Financial Law Review

No. 28 (4)/2022

UNIVERSITY OF GDAŃSK • MASARYK UNIVERSITY • PAVOL JOZEF ŠAFÁRIK UNIVERSITY
http://www.ejournals.eu/FLR

FILIP BALÁŽI*, ELENA LAZORÍKOVÁ**

TRANSFER PRICING OF DOMESTIC CONTROLLED TRANSACTIONS IN THE CONDITIONS OF THE SLOVAK REPUBLIC

Abstract

The article focuses on the transfer pricing in the Slovak Republic. The main subject of this article is the analysis of the legal regulation of transfer pricing of controlled transactions between domestic dependents. The authors examine the very essence of the extension of the transfer pricing obligation and the related obligation to maintain transfer pricing documentation to domestic dependants, with a focus on the analysis of the effectiveness of the legislation under review. The authors are also providing suggestions for potential improvements to the legislation, with particular emphasis on reducing the administrative burden on taxpayers and tax administrators.

Key words: transfer pricing, transfer pricing documentation, controlled transactions, dependents

JEL Classification: K34, M41

* The author is full time PhD. student at the Faculty of Law, Pavol Jozef Šafárik University in Košice in the Slovak Republic. Also, he has several years of experience in the field of financial audit and accounting. In his research he focuses mainly on the issue of tax evasion and avoidance of tax obligations of tax subjects in the territory of the Slovak Republic, but also abroad.
Contact email: filip.balazi@student.upjs.sk.
** The author is full time PhD. student at the Faculty of Law, Pavol Jozef Šafárik University in Košice in the Slovak Republic. In her publications she focuses on the issue of tax evasion and avoidance of tax obligations of tax subjects in the territory of the Slovak Republic, but also abroad.
Contact email: elena.lazorikova@student.upjs.sk.

1. Introduction

The fight against tax evasion is a legitimate effort of the state to secure financial revenues for the state budget, but also to create a fair economic environment for all business entities operating on the given market. This fight has started to gain momentum in the last decade. The increased focus on combating tax fraud and evasion is due to a number of factors. In particular, the globalisation of the economy, the consolidation of public finances following the financial crisis, or the use of more sophisticated methods by those very taxpayers who are trying to unlawfully reduce their tax liability [Babčák 2022: 847]. The aforementioned ultimately leads to an increased rate of tax revenue losses, which is confirmed by increasingly published estimates.[1] In addition, tax evasion (and fraud) brings with it negative impacts on both social and economic life. High levels of tax evasion reduce the credibility of the state in the international environment. In addition, tax evasion distorts the market environment, reduces public budget revenues, harms the financial interests of the European Union and tempts honest operators to resort to illegal practices.

On the other hand, the impact of the fight against tax evasion on the business environment and the overall economic situation must also be considered. It is in the interest of every state to create legal, social and economic conditions that encourage economic or entrepreneurial activity. At the same time, the environment for entrepreneurs should be competitive, thereby attracting foreign entities to carry out their business plans and investments in the country.

Based on the above reasons, the legislator should also take into account the effectiveness of the instruments introduced in the fight against tax evasion. The transfer pricing institute is one of the effective tools in the fight against tax evasion. However, it must be added that it brings with it a high level of administrative burden, since in the conditions of the Slovak Republic, taxpayers are required to keep transfer pricing documentation. However, this obligation is also imposed on taxpayers who have carried out a controlled transaction with a domestic dependent person during the taxable period, even though the transferred capital remains in the domestic territory and will be taxed there. On these grounds, questions concerning the effectiveness and efficiency of the current legislation appear legitimate.

[1] For example, a the study published on TAXOBSERVATORY.EU shows that the value of global assets held in offshore countries is estimated at EUR 7.5 trillion or 10.5% of global GDP, with EUR 1.5 trillion coming from the EU. The study also estimates the average annual losses due to international tax evasion for the EU between 2004 and 2016 at €46 billion or 0.46% of GDP.

Based on the above, the following hypotheses will be tested in this paper:

- The transfer pricing obligation, which also applies to controlled transactions between domestic dependants, limits the possibilities of tax evasion.
- The purpose of the obligation to keep transfer documentation of controlled transactions between domestic dependants can also be achieved in another, administratively simpler way.

If the second hypothesis is confirmed, the authors will try to formulate their own proposals to improve the legal regulation of the obligation to keep transfer documentation of domestic controlled transactions with an emphasis on increasing efficiency and reducing administrative complexity.

In order to test the above hypotheses, several methods of scientific investigation will be used in this paper. These are mainly the methods of literature search, analysis, comparison, induction and synthesis. The individual methods will be used separately or in combination with each other.

2. Basic characteristics and purpose of transfer pricing

Transfer pricing is an increasingly discussed topic, not only in the world, but also in the Slovak Republic. Until 2015, by Act No. 595/2003 Coll. on Income Tax, as amended (hereinafter referred to as the "Income Tax Act"), transfer pricing in the Slovak Republic applied only to foreign transactions. Since 2015, the issue affects all business entities that carry out business transactions also on the territory of the Slovak Republic with economically or personally related persons, with persons in a kinship and family relationship, with close persons, however, insofar as it concerns business relations with dependants. This means that profits arising as a result of differences in the conditions of the business and financial relationships between dependants and independents, as well as profits that have not been made as a result of these differences, must be included in the profits of the enterprise and taxed. [Bánociová 2017: 22].

