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TRANSFER PRICING SAFE HARBOURS IN THE SLOVAK REPUBLIC[1]

Abstract

This contribution deals with the position of the Slovak Republic in relation to safe harbours in transfer pricing from *de lege lata* perspective and from the perspective of existing application practice of tax authorities in Slovakia. The main aim of the contribution is to confirm or disprove the hypothesis that the existing safe harbour framework in the Slovak Republic is in line with the OECD recommendations in the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations. Methods of analysis and synthesis and of comparative legal method were employed. The results indicate that though *de lege lata* the Slovak law contains certain features which might be described as safe harbours, essentially relieving certain taxpayers from the obligation to have contemporaneous transfer pricing documentation, a safe harbour *stricto sensu* was not identified. However, in the practice of Slovak tax authorities there seem to be routinely accepted safe harbours with respect to low value-adding intra group services. Moreover, there seems to be an excessive reliance on transactional net margin method which in practice may lead to establishment of a *de facto* safe harbour. The authors argue that such practice seems to be in direct

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contradiction to OECD recommendations, poses a significant risk of becoming a target of safe harbour shopping and should be reconsidered.

Key words: safe harbours, arm´s length principle, transfer pricing, income tax.

JEL Classification: K34

1. Introduction

OECD activities in the field of international taxation have a significant impact on European and Slovak legislation and practice. One of these areas is transfer pricing where complex rules and methodology have been developed to assess the adherence of prices in intra-group transactions to the so called arm´s length principle.

However, to alleviate the excessive burden stemming from the complexity[2] and in order to facilitate the cooperation between the taxpayers and tax authorities, the so called safe harbour rules have been developed in multiple jurisdictions as optional sets of rules applicable to certain types of related party transactions. It is assumed that they result in less administrative burden for taxpayers without significantly affecting the tax revenues and simultaneously save resources of tax authorities who could then deal with more complicated transactions.

The subject of this paper is to evaluate the position of the Slovak Republic in relation to these safe harbours in transfer pricing from *de lege lata* perspective and from the perspective of existing application practice of tax authorities in Slovakia. As a starting point, the authors took into account the existing consensus on the appropriateness of safe harbours as formulated in OECD materials. Against this consensus, the existing rules in Slovakia and the procedures of tax authorities in application practice are compared. The research hypothesis was formulated as reading that the existing legal rules and the procedures of tax authorities in Slovakia are in line with the OECD consensus. In research, methods of doctrinal research, analysis and synthesis and method of comparison have been used. Preliminary results regarding the tax authorities´ application practice were obtained from a sample of tax audit results focused on transfer pricing obtained by asking tax advisors for common features of the tax authorities procedure. No detailed analysis of specificities of each individual case was performed.

2. Safe harbours as a transfer pricing concept

[2] Literature suggests that an excessive complexity of tax system may generally result in lower tax compliance. See e.g. [Saad 2014] for review of relevant literature.

The basis of transfer pricing rules is the requirement to adhere to the arm´s length principle in transactions between related parties. The substance of their existence is expressed at national level in Section 17(5) of Slovak Act on Income Tax, according to which it must be included in the taxpayer´s tax base also the difference by which prices or conditions in controlled transactions (i.e. transactions between the taxpayer and its related parties) differ from prices or conditions that would be applied between unrelated parties in comparable transactions. This principle reflects the standard wording of most Double Tax Treaties based on OECD and UN Model Tax Treaties, namely articles corresponding to the Articles 9 of both Model Tax Treaties.

The importance of the above rules and their thorough application by the tax administrations is underlined by the existing conclusions in academic literature that the profit shifting in the OECD countries is significant and the extent of such profit shifting is such that "*on average, a unilateral increase in the corporate tax rate does not lead to an increase in corporate tax revenues owing to a more than offsetting decline in reported profits.*" [Bartelsman & Beetsma 2003: 11]

The standards governing transfer pricing rules have changed in recent years, mainly due to the implementation of the OECD / G20 project called BEPS (Base Erosion and Profit Shifting). [Kočiš 2015: 8]

BEPS, once fully implemented, will affect (i) the way multinational enterprises must and will have to take into account their already established transfer pricing rules within the group, (ii) a documentation process that must reflect the allocation of sales, revenue, taxes and economic activities and other facts; and (iii) the means and possibilities available to tax authorities to use transfer pricing rules as provisions ultimately affecting the distribution of revenue to different jurisdictions or as an instrument against aggressive tax planning strategies.

