

Recommendations for Enhancing Entrepreneurship in Croatia through Direct Selling Activities

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American Chamber of Commerce in Croatia *Američka gospodarska komora u Hrvatskoj*

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Overview of the Direct Selling Industry

Direct selling is a method of marketing and retailing goods and services directly to consumers, in their homes or in any other location away from permanent retail premises. It is usually conducted in a face-to-face manner, either where products are demonstrated to an individual, or to a group or where a catalogue is left with the consumer and where the direct seller call as later to collect orders. Unlike direct marketing or mail order, direct selling is based principally on personal contact with the customer, through a network of independent self-employed sellers. These channels of distribution are particularly suitable for innovative or distinctive products not readily available in traditional retail stores.

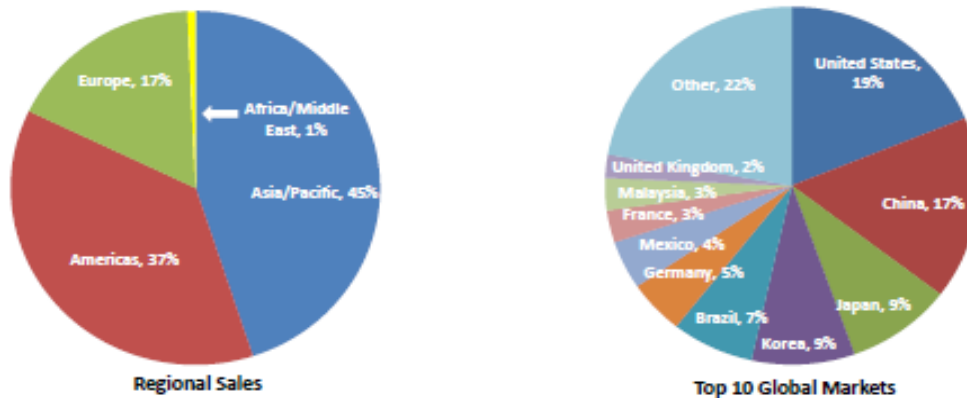
Direct sellers are individuals of different ages and backgrounds who are career-minded entrepreneurs building their own business, or part-time entrepreneurs earning additional income on top of their regular employment income. An individual direct seller is not an employee as he or she is not integrated in the chain of command in a direct selling company, is financially and economically independent from the company, has flexible working hours, holidays and workplace, and exercises his or her activity at own risk. However, a direct seller is trained by the direct selling company about its products and sales skills. Direct sellers are remunerated on the basis of margins on sales of consumer products to ultimate consumers, as well as commissions, bonuses and awards from the direct selling company according to the company compensation plan. Direct sellers do not receive compensation for the recruitment of other direct sellers.

Global Trends

Today, more than 103 million people around the world are engaged in direct selling and it is estimated that the industry has an annual turnover of almost 183 billion dollars. Out of 5,7million persons involved in direct selling in the European Union, 79% are women. Direct selling is a dynamic, vibrant, rapidly expanding channel of distribution of products and services directly to consumers.¹

¹ World Federation Statistical Database (2012-2015)

