Recommendations for the Tax System Reform in 2024

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AmCham

American Chamber of Commerce in Croatia Američka gospodarska komora u Hrvatskoj

Contents

Introduction

AmCham welcomes the tax relief measures implemented over the previous rounds of tax reform.

Irrespective of this, AmCham deems that efforts to improve the tax system should be continued and sets out recommendations to further reduce the tax burden aimed at attracting investment more effectively and increasing Croatian employers' competitiveness in attracting and retaining the workforce.

General Recommendations

Better regulation

Frequent, unpredictable, and non-standardized changes to the tax system, regardless of content, are not good for the economy. AmCham strongly supports the Ministry of Finance's practice of not introducing changes to taxation in the current year unless they were agreed upon in the previous years, and the practice of tax regulation planning. It is essential to maintain this approach.

Tax authorities as partners to the business community

AmCham members still report their impression that tax inspectors are focused on looking for errors in order to penalize businesses. Inspectors and the Tax Administration should position themselves as economic advisors. If it is clear that the error was unintentional, it is sufficient and far more useful to issue a warning with a plan to rectify the error. AmCham calls for the Tax Administration to make further efforts in terms of preventive measures instead of imposing additional tax liabilities and administrative fines for minor omissions.

The procedure for obtaining a special tax status (the "procedure") aims to promote the voluntary fulfillment of tax obligations and reduce the administrative burden. This allows for the deepening of two-way communication between the Tax Administration and the taxpayer.

The regulations govern the procedure that every taxpayer must follow in order to achieve a special tax status. However, it is unclear exactly what information the Tax Administration can request from the taxpayer. This means that the procedure for acquiring a special tax status may be carried out in the same way as regular tax supervision, which is neither the idea nor the essence of that procedure. Therefore, to better understand the implementation of this procedure, we suggest accurately defining the documentation and scope of information that the Tax Administration can request from the taxpayer to create that taxpayer's profile. Likewise, AmCham believes that there should be a deadline for the Tax Administration to enter into an agreement on the voluntary fulfillment of tax obligations.

Furthermore, in accordance with the experiences of other EU countries, we suggest the following:

· Enter into active cooperation with other tax administrations within the EU regarding the implementation of the procedure for acquiring a special status; this especially applies to multinational corporations, which have uniform processes in all countries, which would undoubtedly facilitate and speed up the procedure;

· Hold regular meetings between the taxpayer and the Tax Administration after the taxpayer is granted a special tax status, for example, quarterly or semi-annually; this is necessary to ensure better and continuous two-way communication and to build trust, all for the purpose of improving the taxpayer's business processes and reducing tax risks.

Introducing the possibility of voluntarily reporting undeclared tax liabilities

AmCham welcomes the introduction of the possibility of voluntarily reporting undeclared tax liabilities related to income earned abroad by natural persons without negative consequences under Article 12b of the General Tax Act. However, AmCham deems that such a possibility should also be introduced for other types of tax and not only for income earned abroad. Naturally, a mechanism designed to prevent abuse of this option should be developed.

Administrative measures to facilitate the business of undertakings and the Tax Administration

Businesses often complain about the high level of bureaucracy, i.e., the large number of administrative requirements they have to meet in fulfilling their tax and related obligations. AmCham welcomes continuous digitalization and automation of the entire system (modernization of the information system), as well as the abolition of a certain number of forms, which would contribute to increased transparency, equal treatment, and simplification of the process and would be more environmentally friendly ("paperless business"). AmCham welcomes all changes aimed at reducing the number of forms, simplifying those forms that would remain in use, and reducing the number of codes when filling in the forms (e.g., the UK VAT form contains 5 to 7 fields, while the Croatian one has 20). It is essential to persist implementing measures aimed at improving the investment environment by cutting costs and simplifying doing business in terms of administration.

