REFORM IN THE FIELD OF INDIRECT TAXES

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With Slovakia's accession to the European Union many significant changes occurred affecting all its citizens, businesses, the state and its economy, and thus also the tax system. The Slovak economy, after the eleven years of functioning of its tax system, valid since 1 January 1993, has undergone another radical tax reform. The causes of what is now the second radical reform were internal shortcomings in the Slovak tax system, as well as the need for harmonisation in particular of indirect taxes prior to Slovakia's accession to the European Union.

Harmonisation of indirect taxes in the European Union

In EU tax policy two basic ways of implementing tax legislation have so far stood out in the history of tax harmonisation. The first is positive harmonisation, where harmonisation measures are applied at the level of the EU by means of directives and regulations mainly in the field of customs and indirect taxes (turnover tax, value-added tax, excise duties). Besides such positive harmonisation, direct taxes have also seen attempts at negative harmonisation by means of various types of prohibitions. Nonetheless, the harmonisation process in the EU has in many fields been unsuccessful. The European Commission has proposed the whole range of measures in the form of directives and regulations, many of which however were never passed. Such legislative instruments require unanimous approval. Often a proposal remains unapproved because it was blocked by one or two states that did not want to surrender a further part of their sovereignty, or to overcome strong traditions. After many tense situations the tax policy of the EU was reassessed and the Commission decided that in advancing the harmonisation measures it would use also non-legislative instruments in the form of recommendations, which do not require unanimity. Principal tax issues continue to be enforced in the form of directives, other in the form of recommendations.

Tax harmonisation has been the subject of much debate since the very founding of the EEC; its legal basis is laid down in the Treaty of Rome of 1957. Even if from the outset harmonisation of tax systems was understood as an absolute matter, it later came to be considered as an essential step towards creating a functioning single market. From the historical aspect, the development of the harmonisation process in the EU may be split into two basic stages. The first stage was characterised by an effort at complete harmonisation of tax systems (structural harmonisation and harmonisation of tax rates). The practical implementation of these efforts however revealed the immense complexity of the harmonisation process, mainly in the field of direct taxation. The main barriers to complete harmonisation concerned primarily:

(a) economic barriers – different levels of economic development and performance of member states' economies, the historically arisen and objectively justified differences in tax systems resulting from traditions in the field of production and consumption, fiscal reasons and the need for a certain degree of tax competition,

(b) social reasons ensuing from member states' different social systems and social policies. The different hierarchy of individual states' social preferences can also be seen in their different tax policies,

(c) political barriers ensuing from the mentioned unwillingness of member states to surrender a part of their tax and fiscal sovereignty to the European Community.

These barriers led the European Commission to reassess its approaches to complete harmonisation, and therefore in the second stage its attention was focused on those measures enabling the creation of conditions for a functioning single market. Specifically, this concerned the harmonisation of indirect taxes – value-added tax and excise duties.

The basic aim of harmonising indirect taxes was to introduce a uniform system of indirect taxation. In 1967 the first directive was adopted, introducing VAT and recommending member states to harmonise their systems of indirect taxation. Following its adoption came the so-called Sixth Directive (77/388/EEC) which was considered the basic directive, since it laid down the rules for setting the tax base, territorial application, taxable persons, tax rates, etc. The first step was the structural harmonisation of VAT (subject of activities). The second step represented the harmonisation of tax rates. In this field results did not meet results set nor expected. Despite the fact that in 1992 Directive No 92/77/EEC on approximation of VAT rates entered into force, a large variability in these rates still persists. This directive stipulated that there may be only a single rate in the amount of at minimum 15%, and only two reduced rates in the amount of at minimum 5%. Many states however have not respected this delimitation. A significant harmonisation priority was the application of basic VAT principles – the principles of destination and origin, which are connected with basic fiscal issues of indirect taxation[1].