Figure 1: Regional Sales and Global Markets



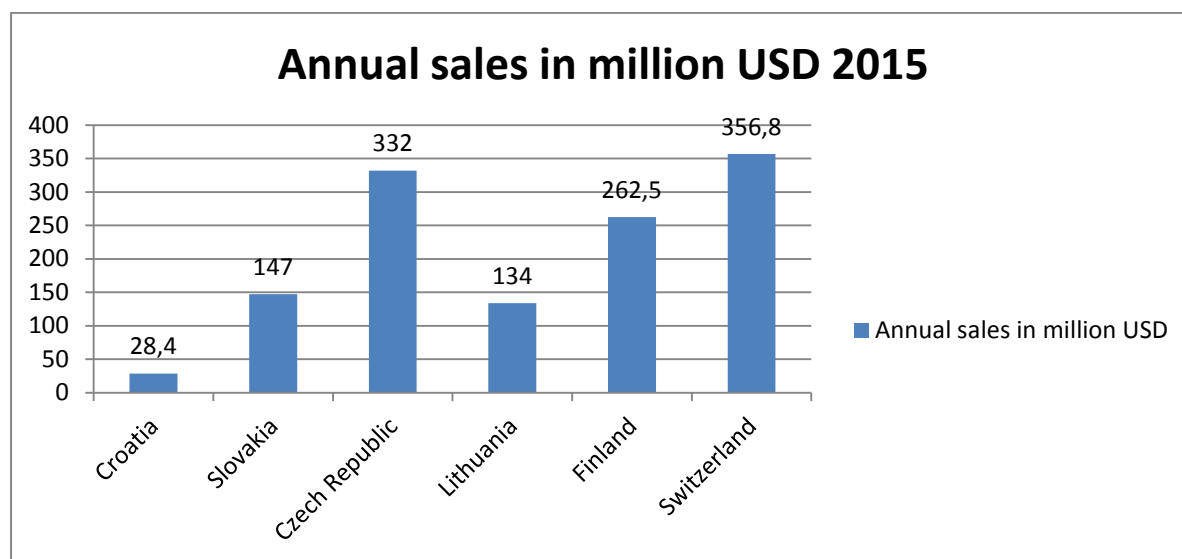
Direct selling provides important benefits to individuals who desire an opportunity to earn an income and build a business of their own; to consumers who enjoy an alternative to shopping centers, department stores or similar; and to the consumer products market. It offers an alternative to traditional employment for those who desire a flexible income earning opportunity to supplement their household income, or whose responsibilities or circumstances do not allow for regular part-time or full time employment.

Consumers benefit from direct selling because of the convenience and service it provides, including personal demonstration and explanation of products, home delivery and generous satisfaction guarantees. Direct selling enhances the retail distribution infrastructure of the economy, and serves consumers with a convenient source of quality products.

Current Situation in Croatia

Despite positive global trends (more than 103 million people around the world engaged in direct selling, annual turnover of almost 183 billion dollars, increase of annual global sales of 6,4%), the situation in Croatia is significantly different. To be exact, industry data for Croatia show a 24% decrease of direct sales in Croatia in the period 2010 – 2015. ²

Figure 2: Annual Direct Sales in 2015



Source: Seldia Statistical Report for 2015

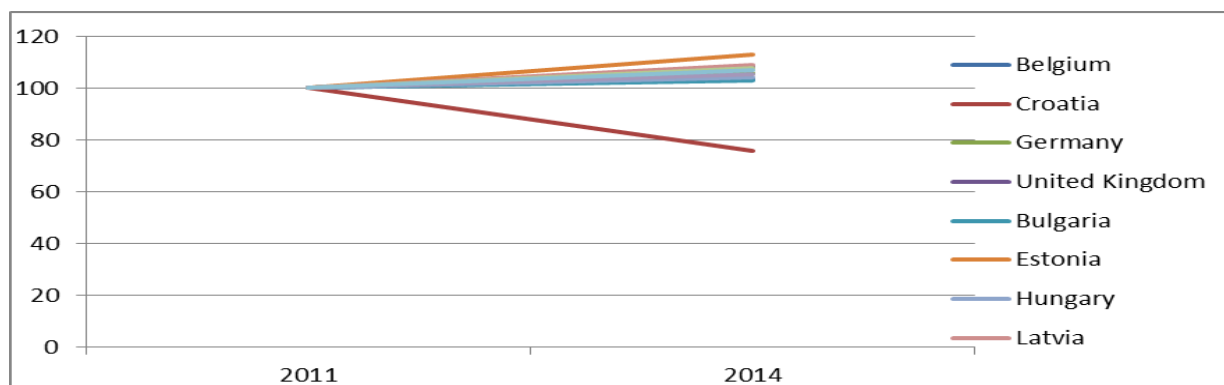
Industry data from other EU Member States show a general increase of sales for the period 2011 - 2014³:

- Belgium 3,5%
- Germany 5,7%
- United Kingdom 8,2%
- Bulgaria 2,8%
- Estonia 13,0%
- Hungary 4,1%
- Latvia 8,8%
- Lithuania 7,8%
- Poland 5,2%
- Romania 6,8%

² Annual Financial Reports of direct selling companies delivered to Financial Agency

³ World Federation Statistical Database (2012-2015)

