

Objective reasons for sustaining losses according to the OECD TP Guidelines and their acceptance in tax audits in Slovakia

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OECD Guidelines

- As an OECD Member State, Slovakia adheres to the **OECD Transfer Pricing Guidelines**
- The OECD Transfer Pricing Guidelines:
 - ✓ **Basis** for the Guideline of the Ministry of Finance of the Slovak Republic No. MF/019153/2018-724 laying down the content of the documentation pursuant to the Article 18 par. 1 of Act No. 595/2003 Coll. on Income Tax, as amended
 - ✓ Serve as **explanatory means**

OECD Guidelines & Losses

- Chapter I section D.3 1.129: **Losses**
- Enterprises **consistently realizing losses**, while the group is profitable should **trigger attention**
- Associated enterprises **may sustain losses due to:**
 - ✓ *Heavy start-up costs*
 - ✓ *Unfavorable economic conditions*
 - ✓ *Inefficiencies*
 - ✓ *Other legitimate business reasons*

Heavy start-up costs

- Start-up costs are **all expenses incurred to plan, register, organize and launch a new business**
- It is the aggregated cost to bring any new business idea to the open market
- **These expenses come from things like:**
 - ✓ *Legal fees*
 - ✓ *Market research reports*
 - ✓ *Insurance*
 - ✓ *Advertisement*
 - ✓ *Other operating costs*

Unfavorable economic conditions

- Economic conditions refer to the **present state** of the economy in a country or region
- **Examples of unfavorable economic conditions:**
 - ✓ *Crisis*
 - ✓ *Market slumps*

Inefficiencies

- **What does inefficiency mean?**
 - ✓ *Not achieving maximum productivity*
 - ✓ *Inability to achieve the desired result*
 - ✓ *Scarce resources are not being put to their best use*

- **Inefficiency can be caused by:**
 - ✓ *Flawed product strategy*
 - ✓ *Outdated tools*
 - ✓ *Inefficient organisational structure*
 - ✓ *Failing to use available knowledge*

Other legitimate business reasons

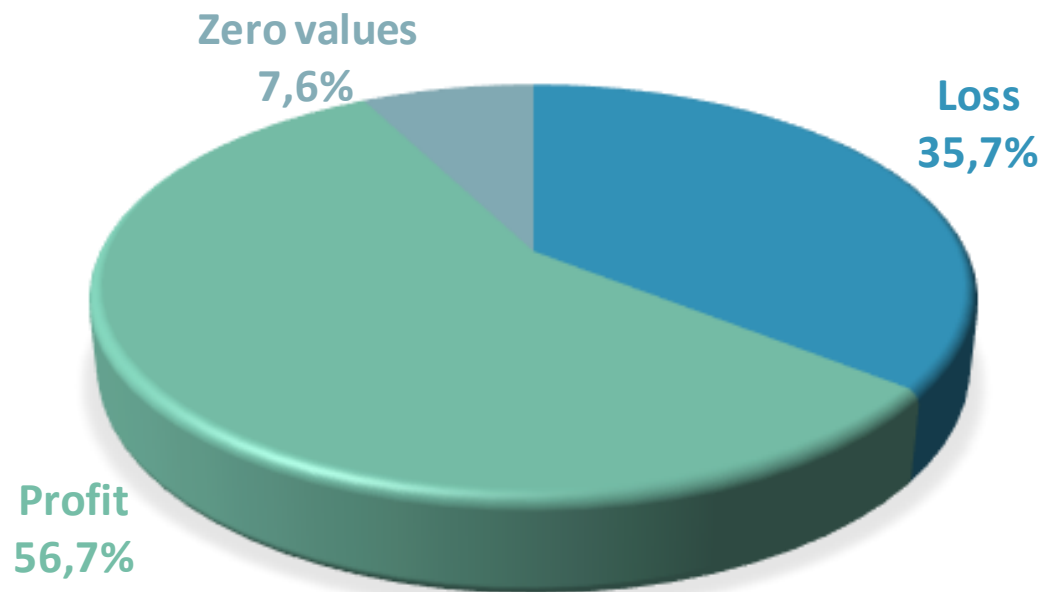
- Other **legitimate business reasons**:
 - ✓ *Achieving market penetration*
 - ✓ *Anything that has some rationale?*

OECD Guidelines & Losses

- **Acceptable period for sustaining losses?**
 - ✓ **OECD:** *not tolerating losses that continue indefinitely*
- **What if losses continue indefinitely?**
 - ✓ **Independent company:** *cease to undertake business*
 - ✓ **MNE group company:** *may remain in business, if beneficial => **adequate compensation required***

Loss-making companies in Slovakia

- Growing trend of tax audits in loss-making companies
- Number of companies in profit and loss for 2018
(sample of 217 510 companies)



Source: <https://www.finstat.sk/analyzy/analyza-financnych-vysledkov-firiem-2018>

Acceptance of losses in Slovakia

➤ Recent experience:

- ✓ *Loss-making company between years 2010 – 2015*
- ✓ *Manufacturing company (combined: toll manufacturer/contract manufacturer)*
- ✓ *Argumentation of the company:*
 - ☐ **Inefficiency**
 - Expansion of production, introduction of new processes
 - Fluctuation of employees
 - Adaptation of employees takes over 1 year (2 years till full adaptation)

Acceptance of losses in Slovakia

➤ Recent experience:

✓ *Argumentation of the tax authority:*

- Admitted that there was **expansion**, however **not significant** (subjective assessment?)
- **Costs are booked on 52x** with **no special analytics** for inefficiencies
- **Performance based remuneration** for employees is **advantageous for the group** even if the company has to pay the wage at the statutory minimum – **comparison to minimal wage in the country of the mother company**

Acceptance of losses in Slovakia

➤ Recent experience:

✓ *Argumentation of the tax authority:*

- **Inefficiency as a common phenomenon** (local inquiries in comparable companies)
- **Introduction of new processes is not in the competence of the company, therefore no losses are accepted**
- **Company was not allowed to offer services & products to others** (even though sale was not guaranteed)

Acceptance of losses in Slovakia

➤ **Recent experience:**

✓ *From the informal talks with tax auditors:*

- **Loss is accepted if realized only 3 years?**

➤ **Outcome** of the tax audit:

✓ *Loss not accepted*

✓ *Increase of tax base*

Ďakujeme za pozornosť 😊

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