All BEPS actions and measures focus on one overarching purpose: aligning the jurisdiction in which income is reported for tax purposes (and therefore taxed) with the place where value is created. [Cottani 2015: 3] These changes are also associated with the phenomenon of safe harbours, which in some cases can successfully complement these rules, but on the other hand, may cause complications in case of their premature implementation and application.

In general, safe harbour is defined by OECD as "*a provision that applies to a defined category of taxpayers or transactions and that relieves eligible taxpayers from certain obligations* *otherwise imposed by a country's general transfer pricing rules.*" [OECD Transfer Pricing Guidelines, mm. 4.100]

2.1 OECD Position

The OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations („Transfer Pricing Guidelines") historically emphasised mainly negative aspects of safe harbours, though it is now admitted that in certain cases the potential benefits might outweigh the inherent risk. Before 2013 review of Transfer Pricing Guidelines the safe harbours were regarded as regimes that should be generally avoided. [OECD Transfer Pricing Guidelines: mm. 4.96]

Nevertheless, safe harbours have been established in several countries over time and a more nuanced position is now taken by the OECD. "*Those rules have generally been applied to smaller taxpayers and/or less complex transactions. They are generally evaluated favourably by both tax administrations and taxpayers, who indicate that the benefits of safe harbours outweigh the related concerns when such rules are carefully targeted and prescribed and when efforts are made to avoid the problems that could arise from poorly considered safe harbour regimes.*" [OECD Transfer Pricing Guidelines: mm. 4.97]

This seems understandable since appropriately set up safe harbours make it possible to avoid the need for a comprehensive (and hence time and resource intensive) methodology to accompany the application of the arm´s length principle. However, their applicability should be limited to cases that are not significantly at risk from the transfer pricing perspective.

In particular, "*the design of safe harbours requires careful attention to concerns about the degree of approximation to arm's length prices that would be permitted in determining transfer prices under safe harbour rules for eligible taxpayers, the potential for creating inappropriate tax planning opportunities including double non-taxation of income, equitable treatment of similarly situated taxpayers, and the potential for double taxation resulting from the possible incompatibility of the safe harbours with the arm's length principle or with the practices of other countries.*" [OECD Transfer Pricing Guidelines, mm. 4.99]

The existing concerns are summarised as follows: [OECD Transfer Pricing Guidelines: mm. 4.110]

1. The implementation of a safe harbour in a given country may lead to taxable income being reported that is not in accordance with the arm's length principle;

2. Safe harbours may increase the risk of double taxation or double non-taxation when adopted unilaterally;
3. Safe harbours potentially open avenues for inappropriate tax planning, and
4. Safe harbours may raise issues of equity and uniformity.

For the purposes of this article we would emphasise the following potential drawbacks.

Firstly, if a safe harbour may lead to non-adherence with the arm´s length principle if it requires the use of a certain transfer pricing method if the taxpayer could or would, in a particular case should use more appropriate method. [OECD Transfer Pricing Guidelines: mm. 4.99]

Further, safe harbours create the risk of double taxation or double non-taxation, for example, if the tax authority sets safe harbour prices at under or above prices that are prices at the arm´s length level (determined for example through a benchmark study) due to an increase in reported income (and then taxable income) in its country. [OECD Transfer Pricing Guidelines: mm. 4.114]

Consequently, on one hand such arrangements may give rise to international tax disputes where the state of taxation will argue with its legislation and its safe harbour settings and the state where certain profits should have been taxed would base its arguments on non-adherence of such rules to the arm´s length principle.

