Opportunities to Ease the Tax Burden Without Lowering Taxes

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AmCham
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Taxation

Background Information

Active, growing, free trade and investment in a country drives GDP growth. The growth of business and production, and growth in business profitability, drives growth in jobs, and an increase in the tax base, and therefore, in tax revenues. It stands to reason that increasing tax revenues simply by increasing the tax burden on existing taxpayers has limited effect on growth in tax revenues and no effect on growth in jobs. There is equilibrium where this strategy actually begins to shrink the tax base. Taxpayers begin to employ tax avoidance schemes or discontinue working in the market all together. There are other factors which cause a destabilizing force against expansion of trade and investment. These include: corruption, protectionist measures, lack of predictability, and burdensome bureaucracy.

Each of these negative forces has a different impact on small business as compared to large and multinational business, and start-up businesses versus active business. In this paper we have tried to address some of these destabilizing forces related to lack of predictability and burdensome bureaucracy with specific examples in order to better illustrate the points. We have also included examples of what we believe could be significant steps taken to neutralize the negative forces, or even drive growth.

While there are many areas of taxation that should be addressed in the context of stimulating investment (the lack of tax incentives, the very heavy burden of taxation on the working laborer, the lack of taxation on the profits gained from speculation of capital, the inefficiencies of the process of appeal when there is a dispute with tax authorities and taxpayers, etc) we have chosen two area to focus on in this paper. These are suggested changes
that will have a high positive impact, without the need for a potentially contentious legislative process.
Taxation

Binding Rulings

The inability for a taxpayer to receive a binding tax ruling diminishes predictability and adds administrative burdens to taxpayers. This is particularly the case where an issue is not clear in the law, and different tax authorities apply different interpretations. One taxpayer with multiple entities within Croatia can be required to account for a transaction differently in different legal entities simply because the local authorities interpret the law differently, and make tax assessments accordingly. This is also the case with respect to different years. One year the tax authority performs an audit and deems a current practice OK, the next year they issue a penalty for the same practice. There are many examples of this, but just to mention a few: the application of VAT on services provided to foreign buyers; the proper tax treatment when one country is the “hub” for several countries and supplying management which is charged to each country in the group, i.e. a Croatian company receives a management service charge from a company located in another jurisdiction. If one Central Body could give a binding ruling to taxpayers, this inconsistency and lack of predictability could be mitigated.

Another situation is where local practice differs from international standards of interpretation. A common example of this is in the interpretation of application of treaty benefits. For example, what constitutes a permanent establishment (hereinafter PE). While Croatia is not yet a member of the OECD, most of the treaties adopted are in line with the OECD model. However, local authorities do not interpret these provisions, for example, what constitutes a PE, in line with the way most countries of the European Union apply the interpretation. This requires business to operate differently.
in Croatia than they do in other countries of operation. It can also lead to negative VAT consequences, and increased cost of doing business in Croatia.

A favorable binding ruling could give them the ability to operate in Croatia harmoniously with the way they operate in other countries, rather than having to develop different systems and ways of managing business flow specifically to do business in Croatia, or worse, not do business in Croatia at all.

Please see Appendix 1 for a brief analysis of how binding rulings could be put into practice. Please see Appendix 2 for a benchmarking of other countries that have binding rulings.
VAT Refunds

Legal Overview

Legislatively, Article 21 of the VAT Act- Tax refund - states that: A taxpayer who in a given accounting period enjoys the right to deduction of input VAT, the amount of which is higher than his tax liability, shall have the right to a refund of the difference. The Tax Administration shall refund the difference within 30 days after the tax return was submitted.

In practice VAT refunds are routinely paid with significant delay (over a year in many cases), and taxpayers are put through significant stress in the form of inspections if they request a refund.

The businesses hardest hit by this are the very businesses that a growing economy should nurture and not limit. The effects of the economic crisis are making this issue become especially acute for certain classes of taxpayers.

Small enterprises and start up companies

These companies do not have the financial ability to withstand serious cash flow disruptions, and are the most vulnerable to failure. A company in the start-up phase is typically paying input VAT on expenses of starting up, prior to making significant sales. Without proper VAT refunding, the only practical way to get the input VAT back is to offset it against output VAT. This creates cash flow difficulties which can cripple a small company or a company in the start-up phase, and cause ultimate failure of the enterprise.
Companies making significant capital expenditures

Large capital expenditures cause large amounts of input VAT to be paid in a relatively short period of time. This puts most companies into a VAT refund position. In Croatia, companies do not only have to worry about how to finance their expansion project, but due to the practice of not giving VAT refunds, they also have to worry about how to finance the VAT on the project, until such a time as it can be recovered through generation of enough output VAT. This also applies to investors buying assets. This situation leads many would be investors to look elsewhere to spend their investment funds, and many companies to postpone, or scrap making needed capital expenditures.