Transfer pricing can be considered a separate economic discipline. As a conceptual category, it can be encountered at various levels of tax law research. It deals with the way in which the terms of transactions between related parties are determined, by assessing the consistency of the terms in transactions between related parties with those in comparable transactions between independent persons [Kočiš 2015: 29-30]. Some authors understand transfer pricing as the valuation of transactions between related parties involving goods,

services, intangible assets, loans or leases. In this sense, transfer pricing is determined by the overall distribution of profits within a certain group of related persons. This price affects the taxable income of the entities concerned and can also be regarded as the effective tax rate within a consolidated group. These intra-group prices are subsequently referred to as transfer prices [Levey, Wrappe 2010: 1].

In a broader sense, transfer pricing can be understood to include not only the valuation of goods, services, leases, loans, but also the valuation of assets, technological processes, financial services, management skills and shared support services when they are the subject of transfers between associated persons or foreign related persons [Bronson, Johnson, Sullivan 2012: 3].

For the purposes of this article, transfer pricing will be understood as the aggregate of activities carried out between related parties, the primary purpose of which is to establish prices in their mutual and qualifying transfers. The objects of these transactions may be goods, services, tangible or intangible assets, loans and leases. The prices to be applied in these types of transactions must be determined according to predetermined rules. Transfer pricing rules govern the setting of prices for intra-group transactions. Their main objective is to ensure that intra-group transactions qualify as arm's length transactions for tax purposes. The basic determinant of transfer pricing will be the determination of the dependency criteria of the entities concerned as well as the specificity of the individual transfers. The activities which make up the content of transfer pricing are involved in the creation of a special group of socio-economic relations which are regulated by the norms of tax law and in this sense can be considered as tax-law relations [Kočiš 2015: 31].

The OECD Transfer Pricing Directive for Multinational Enterprises and Tax Administrations defines transfer pricing as *"the price at which a related party transfers tangible or intangible assets or services in a controlled transaction"*[2]. In the case of a transaction between arm's length parties, their commercial and financial terms, such as the prices of goods or services, are normally determined by market forces. Otherwise, where related parties engage in controlled transactions between themselves, their commercial and financial terms may not

[2] By controlled transaction we mean:
- a legal relationship or other similar relationship,
- between two or more related parties,
- where at least one of the persons is a taxpayer with income under Section 6 (income from a trade or self-employment) or a legal person who derives taxable income (revenue) from an activity or from property handling.
However, it is not considered a controlled transaction:
- a lease from which income is derived pursuant to Section 6(3) of the Income Tax Act,
- where the immovable property is not classified as commercial property and the lessee is a natural person who uses the immovable property for personal purposes.

be influenced by external market prices [OECD Guideline 2017]. The OECD Directive referred to above is one of the internationally recognized documents that member states implement in their laws. In the area of transfer pricing, the Slovak Republic is one of the EU Member States that respects the rules resulting from the OECD Directive on Transfer Pricing for Multinational Enterprises and Tax Administration and the Resolution of the Council and Representatives of the Governments of the Member States of the European Union.

A transaction only becomes a controlled transaction when it takes place between two related parties and at least one of the two parties must be an entrepreneur or engaged in other gainful activity.

A dependent person for transfer pricing purposes is:

- A close person,
- an economically, personally or otherwise related person or entity,
- a person or entity that is part of a consolidated whole for the purposes of consolidation [Solikova 2022].

Considering the approach of countries to the legal treatment of intra-group transfers, two basic regimes (approaches) of national legislation can be distinguished on a global scale. These approaches are significant in that they offer a method for apportioning intra-group profits between national tax jurisdictions. The first approach concerns the regulation of transfer pricing by a comprehensive set of legal rules based on the application of the arm's length principle.[3] It is the OECD that has played a dominant role in promoting the application of this approach in the sense that it has not only fundamentally influenced the legal arrangements of its member states, but has also become a model for transfer pricing regulation globally [OECD 2017: para. 1.6]. The second approach to the valuation of intra-group transfers of foreign dependants concerns the allocation of group profits between countries on the basis of the application of a set formula. However, this approach does not look at the prices of intra-group transfers, but the allocation of profits is done through a formula with predefined variables [Kočiš 2017: 34].

The main objective of transfer pricing is to eliminate the manipulation of the amount of the tax base. In the absence of transfer pricing rules, some entrepreneurs would set the prices

[3] The essence of the arm's length principle is the requirement that the terms and conditions of the financial and commercial relationship between related parties should not differ from those that would be agreed between independent entities. This requirement can be derived from the fact that the objective of a group of dependants is to maximise profit from the point of view of the group as a whole [Kutišová-Luknárová 2009: 17].

of goods and services in such a way as to unduly reduce or manipulate the amount of their tax liability.

