

## TAX LICENCE OF A LEGAL ENTITY – PROS AND CONS

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**Abstract:** In 2013, the Slovak Parliament adopted the Law on Amendments to the Law on Income Tax. One of the most significant changes was the introduction of the Tax License of a Legal Entity. On January 1<sup>st</sup>, 2018, a minimum corporate tax (the so-called tax license), which was introduced in 2014, was abolished. The main aim of this paper is the evaluation and quantification of the impact which the minimum corporate tax has on the amount of tax liability of a selected group of legal entities in the agricultural sector. The research had tried to find an answer if the tax license abolishment was more in the political interests or if it had some economic background. The main research questions are how has the corporate tax duty increased in the agricultural sector in the Slovak Republic after introducing the minimum corporate tax and how has the tax burden for agricultural holdings increased after introducing the tax license. The analysis presented in this paper confirms that the instrument of introducing the minimum tax is for loss-making sectors, such as the agricultural sector, undoubtedly unfair. On the other hand, the study has confirmed that the public which regularly pays the taxes, agrees with its introduction.

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### Introduction

The problem of zero tax liability tolerated by the state can also be perceived as a problem of tax justice towards those who fulfil their tax liability every year. Bojňanský, Krajčírová and Ferenczi-Vaňová (2013), as well as Baštinčová (2009) consider the income tax to be the most significant direct tax from both natural and legal persons. Most economists believe that direct taxes have more negative impact on economic growth than the indirect taxes, e.g. Borys (2014). According to Banks (2010) and (Barbone and coll., 2015), a number of studies have confirmed the significant impact of tax policy on the business environment. This is confirmed also by the study by Sandmo (2006). One of the state tax policy principles, the principle of taxation universality, is not always respected (Šlosár, Horáčková, 2005). An example is the amount of monthly tax liability of a natural person without any children who had an average monthly salary in the national economy EUR 954.00 in 2017. Such a natural person paid an average EUR 97.92 per month, which represents EUR 1,175.04 per year. If the natural person decides to do business in the form of a legal person, its income tax savings would be at least EUR 1,175.04 in the absence of the tax license. On the other hand, economic conditions in the Slovak Republic in some areas of economic life are the direct cause of achieving the annual negative economic results. An example of such an economic environment is agriculture. Enterprises whose line of business activity is primary agricultural production are mostly loss-making. Also, these two specific examples highlight that the views not only of the public, but also of the economists, on the existence or the absence of the tax license being different, are justified. The state tax policy significantly affects development of the business structure in primary agricultural production (Gubová, 2005). The issue of the tax license eligibility is problematic. The instrument of such a minimum tax license is established for example in Austria and in the U.S.A. In the Slovak Republic, this instrument has lasted for 4 years. Authors of this paper have hypothesized that while natural persons agree with the introduction of the minimum tax for legal persons, the positive attitude of legal persons depends mainly on the sector in which they operate.

### Data and Methodology

The authors have set an objective to assess the impact of the tax license on the tax liability of agricultural holdings. This paper compares the economic result development with the tax liability development of enterprises doing their business in the agricultural sector. Furthermore, the paper assesses separately the development of the total tax liability of profit-making enterprises and separately development of the enterprises that were loss-making in the assessed period. The development of the total tax liability

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is compared with the development of the minimum tax, also separately for profit-making and separately for loss-making agricultural holdings. The second part of the research is focused on the assessment of the positives and negatives of introducing the minimum tax instrument - the tax license.

The research objective presented in this paper are the tax obligations of legal persons in the Slovak Republic, whose principal line of activity, declared by their filed tax return, belongs to Section A SK NACE - Agriculture, Forestry and Fisheries. This section includes the use of plant and animal natural resources. The section consists of activities such as plant production, animal husbandry and feeding, logging and usage of other plants and animals on the farms or in their natural habitat.

In order to be included in the analysed model, the enterprise had to meet the following criteria:

- The main line of its business activity declared by the filed corporate income tax return belongs to Section A of Division 01 Plant Production and Animal Husbandry, Hunting and Related Services, or Division 02 Forestry and Logging.
- The business year of the enterprise is the same as the calendar year.
- The enterprise is registered as a legal person in the Commercial Registry of the Slovak Republic. Natural persons, self-employed persons and forest owners' communities have not been included in the model.

The model consists of an average 7,221 legal person for each year under assessment.