The harmonisation of excise duties is contained in Directive No 92/12, which was adopted in connection with the single internal market. According to this directive goods at the moment of their importation or production are subject to excise duties, the tax is payable only upon the final consumption. With effect from 1 January 1993 the harmonisation of tax bases has been ensured by the Common Customs Tariff. In 1994 a directive was issued that in member states excise duty may apply only to mineral oils, alcohol, tobacco, beer and wine. The directive allows for the existence of other taxes, provided that these do not present a barrier to free trade, must not require frontier checks and another amendment in tax legislation.

Application of value-added tax following the SR's accession to the EU

On the date when the Treaty of Accession of the SR to the EU entered into force on 1 May 2004, the new Act No 222/2004 Z.z. on value-added tax (hereinafter simply the VAT Act) also entered into force also acquired its force.

The Slovak Republic through entering the EU also became a part of its single internal market. In connection with value-added tax it is necessary to emphasise that on the basis of Article 99 of the EC Treaty the legislation in the field of indirect taxes of each EU member state must be harmonised with EU law. Rules in the field of VAT, contained in the Sixth Directive, became the basis of the new VAT Act in the SR. Since each Council directive has greater legal force than an act of the SR, in practice this means that should the VAT Act in the SR be at variance with that directive (either incorrectly transposing the directive into the act of the SR, or through the absence of mandatory rules and principles in the act of the SR), each subject can demand tax treatment according to the Sixth Directive of the Council.

The EU single market, which has existed since 1 January 1993 constituted the closure of customs offices and customs checks at borders between member states of the EU. The establishment of a common area free of internal borders, providing for the free movement of persons, goods, services and capital, where no tax barriers exist between EU member states, also required a serious change in the rules of the common system of VAT that had applied prior to its formation. In the framework of the EU single market it was not possible, in a VAT system, to adopt or apply a general principle of origin, meaning the principle of taxing goods or services to the supplier of goods and services in the supplier's member state, since this would cause fiscal consequences unacceptable for the recipient country. For example, in the sales of goods or services between two registered VAT payers from Denmark to Germany the tax on the output would constitute an income of Denmark's state budget and the tax on the input in Germany would be a tax deduction and thus a deduction from Germany's state budget. This principle of taxing supplies of goods and services between businesses (taxpayers) from one member state to another member state could exist only concurrently with a clearing system ensuring the reallocation of taxes collected in the country of origin to the country of consumption. In establishing the single market the member states however did not manage to agree on such a clearing system, which was and still is today complicated also by various VAT rates in these countries. Therefore for supplies of goods and services from one member state to another member state between registered tax payers a destination principle has been adopted. This principle means that goods and services are taxed in the member state of the recipient. The origin principle is applied in the sale of goods to final consumers, primarily citizens. This means that goods are taxed once, this in the country of the supplier, where these sold and taxed goods may move freely within the EU without further checks and without further obligation to pay tax. In summary it may be said that the VAT system within the EU single market is applied on the basis of combining two general principles, the destination principle and the origin principle, as depicted in the following diagram[2]:

1. destination principle
business ⟶ business

2. origin principle
business ⟶ consumer

There are three special exceptions exist from the

[1] These principles and their application are explained in the second part of this article.

[2] Jablonková, Z.: Complete wording of the Act on Value-Added Tax. Tax and Consultancy Guide for Businesses no. 10/2004, commentary on Act, pg. 7.

application of these general principles:

(a) in the case of the package sale of goods from one member state to another member state and where the buyer is a person not registered for value-added tax, then in such a sale of goods the origin principle is applied only up to a certain value and above this value destination principle is applied,

(b) in the purchase of goods by a juristic person that is not a taxable entity and where this purchase is made from one member state to another member state, the origin principle is applied up to a certain value of the goods purchased, and then above this value the destination principle is applied,

(c) in the sale of a new means of transport, the destination principle is always applied.

Slovak VAT legislation has since 1993 undergone a complicated eleven years of development. In the years 1993 – 1995 VAT was applied according to Act No 222/1992 Zb. as later amended and from 1 January 1996 to 30 April 2004 according to Act No 289/1995 Z.z. as later amended. On the date of the SR's accession to the EU a third legal amendment to this tax came into force in the form of Act No 222/2004 Z.z.

