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Slovakia economy briefing:
Legislative changes in the business environment

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Legislative changes in the business environment

Overview

According to Kullová (2019b), Slovak tax-paying system is unnecessarily complicated, unfair and with one of the highest rates. At the same time, the current set-up hinders economic growth as proposed by Asociácia zamestnávateľských zväzov a združení SR (Federation of Employers' Associations – FEA SR). The state's tax gap is currently 23 percent, or EUR 1.8 billion over the past year (2018). The Council for Budget Responsibility estimates a risk of more than EUR one billion this year (2019). Also, an important fact is, that the current 21% income tax for legal entities in Slovakia is among the highest of all countries of Central and Eastern Europe (CEE) as shown in table 1. The only exception is Austria, where the statutory corporate income tax levels at 25%.

Table 1 Comparison of statutory corporate tax rates in CEE (EU member states), 2017

Country	Tax rate
Hungary	9%
Bulgaria	10%
Romania	16
Poland	19%
Czechia	19
Slovakia	***21%***

Source: OECD (2019).

Besides the high statutory corporate tax rate, in the beginning of year 2019, the legislation on minimum wage was passed increasing the minimum wage to EUR 580 (hourly wage of EUR 3.333) since January 2020 from EUR 520 (hourly wage of EUR 2.989) in 2019 with estimated increase to EUR 640 in 2021 (hourly wage of EUR 3.678). In 2018, Part Four on wages and average earning of the Labor Code received significant changes with the approval of Act No. 63/2018 (2019) as an amendment of the Labor Code. Act No. 63/2018 was approved in February 2018 and entered into force in May 2018. The most significant change was an increase in the premiums paid to employees for work at night, on holidays and on weekends. According to Kollárová (2019), premiums are based on the minimum hourly wage. An exception is a premium for work on holidays, which is calculated from the average salary of the employee.

Since May 2018, the premium has been set at 100% of the employee's average hourly earnings with no change in 2019. We assume that the amendment of the Labor Code that was approved in 2018 with the intention to increase the premiums paid to employees for work at night, on holidays and on weekends will mean increased costs for employers in private sphere, especially in the context of rising minimum wage in 2020 and 2021, since premiums are calculated as percentages and are derived from the minimum hourly wage (EUR 2.989 in 2019, EUR 3.333 in 2020) except the premiums paid for the work on public holidays which are paid based on the average salary of the employee. Thus, reducing the taxes and levies burden may be the way in which businesses deal with these legislative changes regarding minimum wage and premiums that are linked to the minimum wage. According to Kullová (2019b), wage costs are increasing and also Republiková únia zamestnávateľov (the National Union of Employers – NUE) as the biggest employers organization in Slovakia, which associates two thirds of employers producing 70% of GDP and 80% of the Slovak export argues that higher numbers of premiums lead to increased problems in cost increase and disruption of motivational systems and planning in companies. The NUE was established on March, 30th 2004 in Bratislava with the intent to protect common employers´ interests, business rights and citizens freedom as well as to protect the members against the measures leading to the degradation of the equal market business environment (NUE, 2019). Since premiums are bound to the level of minimum wage, the increase of minimum wage is a sensitive issue for the business sector, especially in those segments, where premiums are mostly paid. One of these sectors is food industry, where, according to Kullová (2019b), wage costs increased in 2018 by 67% for work during Saturdays, by 137% for work during Sundays and by 45% for work during the night compared to 2017. Another fact that might negatively impact the activities of companies within business sector is the year-on-year increase of average gross nominal wage in the second quarter of 2019 to EUR 1 101 or by 9.7%.

Lower tax rates for selected businesses

Parliament of the Slovak Republic approved changes in the taxation for legal entities in September 2019. Ruling coalition pushed income tax cuts for companies with annual turnover up to EUR 100 000 from 21% to 15%. This change will affect self-employed and small businesses the most. In the original parliamentary proposal, the tax rate was to be reduced only for legal entities, however, the reduction to 15% was also extended to self-employed – natural persons. Tax advisor Radovan Ihnát proposes that "injustice" is created (Kullová, 2019a) and Kullová (2019a) introduces an example for this injustice regarding the fact that a company with annual turnover up to EUR 100 000 will be taxed by 15%, while the company with annual turnover more than EUR 100 000 will be taxed by 21% leading in practice to higher net income for a taxpayer with lower turnover and a lower net income for taxpayer with higher income. For example: Let us have two companies with no costs. The one with a turnover of EUR 100 000 will pay 21% tax (EUR 21 000) and will achieve a net profit of EUR 79 000. A company with a turnover of EUR 92 942 and up to EUR 99 999 will pay 15% tax (EUR 13 941.3 to EUR 14 999.85) and its net profit will be EUR 84 999.15 to EUR 79 000.7. In the second case (annual turnover of EUR 99 999), the difference in net income with a company with annual turnover of EUR 100 000 will be higher by EUR 5 999.15. These differences will be equalized at annual turnovers of EUR 100 000 (21% tax) and EUR 92 941.18 (15% tax) with net incomes at EUR 79 000.

Tax advisors and lawyers conducting activities in Slovakia also see another problem that may arise from this new legislation, which is present even currently in Slovak business environment. They assume a trend (already existing as a common practice because of the value added tax (VAT)) of setting up smaller companies to a certain income threshold (in this case with annual turnover of maximum EUR 100 000) even before the entering of the act into force since January 2020. Business Register (2019) registers owners with tens of companies with similar or even the same business activities, which is possible under current Slovak legislation. However, the artificial breakdown of companies due to the lower tax rates will be considered as a special-purpose procedure with the aim of obtaining an unjustified advantage. In that case, the tax administration could proceed to assess the difference between the taxes.

According to Slovenský živnostenský zväz (Slovak Association of Crafts – SAC), the announced tax rate cut may be of particular interest to smaller companies, which can benefit from a six percent tax cut. The lower tax rate for companies with lower turnover, according to the Secretary General of SAC, will not only support the domestic business environment, but may also be motivating for the entry of foreign investors. This in turn will support the domestic labor market and translate into higher household consumption (Kullová, 2019b).

Conclusion

One of the most important legislation changes regarding the tax rates was approved by Slovak parliament in September 2019. Tax cuts for companies with income up to EUR 100 000 from 21% to 15% will be in force since January 2020. We note that the corporate tax rates in Slovakia are currently highest among the CEE member countries of the EU (table 1). We also note the tax experts debate on this topic assuming that state should maintain consistent and simple tax policy with minimum exceptions regarding the corporate taxes (Kullová, 2019a), since this kind of approach contributes to costs reduction in state's financial matters together with lowering the possibilities for tax evasion. We assume the risk may arise through the increase in the number of small companies with a turnover of up to EUR 100 000, which will try to optimize their business activities in Slovakia with the effect on the state through no macroeconomic benefits while increasing the administrative costs regarding the small business administration at the side of the state. Similar risk is to artificially divide new orders of existing companies into new companies in an effort to fit in each of them up to EUR 100 000 and reduce tax. According to Kullová (2019a), even businesses with simpler activities will probably pull into the artificial division of their business into smaller limited liability companies.

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