Extending the period of tax loss carryforward

Existing rules on the five-year loss carryforward do not encourage long-term investments, especially not high-tech investments. It is necessary to extend the loss carryforward period in accordance with the best European and global practices. For example, Austria has a period of 7 years, while the US has 20 years. AmCham deems that the loss carryforward period in Croatia should be extended from 5 years to 10 years. A good example is the Slovenian scheme, where there is no time limit for the loss carryforward in advance, but each year, only 50% of the realized income

can be covered by the loss carryforward, and corporate income tax must be paid on the remaining 50%.

Extension of the deadline for submission of personal and corporate income tax returns

Croatian tax legislation provides for very short annual deadlines for filing personal and corporate income tax returns, which often leads to incomplete submissions due to a lack of information. Many countries in the region have significantly longer deadlines for submission of returns, and Croatia differs significantly in that respect.

A review of deadlines for submitting personal and corporate income tax returns is found in Annex 1.

It is essential to point out that obtaining information from abroad (for both natural and legal persons) is often impossible within the prescribed time limit, specifically because nearly all countries have longer tax return submission deadlines, and the information is simply unavailable. This ultimately results in significant additional administration imposing the greatest burden on taxpayers (because they must perform adjustments) and Tax Administration officials who must process this information (sometimes in several instances).

In order to avoid this unnecessary administration, AmCham deems it necessary to prescribe an **extension of the time limit for the submission of personal and corporate income tax returns**, as proposed below.

Personal income tax

Currently prescribed deadlines for the submission of tax returns are January 31 and February 28 for the previous year, while the deadline for the submission of final information for income earned abroad and certificate of tax paid abroad is November 30 for the previous year (even though, in this case, compliance with the above deadlines is still mandatory).

AmCham's proposal

Introduce March 31 as the single deadline for submissions for the previous year. We propose to keep the deadline for submission of information on income from abroad and accounting of tax paid abroad unchanged (November 30), and we propose the introduction of an option of an "automated" request to extend the deadline for the submission of the information to the Tax Administration if the data from abroad is not available by March 31 (e.g., by simply checking an e-Porezna system box to request the extension).

Corporate income tax

The deadline for filing a corporate income tax return is four months after the end of a financial year. This deadline is final, and no option of extension is provided for. The course of the process is specifically illogical – the deadline for the preparation and submission of (unconsolidated) annual financial statements is six months from the end of a financial year. These statements are the basis for the preparation of a corporate income tax return, i.e., accounting income is the starting point for

determining the corporate income tax liability. This means that taxpayers must first prepare and determine their annual financial statements in order to have accurate and complete information for determining the corporate income tax liability, but the legal deadline for their preparation and submission is longer than the deadline for the preparation and submission of a corporate income tax return.

In practice, it is very demanding to close the business books, prepare the annual financial statements, and audit them by the deadline for filing a corporate income tax return.

In some cases, taxpayers have to intervene in their business books even after filing a corporate income tax return, either to correct the errors they observe themselves or because of audit findings. Even though, in such cases, taxpayers prepare and submit their annual financial statements for publication within the deadline, they are forced to make a subsequent correction of the corporate income tax return.

AmCham's proposal

We propose **extending the deadline for filing corporate income tax returns to six months after the end of a financial year** (i.e., to be equal to the deadlines for submitting annual financial statements for publication).

Tax liability maturity for natural persons

Based on Article 54(1) of the Income Tax Act, the Tax Administration, applying a special procedure for determining the annual income tax, is obliged, based on the records and data at its disposal, that is, data submitted by the taxpayer, to determine the taxpayer's annual income realized in the tax period and the difference of tax and surcharge for payment or for refund, about which it issues a temporary tax decision. In cases where the decision results in a liability, the tax authority debits the determined tax liability, and the taxpayer must pay it.

In practice, despite the data available to the Tax Administration, on occasion, the tax liability is not correctly determined. Even though further administrative steps are possible for the taxpayer to correct such a decision (appeal), the appeal does not delay the execution of the decision, and the taxpayer is obliged to settle the tax liability in the amount determined by the incorrect decision.