This may result both in double taxation and double non-taxation in dependence on the circumstances. The risk of double taxation may be illustrated through the so-called "corresponding adjustments" mechanism. The corresponding adjustment balances the consequences of the application of the arm´s length principle. Therefore, an increase of the tax base of one company within the multinational group should simultaneously result in reduction of the tax base of another company within the group (if the conditions laid down by law are met). In Slovak Republic corresponding adjustment is regulated by Section 17(6) of the Income Tax Act and essentially reflects the mechanism currently in Articles 9(2) of Model Tax Treaties.

However, the prerequisite condition of such a procedure is compliance with the arm´s length principle. Thus, if a taxpayer opts for a safe harbour, as a result of which its tax base is increased in the respective tax jurisdiction, it would likely not be able to claim corresponding adjustment in the other tax jurisdiction under a tax treaty.

On the other hand, safe harbours may be susceptible to abuse. Disproportionately generous or otherwise advantageous safe harbour may lead multinational groups to the idea of seeking the countries with the most advantageous safe harbours and to allocation of specific companies to specific countries, which opens the door for abusive behaviour and aggressive tax planning.[3]

In principle the taxpayer cannot be blamed for using legal possibilities for tax planning between countries if its actions are in direct accordance with the arm´s length principle. However, if some safe harbour rules would allow in a tax jurisdiction less taxation than the price range adhering to the arm´s length principle (which would ensure the tax authority collects tax revenue in the sense of 'less but stable income'), it is not ensured (in fact it is highly unlikely in the light of the above cited literature) that the taxpayer will pay accordingly higher amount of tax (above the arm´s length price) in the second tax jurisdiction and therefore the risk of double non-taxation would occur. Moreover, the tax authority of the second tax jurisdiction would in principle not have means to levy the reduced amount of tax in the first tax jurisdiction, since such unilateral adjustment would be in contradiction with the arm´s length principle.

Safe harbours can thus encourage taxpayers to "shift" part of their profits to jurisdictions with a lower tax burden. "*If a safe harbour were based on an industry average, tax planning opportunities might exist for taxpayers with better than average profitability. For example, a cost-efficient company selling at the arm's length price may be earning a mark-up of 15 percent on controlled sales. If a country adopts a safe harbour requiring a 10 percent mark-up, the company might have an incentive to comply with the safe harbour and shift the remaining 5 percent to a lower tax jurisdiction. Consequently, taxable income would be shifted out of the country. When applied on a large scale, this could mean significant revenue loss for the country offering the safe harbour.*" [OECD Transfer Pricing Guidelines: mm. 4.123]

However, if such planning is performed on a systematic basis and taking into account several territories, it is referred to as "safe harbour shopping". [OECD Transfer Pricing Guidelines: mm. 4.123] Such conduct, and safe harbours allowing for it, then present a risk of profit shifting with international impact.

Based on the above stated, OECD in principle allows safe harbours only as an exception, and the explicit formulation of standard frameworks for their application is not recognized yet. Each country has to consider individually whether it will provide for simplification measures for taxpayers and establishes safe harbours. Given the safe harbours are measures providing for an option to avoid the use of rather complex methodology

[3] On the topic of abuse of tax law and aggressive tax planning see further Babčák [2017: 16].

connected with adhering to the arm´s length principle they may be recommended to developing countries. [Mehta 2016]

3. Approach of selected countries globally

Several forms of safe harbours have been implemented in national legislations worldwide. [Joint transfer pricing forum – Member States' Transfer pricing profiles] and [OECD Transfer Pricing Profiles] In European Union these have been mostly aiming at SMEs. [Solilová & Nerudová 2015]

These can be divided into several categories as follows:

- simplification for small and medium-sized enterprises (SMEs): Australia, Belgium, Canada, Denmark, Estonia, Finland, France, Germany, Hungary and others,
- simplification for low value transactions: Australia, Belgium, Denmark, Finland, Germany, Hungary, India and others,
- simplification for the so called low value-added services: Netherlands, New Zealand and the United States, Czech Republic, Poland and others,
- simplification with respect to intra-group financing transactions: Austria, Japan, New Zealand, Slovenia, South Africa, the United States and others.