The data analysed in the article have been obtained from the following sources:

The Information Portal of the Slovak Republic ISFS SAP-ISFS SR

Electronic filing of corporate income tax returns.

(Data obtained from a non-publicly accessible part of the website  
<https://intranet.financnasprava.sk/SitePages/Domov.aspx>)

The paper analyses data covering the period 2012-2017. This period includes the years in which the applicable tax license was introduced (2014, 2015, 2016 and 2017), and for comparison purposes, it is extended by two years in which the tax license instrument has not yet been introduced (2011 and 2012).

The data assessed in the first part of the paper were obtained from the information system of the Financial Administration of the Slovak Republic on condition of full anonymity of the taxable units. Assessment of the positives and negatives of the tax license was carried out based on the data obtained from the questionnaire survey.

The group of respondents was selected to represent the biggest taxpayer groups in the Slovak Republic. The numbers of addressed respondents were not random; the following groups were intentionally addressed: employees (taxpayers of economically dependent activity), natural persons - self-employed persons - tradesmen, statutory bodies of legal persons doing business in the agricultural sector and statutory bodies of legal persons doing business in the non-agricultural sector.

Totally, 150 respondents were addressed. The tax license assessment by taxpayers was quantified through some pre-specified factors. The factors were chosen on the basis of empirical evidence and based on practical experience of 20-year long lasting experience of one of the authors of this paper in the Financial Administration of the Slovak Republic.

The standard methods of scientific work as a method of selection, analysis and comparison of selected provisions of the Income Tax Act No. 595/2003 Coll., as amended, including related acts have been used in the topic processing. The standard mathematical and statistical methods were used for analysing and comparing the partial indicators in the reporting period (arithmetic average, base index).

The questionnaire method was used in the second part of the research. Questions in the questionnaire, as well as the target group of respondents were chosen so that the hypothesis set by the authors on the basis of practical experience and objective information on the results of agricultural holdings management was confirmed or refuted after their assessment. The authors hypothesized that while the taxpayers who regularly pay taxes in comparison with their income in relatively high amounts had agreed with the introduction of the tax license, the taxpayers who had been allowed not to pay any tax under the valid legislation, did not agree with the tax license.

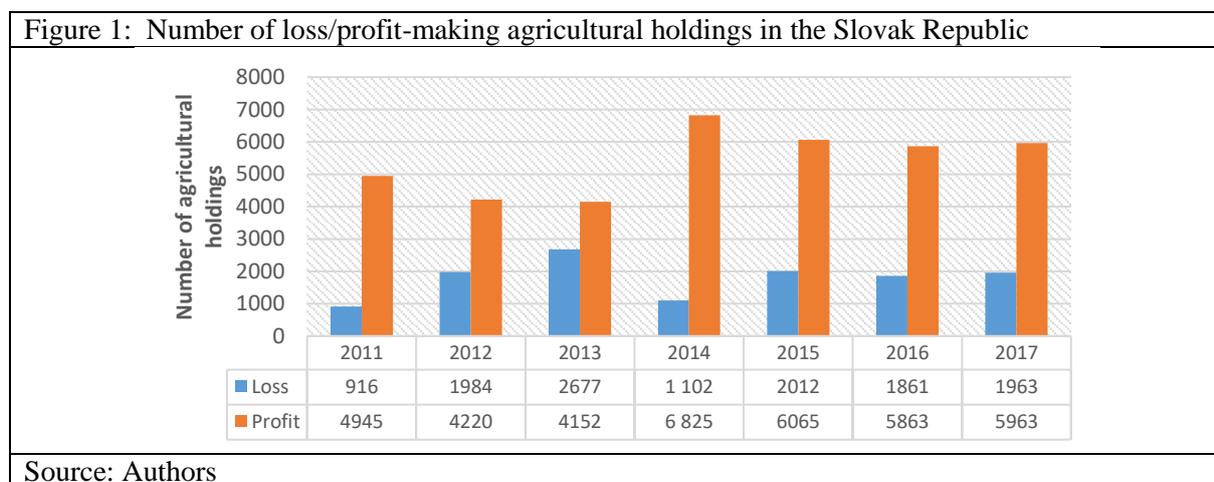
The achieved results, their analysis and presentation in the form of tables and figures, as well as impact assessment are included in the Results and Discussion section.