Often, such tax liabilities are exceptionally high, forcing the taxpayer to incur debt to raise funds and avoid enforcement, which the Tax Administration initiates for larger sums in the shortest possible time. Only after the appeal is over can the taxpayer retrieve their funds, which often takes a long time.

AmCham particularly refers here to a mismatch of deadlines when issuing a temporary tax decision within a special procedure. Namely, after a temporary tax decision is issued, the taxpayer has 45 days to settle the tax liability. The deadline for submitting an appeal is July 31 of the current year for the previous year, or 30 days from the delivery of the decision (if it was delivered after June 30), and the deadline for the tax authority's decision on the submitted appeal is 30 days from when the appeal was submitted. Even if the tax authority were to adhere to the set

deadlines for resolving appeals (which is often not the case in practice), this usually means that the tax authority makes its decision (if it adheres to the set deadlines) within 60 days from the date of issuing the decision, and the deadline for payment of the due tax (based on an incorrect decision) is 45 days.

AmCham considers the inconsistency of deadlines and the fact that the appeal does not delay execution unjustified. Namely, any appeal should be seen as an integral part of a special procedure, i.e., part of the communication between the (first-instance) tax authority and the taxpayer, all for the purpose of issuing a single decision.

Therefore, AmCham proposes that the provisions of the Income Tax Act, valid until March 19, 2020, be reinstated, according to which: *"The submitted appeal postpones the execution of the temporary tax decision pending the decision on the appeal."*

Furthermore, similar problems are encountered in procedures for determining the income tax liability for the previous tax period based on the submitted voluntary filing of undeclared income. It is a relatively new procedure, so the practice of tax offices is still not settled. However, in these cases, the tax authorities resolve the cases directly without investigating, which means issuing a decision where the appeal does not delay its execution.

In this case, the Tax Administration usually refers to Article 87, paragraph 1 of the General Tax Act, i.e., to the fact that the taxpayer has stated facts in the tax return or submitted evidence on the basis of which the state of affairs is established. However, the voluntary filing of undeclared income can be a very complex matter. Accordingly, it is debatable whether in such cases the matter can be resolved at all without conducting an investigation, which consequently results in incorrect decisions where the appeal does not delay the execution of the decision, and the taxpayer must pay significant tax liabilities determined by the (incorrect) tax decision.

To avoid such situations, AmCham proposes adding a provision to the General Tax Act based on which: *"An appeal submitted against the decision on income tax liability based on the submitted voluntary filing of income from abroad from Article 12b (1) of the General Tax Act shall postpone the execution of the decision."*

Archiving of accounting documentation

The Accounting Act (Article 10) stipulates the obligation to keep documentation in its original form for a certain number of years (depending on the type of documentation) or the need to convert the original documentation using a precisely defined method into electronic form (which includes payment to a professional institution, because businesses usually do not have the resources to do that themselves). On the other hand, many companies already have all accounting documentation in electronic format (PDF or TIF format) as it is generated immediately following implementation in software and applications, but, unfortunately, it is insufficient to retain it only in that format. It is important to regulate the storage of documentation in a format that can be generated more efficiently without the need for additional electronic conversions, which incur extra costs. Furthermore, we suggest introducing a qualified electronic signature as a

universal means of signing, which would be acceptable in all our institutions/enterprises and could also serve as protection for electronically generated documents.

Personal income tax and mandatory contributions

Despite significant progress in reducing the taxation of labor, AmCham believes that there is more room for further reduction to make it more competitive compared to other Central and Eastern European countries and to retain the workforce in Croatia.

An overview of tax rates and contributions in the Croatian and competing markets is found in Annex 2.

