Paying taxes the Slovak way

The 2012 Paying Taxes study measured the ease of paying taxes for businesses in 183 countries. The objective is to compare and benchmark tax systems around the world. The study is performed each year by The World Bank, IFC and PwC and the results are widely publicized.

The study is based on a model domestic business which manufactures and sells goods. The tax characteristics of the business are measured for each country comparing the total tax cost, the time it takes to comply with the law and the number of tax payments required annually.

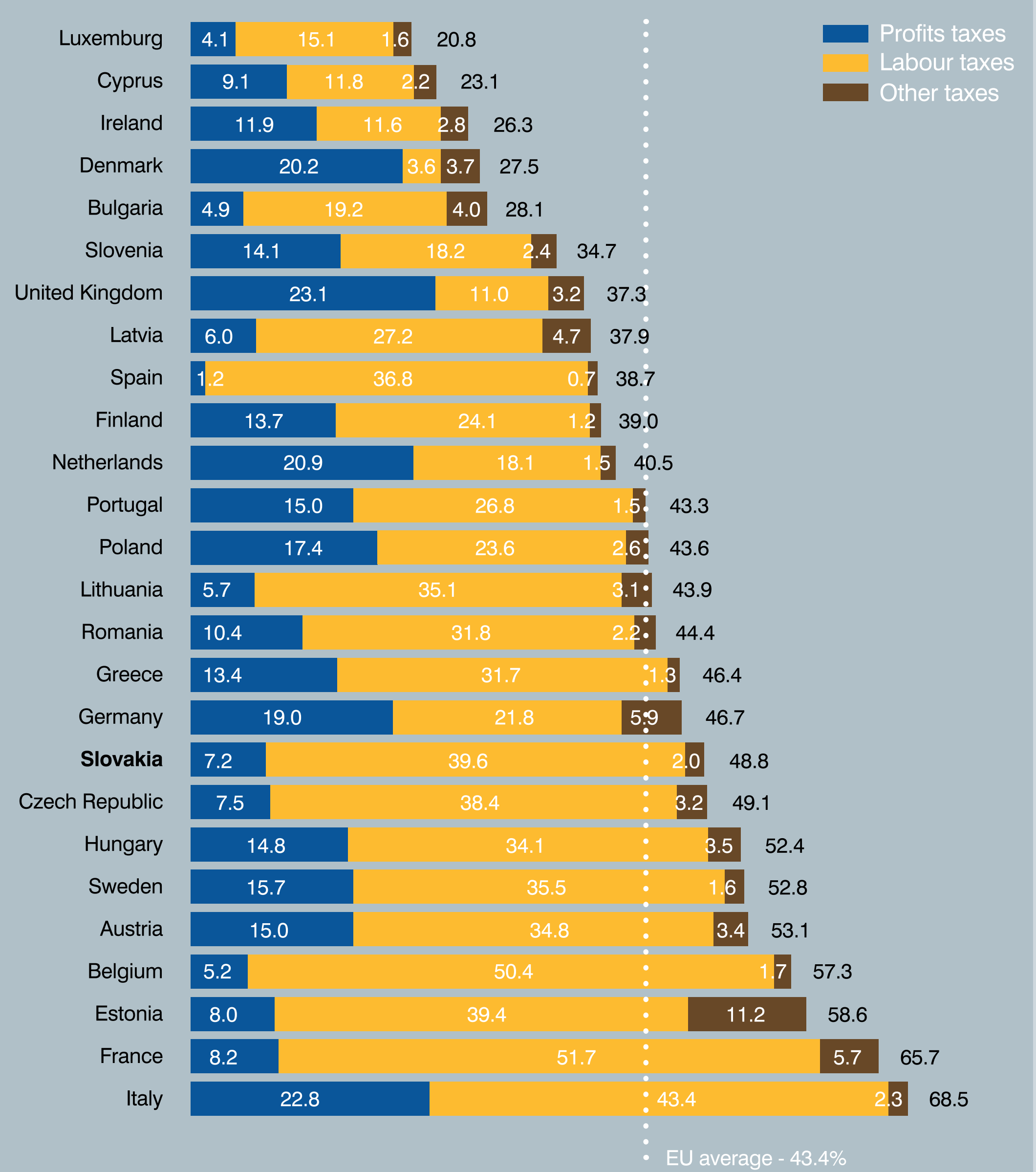
Overall, Slovakia ranked 129 out of 183 countries in the study. In comparison to the previous year's rankings, the ranking of Slovakia has deteriorated because other countries have done more than Slovakia to reform their tax systems. More than 73 % of the countries in the study have a lower total tax burden than Slovakia. So what are the problem areas that are keeping Slovakia from ranking higher? Let's start by looking briefly at the Slovak tax system which was redesigned from 2004.

People think that the 2004 Slovak tax reforms were about reducing tax. The tax reform was not designed to reduce the overall tax burden. It was designed to be revenue neutral for the government, which is why it was ridiculous for some people within the EU to say that Slovakia was tax dumping. The 2004 tax reforms simply rebalanced the tax system from direct taxation (company and personal taxes) toward indirect taxation (VAT and excise taxes). Overall, it was designed to simplify the tax system, provide incentives for people to work and for business to invest.

Two important elements were missing from the scope of the 2004 tax reforms. These were reform of the tax administration system and reform of taxes on labor (e.g. social security and health insurance). These are the two main areas where the Slovak tax system rates poorly compared to other countries.

