

Transactions between dependent entities

Transactions can have tax and legal consequences for companies

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Relations between dependent entities are subject to special legislative provisions which are constructed to prevent tax evasion by means of profit channelling between related entities with different tax loads.

This issue is important for all groups of companies with several legal entities which have internal commercial relations (transfer of goods, lease of movable and immovable assets between the companies within one group, etc.).

Definition of dependent entities

Dependent entities are defined, under the 2003 Income Tax Act (ITA), as entities economically, personally or otherwise interrelated. In general, economic or personal interrelation means the participation of an entity in the assets, control or management of another entity, or a mutual relationship between entities that are under the control or management of an identical entity or wherein such an identical entity holds a direct or indirect proprietary share.

Another type of interrelation is a commercial relationship created solely for the purpose of the reduction of a tax base or an increase in the tax loss.

Typically, when a foreign investor sets up a company in Slovakia of which he is the sole founder and participant, the relation between his (mother) company and the Slovak (daughter) company is considered to be a relation between dependent entities.

Market prices between dependent entities

In order to prevent the channelling of profits between related entities, which is based on the obligation of respecting the applicable market prices in their mutual transactions, the ITA states that "the tax base of a non-resident related party shall also include the

difference between the prices agreed in the business transactions of non-resident related parties (including the prices of services, loans and credits), and the prices applied between unrelated parties in comparable business transactions, as long as such a difference results in a reduction of the tax base."

The prices employed in current

charged by a connected entity were higher than the common market prices.

Naturally, should such a taxpayer not increase its tax base as given in its tax return voluntarily, the tax administrator will do this for the taxpayer and will assess an additional tax duty including the applicable penalty.



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business relations are referred to as common market prices.

Under the ITA, the difference between the price negotiated amongst related entities and the common market price is to be determined by one of the price-comparison methods. The ITA also gives taxpayers the opportunity to consult with the tax administrator on the method of the establishment of the common market price.

Adjustment of the tax base when disregarding market withdrawal

Non-compliance with the rule of market withdrawal entails negative tax consequences.

In the Slovak Republic, a taxpayer is obliged to increase its tax base if the prices charged to a related entity were lower than the common market prices, or if the prices

Legal aspects of the transfer of a company's assets

Besides the above-mentioned tax aspects of the application of the rules of market withdrawal there are other important provisions in Slovak legislation which concern the transfer of assets between connected companies and which apply to limited liability companies and joint stock companies.

According to the Slovak Commercial Code, if a company acquires assets under a contract made with its founder or partner for a consideration amounting to at least 10 percent of the value of the registered capital, the value of the contract's subject matter must be determined on the basis of an expert report.

This contract may not enter into force before it is deposited together

with an expert report in the Collection of Documents (which is a part of the Commercial Register kept by the Court). Furthermore, if the company enters into such a contract before the expiration of a two-year period from the date of the setting up of a company, the contract must be approved in advance by the General Meeting of the company.

If the contract's taking effect requires an entry in the special register (e.g. the real estate cadastre) according to law, the contract together with the expert report must be deposited in the Collection of Documents prior to the entry in the special register.

The above-mentioned rules apply mutatis mutandis to contracts the company enters into with entities close to the founders or partners of the company.

The legal consequences of not depositing the contract together with the expert report in the Collection of Documents before entry in the special register within the framework of an asset's purchase between dependent entities is that such a contract does not enter into force.

However, the above-mentioned provisions do not apply to contracts made in normal business relations and to acquisitions of assets acquired at a stock exchange equal to the rate corresponding to the given offer and demand.

Conclusion

As can be seen above, business transactions between dependent entities can have both tax and legal consequences for a company. For this reason, it is recommended to pay increased attention to the establishment of transfer prices and, in particular, to the documentation of the prices applied.

In the case of the transfer of an asset within a group of companies it is also important to take care to deposit documents into the Collection of documents, as failure to do so prevents the contract from entering into force.

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