3. Transfer Pricing Legislation in the Slovak Republic

Each OECD member country is free to choose how to incorporate transfer pricing rules into its national tax legislation. Therefore, some countries have adopted the governing principles and principles in their national tax legislation, while others merely refer to the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administration in their national tax legislation. In the Slovak tax legislation, the transfer pricing issue is implemented in a framework way in the relevant national tax legislation [Kutišová-Luknárová: 2011].

The transfer pricing issue itself is regulated in the Income Tax Act, Act No. 563/2009 Coll. on Tax Administration (Tax Order) and on Amendments and Additions to Certain Acts, as amended (hereinafter referred to as the "Tax Administration Act") and in the individual treaties on avoidance of double taxation in the field of income and property taxes to which the Slovak Republic is bound.

When interpreting individual double taxation treaties that have been concluded according to the OECD Model Double Tax Treaty on Income and on Property (hereinafter referred to as the "OECD Model Treaty"), it is necessary to rely on the Commentary to the OECD Model Treaty. As the OECD Model Treaty Commentary to Article 9 of the OECD Model Treaty shows that the transfer pricing issue requires further clarification and coordinated action by the Contracting States, the OECD Committee on Tax Matters issued a Transfer Pricing Guideline for Multinational Enterprises and Tax Administrations in 1995. The Directive is considered to be a generally accepted guide on how to apply transfer pricing rules in practice. In doing so, it also encourages OECD member countries to coordinate their procedural practices. Since its original publication in 1995, the OECD Transfer Pricing Directive for Multinational Enterprises and Tax Administrations has been amended and updated several times. The Directive, as well as all its updates, belongs to the group of documents to be taken into account in the interpretation of international treaties (Article 31(3) of the Vienna Convention on the Law of Treaties). In Slovak Republic, the Vienna Convention on the Law of Treaties was promulgated by Decree No 15/1988 Coll. The Slovak Republic acceded to it in 1994 on the basis of succession (Notification of the Ministry of Foreign Affairs of the Slovak Republic No 53/1994 Coll.).

It is also necessary to take into account the documents adopted within the European Union, whether they have been implemented into the national law of the Slovak Republic or are

merely a political commitment of a Member State of the European Union resulting from its membership. These are in particular documents such as the Code of Conduct in Transfer Pricing Documentation for Associated Enterprises in the EU (Official Journal of the European Union 2006/C 176/01), Convention 90/436/EEC on the elimination of double taxation in connection with the adjustment of profits of associated enterprises (Official Journal L 225, 20/08/1990; Official Journal C 202, 16/07/99), Revised Code of Conduct for the effective implementation of the Convention on the elimination of double taxation in connection with the adjustment of profits of associated enterprises (Official Journal of the European Union 2009/C 322/01) [Kutišová-Luknárová 2011].

The obligations to adjust the tax base and to keep transfer documentation are regulated in Sections 17(5) and 18 of the Income Tax Act. Historically, the adjustment of the tax base of dependants was already regulated in Act No 286/1992 Coll., on Income Taxes.[4] However, it has not been part of the Act since its entry into force. The obligation to adjust the basis, or the transfer pricing institute, was introduced into the Slovak legal order only by an amendment to the aforementioned Act on Income Taxes, which was adopted on 12 May 1998.[5] By this amendment, the legislator has created a methodological framework for adjusting the tax base for dependants on the basis of prices used in the sale of comparable goods, securities or the provision of services, including the transfer of rights in ordinary course of business. The reason for the introduction of the tax base adjustment methodology into Slovak tax law was an effort to move closer to the most advanced economies and to increase the chances of the Slovak Republic joining the OECD and the European Union. [Explanatory report to Act No 173/1998 Coll.: point 36].

The legal but also the economic category itself consists of valuation methods. Transfer pricing methods are regulated in Section 18 of the Income Tax Act and specified in more detail in the Methodological Instruction on the Application of Transfer Pricing Methods issued by the Ministry of Finance of the Slovak Republic. Transfer pricing methods can be subsumed under certain analytical tools for determining and assessing the market value of transactions between related parties. Business entities are obliged to compile transfer pricing documentation using these methods. Financial authorities use these methods to test the market value of related party transactions in order to determine the actual profits, i.e.

[4] This is the legislation which regulated the taxation of natural and legal persons in the period from 1 January 1993 to 31 December 1999. This legislation was subsequently replaced by Act No 366/1999 Coll. on income taxes, which was in force from 1 January 2000 to 31 December 2003.
[5] The amendment in question was the subject of Act No. 173/1998 Coll. amending Act No. 286/1992 Coll. on Income Taxes, as amended, and Act No. 563/1991 Coll. on Accounting, as amended by Act No. 272/1996 Coll. of the National Council of the Slovak Republic.

those that would have been obtained in the absence of a relationship between the two parties. There are no special rules applicable to each case when using each transfer pricing method. Therefore, the tax administrator should consider possible adjustments when applying the relevant method in a particular situation. The application of transfer pricing methods adjusts the tax base of dependants by increasing the difference by which the prices in the reciprocal business relationships between foreign dependants differ from the prices used between independent persons in comparable business relationships. One or a combination of transfer pricing methods shall be used to determine that difference.[6] A necessary condition is that the use of the method must be consistent with the arm's length principle as defined in section 18(1) of the Income Tax Act[7] [Bánociová, Martinková 2017: 22].

