Double taxation of profit distribution in the Slovak Republic: Consistency with the EU law?

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Abstract:

In many countries the corporate profit is subject two level of tax, corporate level of income tax and investor level tax when corporate profit are distributed as dividends. The paper presents taxation of profit and disparities in taxation of profit distribution of the Slovak limited liability company generated in different taxation periods. In this context the taxation of profit and taxation of profit distribution in the form of dividends are reviewed from the Slovak tax perspective and in accordance with the secondary EU legislation.

Keywords: *profit, profit distribution, dividends, corporate income tax*

JEL codes: D39, K34, M40

1 Introduction

Every country has a privilege to adopt the rules of taxation, tax acts, impose, collect and request taxes. There is a risk of double taxation from profit sharing by expanding of business activities to other countries in the country of income source and in the country of taxpayer residency (Kuceková, 2015). Double taxation of dividends describes the situation where stockholders pay income tax on dividends received, although the paid dividends were already taxed at the corporate tax rate prior to distribution (Litzenberger and Van Horne, 1978). Lie and Lie (1999) demonstrate that tax issues clearly influence dividend policy.

The mechanism of dividend declaring and payments differentiates according to individual countries (Kráľovič et al., 2002). From a political perspective, concern about profit shifting to low-tax jurisdictions is growing due to increasing international tax rate differentials (Martini et al., 2012).

Profit distribution and loss settlement is decided by the General Meeting of a company, generally when the financial statements are approved (Šteker and Otrusinová, 2013). Similarly, the profit distribution is defined by Strouhal et al., 2013. The legislation stipulates mainly the manner of payments, respectively shares in profits in relation to the profit distribution (Commercial Code, 2017).

One of the most important issues regarding a further existence and development of a company is a means of quantification of the part of a produced gain, that can be divided by a shareholder (investor) without any imperilment of a business property of a company, i.e. performance potential, that is a pre-condition for a further, long-term existence of a company (Pakšiová and Kubaščíková, 2014).

According to Kotulič et al. (2010) the maximalization of profitability is one of the main task of each company. In connection with this statement, various determinants of profitability are mentioned: natural conditions, economic conditions, production structure, used manners and technologies, the level of labour utilization, production quality, sales prices, the amount of costs, turnover, liquidity, the manner of financing of business activity, other factors.

The aim of the paper is to evaluate taxation of profit and profit distribution of the Slovak limited liability company according to the Slovak tax legislation and according to the legislation of EU, i.e. whether the EU Parent Subsidiary Directive is implemented into the Slovak tax law. The paper presents taxation of profit and disparities of taxation of profit distribution in the context of different tax periods.

2 Methodology and Data

The paper analyses the taxation of profit and taxation of profit distribution of the Slovak limited liability company registered in the territory of the Slovak Republic. In our research, we focused on the taxation of profit of the Slovak limited liability company generated in previous years, in particular from the period of 2000 to 2017. Further, the respective profit after tax is distributed after 31 December 2016 to company shareholders residing within the Slovak Republic or within the EU countries.

Given the subject of the research, we theoretically interpret the provisions of the Act no. 595/2003 Coll. on Income Tax as amended (further referred as "Income Tax Act"). Further, the Council Directive 2011/96/EU of 30 November 2011 on the common system of taxation applicable in the case of parent companies and subsidiaries of different member states (further referred as "EU Parent Subsidiary Directive" or "Directive") is also taken into consideration. Based on the comparison of the provisions of the Slovak Income Tax Act and provisions of the given Directive we verified the level of their transposition into Slovak tax taw.

In our research, the standard methods of scientific work as selection, analysis, comparison, synthesis and deduction are further used in this paper.

3 Results and Discussion

When a corporation makes a profit, it pays corporate income tax on that profit. Profit after tax can be (i) retained in the business, or (ii) distributed to its shareholders in the form of dividends. Because the corporation pays corporate tax on its profit, and then also the dividends are taxed, it refers to double taxation of dividends. Corporate shareholders often complain that they are being "double taxed".

Within the Slovak Republic the profit of the Slovak limited liability company is included in the general tax base, subject to standard corporate income tax rate. The table 1 shows how corporate income tax rate have developed in the Slovak Republic over the 17 years period, i.e. the corporate income tax rate has been reduced to current 21%. Within the respective period, the Slovak Republic presents the lowest corporate income tax rate in the amount of 19% over the years from 2004 to 2012.

Table 1 Development of corporate income tax in the Slovak Republic

Year	**Rate (in %)**
2000-2001	29
2002-2003	25
2004-2012	19
2013	23
2014-2016	22
2017	21

Source: own processing based on the Ministry of Finance of the Slovak Republic

In general, the tax base of the Slovak limited liability company is represented by gross income deducted by related expenses, modified by a number of adjusting items. Companies considered as Slovak tax residents are taxed on their worldwide income, i.e. such companies have unlimited tax liability. A company is treated as a Slovak tax resident if it has its registered seat or its place of actual management in the territory of the Slovak Republic. The place of actual management shall be the place in which management and business decisions are taken by supervisory bodies of the legal entity. On the contrary, companies treated as Slovak tax non residents are taxed only on income from Slovak sources, i.e. such companies have limited tax liability in the Slovak Republic.

Table 2 presents the comparative analysis of the corporate income tax rate in the countries of Visegrad group over the period of last 17 years. Over the years, it can be stated that the corporate income tax rates in the selected countries has lowered, currently ranged from 10,8% to 21%. Within the period of 17 years, the most significantly reduced the corporate income tax rate in the Czech Republic, i.e. by 12 percentage points. Currently, the lowest corporate income tax rate presents Hungary.