### Results and Discussion

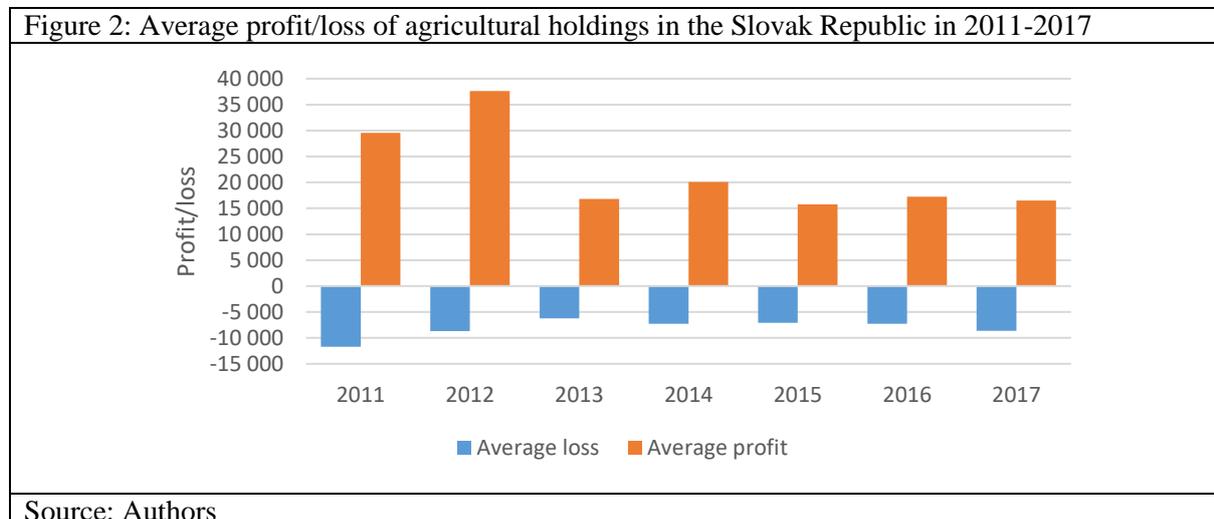
A significant part of the Slovak Republic state budget revenues is formed by income tax revenues. Its importance from the fiscal perspective is mainly due to its high share in total tax revenues. As the amount of the tax liability does not depend on the reached income, but mainly on the result of the management transformed into the tax base, the sectors with a low profit ratio or with high costs contribute by this tax to the state budget much less than the profitable sectors (e.g. IT technologies).

During the period under assessment: the period 2011-2017, on average 34.85 % enterprises from all agricultural holdings were loss-making. If we do not consider the year 2011, when subsidies formed part of the revenue, the share of the loss-making enterprises will increase to 37.58 %. The highest number of loss-making agricultural holdings - 2,677 was in the year 2013.

The number of loss-making and profit-making enterprises in years of the period under assessment is presented in Figure 1.

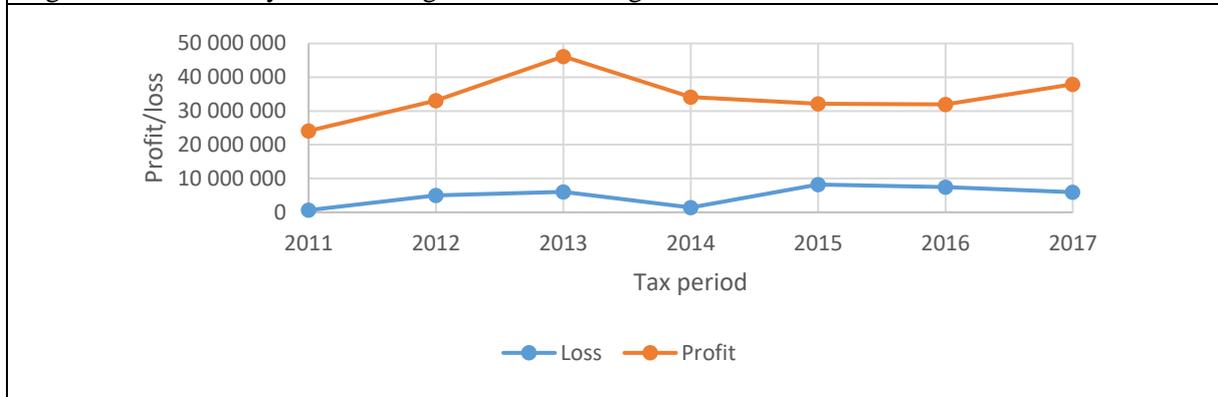


In 2013, the amendment to Act No. 595/2003 Coll. on Income Tax introduced the minimum tax instrument. The obligation to pay the tax license concerned all legal persons; the legislation did not recognize any exemptions due to disadvantages of a sector - undoubtedly being agriculture. In particular, the enterprises doing their business in primary agricultural production have been reaching a long-term loss. The total loss of agricultural holdings in the period under assessment was from EUR 8 million to EUR 17 million. Enterprises which reached profit in the period under assessment are mainly the enterprises with a significant acreage of agricultural land (and therefore higher subsidies). In particular, these enterprises are profit-making mainly due to subsidies and they had paid the income tax before introduction of the minimum income tax.



