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Stimulating factor in the provision of tax credits in Slovakia

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Abstract

The aim of this paper is to evaluate the issue of tax incentives in the Slovak Republic. Characteristics of particular types of the tax incentives used in tax practice and impact of tax incentives on the income tax used in Slovakia were analysed. All approval processes and terms of taking incentives were solved through the model casa study. Based on the analysis of primary and secondary sources and practical experiences, it was elaborated a SWOT analysis of the strengths and weaknesses of fiscal incentives in Slovakia.

Keywords: Tax incentives, Slovak Republic, income tax.

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1. Introduction

Easson and Zolt (2011) define in their study, tax incentives as at one level easy to identify. They are those special exclusions, exemptions or deductions that provide special credits, preferential tax rates or deferral of tax liability. Tax incentives can take the form of tax holidays for a limited duration, current deductibility for certain types of expenditures or reduced import tariffs or customs duties (Mankiw, Weinzierl & Yagan, 2009). But at another level, it can be difficult to distinguish between provisions that are deemed to be part of the general tax structure and those that provide special treatment (Hajduchova & Kupcak, 2004). As Harumova (2002) argue, this distinction will become more important as countries may be limited in their ability to adopt targeted tax incentives. For example, a country can provide a 10% corporate tax rate for income from manufacturing. As O' Sullivan and Sheffrin (2003) present, this low tax rate can be considered simply an attractive feature of the general tax structure as it applies to all taxpayers (domestic and foreign) or it can be seen as a special tax incentive (restricted to manufacturing) in the context of the entire tax system. Zee, Stotsky and Ley (2002) also define tax incentives in terms of their effect on reducing the effective tax burden for a specific project. Interest about tax incentives was started by the financial crisis (Bitzenis, Vlachos & Schneider, 2016). And what has changed in recent years? Tax incentives may now play a larger role in influencing investment decisions than in the past years (Babcak, 2010). So while tax advisors may have been correct in concluding that the past use of tax incentives has been largely ineffective, this may no longer be true. Several factors may explain why tax considerations may be more important in investment decisions mentioned by Easson (2001). As Lisy et al. (2011) stated the financial crisis has forced the government to introduce fiscal consolidation measures. One of the measures is tax incentives. Tax incentives are common, but they are far from homogeneous and could be various (Grun, 2000). Differences in tax incentives among 33 surveyed countries processed by experts in the final study 'Tax incentives for R & D' (2014).

2. Material and methods

The paper points to what options exist in the disbursement of aid provided by the state, what conditions must be satisfied before such an aid is approved and not least the theoretical knowledge translated into a real-world example and model examples, where the combination of incentives is shown. First of all, a short literature review was conducted and was summarised the results of the analysis of secondary sources dealing with the issue of tax incentives. Then, the method of synthesis was used, through which a comprehensive picture of the investigated issue was reflected. In the end was used a method of abstraction from the mentioned sources and the most serious facts were applied. This was the analysed process of approval of incentives of the Government of the Slovak Republic using the case study in Slovakian conditions. In identifying the particular conditions of drawing of investment aid to the company based on information which is not applied generally for entire Slovakia, but only for a particular company of our choice in the region of Slovak republic—Brezno.

Table 1. Factors in the provision of tax incentives in the Slovak Republic

Description	Value
Amount of investment (€)	2,500,000
– new plants (%)	50%
– new plants (€)	1,250,000
– equity investment uncovered (%)	50%
– equity investment uncovered (€)	1,250,000
Maximum amount of aid (%)	35%
Maximum amount of aid (€)	875,000
Increase of production capacity (%)	15%
Number of new jobs created	40
Contribution (€)	9,000

2.1. Calculation of investment aid

In the category of small and medium—pays condition, that the minimum investment amount must be 2,500,000€. For our calculation, it was used the maximum limit of the possible amount of money, while the funds were used as follows:

The maximum contribution that can be taken in our district is set at 35% of the total eligible costs and therefore:

The maximum total rebate = 0.35 × 2,500,000€

The maximum total rebate = 875,000€

This amount will be redistributed to the tax credits, subsidies for tangible and intangible assets and a contribution to job creation. Model described lower—relief on income tax. First, it is necessary to calculate the coefficient, from it the proportion of the tax base and at last the tax relief. All relations (1, 2 and 3) were calculated according to Harumova (2002).

$$\text{Coefficient} = (\text{eligible costs}) / (\text{equity} + \text{eligible costs}) \quad (1)$$

$$\text{Proportionof tax base} = \text{tax base} \times \text{coefficient} \quad (2)$$

$$\text{Tax relief} = \text{proportion of tax} \times (\text{tax rate}) / 100 \quad (3)$$

3. Results and discussion

Model example is assessed in the company which is operating in the category of small and medium enterprises. There is a condition that the minimum investment amount must be 2,500,000€. It takes into account the minimum amount for the calculation, while the funds were used as follows:

- 1.25 million euros for the purchase of a new production line that can produce the required amount of products. It takes into account the volume that is produced for foreign markets, also allowing for a provision for further expansion.
- The other half (1.25 million euros) is used to buy light prefabricated halls (which is necessary due to the increase in the production) and for the land on which are the halls situating.

To increase sales, and therefore, the related production, it is expected an increase over the current state of about **20%**. The company is committed to create 40 jobs, which is also a legal minimum for the aid. The company has to produce profits which stems from investments by 8% while maintaining the same market development. The maximum contribution in Slovak district is set at 35% of the total eligible costs and therefore, it is **875,000€**.

The amount is allocated to income tax relief, subsidies for tangible and intangible assets and a contribution to job creation.

Contribution to job creation:

The maximum contribution = 40 × 9,000 = 360,000€.

Analysed company has approved a contribution of 300,000€.

Subsidies for tangible and intangible assets:

By virtue of the investment aid, the company is entitled to a subsidy, which is used to partially cover these costs. Subsidy granted in the amount of 270,000€. The company remains amount of money 305,000€ (875,000−300,000 −270,000€).

Relief on income tax:

Coefficient = (2,500,000)/(3,750,000 + 2,500,000) = 0.4

The calculation of the proportional part of the tax base is indicated in the first year in which the tax base is 1,000,000€. Proportion of the tax basis is 400,000€ and the tax relief is 88,000€ (400,000 × 22)/100).

Table 2 reflects the calculation of the tax credit for each year with coefficient 0.4.

Table 2. Calculation of the tax credit for each year with coefficient 0.4

Item/Year	2017	2018	2019	2020	2021
Profit	1,000,000€	1,080,000€	1,166,400€	1,259,712€	1,360,489€
Proportion the tax rate	400,000€	432,000€	466,560€	503,885€	544,196€
Tax rate	22%	22%	22%	22%	22%
Total amount of tax	220,000€	237,600€	256,608€	277,137€	299,308€
Current tax	132,000€	142,560€	153,965€	166,282€	179,585€
Amount of tax relief	**88,000€**	**95,040€**	**102,643€**	**110,855€**	**119,723€**
Cumulative amount of tax relief	88,000€	183,040€	285,683€	396,538€	516,261€