In comparison with previous legal standards the internal arrangement of the VAT Act, its content and scope are completely different. The new VAT Act contains 88 articles and six annexes. New terminology is used too, mainly in connection to the subject of taxation and the taxpayer.

From the definition of the subject of the tax it is apparent that the Act contains specific rules for the application of the tax in the case of:

– the supply of goods and services for consideration in the domestic market and effected by a taxable entity,

– the acquisition of goods for consideration in the domestic market from another member state,

– the importation of goods from third countries.

Subjects of the tax are defined in more detail as taxable transactions in Articles 8 to 12 of the Act: the supply of goods (within the domestic market), the intra-Community supply of goods, the supply of services, the acquisition of goods in the domestic market from another member state (the intra-Community acquisition of goods), the import of goods (import from third countries). In commercial transactions between businesses registered for the tax in various member states the destination principle applies. Since upon entering the EU Slovakia became a part of the common market free of internal tax and customs borders, ensuring free movement of persons, goods, services and capital, and without internal borders, the Slovak Act had to cancel the taxation of goods from another member state, and cancel the exemption from tax for goods supplied to another member state in the form performed prior to the accession to the EU. The taxation of goods and tax exemption in the case of export of goods was retained only towards third countries, i.e. those territories that are not a part of the common system of VAT in the EU. The delimitation of the subject of tax together with territorial application (the place of taxable trade in Articles 13 to 18) and the time definition of the occurrence of the tax obligation (Articles 19 to 21) may be considered as the core of the new VAT Act.

For the practical implementation of the common VAT system in the EU a “personal” definition is also very important – defining the sphere of taxable persons and their obligations in registration. It may be said that even despite certain terminological changes the act continues to define mandatory registration and voluntary registration. Mandatory registration applies to a taxable person – resident having reached a turnover of SKK 1.5 million over the preceding consecutive 12 calendar months, where this person is obliged to register by the 20th day of the calendar month following that in which the turnover of SKK 1.5 million was achieved. The registration obligation applies also to foreign businesses carrying on an activity in Slovakia, where this activity is a subject of the tax. In this case registration is not bound to the attainment of an SKK 1.5 million turnover. A new feature is the registration for tax pursuant to Article 7 – registration for the payment of tax on the acquisition of goods from another member state, where such persons do not become “classical” taxpayers, i.e. they will not have the right to deduct the tax, but have the obligation to tax in the country the goods acquired from another member state. This concerns cases where such persons acquire goods from another member state and the value of these goods, excluding tax, totals SKK 420 000 or more per calendar year. The registration is connected with the allocation of VAT payer identification numbers, a component of which are prefixes identifying the country of registration of the particular payer. Identification numbers together with prefixes must be stated upon the relevant documents and records. Tax bodies in each member state have created a system by means of which it is possible to check a customer's registration for VAT in any member state. Taxpayers in their own member state may ask the tax authority to check the validity of the identification number of the customer from another member state in writing, or by phone, fax, or e-mail[3].

Since 1 January 2004 a single VAT tax rate has applied in the Slovak Republic in the amount of 19% on all taxable transfers. The introduction of this tax rate in the Slovak tax system was connected with Slovakia's tax reform, in

[3] This verification is made on the basis of Act No 472/2002 Z.z. on international assistance and cooperation in tax administration. The validity of tax identification numbers issued in all member states may be checked also on the European Commission website http://europa.eu.int/vies.

place since 1 January 2004, together with other systemic changes in the whole tax system. Despite the fact that there is no obligation to apply a single VAT rate in member states and despite the fears of experts and the lay public that the introduction of this tax rate will cause harsh social impacts, primarily on a low-income groups of the population, the introduction of a single tax rate of 19% in Slovakia has not brought about protests and after 10 months of its application positives may be "enjoyed", primarily due to simplicity and the actual application of taxation neutrality in the VAT system.