The average economic result of a prof-making agricultural holding in the period under assessment amounted to EUR 21,948.46. Since 2012, it has been gradually declining (profit of EUR 37,620.54 per one enterprise). If the current corporate income tax rate is considered, the agricultural holding has paid EUR 5,048.00. The current tax rate has not significantly changed over the period under assessment.

Figure 3: Tax liability of Slovak agricultural holdings



Source: Authors

In particular, in the context of the Income Tax Act, the negative economic result, being transformed based on the tax, was positive. This fact had also caused that some loss-making agricultural holdings had to pay corporate income tax as early as in 2011 and 2012 even though the minimum tax had not existed. Development of the tax liability of loss-making agricultural holdings and profit-making agricultural holdings is illustrated in Figure 3. The development trend in both tax obligations is largely the same, which is related to the fact that the economy of agriculture is heavily influenced by external factors, such as drought.

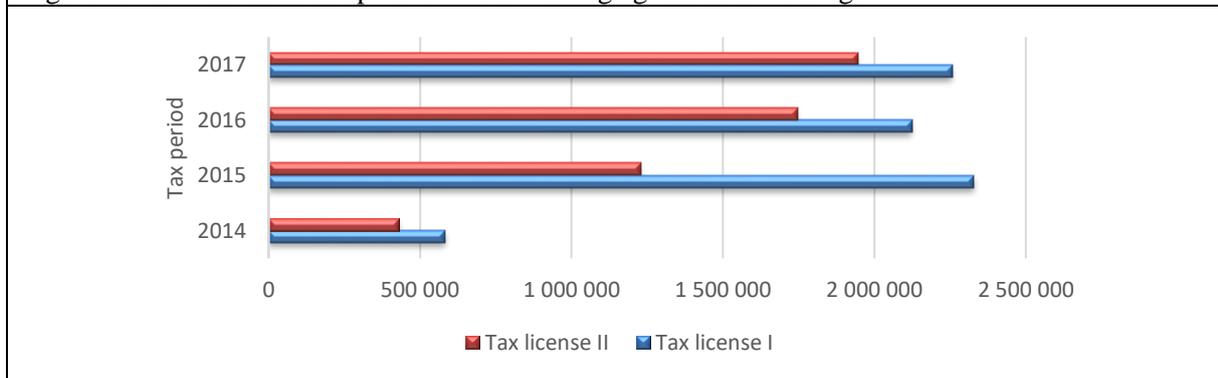
Table 1: Average liability per agricultural holding in the Slovak Republic in EUR

Period	Average liability of loss-making holdings	Average liability of profit-making holdings
2011	685.50	4,872.08
2012	2,505.96	7,843.09
2013	2,256.18	11,119.28
2014	1,293.92	4,998.84
2015	4,087.22	5,303.15
2016	4,000.68	5,451.56
2017	3,027.34	6,355.11