The last line of the scheme represents cumulative amount of tax relief. The cumulative amount of tax relief is in our scheme because besides of respecting the maximum amount of the exemption in individual years, it is necessary to respect the limit of the total investment aid which in our case 305,000€. Internet page of the Institute of Economic and Social Studies reported that the Government through the Ministry of Economy has approved during the election period 2012–2016, investment aid in a total of **338,421,519€**. Another significant number is the number of tax reliefs in the years 2002–2012 which was 128. In these 10 years was created more than 45,000 jobs and the total value of tax reliefs was 14 billion euros. Slovakia is an interesting country for investment. In addition to the tax incentives mentioned above (which are one of the biggest driving forces of economic growth in Slovakia), also a stable political and economic environment, significant and strategic geographical position as it is situated in the middle of Europe, skilled workforce, constantly developing infrastructure, etc. According to the statistics for the period 2002–2012, there was the highest number of the total volume of incentives in the form of income tax relief (44.47%) and second in the form of subsidies for tangible and intangible assets (41.56%). The remaining 13.98% was divided among the remaining incentives. Based on recent data, we have managed to quantify the percentage distribution of aid in 2013–2015. The most provided aid in these years was the income tax relief for legal entities which represents a total volume of 77.18%, which means an amount of 162.4 million euros. Subsidies for tangible and intangible assets are on the second place representing only 13.58% which means in figures an amount of 28.6 million euros and the last were subsidies granted for newly created jobs which means in figures an amount of 19.4 million euros. This fact and the remaining forms of assistance can be seen in the following Figure 1:

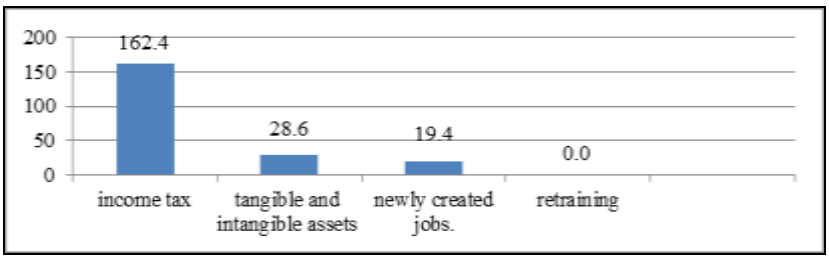

Figure 1. The forms of provided assistance in euros (years 2013–2015)

Table 3 presents strengths and weaknesses of fiscal incentives in Slovakia.

Table 3. Strengths and weaknesses of fiscal incentives in Slovakia

Strengths	Weaknesses
• Revenue effects • Equity • Encourage support through less attractive sectors • Equalisation of domestic and foreign investors in obtaining investment incentives • Spending on EU funds • Foreign investment • Wiping regional disparities • Creating jobs and thus reduced unemployment • Starting and acceleration of economic growth of the country • Modernisation and expansion of production • Support for less-attractive sectors • New foreign investors in terms of the inflow of funds into the state budget in the form of taxes (if they are not given tax holidays)	• Facilitating the establishment of social enterprises • Contribution to commuting • Support work in agriculture • Contribution to the salary • Economic efficiency • Inflation
Other strengths	**Other weaknesses**
• Program UNITAS—merging tax and customs administration, unifying the collection of taxes, customs duties and insurance contributions	• Budgets built on optimism • High unemployment • High indebtedness

Government aid for investment into infrastructure is crucial for the economic development. Infrastructure investments are often considered to be a stimulating factor for promoting local economic growth. Improvement of the infrastructure is crucial for economic development in Slovak municipalities and regions. Many local governments are making great efforts to carry out capital improvements in their regions. With the help of national and international EU funds financed projects in municipalities such as—water, sewerage, heat supply, refuse collection and public transport. Slovakia is a major beneficiary from the European Structural and Investment Funds and can receive up to 15.3 billion euros for the period 2014–2020. This is equivalent to 2.6% of GDP annually and 64.7% of the expected national public investment are in as supported by ESI.

4. Conclusion

The tax burden in Slovakia is low. Taxes and social contributions represent an important revenue source for Slovakia. With a tax-to-GDP ratio of 31% of GDP, Slovakia is among the countries with the lowest tax burden in the EU. In 2014, taxes represented approximately 80% of all revenues which is one of the lowest shares in the EU. The composition of tax revenue has been relatively stable over time relying heavily on social contributions, while receipts from taxes on income and wealth are comparatively low. Although taxes on production and imports (e.g., VAT) as a share of GDP are below the EU average, they are the second largest revenue source in Slovakia.

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