The table in Annex 2 shows that Croatia is still insufficiently competitive regarding the total tax burden arising from public dues, particularly in the area of higher salaries. At the same time, Croatia has the highest consumption taxes (VAT) among the countries listed and ranks near the top in corporate income tax. Therefore, the tax burden is still relatively high in all areas. That is one reason why many propulsive sectors in Croatia are experiencing problems with a lack of qualified workers, a fact especially evident in the ICT industry and tourism. AmCham welcomes previous personal income tax reductions but also sees the need for further reductions of the burden imposed on labor through taxes and contributions.

Reducing the tax burden on labor would contribute to the opening of regional centers of international companies in Croatia since reducing the burden imposed on salaries by public contributions would make it more affordable for undertakings to remunerate the best managers. In this way, Croatia would position itself as a regional business center, with EU membership and its geographical location as contributing factors, along with the membership in the Eurozone and the Schengen Area from 2023, with expensive employment as a detriment.

As short-term measures, AmCham proposes **three key changes** to achieve the stated goals:

- Increase non-taxable personal deductions to EUR 840;
- Increase the higher income tax rate threshold to EUR 5,000 per month;
- Apply the maximum monthly and annual bases in the calculation of healthcare insurance contributions.

Increase non-taxable personal deductions

The Government of the Republic of Croatia has outlined several key objectives regarding the tax system in its program. These include simplifying the system, broadening the tax base, and providing relief for citizens and businesses. The government consistently promotes these objectives, such as through successive increases in the non-taxable part of income (personal deduction). However, AmCham believes that, given the inflation and its impact on living standards, further income relief is necessary – therefore, we propose increasing the personal deduction to EUR 840. This amount is the current minimum salary level in the Republic of Croatia. On the one hand, AmCham believes that it is justified not to tax income below the minimum living threshold, while, on the other hand, this measure would benefit a wide range of the working population in Croatia by reducing the overall tax burden

and boosting the net income of individuals earning medium and high salaries. This would make the salary levels that Croatian employers can offer more competitive compared to foreign employers, which has a positive effect on reducing the outflow of labor.

It would also open up space for employers of persons with net income of up to EUR 840 (who would not otherwise feel an effect of the increase of the non-taxable part of the salary as they do not pay personal income tax because of their relatively low salary) to consider increasing salaries of those persons as the net effect for the employee and the gross effect for the employer would be more favorable than in the situation where a 20% personal income tax would have to be applied to the part of the increased salary if personal deductions remained the same. The social effects of this measure require no further explanation.

Increase the higher income tax rate threshold

Currently, the threshold for the higher tax bracket of annual types of income (subject to taxation at higher rates ranging from 25% to 35.4% depending on individual local self-government units) is EUR 4,200 per month or EUR 50,400 per year. AmCham believes that to further alleviate the tax burden on annual income types and ultimately increase net income, the threshold should be raised to EUR 5,000 per month (EUR 60,000 per year).
The proposal to increase the threshold stems from the AmCham members' efforts to increase the share of jobs with high added value and correspondingly higher salaries, such as jobs in research and development, ICT, pharmaceuticals, energy, or in regional company branches.

At the same time, recent years have seen continuous market pressures to increase salaries for vocational jobs, driven by factors such as EU single market integration and the option for emigration and employment in other countries. The potential for remote work in developed markets has also contributed to this trend.

On top of that, the inflationary pressure on salaries additionally increased employee costs, especially for employers in industries exposed to international competition.

- *https://web.dzs.hr/calcinfl.htm*
- February 2021 – February 2024 = 23.9%

Application of the maximum monthly and the maximum annual bases in the calculation of healthcare insurance

In addition to the relief from the point of view of personal income tax, AmCham deems it necessary to examine the potential of relief in terms of deductions at source and mandatory insurance contributions.

At the same time, AmCham is mindful of the current situation, in which funds collected through contributions are insufficient for the pension and healthcare system's needs and are financed from the state budget's tax revenues.

In this respect, a momentary reduction of the general rate of contribution over the short term seems unrealistic (even though it would also have to be reduced in the

future as part of a more comprehensive reform of the pension and healthcare system). However, AmCham believes that there are valid reasons for **limiting** the level of health insurance contributions.