A further element of taxation policy in the VAT system – tax exemption – is solved in a similar manner as in the past. It however concerns a substantially broader definition of exemption as regards the EU common market. For this reason we may classify tax exemption as follows:

(a) in the framework of supply of services in Slovakia (Articles 28 to 41):

• social tax exemptions, covering the public interest field,

• commercial tax exemptions, having a more technical reason (in some cases it would be technically complicated to apply the tax).

In these types of exemptions it is not permitted to deduct input tax. This means that it in these activities the tax is collected at the preceding level and the final supply to the end consumer is no longer taxed.

(b) in the supply of goods and services (Articles 42 to 48) within the EU common market, where the deduction of input tax is applied provided that conditions set in advance are met. This type of exemption fully respects the basic principles of VAT application in the EU.

This concerns primarily tax exemption:

• in the supply of goods on which tax has not been deducted, tax exemption in the intra-Community supply of goods,

• in the acquisition in the domestic market of goods from another member state,

• in the case of trilateral trade,

• in the case of transport services,

• in the export of goods and services,

• in the import of goods (defined supplies).

A basic feature of value-added tax is the fact that collection is made at each level of the production and distribution chain as the balance between the "tax on output" and the "tax on input". For this purpose the rule on deducting tax is set out in Articles 49 to 55 of the VAT Act. The system of deducting tax is founded on the principle of the material allocation of each good and service received in respect of fulfilments, supplies that the taxpayer makes according to whether individual goods and services are intended:

• exclusively for fulfilments that are subject to output tax, intra-Community supplies of goods, the export of goods to third countries – the full deduction of input tax,

• exclusively for fulfilments exempted from tax (Articles 28 to 41) without the possibility of deducting input tax,

• concurrently for fulfilments with the right of deducting input tax and also without the right of deducting tax.

This concerns differentiating goods and services received for the needs of deducting tax (full deduction, proportional deduction with the aid of a coefficient or without deduction) in the taxpayer's records.

The VAT Act contains also provisions (Articles 65 to 68) solving specific cases in the application of tax and simplifying the tax regime in the case of certain taxable transactions. This specifically concerns arranging the application of tax for travel agencies, in the purchase of works of art, collectors items, antiques, used goods, investment gold, as well as in the electronic supply of services from non-member states.

The new legislative arrangement has newly specified the obligations of persons obliged to pay tax, i.e. to maintain tax records, issue invoices, complete tax returns and summary statements. The Tax Act also includes annexes and measures of the Ministry of Finance of the SR stipulating a specimen value-added tax return and instruction for filling in the tax return and summary statement.

In conclusion to this part it may be said that the new legislative provision for VAT in the SR respects in full degree and great detail all the rules of applying this tax in the framework of the single market. For the business community this legal arrangement is demanding, though on the other hand also very transparent. It may be said that the application of a single tax rate in this system is a significantly simplifying element.

Harmonisation of excise duty legislation

The harmonisation of excise duty legislation in Slovakia reached its peak on 3 February 2004 when the National Council of the SR passed the acts on excise duties[4]. Complete harmonisation in the EU was achieved by the application of the provisions of Council Directive 92/12/EEC on the general arrangements for products subject to excise duty and on the holding, movement and monitoring of such products. Through harmonising the national legislation of the SR with EU law one of the principles of the common market's functioning has been fulfilled, that being the free movement of goods in the case

[4] Act No 98/2004 Z. z. on excise duty on mineral oil; Act No. 104/2004 Z. z. on excise duty on wine; Act No. 105/2004 Z. z. on excise duty on spirits and on the amendment and supplementing of Act No 467/2002 Z. z. on the production and marketing of spirits as amended by Act No 211/2003 Z. z.; Act No 106/2004 Z. z. on excise duty on tobacco products; Act No 107/2004 on excise duty on beer; Act No 556/2004 Z. z. of 21.9.2004 amending Act No 105/2004 Z. z. as later amended.

of excise duties. This harmonisation set off in Slovakia the first tax reform and application of a new tax system in 1993, specifically harmonisation in the sphere of goods subject to excise duties on:

- mineral oils (until 2001 termed "hydrocarbon fuels and lubricants"),
- alcohol and alcoholic beverages (spirits, beer, wine),
- tobacco products(cigarettes, cigarillos, smoking tobacco).

