

SLOVAKIA

Tax reform by Dzurinda's government was followed by record growth figures. Highest GDP growth in the history of Slovak Republic, high jobs creation rate or low unemployment rate, all correlated with the tax reform. However, there is still a substantial difference between correlation and causality. And unfortunately, the latter one is always much harder to establish or prove.

Slovakia adopted a tax system usually called the flat tax in 2004. It survived almost intact the political change in 2006, when social democratic party SMER won the parliamentary elections and Robert Fico has been appointed Prime Minister of the Slovak Republic. Quite surprisingly, he didn't try to dismantle the system of flat tax and proposed only a few corrections. The parliament, though with leftist majority, did not re-establish the gift tax or the dividend tax abolished by the former centre-right Dzurinda's government.

Some of the changes are nevertheless worth mentioning. First of all a millionaire tax was introduced. This election bestseller by Robert Fico was planned to be 25% of total annual income exceeding one million Slovak crowns (about 30,000 €). But eventually, the millionaire tax ended up only as a gradual reduction of the overall tax deductible for incomes exceeding 47,500 SKK (about 1,400 €) in one month. This causes an increase in the marginal tax rate from 19% to 23.75% for the income of 89,000 SKK (2,700 €). Then the marginal rate gradually decreases back to 19% again.

Also some other tax deductions were dissolved, such as a tax deduction for life insurance and a deductible allowing non-profit organizations not to pay taxes from profits below 300 thousand SKK (9,000 €). The life insurance deduction was lobbied during 2005, as a similar tax deduction for supplemental pension saving survived the introduction of the flat tax in 2004 and still exists.

However, more substantial changes of the tax system were proposed during 2007. A commission, set up by the Ministry of Finance, prepared an amendment of the Income Tax Act. The goal was to create a brand new Income Tax Act based entirely on the tax principles, without any compromises due to interest groups influence. The main condition was the



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the social democratic party elected in 2006 has left almost unchanged the (flat) tax system which had been reformed by the previous government

Among the minor changes, a "millionaire tax" was planned which would tax all incomes above 1 million at 25%. A milder version was finally enacted

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requirement of revenue neutrality. The commission therefore proposed to abolish 40 different tax deductions, special tax regimes and simplify the fiscal procedures. This would allow them to decrease the tax rate from 19% to 16% and still keep the current level of tax revenues. Prime Minister Fico called the proposed amendment a theoretical and very unrealistic one and refused even to think about the suggested modifications, as he in no way would agree to lower the tax rate below 19%.

Letting the political reality aside, the proceeding discussion about the form of tax system in Slovakia is nonetheless a very interesting one. Some economists see the maximum effectiveness of the tax system as an ultimate goal, and, therefore, suggest revenue-neutral modifications of current system. It would lead to abolishment of all, or most of, deductibles and, at the same time, reduction of the tax rate. On the other hand, there are also economists who argue that some tax deductions are necessary in order to avoid undesirable situations. An example could be a modification introduced by the current amendment of the Income Tax Act, which was proposed by the government in September, and now awaits for the final approval in the parliament. The main objective of this novelty is the elimination of tax deductibles allowing banks and insurance companies to deduct from their tax base some rectifying items and reserves. It will lead to taxation of nonexistent profits, but it is expected to raise the tax revenues by almost 3 billion SKK (90 million €).

To sum up, the trend in Slovak tax system development is further elimination of deductibles. Both politicians and economists in Slovakia favor it. But only the economists have courage to promote tax rate cut as the further economic policy step. As a consequence, the average tax burden is expected to go up. Also the dividend tax is considered to be reintroduced. For the Slovak Prime Minister Robert Fico it is mostly a tool for redistribution on behalf of the so called social justice. 

an independent study suggested to abolish some 40 tax deductions and reduce the flat rate from 19 to 16%. The idea was rejected by the Prime Minister who judged it unrealistic.

an interesting debate is still going on to decide whether one should aim at the most possible neutral system or keep using deductions as incentives

one expects the average tax burden to increase in the near future and a dividend tax to be reintroduced as a tool for redistribution



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