Governments are very creative when raising taxes. Governments often create new taxes under different names such as duties, contributions, levies, and insurance. In fact, these are all taxes in disguise. A tax is defined in the study as a compulsory

Comparison of the Total Tax Rate in the European Union



Source: Paying Taxes 2012, Study by the World Bank, IFC and PwC payment - made to the government - which is included in public finances and which has no direct return of value for the payer.

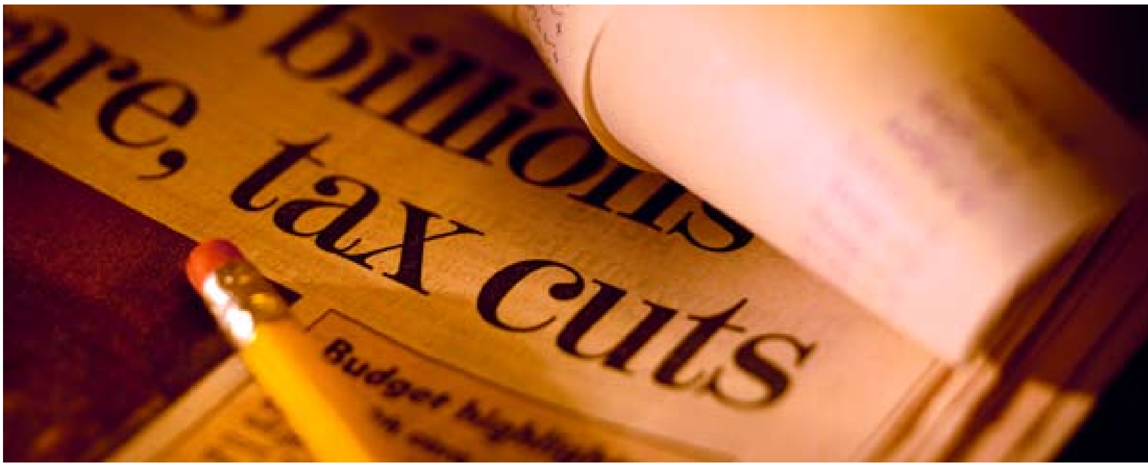
The corporate tax burden on Slovak business is lower than most other EU countries; however, corporate tax is only a part of the broader picture. The study showed that the total tax rate levied on the hypothetical Slovak business was 48.8%.

This is significantly higher than the EU average of 43.4%. In the study, Slovakia ranked 135 out of 183 countries in terms of its Total Tax Rate. This compares to the Czech Republic which ranked 137 and Poland which ranked 112. Hungary ranked 143 due partly to the costly tax on business turnover.

Total Tax Rate – Slovakia

Tax	% of profit before tax	% of total tax due
Profit Tax	7,2%	14,8%
Labour Tax	39,6%	81,1%
Other taxes	2,0%	4,1%
Total	48,8%	100,0%

The table displaying TTR structure for Slovakia shows that, although the social security contributions are capped with upper limits, effectively 81.1% of the Slovak business tax burden is in the form of taxes on labor. In Slovakia, this includes many different taxes calculated based on each employee's monthly salary level (mostly with some upper limits) e.g. Health Insurance, Retirement Insurance, Permanent Disability Insurance, Unemployment Insurance, Guarantee Insurance, Reserve Fund and Injury Insurance.



It seems that over time the government has simply added more and more new labor taxes. It is these high labor taxes that make the Slovak tax burden significantly higher than in other EU countries. The most surprising aspect is that some politicians still wish to increase these taxes on labor. You don't need to be an economist to understand that the higher the taxes on labor, the less incentive there is to employ people legally and that illegal employment becomes more attractive.

Slovakia can improve its tax system by reducing the number of taxes on labor, by using a single base for calculating all labor taxes and by eliminating the need for manual filing of documents

In an economic downturn business tends to have lower profits, which results in lower corporate tax. Most other taxes are not determined on the basis of profits, e.g. labor taxes are determined on the basis of employee's salary. This means that the overall tax burden (as a percentage of profits) can increase during a downturn. The high labor taxes in Slovakia means that there is an even greater incentive for business to lay off staff during an economic downturn than in other countries with relatively lower labor taxes.

It is important for governments to understand the clear relationship between employment, unemployment and the tax burden on labor. In addition to the high Slovak tax burden on labor, there are multiple computation bases for labor taxes and also a heavy administrative burden.

Slovakia can improve its tax system by reducing the number of taxes on labor, by using a single base for calculating all labor taxes and by eliminating the need for manual filing of documents (i.e. only requiring electronic filing). This would be a win for business and a win for government, i.e. it can reduce cost and the administrative burden for both parties.

The economic downturn creates a real challenge for the Slovak government. How can they safeguard public revenues necessary for providing public services and their social objectives, while at the same time encouraging investment, growth and job creation? It is essential that they take a holistic approach. The biggest risk is that individual changes are introduced without a sound underlying basis aimed at achieving the broader strategic objectives. This risk is evident when we see individual ministries pushing to make ad hoc tax increases to suit their own agenda.

People don't like to be taxed and increasing or adding new taxes is not usually a vote winner. There is certainly some expectation within the business community that there will be some post-election tax increases particularly in the area of personal tax, corporate tax and bank tax.

Tax increases do not always result in an increase in government revenues. Many countries have increased total tax revenues by decreasing tax rates, as this encourages investment and compliance with the law.

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