Namely, unlike pension insurance, for which the contribution liability is calculated up to the maximum monthly and/or annual base, this limitation does not exist for the healthcare insurance contribution. This particularly affects employers of highly qualified workers since they have an "unlimited" healthcare insurance contribution liability of 16.5% calculated using the full amount of salary and other income from employment, while on the other hand, the rights from health insurance that workers use are essentially limited, for various reasons:

- Payment of a supplemental contribution is required for full healthcare service;
- The healthcare service is often not available at a time when it is needed – insufficient capacity of the public healthcare system (waiting lists);
- Certain drugs and treatments are not covered by the CHIF.

It is important to consider that employees are entitled to salary compensation during sick leave, with the employer covering the cost for "regular" sick leave up to 42 days. This further disadvantages employers, as they not only have to reimburse the salary of an employee on sick leave for up to 42 days but also calculate mandatory contributions based on the full compensation amount.

That is why AmCham proposes limiting the healthcare insurance contribution liability in the same way the pension insurance contribution liability is limited, i.e., to 6 average monthly/annual gross salaries. AmCham believes that this type of limitation would not represent a significant blow to the CHIF budget since it affects a relatively small number of employees who earn an annual gross income (salary and other income, such as bonuses) in an amount exceeding EUR 100,000 (corresponding to the maximum annual base for the calculation of contribution to the 1st pillar of the pension insurance).

We also expect this change to have favorable effects in terms of attracting and retaining the workforce in Croatia because the reduced cost for employers would open space for increases in employee salaries, ultimately leading to increased spending and growth of state income through personal income tax and value-added tax.

Reduction of the base for calculating pension insurance contributions

AmCham welcomes the relief of the lowest salaries from public dues by reducing the pension insurance base for gross salaries of up to EUR 1,300 per month.

AmCham proposes to additionally raise the threshold for this relief to the amount of EUR 1,800 per month (gross 1), and amend the current administrative model behind this relief. That is, practice has shown that the current administrative solution is highly complex and often unenforceable in practice (especially when the taxpayer has two or more employers who would have to continuously exchange confidential information about employees with each other to be able to apply the legal provisions correctly).

Since the Tax Administration has all the information on taxpayers submitted by employers via JOPPD forms, AmCham proposes applying this relief at the end of the tax period (calendar year), in such a way that the Tax Administration ex officio approves contribution refunds to taxpayers who meet the prescribed criteria.

In this regard, AmCham additionally suggests the following:

- Clearly define in the Contributions Act that the relief in question refers only to the first pillar of pension insurance (compulsory pension insurance based on generational solidarity), which is currently not the case, opening room for interpretation that the relief refers to both pillars of pension insurance;
- Consider the less paid contributions for the first pillar of pension insurance a deduction when calculating income tax, ensuring administrative simplicity when paying pensions. We know that paid contributions for pension insurance are a de facto form of tax relief, i.e., deferred tax. Essentially, these contributions reduce the taxable income by the amount paid "from" the worker's salary (i.e., the pension insurance contributions themselves). Consequently, when the pension is eventually paid out from these contributions in the future, it becomes subject to taxation. The 2023 amendments to income tax regulations did not cover this aspect and failed to allow for a reduction of the tax base corresponding to the difference in contributions made by the state to the employee's pension fund. In addition to the fact that workers with the lowest salaries pay slightly higher tax than before, it is highly questionable whether the CPII will make sure not to tax that part when paying the pension, because it was not a tax relief for the worker, the tax on that part having already been paid.

Reduction of the tax rate from 20% to 10% and from 30% to 20% in the mid-term

AmCham believes that reducing income tax rates from 20% (i.e., 15%-23.6%, depending on the city/municipality) to 10% and 30% (i.e., 25%-35.4% depending on the city/municipality) to 20% would have an additional strong positive impact on the Croatian economy and would increase the purchasing power of a large number of workers.