4. Practical Analysis of Transfer Pricing of Controlled Transactions between Domestic Dependents

As mentioned in the previous section of this article, the transfer pricing is primarily concerned with controlled transactions between dependants with tax residence in different countries. Thus, the main objective of the transfer pricing is to prevent the spill-over of taxable profits between jurisdictions with different corporate tax rates (or equivalents of corporate tax). The efforts of individual governments to restrict cross-border flows of accounting profits must be regarded as legitimate. By the very nature of the matter, it follows that where economic activity is carried out, the results of which are subject to taxation, there are externalities of various kinds[8]. It is by taxing activities that generate externalities that

[6] The legislation in the Slovak Republic regulates a total of six methods of transfer pricing, namely:
1. transfer pricing method based on price comparison,
2. independent market price method,
3. the subsequent sale method,
4. the incremental cost method,
5. the profit sharing method,
6. the net trading margin method.

[7] The arm's length principle is defined in Section 18(1) of the Income Tax Act. This principle is based on a comparison of the terms and conditions agreed in a business or financial relationship between dependants with the terms and conditions that would be agreed between independent persons in a comparable business or financial relationship in comparable circumstances. The comparison shall take into account, in particular, the activities carried on by the comparators, namely their production, assembly, research and development, purchase and sale, etc., the extent of their business risks, the characteristics of the asset or service being compared, the contractual terms agreed, the economic environment of the market as well as their business strategy. Terms and conditions are comparable if there is no material difference between them or if the effect of those differences can be eliminated.

[8] For example, industrial production, which results in air pollution and reduced environmental quality. When accounting profits are shifted across borders without being taxed, a situation arises where the

their negative impact can be indirectly limited[9]. Consequently, the transfer pricing obligation itself limits the geographical separation of externalities from the activities that caused them.

However, what if the government introduces an obligation to transfer pricing even transactions without an international element, i.e. transactions between entities with tax residence within a single tax jurisdiction? In such a case, questions begin to arise as to the purpose and objectives of such a measure. The ratio of the results achieved to the potential administrative burden on taxpayers (especially in the small business segment) may also be questionable. The aim of this part of the article will thus be to elaborate on the issue of transfer pricing of controlled transactions without an international element and to analyse the impact and effectiveness of the current legislation. Subsequently, solutions will be developed and proposed in order to improve the legislation, especially with a view to increasing efficiency and reducing the administrative burden.

4.1. Legal and economic aspects of the transfer pricing obligation between domestic dependants

As mentioned in the previous part of this paper, the obligations to adjust the tax base and to maintain transfer documentation are regulated in Sections 17(5) and 18 of the Income Tax Act. Since the introduction of the tax base adjustment for dependants, this obligation has only been applicable to foreign dependants.[10] This means that domestic dependants were not required to take into account transfer pricing of their mutual financial relationships and operations. This situation lasted until 1 January 2015, when the amendment to the

cost of the externality is borne by the state where the economic activity took place, but the income tax is the revenue of another state.

[9] The basic theory of tax law already tells us about some of the functions of taxation, which are: fiscal, allocative, control and regulatory [Babčák 2022: 28]. It is on the basis of the regulatory function that the government has the possibility to influence some activities of market actors. By default, the tax burden on economic activities increases the price of their outputs, which leads to a reduction in interest in their consumption. At the same time, through the allocative function, the government can use the taxes collected to finance the costs of externalities.

[10] A foreign dependent is a legal term of Slovak tax law, the definition of which has evolved over time. Section 23a(1) of Act No. 286/1992 Coll. on Income Taxes, as amended, specifies dependants as "economically or personally interrelated domestic natural persons or legal persons with foreign natural persons or legal persons." Following the replacement of this Act by Act No 366/1999 Coll., the lexical definition of a foreign dependent has also been changed. Act No 366/1999 Coll. also introduced the definition of a domestic dependent, but the obligation to adjust the tax base applies only to foreign persons. The new regulation defined a foreign dependent as "a mutually related domestic natural person or a domestic legal person with a foreign natural person or a foreign legal person", where the relationship could be of a property or personal nature. A property link in the newer regime is defined more broadly than an economic link in the older regime (in addition to a certain share in the share capital or voting rights, it also includes a so-called business relationship between close persons).

Income Tax Act of 30 October 2014 entered into force[11]. From that moment on, the transfer pricing obligation also applied to transactions between dependants without an international element.

However, the reasons on the basis of which the legislator decided to extend this obligation in the above-mentioned manner are questionable. In the explanatory report to Act No. 333/2014 Coll., which introduced this amendment to the Income Tax Act, the legislator did not provide any reasons, apart from a brief description of the extension of the obligation to domestic dependants. The extension of the transfer pricing obligation is not even part of the so-called Action Plan to Combat Tax Fraud for the years 2012 to 2016, which was authored by the Ministry of Finance of the Slovak Republic and aimed at developing thirty proposals to prevent tax fraud and tax evasion. The reasons for the extension thus remain unclear.