Simplifications, i.e. safe harbours *sensu largo* for a certain group of taxpayers or for a group of transactions mostly occur in one of the following forms:

a) **simplified documentation obligations**: The tax jurisdiction grants an exemption from the requirement to prepare transfer pricing documentation or simplification of transfer pricing documentation in the form of waiving some of the particulars that are normally included in transfer pricing documentation (e.g waiving from preparation of functional, risks and assets analysis, waiving of the preparation of the benchmark analysis).

b) **safe price (margin)**: The tax jurisdiction grants an exemption from the need for additional examination of the transaction price when using a predefined transfer pricing method with a predetermined mark-up (e.g. safe harbours for low value-added services and safe harbour for intra-group financing). For example, in the Czech Republic there have been efforts in the academic literature to formulate ranges of safe margins differentiated in dependence on the particular industry segment. [Solilová & Nerudová 2016]

c) **non-application of transfer pricing rules**: The tax jurisdiction grants an exemption from transfer pricing rules in their entirety and accordingly an exemption from transfer pricing adjustments (primary adjustment of the tax base). The point is to set a threshold to which the transfer pricing rules will not apply. Such a set of rules can relate to the size of the transaction or group of transactions or it can relate to size of the taxpayer.

d) **exemption from sanction**: The tax jurisdiction grants an exemption from sanctions or provides for reduced sanctions. Sanctions for breach of an obligation are reduced in cases where the taxpayer requests for an Advanced Pricing Agreement or pays its outstanding taxes without appeal. In some countries, there are other possibilities of waiving the sanction if the taxpayer has made a "reasonable effort" to determine the price in accordance with the arm´s length principle.

4. Safe harbours in Slovak legislation

The Slovak Republic is one of the countries that have a formally established safe harbour which reduces the documentation obligation for selected transactions or for selected taxpayers. However, Slovak Income Tax Act does not in any way explicitly exempt taxpayers from the obligation to respect the arm´s length principle in the controlled transactions covered by this safe harbour.

The only exception is the exemption from the obligation to observe the arm´s length principle for individuals, but this exemption is not expressly provided for in the Slovak Income Tax Act, rather it stems from its grammatical and systematic interpretation. The wording of the Slovak Income Tax Act provides for application of arm´s length principle in its Section 17(5) where the general rules for tax base calculation are included.

However, the Slovak Income Tax Act contains special rules for tax base calculation with respect to selected incomes of individuals and an express reference to general rules is made only with respect to entrepreneur income. [Slovak Income Tax Act: Section 6(6)] Thus, e.g. incomes (and expenses) of individuals from loans or capital gains from transfer of shares are outside the scope of Slovak transfer pricing rules.

Further, until the end of 2014, the Slovak Income Tax Act provided for the application of transfer pricing rules almost exclusively in relation to cross-border transactions. Domestic transactions, "*with the exception of transactions of Slovak legal entities that were beneficiaries of tax incentives, were outside the scope of transfer pricing legislation.*" [Choma & Balco 2015;

73] With effect from 1 January 2015 the Slovak Income Tax Act has been amended and the scope of application of transfer pricing rules has been extended also to domestic controlled transactions.

For the purposes of this article we will not regard the above as safe harbours and we will narrow down our analysis only to safe harbours *stricto sensu*. We have identified an express safe harbour *de iure* stipulated in the Slovak by-laws and, further, we have identified a repetitive conduct of Slovak financial authorities which shows features of a *de facto* safe harbour.

These will be described in detail below.

4.1 *De iure* safe harbour

The *de iure* safe harbour lies in less burdensome documentation obligations for a selected group of taxpayers.

In general, under the Slovak Income Tax Act, in addition to the obligation to comply with the arm's length principle in controlled transactions, taxpayers are required to keep documentation of "*controlled transactions and the method used to determine the pricing and conditions to be applied among independent parties in comparable transactions.*" [Slovak Income Tax Act: Section 18(1)]

The Slovak Income Tax Act leaves it up to the Ministry of Finance of the Slovak Republic to set the content of documentation on controlled transactions and the transfer pricing method used. This is being stipulated by the Guidelines of the Ministry of Finance of the Slovak Republic published in the Financial Gazette.