This measure would ensure that, with the same cost for employers, employees receive higher net income, which increases their economic power and capacity for consumption and ultimately increases their standard of living (especially now, in conditions of significant inflation). That would also positively impact economic growth in Croatia. Over the past few quarters, the greater economic power of the population stemming from the implemented reduction of the income tax burden has led to higher rates of economic growth generated significantly by personal consumption. Namely, the majority of tax revenue comes from indirect taxes, primarily VAT, so the "relief" of income from income tax increases VAT income due to higher consumption.

In addition, AmCham proposes a reduction of the 24% personal income tax rate applicable to capital income from allotment of shares, income on the basis of property rights, and disposal of assets to 12%, thus equaling it to the rate applicable to other capital and property income (dividends, interest, lease, etc.).

Effects of changes to personal income tax and mandatory insurance contributions proposed by AmCham are shown in the table below:

EFFECTS OF THE PROPOSED CHANGES TO PERSONAL INCOME TAX AND MANDATORY INSURANCE CONTRIBUTIONS

		Calculation of personal income tax and mandatory contributions according to				Calculation of personal income tax and mandatory contributions according to the			
		Salary 1	Salary 2	Salary 3	Salary 4	Salary 1	Salary 2	Salary 3	Salary 4
Income		**1.300,00**	**3.300,00**	**6.600,00**	**13.000,00**	**1.300,00**	**3.300,00**	**6.600,00**	**13.000,00**
Total tax		**96,00**	**416,00**	**996,00**	**2.750,40**	**20,00**	**180,00**	**444,00**	**1.557,60**
Net income		944,00	2.224,00	4.284,00	8.377,60	1.020,00	2.460,00	4.836,00	9.570,40
Healthcare insurance contribution	16,50%	214,50	544,50	1.089,00	2.145,00	214,50	544,50	1.089,00	1.544,40
Total cost for the employer (Gross 2)		**1.514,50**	**3.844,50**	**7.689,00**	**15.145,00**	**1.514,50**	**3.844,50**	**7.689,00**	**14.544,40**
Effect for the worker									
Net salary increase						76,00	236,00	552,00	1.192,80
Net salary increase percentage						8,05%	10,61%	12,89%	14,24%
Effect for the employer									
Salary cost reduction						0,00	0,00	0,00	600,60
Salary cost reduction, percentage						0,00%	0,00%	0,00%	-3,97%

Increase in personal deduction based on medical needs

It is proposed to recognize an increased personal deduction cumulatively up to EUR 3,000 per year for the medical needs of taxpayers, by the amount of actual costs of health services incurred for own needs in a health institution or with a healthcare professional in private practice, which is authorized/registered to provide healthcare in the Republic of Croatia in accordance with a separate regulation, provided that these expenses are not paid from compulsory, supplementary, additional or private health insurance and if they are not financed from donations received for these purposes.

The proposed amount is reasonable at the current moment, taking into account the fiscal power and income of Croatian citizens. In terms of implementation, it is proposed that the taxpayer would exercise their right to the increased personal deduction for medical needs by submitting the ZPP-DOH form.

This increase in the personal deduction based on medical needs should be used exclusively on the basis of authentic documents and proof of payment of bills that are in the taxpayer's name, i.e., on the basis of fiscal receipts issued by a health institution or a healthcare professional in private practice which is authorized/registered to provide healthcare in the Republic of Croatia in accordance with a separate regulation.

The assumption is that citizens whose salaries are already burdened with a significantly higher cost of health insurance contributions, which is not commensurate with a higher standard of health services and a greater scope of rights from compulsory health insurance, would use this relief. The number of citizens who would use this relief is not significant, so no significant negative impact on the revenues of the State Budget is expected.

Changes to the tax treatment of "income in kind"

The Personal Income Tax Act lays states that any non-cash income provided by the employer to its worker is categorized as income in kind and constitutes the worker's taxable income (with certain exceptions outlined in the Act and Ordinance).