Table 2 Comparison of corporate income tax in the countries of Visegrad group (expressed in %)

Country/Year	**2000**	**2008**	**2017**
Hungary	19,6	21,3	10,8
Poland	30	19	19
Czech Republic	31	21	19
Slovak Republic	29	19	21

Source: based on Taxation trends in the European Union, 2017 Edition

Double non taxation is one of the key EU areas for urgent and coordinated action: it forms part of an on-going effort to improving the paper functioning of the internal market, by closing tax loopholes generated by exploiting the differences in national tax systems (Explanatory memorandum of the proposal for a Council Directive amending Directive 2011/96/EU on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States).

The same tax regime for distribution of profit reported by subsidiary companies registered in EU countries should be pursued by EU Parent Subsidiary Directive. The EU Parent Subsidiary Directive allows exempt dividends and other profit distribution paid by subsidiary companies to their parent companies from withholding taxes and eliminates double taxation of such income at the level of the parent company. The EU Parent Subsidiary Directive is applied in companies which legal form corresponds to the conditions of companies with limited liability and joint stock companies in the Slovak Republic. In general, the status of the parent company according to the EU Parent and Subsidiary Directive is to be attributed (i) at least to a company of a EU Member State which has a minimum holding of 10% in the capital of a company of another EU Member State, (ii) to a company of a EU Member State which has a minimum holding of 10% in the capital of a company of the same EU Member State, held in whole or in part by a permanent establishment of the former company situated in another EU Member State. Should conditions stated in the EU Parent Subsidiary Directive are not met, the respective bilateral Double Tax Avoidance Treaty need to be taken into account.

The EU Parent Subsidiary is mandatory for all EU Member State, each EU Member State is obliged to put the EU Parent Subsidiary Directive into practice through their national laws. As the Slovak Republic is a member of EU, the EU Parent Subsidiary Directive is accepted and implemented in the Slovak Income Tax Act.

According to the current Slovak Income Tax Act, effective from 1 January, 2017 in the territory of the Slovak Republic, the profit shares (dividends) are subject to tax, if paid to

individuals and in specific cases also to companies for tax periods starting after 1 January 2017. There are some specific dividends, according to the current ITA, which are not subject to tax.

The dividends paid between two Slovak tax resident companies are not subject to tax for tax periods starting January 1, 2017. However, dividends distributed out of profits generated from January 1, 2017 onwards and paid to a resident of a country with which the Slovak Republic has not concluded a double tax treaty or a treaty on the exchange of tax information (i.e. non treaty country) are taxable.

From 1 January 2004, the Slovak Income Tax Act allows exemption of profit distribution of the legal entity. In general, the dividends represent the profit shares paid from profit of legal entities to the extent that they have not been deducted by the taxpayer paying this profit share.

In addition, according to the transitional provisions of the Income Tax Act, the dividends distributed out of profits generated from 1 January 2004 to 31 December 2016 paid out after 31 December 2016 are not subject to tax, nevertheless distributed to Slovak tax resident company or a company tax resident in a treaty country (i.e. countries with which the Slovak Republic has concluded a double tax treaty or a treaty on the exchange of tax information). This mean, that payments of a dividend from profits declared from 1 January 20)4 to 31 December 2016 by a Slovak limited liability company to a Slovak resident or Slovak tax non resident company are not subject to tax.

Further, if the dividends from profits made before 31 December 2003 distributed after 31 December 2016 arises to a taxpayer with a limited tax liability, it will be income from a source in the territory of the Slovak Republic that is taxed by way of withholding tax at at rate of 19% (Article 43 of Income Tax Act). The respective double tax treaty can reduce this withholding tax. Such income will not be subject to tax, if refers to a taxpayer with its seat in a Member State of the EU having, at the time of the payment, remittance, or crediting of such income in its favour, of at least a 25% direct interest in the registered capital of the entity from which such income is gained, otherwise the relevant provisions of the double tax treaty applies.

Should dividends, i.e. from profits made before December 31, 2003 be distributed after 31 December 2016 to the Slovak tax resident company (according to the Article 52 Sec. 24 of the Income Tax Act), these are included into the general tax base of the recipient subject to current corporate income tax rate. This means that the profit of the Slovak limited liability company generated in the period from 1 January 2000 to 31 December 2003 paid out after 31 December 2016 to Slovak resident company are subject to 21% corporate income tax rate.

Conclusions

Based on the research of the taxation of profit and taxation of profit distribution of the Slovak limited company it can be concluded:

1. The EU Parent Subsidiary Directive is implemented in the Slovak tax legislation, i.e. the Slovak Income Tax Act is consistent with EU legislation.
2. The profit of the Slovak limited liability company treated for tax purposes as Slovak tax resident company is included in the general tax base and is subject currently to 21% corporate income tax rate.
3. The profit share (dividends) distributed after December 31, 2016, by the Slovak limited liability company, from tax profits made from 1 January 2004 to 31 December 2016 to Slovak resident company as well as company residing in the EU member states are not subject to tax.
4. The dividends of Slovak limited liability company from tax profits made until 31 December 2003 paid out after 31 December 2016 to the Slovak resident company are included into the general tax base of Slovak resident company and will be liable to 21% current corporate tax rate. Dividends from tax profits made from 1 January

2012 to 31 December 2016 are treated as an item decreasing the tax base when the accounting profit of Slovak resident company is transformed into the tax base.

5. The dividends generated for tax periods until 31 December 2003, distributed by Slovak limited liability company to the company residing in EU member states after 31 December 2016, are subject to 19% withholding tax. However, the respective double tax treaty may reduce this withholding tax. Such income will not be subject to tax, if refers to a taxpayer with its seat in a Member State of the EU having, at the time of the payment, remittance, or crediting of such income in its favour, of at least a 25% direct interest in the registered capital of the entity from which such income is gained, otherwise the relevant provisions of the double tax treaty applies.

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