Figure 3: EU Trends for Direct Selling

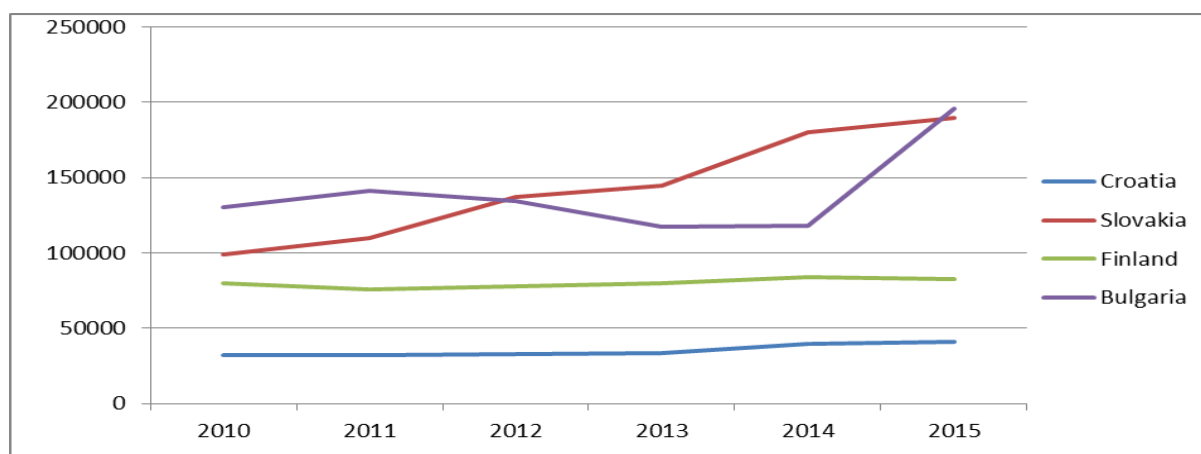


As seen above, Croatian results are significantly different to those of other EU Member States. Based on information from AmCham members engaged in direct selling, this is directly connected to current tax and administrative barriers to the development of direct selling industry in Croatia.

The decrease of direct sales activity in Croatia discourages further direct selling efforts in Croatia and directly affects sales results in Croatia. Even though a large number of individuals express their interest in engaging in direct selling, the majority of them decide to cease their activities at a later stage, due to existing obstacles.

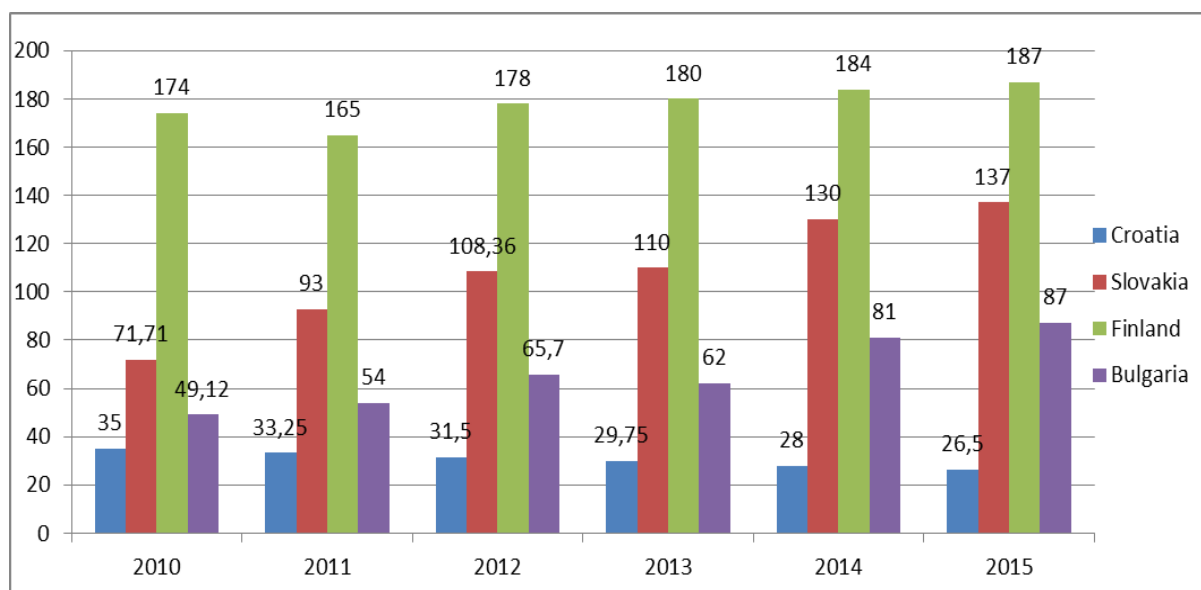
Additionally, the number of people engaged in direct selling in Croatia is significantly lower than in comparable countries in terms of population, indicating a strong growth potential of the industry.