Source: Authors

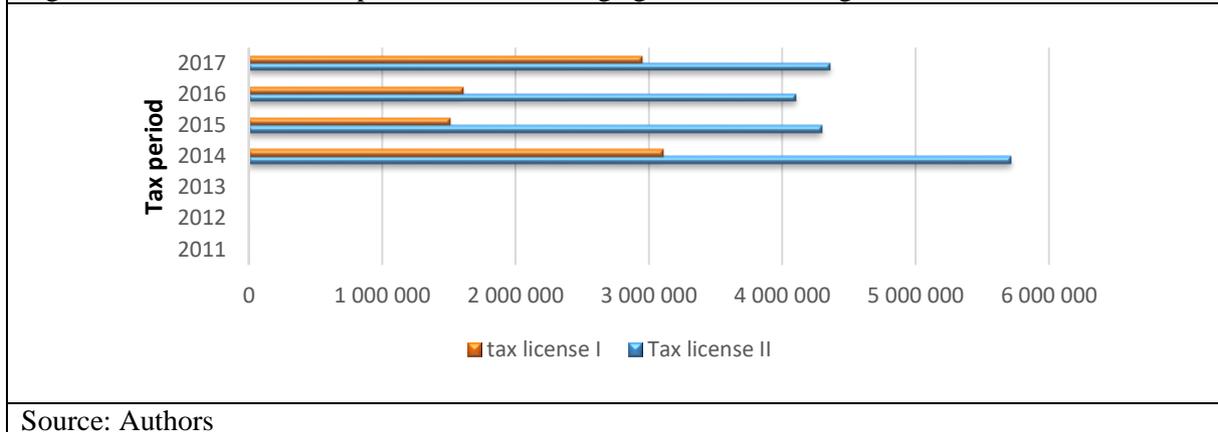
Tax liability of loss-making agricultural holdings was EUR 2,550.97 on average. It was significantly increasing after introduction of the minimum tax up to the year 2016. Tax liability of profit-making agricultural holdings was EUR 6,563 on average.

Figure 4: Tax license development in loss-making agricultural holdings



Source: Authors

Figure 5: Tax license development in loss-making agricultural holdings



Source: Authors

Figure 4 and Figure 5 illustrate the differences between the stated tax license amount (Tax license I) and the amount exceeding the actual amount of the tax up to the amount of the stated tax license (Tax license II).

The stated tax license is the tax which the taxpayer is obliged to pay even if they report loss, or the tax lower than the stated tax license in the respective tax period. Its amount depends on the fact whether the taxpayer was the payer of value added tax on the last day of the tax period, whether their annual turnover for the tax period exceeded EUR 500,000 and whether they apply the tax license reduction in half. This positive difference between the tax license (Tax License I) and the calculated actual tax after the relief and any deductions (Tax License II) can be counted against the tax liability in the subsequent tax periods.

In the agricultural holdings, on average, up to 73.82 % of the tax license paid is the tax payment beyond the calculated tax liability. Although this amount may be deducted in the future, it can be assumed that holdings will not deduct it from the higher tax liability in the future due to the loss ratio of part of the agricultural holdings.

Four basic groups of respondents were addressed in the questionnaire survey:

Group 1- natural persons - employees who have the income only from dependent activity

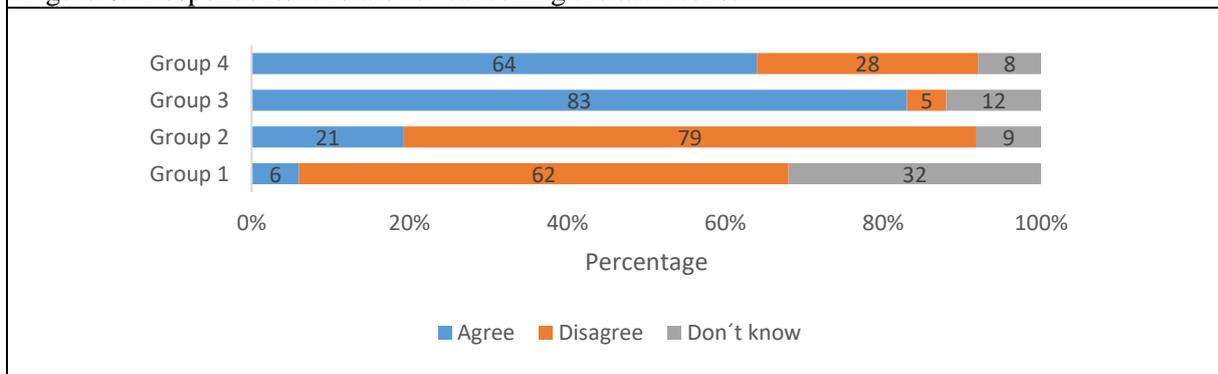
Group 2 - natural persons doing business based on a trade license, whereas line of their business activity at inclusion in the research sample was not important

Group 3 - natural persons, CEOs of companies whose main activity is agricultural production

Group 4 - natural persons, CEOs of companies whose main activity is not agricultural production; their main activity being not important if it is not agricultural production

