

# Continuity in the Practice of the Tax Administration with Regard to the Interpretation of Income Taxes in the Beverage Manufacturing Sector

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

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# Introduction

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The American Chamber of Commerce in Croatia (AmCham) is actively championing practices that contribute to the creation of a predictable and stimulating business environment in Croatia – a business environment that reduces the tax burden, enables investments in innovation, sustainable business operations, and higher productivity of businesses that operate on the domestic market, and places Croatia in the position of an attractive destination for new investments.

AmCham welcomes a range of measures introduced by the Ministry of Finance that have contributed to the predictability and the reduction of the tax burden of business operations in Croatia.

AmCham would like to point out the recent change in the practice of the Tax Administration with regard to the interpretation of income taxes of economic operators in the beverage manufacturing sector, which resulted in a significant increase in the tax burden of their business operations. It is important to highlight that neither legislation nor accounting standards changed during this process. Longstanding practice and the interpretation of provisions were changed abruptly by the Tax Administration.

With this opinion, AmCham wants to bring attention to the current situation and request a revision of the tax treatment of drink manufacturers, which have been the subject of additional tax burdens on their business operations in the last few years.

## Issues

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The business operations of drink manufacturing companies are guided by the Ordinance on packaging and packaging waste, which stipulates that manufacturers, specifically those placing returnable packaging on the market, must ensure, through a deposit scheme or alternative means, the return and reuse of the returnable packaging they place on the market. The deposit schemes have been in place in Croatia for more than 30 years, and the Tax Administration, as well as the regular annual reviews, has yet to determine irregularities in that scheme, given that neither the legal nor the accounting/tax framework was changed.

Nevertheless, after the fiscal supervision conducted in late 2022, the Tax Administration drew a range of conclusions that surprised manufacturers. The conclusions include the following:

- During the process of invoicing goods to the customer, the deposit for the returnable packaging is also charged. The Tax Administration disputes the recording of the liabilities for the received deposits with the interpretation that at the moment of invoicing, no deposit from the customer has been received. Instead, it argues that the matter includes not a liability towards customers but receivables from customers. As such, the conclusion is that the non-existing liabilities should be recorded as sales revenue.
- The Tax Administration concludes that the deposit for returnable packaging should be recognized as revenue, not a liability, according to the "IFRS – 15 Revenue from Contracts with Customers", which AmCham considers incorrect. In light of this, if revenue is incorrectly recognized, the additional tax burden on profit (18%) will be incorrectly calculated, and so will the interest owed. For clarity, we emphasize that this total liability pertains to the accumulated amount of the received deposit from each tax period that includes the obligation to repay the received funds at the moment of return of the packaging.
- In its decision, the Tax Administration did not provide instructions on the correct procedure with regard to future tax periods, specifically when the returnable packaging is returned and the liability towards the customer becomes due. In other words, it is unclear how taxpayers should proceed in future tax periods and in what way the return of the funds will affect their tax liability (or whether it will be possible to reduce the liability resulting from the deposit yield).

We consider the aforementioned conclusions of the Tax Administration incorrect for the following reasons:

- Every contract of sale and every dispatch note evinces the type, quantity, and value of the packaging that is charged to the customer, which is precisely the purpose of the guarantee deposit. For this reason, it is neither logical, possible, nor practical to catalog the assets (thousands of bottles/packaging) that customers hold.
- Customers have no control over the packaging because **the ownership rights of the packaging are still retained by the seller even when the packaging is held by the customer**. It is also evident from the contracts with the customers that the customer **accepts the obligation to return the packaging** by signing the contract.
- Therefore, the conditions to recognize the revenue according to IFRS 15 are not met because the customers have a clear obligation to return the packaging, guaranteed by the paid deposit (customers neither become the owners of the packaging nor have any economic benefits from the packaging).
- The guarantee deposit has the same purpose as any other form of guarantee and thus cannot be considered revenue.
- If, according to the Tax Administration, the guarantee deposit for the packaging given to the customer is revenue, then it should be considered an expenditure of the customer who took the packaging in exchange for the deposit, which has no basis in the tax, legal, or accounting frameworks enforced in Croatia.
- Moreover, the Ordinance on packaging and packaging waste stipulates:

*"Article 14*

*(1) The manufacturer that places returnable packaging on the market is required to ensure through a deposit scheme or alternative means that the returnable packaging placed on the market by that manufacturer is returned and reused."*

This provision also evidences the rationale and the legal basis of the previous conduct of the businesses in the market.

## Conclusion

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AmCham considers it necessary to promptly revise the new tax interpretation that resulted in the unannounced considerable additional financial burdens for economic operators while the legal framework remained unchanged. The sudden, irregular change in the treatment by the tax authorities in relation to a system that has been unchanged for decades has a negative impact on all the positive actions taken to enable a predictable and stimulative tax environment in Croatia.

The undisputed fact remains that under the previous business practice and regulations, it was the obligation of the customer to return the packaging and pay a guarantee deposit which is repaid upon the return of the packaging. The circulation of the packaging and the deposit can be seen clearly in the seller's accounts, as well as the accounts of the customers. Therefore, the argument that the deposit balance would be taxable at the end of the year has no legal basis.

The existing returnable packaging scheme, which has been in place in Croatia for decades, is an example of a good practice European Union-wide. It allows Croatia to meet the national recycling goals and the European Green Plan and ensures business operations under the principle of a circular economy. Furthermore, this scheme also encourages sustainability and environmental responsibility, promotes the reuse of resources, and reduces the amount of waste. Considering this positive perspective, sudden changes in the tax practice relating to the returnable packaging sector negatively impact on Croatia's ability to accomplish these goals and the circular economy in general.

Finally, this change in the interpretations and treatment by the tax authorities, which has no basis in any legislative changes, calls into question the predictability of business operations, legal certainty, and protection of investment, especially when keeping in mind a range of bilateral contracts where the Republic of Croatia is either the signatory or the contracting party, such as the Treaty concerning the encouragement and reciprocal protection of investment between the Republic of Croatia and the United States of America.

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For additional information, please contact:  
American Chamber of Commerce in Croatia  
Andrea Doko Jelušić,  
Executive Director T: 01 4836 777  
E: [andrea.doko@amcham.hr](mailto:andrea.doko@amcham.hr)