At first glance, it might seem that the introduction of a transfer pricing obligation also for transactions between domestic dependants is unnecessary. The basis for this presumption is that if taxable income of one dependent is transferred to another dependent (even by means of a transaction without an economic base), the transferred income, although not taxed by the first person, will subsequently become taxable income of the second dependent, who will tax it[12]. However, it should be noted here that until 2012, Slovakia levied a flat tax based on a 19% rate. This rate applied equally to natural persons and legal entities. However, in 2013 a different rate for natural and legal persons started to apply[13]. In addition, Slovakia currently applies a progressive tax rate also for legal entities. However, this was only introduced into the legislation in 2020[14]. Different tax rates applied to different taxpayers create room and incentive for shifting taxable income from taxpayers with a higher tax rate to taxpayers with a lower tax rate. In practice, this could lead to different situations.

[11] In this case, the Income Tax Act was amended by the adoption of Act No. 333/2014 Coll., amending Act No. 595/2003 Coll. on Income Tax, as amended, and amending and supplementing certain acts. With this amendment, the legislator deleted the word "foreign" from Sections 17(5) and 18 of the Income Tax Act, thus extending the transfer pricing obligation to all dependants, including domestic ones.

[12] Thus, the basic equation is that the costs of the first dependent are equal to the income of the second dependent. Since the income does not cross the border of the Slovak Republic but remains in the Slovak Republic, there is no tax evasion from the point of view of the state.

[13] A progressive tax has been introduced for individuals. The tax rate on the tax base that did not exceed 176.8 times the applicable minimum subsistence level was 19%. The tax rate on the tax base exceeding 176.8 times the applicable minimum subsistence level was 25%. For legal entities, a universal rate of 23% was introduced. This rate was applied regardless of the amount of the tax base. [Act No. 395/2012 Coll.: § 71].

[14] At the time of publishing this article, the Slovak Republic applies a progressive tax rate also for legal entities. It is 15% for a taxpayer who has earned taxable income not exceeding EUR 49,790 for the preceding 12 months. For other legal persons a rate of 21% applies. [Act No. 595/2003 Coll.: § 15] The progressive tax rate was introduced for corporations only as of 1 January 2020.

In general, the progressive rate for individuals provides an incentive to shift capital between higher-rate and lower-rate individuals. The progressive rate has the same effect for legal persons. In addition to the above cases, the difference between the rates applied to natural persons and those applied to legal persons must also be taken into account. The fact that a lower rate was applied to natural persons created an incentive for legal persons to transfer capital to natural persons. All of the above capital transfers can take place on the basis of artificial transactions with no real economic basis. It is these facts that could appear as a potential justification for extending the transfer pricing obligation to transactions between domestic dependants. However, it should be noted here that at the time of the introduction of this extension, a flat tax applied to legal persons, which means that the shifting of capital from one legal person to another was almost meaningless at that time[15]. Regarding the transfer of capital from legal entities to individuals, it should be noted that the increased tax rate for individuals was higher than the tax rate for legal entities in 2015. Thus, the transfer of capital from a legal person to an individual only made sense until the individual's taxable income amounted to 176.8 times the applicable minimum subsistence level[16]. Another limitation is that the number of natural persons is limited and they cannot be generated like legal entities.

Based on the above reasons, it is possible to confirm the first of the hypotheses that were set out in the introduction. The transfer pricing obligation for domestic controlled transactions does have the potential to reduce tax evasion, but only to a limited extent.

4.2. Transfer documentation of domestic controlled transactions

The extension of the transfer pricing obligation to transactions between domestic dependants also brought with it an additional obligation for taxpayers who carried out such transactions during the tax year. This is the obligation to keep so-called transfer documentation[17]. It is this obligation that has brought with it a high degree of uncertainty to the small business segment. By default, it is a relatively complicated administrative obligation

[15] The transfer of capital between dependent legal entities for the purpose of reducing tax liability or increasing tax losses only started to make sense in 2020, when a progressive tax rate was introduced for legal entities as well. However, even this transfer has a limit. It is the threshold of the turnover achieved in the last 12 months, when the tax rate increases from 15% to 21% (currently EUR 49,790).
[16] At the time the transfer pricing obligation was extended to transactions between domestic dependants, i.e. in 2015, 176.8 times the applicable minimum subsistence level amounted to approximately EUR 35,000.
[17] This obligation arises from the provisions of Section 18(1) of the Income Tax Act, which provides as follows: "(...) The taxpayer is required to maintain documentation on the transactions under review and the method used to determine the method of determining the prices and terms that would be used between arm's length persons in comparable transactions".

which can be disproportionately costly for smaller businesses[18]. This raises the question of whether the overall societal costs are commensurate with the benefits that this measure has brought. It also raises the question of whether the intended objective could be achieved by other, ideally more effective, instruments.