Figure 4: Number of direct sellers in Croatia and similar countries in the period 2010-2015



Source: information provided by direct selling companies in Croatia

Figure 5: Revenue of direct selling industry in the period 2010–2015 (million EUR)



Source: Annual Financial Reports delivered by direct selling companies to FINA in period 2010 - 2015

The above data shows that Croatia suffered a significant loss of potential business income from direct selling (57 million HRK or 24%) in the period 2010 – 2015. As a result, some direct selling companies closed their branches in Croatia, leading to loss of employment and income for the state budget.

It is interesting to note that the number of individuals involved in direct selling actually increased by 9 thousand in the same period. However, this did not have an positive effect on the levels of business income in Croatia. In normal circumstances, a positive correlation would be expected.

Recommendations for Development of Direct Selling Industry in Croatia

Development of the Legal Framework for Direct Sales

AmCham consider that it is necessary to develop the regulatory framework that will facilitate direct sales by individuals (up to 2014 regulated by the Trade Act and the Bylaw on Direct Selling) and thereby encourage additional entrepreneurial activity.

The main problem lies in the lack of definition of direct selling activities in the current legal framework, as a result of changes that removed all legal provisions related to direct selling from the Trade Act of the Republic of Croatia in 2014.

The following provisions have been removed from the Trade Act and relevant bylaws:

- Definition of direct selling from Article 2.7
“Direct selling” means the sale of products directly to consumers by the producer or registered seller, on the location of production or by direct selling representatives in homes of consumers, homes of other persons and on other locations out of permanent retail stores;
- Provision that direct selling representatives are authorized to sell products from Article 5.1.5
Trade activities may be performed by direct selling representatives who are performing such activities for registered seller or producer;
- Definition that direct selling is a special type of retail selling from Article 10.1.7
Retail trade out of retail stores is a type of retail trade when sale of products or services is done in one of below mentioned manners:
 - *by direct sales through direct selling representatives*
- The Direct Selling Bylaw, due to the fact that Article 12.4 of the Trade Act was removed.
The Minister of Economy shall prescribe in detail terms and conditions for rendering of activities of direct sales through representatives.
- Provision on direct selling from Article 26 of the Bylaw on Classification of Retail Stores and Other Types of Retail Sales
“Direct selling” means the sale of products directly to consumers by the producer or registered seller, on the location of production or by direct selling representatives in homes of consumers, homes of other persons and on other locations out of permanent retail stores. Range of products which may be sold by direct selling includes food and non-food products and services.

These amendments have led to a lack of a clear legal framework for direct selling activities in Croatia.

AmCham proposes that changes to existing legal regulations are made in order to create a suitable legal framework for direct selling activities in Croatia. These changes should primarily be made to the Trade Act and related legal regulations or bylaws, as shown below:

1) Reintroduction of the definition of direct selling to the Trade Act

- Proposed new wording: *“Direct selling” shall mean a sale of products and/or services to consumers by the producer or seller (hereinafter: the Seller) concluded out of business premises.*

2) Reintroduction of the definition of direct selling representatives to the Trade Act

- Proposed new wording: *“Direct sales representative” shall mean any independent natural or legal person who, pursuant to the provisions of the Trade Act and provisions of the Consumer Protection Act:*
 - *Sells products and/or services of the Seller in the name and on behalf of the Seller; or*
 - *Sells products and/or services of the Seller in its own name but on behalf of the Seller; or*
 - *Sells products and/or services of the Seller in its own name and on its own behalf, being bound by the Seller’s policies and the terms of the agreement entered into with the Seller.*

3) Reintroduction of the definition that direct selling is a special type of retail sales to the Trade Act, in the original form removed in 2014

4) Reintroduction of a special bylaw prescribing conditions for the rendering of direct selling

5) Reintroduction of the definition of direct selling to the Bylaw on Classification of Retail Stores and Other Types of Retail Sales

More Equitable Taxation Model for Direct Sales

AmCham members recently conducted an analysis of the tax treatment of individuals engaged in direct sales activities in seven EU member states (Hungary, Italy, Slovenia, Czech Republic, Slovakia, UK and Netherlands).