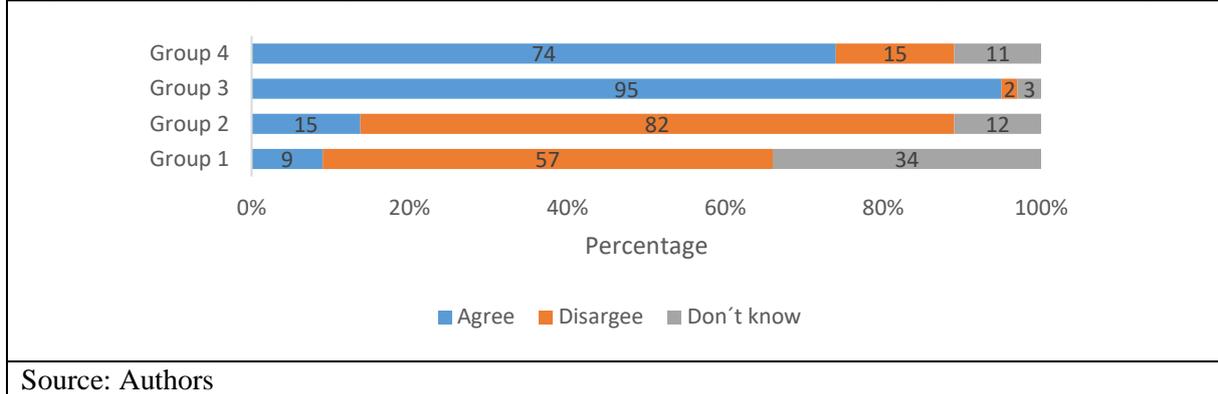
150 respondents participated in the questionnaire survey, with the distribution of questionnaires among the four target groups being even. The most important results are presented in Figures 6 to 8.

Figure 6: Respondents who are for cancelling the tax license.



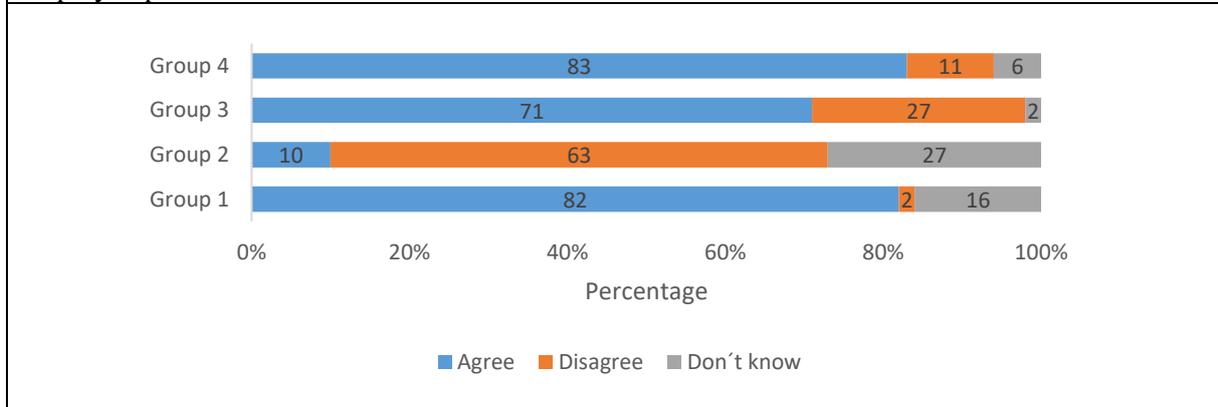
Source: Authors

Figure 7: Percentage of respondents who are for limiting the tax license for agricultural holdings



Source: Authors

Figure 8: Percentage of respondents who are for keeping the tax license and its extension for self-employed persons



Source: Authors

### Conclusion

The instrument of tax license introduction cannot be judged only in a positive or a negative way. The positives include mainly the introduction of the element of higher tax justice among taxpayers and mitigating the corporate tax optimization. Concerning the state tax policy positive is also increase in the state budgeted income. The negatives include all enterprises that have an obligation to pay the tax license, regardless of whether the loss has been achieved due to any objective reasons and this tax also applies on loss-making, subsidized sectors (agriculture). The negative is also the fact, that the amount of the tax license may be disproportionate for small enterprises. On the contrary, for a natural person with a high turnover, there may be zero tax. The analysis presented in the article confirms that the instrument of introducing the minimum tax is for loss-making and subsidized sectors, such as the agricultural sector, undoubtedly unfair. On the other hand, the study has confirmed that the public, especially the part of public which regularly pays taxes, agrees with its introduction. A solution might be to limit it for the loss-making sectors and to leave it for the sectors where profit can be expected to be achieved under normal economic conditions - not only for legal persons but also for natural persons.

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