Exporters

Because exports do not have a VAT charge on the sale, exporters are perpetually in the situation where their input VAT exceeds their output VAT. A country with healthy exports grows better than a country with deficits. By not providing timely VAT refunds, exporters are discriminated against, rather than supported and encouraged as economic stimulators.

There is no reasonable explanation as to why the VAT refunds are not given within the time period required by law. It is not reasonable to make a taxpayer wait until they have undergone tax inspection to provide a refund. A refund can be given based on a properly filed tax declaration, and tax authorities can perform inspections as an independent process. Just because a refund is given does not mean that the tax authorities forfeit their right to audit. One should not depend on the other.
Appendix 1

Binding Tax Ruling recommendation for putting a system in place

Ultimate goal: to obtain binding tax ruling applicable to specific case / applicant only

Legal Basis*

- Changes in General Tax Act:
  - To regulate rights and obligations of a taxpayer and the Tax Authority by adding the article on binding tax rulings.

- Changes in the Act on the Tax Authority:
  - To regulate the binding characteristic of the rulings.

- Changes in Law on General Administrative Procedure:
  - 30 days for issuing the ruling.

- Changes in the Act on Administrative Duties:
  - Fee: HRK 15,000.

* to be further investigated
Procedure

- Submission of a request along with the proof of payment;
- Request to be prepared in a prescribed format, comprising: identification information about the taxpayer, background on the issue, question and, suggested solution;
- Fee: HRK 15,000;
- Eligibility: domestic and foreign corporations and individuals;
- Possibility for a foreign company to apply through appointed domestic advisor;
- Deadline for issuing the ruling: 30 days upon the request with the proof of payment is filed;
- If not issued within prescribed deadline, reminder to be sent to the Tax Authority;
- If ruling is not issued within 10 days upon receipt of a reminder by the Tax Authority, refund of the paid fee to the taxpayer;
- Ruling not to be published – sent to the applicant only and the relevant Tax Authority office.
## Appendix 2 - Tax Rulings in EU

Overview of tax rulings in EU (only those near to Croatia and inclusive of Germany)

<table>
<thead>
<tr>
<th>Country</th>
<th>Coverage advance rulings (VAT, PIT, CPT) and APA</th>
<th>Applicants</th>
<th>Binding force</th>
<th>Fees</th>
<th>Publication</th>
</tr>
</thead>
<tbody>
<tr>
<td>Austria (as of 1.1.2011.)</td>
<td>International aspects and general tax</td>
<td>All TPs</td>
<td>TA: no, TP: no</td>
<td>From EUR 1,500 to EUR 20,000</td>
<td>No</td>
</tr>
<tr>
<td>Austria</td>
<td>International aspects and general tax</td>
<td>All TPs</td>
<td>TA: yes, in the form of Resolution (binding character ceases if the background facts altered)</td>
<td>No</td>
<td>Some, in tax journals if of general interest</td>
</tr>
<tr>
<td>Germany</td>
<td>Binding rulings re a planned scenario, Binding ruling due to a tax audit APA</td>
<td>All TPs</td>
<td>TA: yes (provided that facts do not change), TP: no</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Hungary</td>
<td>Advance binding ruling APA</td>
<td>All TPs</td>
<td>TA: (provided that facts do not change), TP: no</td>
<td>Yes</td>
<td>Yes, however on no name basis</td>
</tr>
<tr>
<td>Italy (introduced in 1991)</td>
<td>Ordinary rulings, Specific advance rulings, particularly referred to TPP, interest, dividends, and royalties Advance international tax rulings</td>
<td>All TPs</td>
<td>TA: yes, TP: yes</td>
<td>No</td>
<td>Yes, if of general interest, otherwise at the discretion of the TA</td>
</tr>
<tr>
<td>Slovenia (only as of 1.1. 2007)</td>
<td>As prescribed in GTL for advance ruling</td>
<td>TPs</td>
<td>TA: yes, TP: yes</td>
<td>From EUR 50 to EUR 500</td>
<td>No information</td>
</tr>
</tbody>
</table>

List of abbreviations:
APA: Advance Pricing Arrangements
TA: Tax Authorities
TP: taxpayers
TPP: transfer pricing
Tax rulings (official opinions) in Croatia

Croatian Tax Authorities (CTA)

Legal basis
Zakon o poreznoj upravi (NN 67/01, 94/04 i 177/04):
“Porezna uprava ovlaštena je davati mišljenja o primjeni propisa o pojedinačnom poreznim predmetima”.
The same stipulation is used in Pravilnik o unutarnjem ustrojstvu Ministarstva financija.