Beside lower tax rates (e.g. Hungary 16%, Czech Republic 15%, Slovakia 19%-25%), the majority of mentioned countries have more favorable administrative and taxation rules for similar activities compared to Croatian regulations:

- Italy - no social contribution paid below 6.410 EUR of annual revenue from direct sales;

- Slovakia and Netherlands – actual expenses incurred by direct selling representatives in process of rendering of their activities recognize as deductible expenses;
- United Kingdom – annual earnings up to 10.000 EUR non-taxable;
- Hungary – simplified administration and taxing of small entrepreneurs which earn up to 20.500 EUR annually (e.g. lump sum of 170 € covers all taxes and contributions);
- Slovenia – increased the fixed recognized tax expense from 25% up to 70% of taxable earnings; no additional contribution obligations if already covered through regular employment or other.

These examples show that EU practice recognizes the economic importance of occasional activities by which individuals gain limited additional earnings, and encourage simplified administration and taxation for these activities.

Taking into account the above examples of EU best practices, as well as the needs of the Croatian economy, AmCham proposes the following changes to the tax treatment of direct sales activities, both retail sales and promotional activities:

- 1) Introduction of a non-taxable threshold for occasional direct sales activities** (e.g. up to the amount of 37.500 HRK);
- 2) Recognition of incurred expenses** - earnings above the non-taxable threshold should be taxed after a deduction of actual business expenses (travel, telephone, presentation and similar), or an agreed lump sum expense (e.g. 22%) and/or monthly personal deduction
- 3) Introduction of a non-taxable yearly personal consumption limit**
- 4) Taxation of earnings coming from engagement with direct sales companies, above the non-taxable threshold, by the lowest personal income tax rate of 24% (similar to Italian regime) and city tax (0-18%).**

These recommendations would go in line with existing practices, such as:

- Direct selling may be performed by companies and crafts (d.o.o. and "obrt"), in addition to the recognition of individual direct sellers;
- Mandatory health insurance and social contributions are withheld on earnings above determined threshold as per current process and at current rates.

Removal of Administrative Barriers

In addition to regulatory and fiscal barriers presented in this position paper, there are a number of administrative barriers hampering the development of the direct selling industry in Croatia.

AmCham proposes the removal of the following administrative barriers:

- 1) Obligation by individual direct sellers to register with the Tax Administration and the Pension Insurance Institute –** payments of high monthly contributions regardless of the amount of monthly earnings (approximately 1,700 HRK).

Furthermore, such activity often requires engagement of accounting, tax and legal advisors due to lack of understanding and complexity of existing (primarily tax) regulations;

- 2) Requirement that an EU company has to establish a company or a branch, or find a distributor to be able to sell products or provide services in Croatia,** in order to satisfy terms and conditions of the Act on nutritional and health claims and food enriched with nutrients (Article 10 of the Act) and Article 38 Paragraph 6 Point 1 of the Bylaw on registration of subjects doing business activities with food – *the subject is obliged to deliver evidence that it has been registered for business activities and entered in the required register in the Republic of Croatia;*
- 3) Requirement that an EU company has to establish a company or a branch to be able to provide services in Croatia.**

Conclusion

AmCham's recommendations for enhancing entrepreneurship in Croatia through direct selling activities include:

- 1) Development of the legal framework for direct sales;
- 2) More equitable taxation model for direct sales;
- 3) Removal of administrative barriers for direct sales.

AmCham believes that the adoption of these recommendations, presented in more detail in this position paper, would improve the competitiveness of the direct selling industry in Croatia. Additionally, it would facilitate stronger entrepreneurship uptake by providing commercial opportunities to interested individuals, thereby positively impacting consumption level and general economic activity.

Specific benefits of the developed direct selling industry include:

- Increased self-employment opportunities for individuals to generate additional income;
- Easier route into entrepreneurship for individuals due to:
 - Low cost of starting a business,
 - Low level of risk,
 - Flexible working hours;
- Increased probability of individual commercial success due to:
 - Favorable taxation treatment of initial/lower earnings leading to fewer individuals leaving the industry,
 - Life-long training offered by direct selling companies;
- Better regulation of the direct selling industry, leading to:
 - Effective control of retail activities of direct selling companies,
 - Increased state budget revenues through VAT/income tax payments due to increased disposable income and consumption levels.

AmCham would welcome the opportunity to exchange views on how to facilitate the further development of direct selling industry in Croatia, with the goal of reversing the negative industry results when compared to global trends and contributing to further growth of the Croatian economy.

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