There could be identified two distinct periods in the approach to documentation requirements. First period may be marked by Guideline No. MF/8288/2009-72 effective with respect to tax periods starting after 31 December 2008. This guideline, which was effective until 31 December 2014, essentially stipulated that only accounting units with statutory obligation to hold accounting in line with the IFRS accounting standards[4] were required to hold full transfer pricing documentation while the remaining accounting units merely had to record their intercompany transactions in notes to financial statements

[4] The requirement essentially applied to financial institutions and to accounting units where at least two of the following criteria were met for the applicable accounting period and the immediately preceding accounting period: (i) total value of assets exceeded EUR 165,969,594.40; (ii) total turnover exceeded EUR 165,969,594.40; or (iii) average number of employees exceeded 2,000. [Slovak Accounting Act; Section 17a(2)]

stating identification of the counterparty type of transaction and the amount of the transaction.

Then the Guideline no. MF/8120/2014-721 applying to tax periods starting on or after 1 January 2014 expanded the standard documentation requirements to all the taxpayers with only a slight variation in the amount of detail required. Essentially, though SMEs were required to hold both a master file and a country file in line with the structure set by the code of conduct on transfer pricing documentation for associated enterprises in the European Union [EU Code of Conduct], they were not required to prepare e.g. benchmark analysis. No express safe harbour was included in the Guideline. With slight variations introduced by Guidelines nos. MF/011491/2015-724 and MF/014283/2016-724 this regime applied until 31 December 2017.

The latest Guideline no. MF/019153/2018-724 applicable to transactions occurring after 1 January 2018 once again expressly relieved a certain group of taxpayers completely from the documentation obligation. However, the selection criteria are different and essentially domestic controlled transactions are relieved from the documentation obligation. [see further Relief from documentation requirement and certain documentation principles]

Nevertheless, it should be pointed out that even if these taxpayers are no longer required to produce transfer pricing documentation, they still have the obligation to adjust their tax base of the prices in their controlled transactions are not in accordance with the arm´s length principle. Accordingly, in the event of non-compliance, the tax authority can adjust the tax base and penalize the taxpayer. Simply put the relief from documentation requirement does not correspond to any actual relief from obligation to adhere to the arm´s length principle.

This is emphasised also by Section 2(2) of the Guideline no. MF / 019153 / 2018-724 which reads that *“the guideline determines the minimum scope of documentation. The tax authority may require the taxpayer to submit further information to demonstrate the compliance of the prices used in the controlled transactions with the arm’s length principle.“*

Thus, the Slovak Republic belongs to countries that have safe harbour for a defined group of taxpayers or for a defined group of transactions in the form of a simplification of documentation requirements. At the same time, this safe harbour does not relieve taxpayers from the obligation to adhere to the arm´s length principle and the tax authority still has the option of adjusting the tax base and has the possibility to request additional information even if there is no or minimal documentation obligation.

In practice, taxpayers still have to weigh the potential relief from administrative burden against a potential risk of tax assessment. According to relatively common practice in Slovakia the tax authorities tend to interpret non-existence of transfer pricing documentation (even if this is expressly allowed by the law / guidelines) as an "invitation" to apply own method, perform own benchmark analysis, adjust prices in controlled transactions, and assess tax.

The main benefit stemming from the transfer pricing documentation, being the transfer of burden of proof, is then virtually non-existent. This also follows from the express wording of Slovak Income Tax Act under which "*the correct application of the [transfer pricing method] shall be inspected by the tax authorities or the Financial Directorate of the Slovak Republic during the tax audit, while relying on* ***the arm's length principle, the applied method and the benchmark analysis."***[5] [Slovak Income Tax Act: Section 18(11)]

Thus, if the taxpayer resorted to the Slovak safe harbour and did not prepare transfer pricing documentation, the tax authority is not bound to rely on the applied method (as there was no method applied) or on the benchmark analysis (as there is none). In case of more complicated and more material transactions the resulting costs of dispute and of preparation of supporting documentation would likely exceed the initial savings from the safe harbour.