The Ministry of Finance of the Slovak Republic is responsible for the specification of the form and content of the documentation, to which the legislator transferred this authority in the last sentence of Section 18(1) of the Income Tax Act. Since 2015, the Ministry of Finance of the Slovak Republic has issued a total of three guidelines which set out the different types of transfer documentation, their content and the conditions under which they are to be maintained by different categories of taxpayers. The main purpose of transfer documentation is to document the process of valuation of mutual business relations between dependants. Thus, transfer documentation should be a set of information, data and facts that demonstrate and explain the taxpayer's pricing method in controlled transactions. [Guideline of the Ministry of Finance of the Slovak Republic No. MF/011491/2015-724: Art. 2] The Guideline is the first of the three above-mentioned guidelines and applies to the tax period beginning no earlier than 1 January 2015. The Ministry of Finance of the Slovak Republic distinguishes three types of transfer documentation in this Guideline, which are basic, complete and abbreviated. The application of the obligation to keep one of the types of transfer documentation depends on various factors. In principle, however, the abbreviated documentation is required to be maintained by taxpayers who carry out controlled transactions with domestic dependants. All other taxpayers who carried out controlled transactions in a given tax year are required to keep basic and complete documentation[19]. The obligation to keep abbreviated transfer documentation will in practice apply mainly to smaller entrepreneurs, operating mainly on the Slovak market, who carry out various types of transactions with their family members or with companies in which they or their family members have an ownership interest.

The main difference between the different types of transfer documentation lies in their content. The lowest administrative requirements are imposed on the abbreviated

[18] For comparison, the Czech Republic applies the transfer pricing obligation also to domestic controlled transactions, but the Czech legislation does not foresee the obligation to keep transfer documentation at all. [Brichta et al. 2020: 100].

[19] These are mainly taxpayers who have carried out controlled transactions with foreign dependants in the tax year, requested the tax administrator to issue a decision on the approval of the valuation method, claimed tax relief, deducted a tax loss of EUR 300,000 (or EUR 400,000 for the last two tax years) or requested a change of the tax base in relation to foreign controlled transactions. See more details in Article 2 of the Guideline of the Ministry of Finance of the Slovak Republic No MF/011491/2015-724.

documentation, which must contain, in particular, the identification and legal form of the individual members of the group, a description of the organisational and ownership structure of the group, a list of controlled transactions, a description of the individual controlled transactions of the taxpayer, which includes the identification of the parties to the controlled transaction, a monetary expression of the value of the transaction and other information on the controlled transaction (commercial terms and other facts affecting the controlled transactions). The main difference in content between the abbreviated documentation, on the one hand, and the basic and full documentation, on the other hand, is that for the latter, the taxpayer is required (among other obligations) to describe the taxpayer's transfer pricing system, which includes information relating to the selection, application of transfer pricing methods and pricing of the controlled transactions.

In practice, taxpayers who have carried out controlled transactions with domestic dependants during the tax period are obliged to keep transfer documentation in a short form. However, they are not obliged to define the methods on the basis of which the individual transactions were valued in the context of keeping abbreviated documentation. Nor are they required to document the pricing process itself. At this point, the question arises as to what is the point of keeping transfer documentation without documenting the methods and procedures of the pricing itself, when that should be its main purpose. The absence of the purpose of keeping abbreviated documentation has been reinforced by the issuance of the Guideline of the Ministry of Finance of the Slovak Republic No MF/019153/2018-724. In Article 6 of the quoted Guideline, the Ministry of Finance of the Slovak Republic introduces a sheet to be used as a form for abbreviated documentation. The contents of this form can be considered absolutely minimalistic. Basically, the taxpayer is obliged to indicate the name of the dependent with whom he has carried out the controlled transaction and then to break down the income and expenses in the individual boxes on the basis of their commercial substance, i.e. whether they concern the purchase or sale of goods or services, or the receipt or granting of a loan, etc. This is information that can be read off the books of double-entry bookkeeping as standard, namely the general ledger and the accounting journal.

It follows from the above that the second of the hypotheses set out in the introduction must be confirmed. Although dependants carrying out domestic controlled transactions are subject to the obligation to keep abbreviated documentation, which is the simplest in terms of content, the information contained therein can also be deduced from the accounting books by default. This suggests that the purpose of the transfer pricing obligation for domestic controlled transactions may be achieved in other ways.

4.3. Proposed changes in the legal regulation of transfer documentation with overlap into double-entry accounting procedures

In view of the above, it is questionable for what purpose it is necessary for the legislator to burden small entrepreneurs who carry out controlled transactions without an international element with the obligation to keep transfer documentation. A simpler solution seems to be to modify the accounting procedures in the double-entry bookkeeping system in such a way that, when accounting for transactions, entities create separate analytical accounts of receivables, payables, income and expenses for each dependent person with whom they carry out controlled transactions. All commercial companies having their registered office in the Slovak Republic are obliged to account in the double-entry book-keeping system[20]. For this reason, this paper will propose changes in the legal regulation of transfer documentation with an overlap into the accounting procedures only within the double-entry system of accounting.

The legal regulation of the creation of analytical accounts is contained in the Measure of the Ministry of Finance of the Slovak Republic No. 23054/2002-92, which establishes details on accounting procedures and the framework chart of accounts for entrepreneurs accounting in the double-entry bookkeeping system. The analytical records are normally established by the accounting units primarily according to their needs, but Article 4(1) of the measure referred to in the previous sentence stipulates that the analytical records must take into account, among other things, the breakdown of the analytical accounts according to individual debtors or homogeneous groups of debtors, the breakdown according to creditors or homogeneous groups of creditors, and the breakdown according to the requirements for the calculation of the tax base. It follows from the above that the current legislation on analytical records already contains a basic framework that can be used for the documentation of controlled transactions between domestic dependants, so as to maintain the content requirements of the current short form of transfer documentation.