Fees
No charge.

Time required for answer
Not defined.

Main characteristics of the currently issued official opinions, according to available article titled: “Uloga mišljenja u poreznom postupku”, Porezni vjesnik, February 2010 from Zdravko Vukšić (Senior Advisor, Središnji ured Porezne uprave, Odjel za nadzor velikih poreznih obveznika):
- Issued by the CTA;
- Based on the legislation;
- Subject of the official opinion are public charges;
- Are related to one specific tax matter; and
- Binding for both the taxpayer requesting the official opinion and the CTA.

In order to enhance future official opinions the proposition to the CTA could be to:
- Amend the GTL (as this law governs the rights and obligations of taxpayers and the Tax Authorities) which would in future govern the procedure for issuance of official opinions which would provide transparency, certainty and consistency for taxpayers
- Divide binding from non-binding official opinions; for example: issuance for specific cases only, such as mergers, transfer pricing
Clear stipulation of the time required for the issuance of the official opinions (e.g. general rule from GTL and/or ZUP (Law on General Administrative Procedure; 30-60 days depending on the complexity of the case)

- Determination of fees fixed (like HANFA) or in a range depending on the value of the matter or the legal form of the TP (physical person or legal entities) requesting the opinion.

In the light of the above, an additional section in the GTL could be added which would govern this matter, as follows:

"Glava V Opće postupovne odredbe

Izdavanje mišljenja poreznog tijela

Porezna uprava ovlaštena je davati mišljenja o primjeni propisa o pojedinačnom poreznim predmetima.

Mišljenja iz stavka 1. ovog članka ovlašten je izdavati Središnji ured, Porezne uprave.

Cilj je mišljenja osigurati jedinstvenu primjenu zakonskih i podzakonskih propisa.

Porezna uprava prema zahtjevu poreznog obveznika izdaje mišljenje o svim poreznim pitanjima koja se mogu javiti u poslovanju poreznog obveznika.

Porezni obveznik, podnositelj zahtjeva dužan je zahtjev valjano obrazložiti, točnije dužan je podastrijeti sve činjenice i okolnosti koje bi mogle biti od utjecaja za davanje mišljenja.

Iznimno, Porezna uprava nije dužna izdati mišljenje u slučaju gdje je zakonska, odnosno podzakonska norma jasno utvrdila postupanje.

Porezna uprava neće izdati mišljenje u slučajevima:

- Kada je pokrenut porezni nadzor
- Određivanja metoda transfernih cijena te potvrđivanja korištene metode transfernih cijena
- Etc.

Mišljenje izdano u skladu s ovim člankom obvezuje Poreznu upravu u cjelini kao i poreznog obveznika koji je postavio zahtjev za izdavanjem mišljenja.

Ukoliko se činjenice dane u zahtjevu izmjene na način da se mišljenje ne može primijeniti ili bi poreznog obveznika neopravdano stavljalo u nepovoljniji položaj, Porezna uprava nije dužna primijeniti tako izdano mišljenje.

Porezna uprava je po kompletiranom zahtjevu za izdavanje mišljenja, dužna izdati mišljenje u roku od 30 dana. Iznimno, se mišljenje može izdati i u
kasnije roku koji, međutim, ne smije biti dulji od 60 dana.

Sve troškove oko izdavanja mišljenja snosi porezni obveznik. Troškove izdavanja mišljenja propisat će Ministar financija u roku od 6 mjeseci od donošenja izmjena i dopuna ovog Zakona.

Mišljenje se izdaje u obliku rješenja. Protiv takvog rješenja nije moguće izjaviti žalbu."

**CNB**

**Legal basis** – Zakon o HNB-u, Article 4

"obavljanje ostalih, zakonom utvrđenih poslova."

**Fees**

No charge.

**Time required for answer**

In practice, after submitting a request for the official opinion, depending on the area, it could take between 2-14 days for the answer.

**Binding force**: Yes, for both the CNB and the legal entity/individual entrepreneur requesting the official opinion.

**HANFA**

**Legal basis** – Zakon o HANFA-i, Article 15 (9)

“Davati mišljenje o provedbi ovog Zakona i posebnih zakona iz točke 1. na zahtjev stranaka u postupku ili osoba koje dokažu svoj pravni interes.”

**Fees**

Legal entity – HRK 500 (administrative fees); HRK 5,000 (fee)

Individual - HRK 20,00 (administrative fees); HRK 200 (fee)

**Time required for answer**

In practice, after submitting a request for the official opinion, depending on the area, it could take between 10-20 days for the answer.

**Binding force**: Yes, for both HANFA and the legal entity/individual requesting the official opinion.
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