The benefits from the safe harbours in Slovakia may then be more or less illusory and, in fact, such safe harbours would not even fall within the definition of a safe harbour *stricto sensu* in the Transfer Pricing Guidelines, which does not include "*administrative simplification measures which do not directly determination of arm´s length prices, e.g. simplified, or exemption from, documentation requirements (in the absence of a pricing determination)*". [Transfer Pricing Guidelines; mm. 4.103]

4.2 *De facto* safe harbours

In addition to the above-mentioned formalized safe harbour we have identified several tendencies in the practice of tax authorities in Slovakia that exhibit *de facto* safe harbour features.

One is a safe harbour being also supported both by the Transfer Pricing Guidelines and the Joint Transfer Pricing Forum Report and concerns low value-adding intra-group services. The essence of this safe harbour is that for the services defined in Chapter VII of the

[5] Emphasis added.

Transfer Pricing Guidelines, the margin set out in Chapter VII can be considered as a mark-up that would be applied between unrelated parties. [Transfer Pricing Guidelines: mm. 7.61]

This then relieves the taxpayer from the obligation to prepare a benchmark analysis on a regular basis and ascertain actual mark-up from current data relevant to a particular tax period. It is also relatively commonly used in analysis of controlled transactions by the taxpayers, where the taxpayers directly refer to the relevant provision of the Transfer Pricing Guidelines.

However, in the application of this simplified approach one problem arises. The Transfer Pricing Guidelines in point 7.64 include some documentary requirements which do not correspond to those under Guideline no. MF / 019153 / 2018-724.

At the same time, it must be taken into account that the "*Transfer Pricing Guidelines are not legally binding in Slovakia and as have only limited importance an interpretation tool with respect to double tax treaties due to the nature of its content [and, in principle] it is not appropriate to refer to its selected parts by tax authorities in the same way as to laws having generally binding nature.*" [Kačaljak & Rakovský 2019:11]

According to our experience the Slovak tax authorities largely accept the reasoning in the Transfer Pricing Guidelines and the Joint Transfer Pricing Forum Report with respect to the low value-adding services and do not require presentation of a separate benchmark analysis. Still, it is not clear how to document these transactions or whether to document them under Guideline no. MF / 019153 / 2018-724 or in accordance with the requirements for documenting the above transactions referred to in mm. 7.64 of the Transfer Pricing Guidelines.

However, as it seems the Slovak tax authorities and the taxpayers are aligned in their view of documentation treatment of low value-adding services, it might be advisable to implement this safe harbour expressly into the Slovak Income Tax Act (the existing powers of the Ministry of Finances in the Slovak Income Tax Act are currently limited to setting the documentation requirements).

In our opinion, the second and much more controversial is a safe harbour consisting of a strong tendency of the Slovak tax authorities to rely on one particular transfer pricing method, namely the transactional net margin method (TNMM). This method is usually applied in the simplest (almost mechanical) way, when the total turnover or total costs of the Slovak taxpayer are included in the calculation and the resulting mark-up is compared with the mark-up in the comparability analysis (often taking into account gross industry averages). [6]

This approach might bring some benefits for the SMEs and it might be viewed as a variation on the methodology proposed by Solilová and Nerudová [2016]. However, the apparent simplicity of such an approach also poses the risk of double non-taxation and might not be entirely suitable for large taxpayers entering into more complex transactions.

For example, a manufacturing company X seated in Slovakia which, addition to routine manufacturing activities, also finances and performs functions related to the acquisition of intangible assets (i.e. the DEMPE functions would predominantly be with this manufacturing company X)[7] would normally retain the entire residual profit associated with these intangible assets in accordance with the arm´s length principle.

However, using the transactional net margin method (which is, in principle, suitable for identifying remuneration for routine functions) a "total profitability mark-up" is identified and the actual mark-up of the taxpayer is tested against this value. Profits above this benchmark can then be transferred to the low-tax jurisdiction for example by simply adding a distributor to the structure. This distributor will generate profits clearly disproportionate to its functional and risk profile but the shifted profits will not be captured by the Slovak tax authorities (who will apply the transactional net margin method to Slovak company X as the tested party).