Analytical accounts[21] shall be created to complement synthetic accounts and it shall be obvious from which synthetic account they have been derived. Thus, for the purpose of keeping abbreviated transfer documentation, taxpayers could create analytical accounts for

[20] In the Slovak Republic, all entities, except natural persons, various non-profit organisations, churches and religious societies, are obliged to account in the double-entry bookkeeping system [Act No. 431/2002 Coll., on Accounting, as amended: § 9]. In principle, all legal entities engaged in business shall keep double-entry accounts. In practice, it is not uncommon for natural persons (entrepreneurs) to keep double-entry accounts.

[21] The essence of analytical accounts is to detail the accounting entry in a synthetic account.

the accounts in the relevant accounting classes[22]. For example, for account 311 - Customers, an analytical account 311 001 would be created with a name that would clearly identify that it is an analytical account created for the settlement of transactions with a dependent (e.g. Dependent – XY). Similar treatment would be applied to other settlement accounts such as 321 - Suppliers, 351 - Receivables from related entities and accounting, 361 - Payables to related and participating entities, etc. Receivables and payables recorded in these accounts are also recorded in the corresponding accounts. Typically these accounts are 6xx (revenue), 5xx (expenses), 1xx (inventories), on the basis of which it is possible to identify more precisely the economic substance of the transaction, i.e. whether it is, for example, a purchase of materials, a lease or some other service. The sum of the movements in the individual analytical accounts would thus constitute the total value of the controlled transactions with the individual dependants. The economic nature could be ascertained from the nature of the counterpart account against which the receivables or payables are charged.

This solution is simpler for taxpayers because it is already common in practice for accounting units to create analytical accounts for individual suppliers and customers, or for intra-group or extra-group transactions. In addition, such an arrangement could also simplify the work of the tax authorities. During a tax audit, the taxable entity is obliged to provide the tax authorities with documents proving economic transactions and accounting cases. [Kubincová 2015: 253]. It is a common practice that during a tax audit, the tax administrator first of all requests the general ledger and the accounting journal for the audited period from the taxpayer [Burák 2016: 82]. If the proposed regulation is introduced, the tax administrator could draw the above-mentioned information on the controlled transactions with domestic dependents directly from the received ledgers. Furthermore, by drawing the information directly from the books of account, the tax administrator would not have to subsequently perform a reconciliation of the amounts shown in the transfer documentation to the amounts that are directly posted in the accounting journal.

5. Conclusion

Since transfer pricing limits the possibility of transferring capital between related entities based on artificial transactions, it is an effective tool in the fight against tax evasion. However, the implications that it entails may be problematic. These include, in particular, the

[22] Accounting classes 3 - Accounting relationships, 4 - Capital accounts and non-current liabilities, 5 - Costs and 6 - Revenue are taken into account. For further information on the individual accounting classes, see e.g. [Cenigová 2020].

high level of administrative burden and the associated costs. The legislator should therefore take a sensitive approach to setting specific rules so as not to unnecessarily undermine the competitiveness of the business environment.

The main objective of this article was to present and analyse the transfer pricing issues in the Slovak Republic with a closer focus on controlled transactions between dependants. The aim of the paper was to verify the hypotheses set out in the introduction. The first hypothesis, "the transfer pricing obligation applicable also to controlled transactions between domestic dependents limits the possibilities of tax evasion" was confirmed in the second part of this article. The transfer pricing obligation for domestic controlled transactions has the potential to limit the opportunities for tax evasion, primarily because of the progressive income tax rate and the different income tax rates for individuals and corporations. The inequality of tax rates encourages a shift from taxpayers who are subject to a higher rate to taxpayers who are subject to a lower rate. The transfer pricing obligation thus prevents the creation of artificial transactions between dependants, the purpose of which would be merely to transfer capital from one dependent to another for the sole purpose of applying a lower tax rate.

The second hypothesis, "the purpose of the obligation to maintain transfer documentation of controlled transactions between domestic persons can be achieved in other, administratively simpler ways" was also confirmed. The analysis of the current transfer documentation legislation shows that the content requirements for abbreviated transfer documentation can be met in a different and simpler way. The information required by the current legislation can also be extracted from the books of the double-entry bookkeeping system. With the consistent use of analytical recording in the synthetic clearing accounts, it is possible to record controlled transactions in such a way that the content requirements of the abbreviated transfer documentation are fulfilled. The proposed solution would reduce the administrative burden for taxpayers, as they would not have to keep separate transfer documentation, but also for the tax administrator, as he would not have to reconcile the abridged transfer documentation to the accounting books.

References

Babčák, V.: Dane a daňové právo na Slovensku [Taxes and tax law in Slovakia], Bratislava: EPOS, 2022.