The process of harmonising tax legislation in the SR with that of the EU has been underway since 1993 in all elements of the tax system. This concerns primarily the harmonisation of excise duty tax rates, with the exception of tax rates on cigarettes – in this case the Slovak Republic committed itself to achieving the level of the minimum rate within a transitional period to 2008, which was agreed in the framework of accession negotiations with the EU. As regards individual excise duty laws only the subject of tax and tax rate remained unchanged, with the exception of the rate on cigarettes, in the case of which, for the first time in the SR, and as the last state in the EU, a combined tax rate will be introduced composed of a specific part expressed in SKK/piece and a percentage part expressed as a percentage of the price of cigarettes of a consumer package for the final consumer. From the aspect of taxable subjects the term used to date, "taxpayer" has been replaced by the new term "tax debtor", whose obligations in respect of registration and payment of taxes are defined precisely in the legislation.

Since 1 May 2004 rules for the movement of goods subject to excise duties have been changed similarly as in the case of VAT. The supply of goods subject to excise duties has since 1 May 2004 from Slovakia to other member states ceased to be deemed an export and their collection from other member states an import. This movement of goods is termed intra-Community supply or acquisition of goods. The procedure applied in importing or exporting goods prior to 1 May 2004 has been retained only in the case of the contact with third countries. The exclusive administrators of excise duties are customs authorities, whether this now concerns the tax territory of the SR or the customs or tax territory of the EU, or territories that are not a part of the EU.

Since this is a very extensive issue, I will focus on only the most important elements: primarily the newly-amended tax regime provisions reflected in the excise duty tax legislation. Goods subject to excise duties become a subject of tax upon their production in the territory of member states or their importation into the territory of the EU. The EU area is one tax territory with harmonised rules governing the movement, monitoring of the movement, as well as the holding of goods subject to excise duties. Member states are "autonomous" primarily in their possibility to individually set tax rates, their minimum level being set by respective directives, in the possibility of their own setting of the periods for submitting tax returns, the payment date of the tax and the conditions for authorising tax warehouses, etc. One of the basic rules, contained in individual tax laws, is the destination principle. This means that goods subject to excise duties shall be taxed in the country for which they are intended for end consumption. With regard to the fact that the mechanism for excise duties, in contrast to that for VAT, does not recognise intra-Community supplies of goods subject to excise duties exempted from tax, and in order for the destination principle and the principle of the free movement of goods within the EU to be fulfilled, a special tax regime has been introduced - a duty suspension regime. This regime means the deferral of the tax obligation. If goods are in this regime, they may be produced, processed, re-processed, stored and transported freely without the burden of excise duty. Movement in the duty suspension regime may be made at the national level and throughout the whole of the EU. Tax warehouses are holders of the duty suspension regime, where such warehouses occupy a paramount position in the hierarchy of tax subjects in the field of excise duty. This paramount position however is "redeemed" through fulfilling demanding criteria. The operator of a tax warehouse is obliged to deposit a security relating to the transport, production, processing and storing of goods subject to excise duties. The setting of this security is in the legislative competence of member states. A tax registration number is assigned to tax warehouses, the number being registered in a tax database. Member states exchange these databases by means of the System of Exchange of Excise Data (SEED).

The changes made to the previous system in the field of excise duties, lying in the significant change in the structure of taxpayers, the application of financial securities of tax, as well as the transition of tax administration from tax authorities to customs authorities constituted significant changes in the Slovak tax regime. As a result tax legislation and its gradual smooth application in tax practice have created the preconditions for Slovakia's incorporation into the common EU area.

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