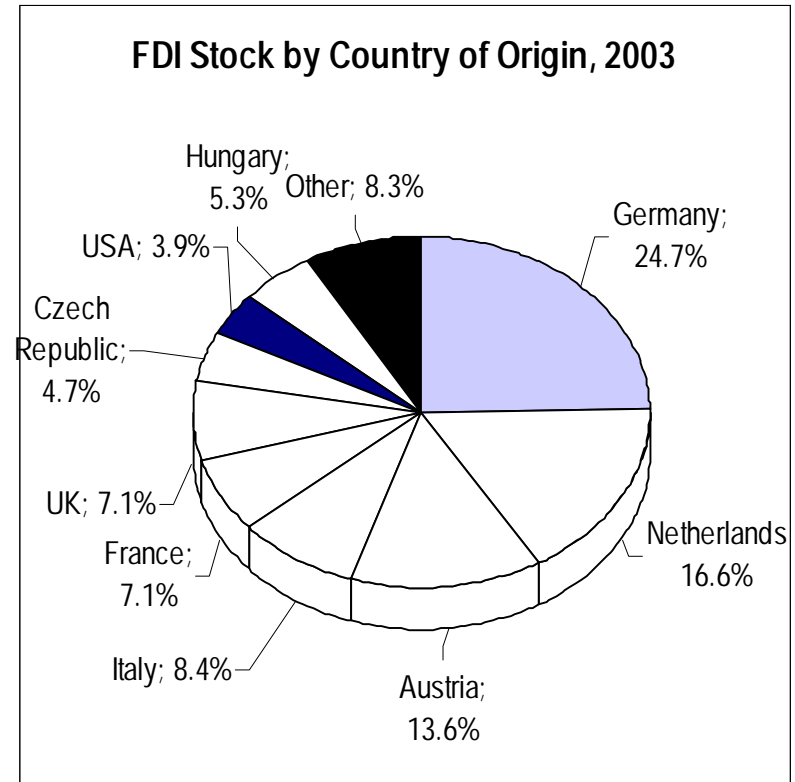


FDI IS GROWING STEADILY



* Forecasts

Source: National Bank of Slovakia





POLITICAL WILL AND MANAGEMENT ARE KEY FOR SUCCESSFUL REFORMS

- must have a clear **vision** where you want to go
- **timing** is key in the implementation
 - implement less popular steps first
- **resist lobbies** and entrenched interests
 - if you give in to one demand, you will be less able to say no to others
- compensate the most vulnerable part of the population



OTHER STRUCTURAL REFORMS

- **pension reform**
 - radical reform of the pay-as-you-go pillar
 - introduction of a fully-funded pillar (private pension accounts invested in capital markets)
- **health care**
 - make the system financially self-sustainable
 - improve the quality of services provided
- **education**
 - improve efficiency and quality of secondary education system
 - increase capacity and quality of tertiary education
- **public administration**
 - improve the quality of the public service
 - continue the de-centralization of public administration



CONCLUSION: ENLARGEMENT CAN GIVE A NEW PRO REFORM STIMULUS TO THE EU

- competitive pressures coming from the new members
 - current EU members will have to reform as well if they will want to stay competitive in medium and long term
- “change of mood” within the EU
 - at least 10 out of 25 people around the table will be from dynamic countries with significant reform experience



THE TAX POLICY IN SLOVAKIA

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