In the view of the fact that major investment projects may result in a temporary loss, the profits of production company X in Slovakia may be temporarily below the "overall profitability mark-up", what can initially be justifying the adjustment by the tax authority. Paradoxically, in the long run such an adjustment could establish a precedent whereby the tax authority would in principle prioritize low and stable profitability (contrary to the arm´s length principle) over fluctuating but overall significantly higher profitability (in accordance with the arm´s length principle) and thus *de facto* would establish a safe harbour.

The above could be regarded as a model example of opportunity for safe harbour shopping referred to in the Transfer Pricing Guidelines [2017: mm. 4.123] and cited above.

Based on a survey we have performed (on an anonymous basis) with tax practitioners providing transfer pricing advice in Slovakia and dealing with tax audits focused on transfer

[6] The discussion of methodological issues of such approach is out of scope of this article. Nevertheless, we note that one of the basic issues with such approach is that it does not allow to calculate the amount of adjustment with respect to a particular double tax treaty, if the taxpayer is a party to multiple transactions with related parties from several treaty states.

[7] The existing literature suggests that shifting of IP functions is relatively commonplace. See further [Evers & Spengel 2014]

pricing it seems that the above has gradually became the prevailing practice of tax authorities.

Though at the moment there are no final court decisions available in Slovakia dealing directly with such approach there is currently at least one decision of a first instance court, where this issue was brought to the attention of the court[8] but the court avoided any direct comment on the matter.

Should the above practice of the Slovak tax authorities settle, it might paradoxically lead to taxpayers claiming same *de facto* safe harbour treatment on the basis of a principle in Slovak Tax Procedure Code reading that "*[the] tax administrator shall take care that no unjustified differences will arise when deciding on cases with identical facts.*" [Slovak Tax Procedure Code: Section 3(9)] Should the tax administrators routinely resort to the above practice (practically invariably) it would then be rather difficult to justify why the very same method would not be accepted if it is applied by the taxpayer.

At the moment we may only speculate what leads the Slovak tax administrator to such practice, with lack of skill and experience with more sophisticated methods being one of the more probable explanations.

In any case, we would advise against such practice and, though legislative remedies do not seem necessary, it might be advisable to cover the issue through an administrative circular discussing potential benefits (particularly for SMEs) and risk (in case of more sophisticated structures) of such simplified approach.

5. Conclusion

Based on the current OECD consensus that safe harbours may essentially bring certain benefits, such as relief from excessive administrative burden, if these are carefully designed we came to a conclusion that the *de lege lata* safe harbour rules in the Slovak Republic essentially comply with these recommendations. The Slovak safe harbour merely provides a relief to certain transaction from the documentation requirement, however, without simultaneously relieving the respective transaction from the requirement to adhere to arm´s length principle. Solely from the *de lege lata* perspective the hypothesis may be deemed confirmed.

[8] Decision of the Regional Court in Bratislava file no. 1S/231/2016 dated 20 September 2018. We would assume the dispute is currently before the Supreme Court of the Slovak Republic.

However, taking into account the practice of the Slovak tax authorities we have identified several features indicating existence of a *de facto* safe harbour.

First, the Slovak tax authorities seem to commonly accept the OECD recommendation with respect to margins relating to the low value-adding intra group services. As this practice seems to be consistent between both taxpayers and the tax authorities, it might seem advisable to expressly recognise this safe harbour in written law.

Secondly, there seems to be an excessive reliance by the Slovak tax authorities on the transactional net margin method which in practice may lead to establishment of a *de facto* safe harbour. This practice might seem acceptable with respect to SMEs and seems to be in line with some of the recommendations in the literature. However, if employed on a systematic basis without differentiating the taxpayers, such practice seems to be in direct contradiction to OECD recommendations, poses a significant risk of becoming a target of safe harbour shopping and should in our view be reconsidered.

Thus, taking into account not only the *de lege lata* perspective but also the common practice of the Slovak tax authorities we conclude that the hypothesis is disproved, i.e. the current safe harbour framework in the Slovak Republic is not fully in line with the OECD recommendations in the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations.

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