Bánociová, A., Martinková, S.: Vplyv transferového oceňovania v činnosti podnikov [The impact of transfer pricing in the activities of enterprises] (in:) Koreňová, D. (ed.), Aktuálne otázky trvalo udržateľného rozvoja miest a obcí [Current issues in sustainable urban and municipal development], Košice: UPJŠ v Košiciach, 2017.

Bronson, M., Johnson, M., Sullivan K.: Overview/Best Practises. In Guide to International Transfer Pricing – Law, Tax planning and Compliance Strategies, Alphen aan den Rijn: Wolters Kluwer, 2012.

Brychta, K., Ištok, M., Sulik-Górecka A., Poreisz, V.: Transfer Pricing in V4 Countries, Brno: VUTIUM, 2020.
DOI: 10.13164/9788021458734

Burák, E.: Daňová kontrola [Tax control]. Ružomberok: TESFO, 2016.

Cenigová, A.: Podvojné účtovníctvo podnikateľov 2020 [Double-entry bookkeeping of entrepreneurs 2020], Bratislava: Ceniga, 2020.

Kočiš, M.: Úvod do práva transferového oceňovania [Introduction to transfer pricing law], Bratislava: Wolters Kluwer s.r.o., 2015.

Kubincová, S.: Daňový poriadok: komentár [Tax Code: commentary], Bratislava: C.H. Beck, 2015.

Kutišová-Luknárová, D.: Transferové oceňovanie I. – legisltíva, princípy, metódy a dokumentácia v príkladoch [Transfer pricing I. Legislation, principles, methods and documentation in examples]. Bratislava: Verlag Dashofer, 2009.

Levey, M., Wrappe, S. C.: Transfer Pricing: Rules, Compliance and Controversery, 3rd edition, Chicago: CCH Wolters Kluwer, 2010.

OECD. Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations. 2017. Ods. 1.6.

Legal Acts:

Act no. 173/1998 Coll. which amends Act no. 286/1992 Coll. on income taxes, as amended, and Act No. 563/1991 Coll. on accounting as amended by Act of the National Council of the Slovak Republic no. 272/1996 Coll.

Act No. 286/1992 Coll. on Income Taxes as amended

Act No. 333/2014 Coll. which amends Act no. 595/2003 Coll. on income tax as amended and which amends some laws

Act No. 366/1999 Coll. on Income Taxes as amended

Act No. 395/2012 Coll. which amends Act no. 595/2003 Coll. on income tax as amended and amending Act no. 580/2004 Coll. on health insurance and on amendments to Act no. 95/2002 Coll. on the insurance industry and on the amendment of certain laws, as amended

Act No. 431/2002 Coll. on accounting as amended

Act No. 595/2003 Coll. on Income Tax as amended

Guideline of the Ministry of Finance of the Slovak Republic no. MF/011491/2015-724

Guideline of the Ministry of Finance of the Slovak Republic no. MF/019153/2018-724

Measure of the Ministry of Finance of the Slovak Republic dated December 16, 2002 no. 23054/2002-92, which establishes the details of accounting procedures and the general accounting framework for entrepreneurs accounting in the double-entry bookkeeping system, as amended

Other official documents:

Explanatory report to Act no. 173/1998 Coll. which amends Act no. 286/1992 Coll. on income taxes, as amended, and Act No. 563/1991 Coll. on accounting as amended by Act of the National Council of the Slovak Republic no. 272/1996 Coll.

Explanatory report to Act No. 333/2014 Coll. which amends Act no. 595/2003 Coll. on income tax as amended and which amends some laws.

Internet resources:

Kutišová-Luknárová, D. Transferové oceňovanie v teórii a praxi – 3 časť [Transfer Pricing in Theory and Practice - Part 3], 2011.
Available at: https://www.danovecentrum.sk/odborny-clanok/Transferove-ocenovanie-v-teorii-a-praxi-3-cast.htm, accessed: 11th October, 2022.

OECD 2017.OECD Smernica k transferovému oceňovaniu pre nadnárodné skupiny a správu daní [Transfer Pricing Directive for Multinational Groups and Tax Administrations], 10.07.2017.
Available at: http://www.keepeek.com/Digital-Asset-Management/oecd/taxation/oecd-transfer-pricing-guidelines-for-multinational-enterprises-and-tax-administrations-2017_tpg-2017-en#.WW2314TyjIW#page1, accessed: 13th October, 2022.

Solíková, V.: Kontrolované transakcie podľa usmernenia ministerstva financií [Controlled transactions according to Treasury guidance], 13.01.2022.
Available at: https://www.podnikajte.sk/dan-z-prijmov/kontrolovane-transakcie-podla-usmernenia-ministerstva-financii, accessed: 10th October, 2022.

Bosquet, L., Casamatta, G., Poniatowski, G., Vellutini, C.: Estimating International Tax Evasion by Individuals, TAXOBSERVATORY.EU.
Available at: https://www.taxobservatory.eu/repository/estimating-international-tax-evasion-by-individuals/
accessed: 16th October, 2022.

Office of the Government of the SR. Akčný plán boja proti daňovým podvodom na roky 2012 až 2016 [Anti-fraud action plan 2012-2016].
Available at: https://hsr.rokovania.sk/mf158742012-73/, accessed: 20th October, 2022.