In practice, this means that the realized income represents the net value, whereby the base must be increased by the corresponding taxes and contributions (so-called gross-up). This calculation method results in an extremely high tax burden with an effective tax rate that can go up to as high as 125.43% (for individuals in a higher tax bracket).

Moreover, no different tax treatment is prescribed depending on whether the tax and contribution liabilities are paid by the employer or the employee:

- If they are paid by the employer, apart from the expense itself for obtaining the income in kind, such a tax burden discourages employers from offering any additional benefits to their employees (except for those expressly defined as untaxable up to a certain amount) because they find the costs too high;
- If they are paid by the employee, the value of the taxes and contributions they must pay is higher than what they receive from the employer; therefore, the employee simply has no financial motive to accept such income.

This issue was partially regulated in the past by the Ordinance on personal income tax (OG 140/03, Article 17, paragraph 11), from which it follows that there was no obligation to "gross up" when the tax liability was borne by the worker. Reintroducing that provision would represent a good basis for further positive upgrading of regulations.

Informative research carried out by KMPG in April 2024 in Austria, Hungary, Slovakia, and Slovenia indicates that, apart from having established taxation exemptions regarding specific categories of income in kind, these countries generally do not treat income in kind as net, but rather gross income, particularly if the employees pay the taxes. A brief overview of taxation method by country* can be found below:

Hungary	Hungarian regulations classify income in kind into two groups: benefits for employees and other benefits. Employee benefits are considered gross income, and the basis for calculating taxes and contributions is the market value of the income (gross down). To calculate the tax base for other benefits, the market value of income is increased by a coefficient of 1.18, and taxes and contributions are calculated from that base (gross down). In addition, some income in kind is completely exempt from taxes and contributions, such as the use of company cars, bicycles, electric bicycles, and tickets for sports and cultural events.
Slovakia	Slovakian regulations define two types of income in kind: monetary benefits and non-monetary benefits. Monetary benefits are treated the same as a salary (gross income), while non-monetary benefits are grossed up for the purpose of calculating taxes and contributions.
Austria	As a rule, Austria treats income in kind as gross for the purpose of calculating taxes and contributions.
Slovenia	Slovenian regulations do not require income in kind to be grossed up if the employee is subject to taxation (the same treatment as cash remuneration). An exception applies only if the tax liability is assumed by the employer.

**Source: KPMG, April 2024*

With regard to the above and the need to find additional methods of rewarding and incentivizing labor in Croatia, AmCham recommends that the authorities consider **deleting from the Act the provision prescribing an increase in the base for related taxes and contributions** in relation to the taxation of income in kind because it makes such income extremely uncompetitive and administratively complex to implement. Instead, we propose that the authorities consider **defining the market value of income in kind as the gross value for the purpose of tax and contribution payment.**

Increasing the threshold for the entry of small entrepreneurs into the VAT system

The threshold for mandatory entry into the VAT system was last changed on January 1, 2018, to EUR 39,816.84 (from HRK 230,000.00 to HRK 300,000.00). A slight change occurred in 2024 when that amount was rounded to EUR 40,000.00. The inflation rate in the period from January 2018 to February 2024 (according to the Croatian Bureau of Statistics) was 26.6%. Faced with inflation, businesses had to increase the prices of their products and services to compensate for the increased purchase prices, thus reaching the threshold for entry into the VAT system faster. In order to ensure equal conditions for businesses, AmCham believes that the threshold for entering the VAT system should be increased to EUR 50,000.00 to mitigate the effects of inflation.

Alignment of VAT treatment of purchases of non-alcoholic beverages (coffee and other hot drinks) with VAT treatment of drinking water consumption

Pursuant to Article 7, paragraph 41 of the Ordinance on personal income tax, taxable income from employment does not include water and hot and cold drinks (except for drinks that contain alcohol), which employers make available to employees at their own expense during working hours in their business premises.

The costs of procurement of drinking water and hot and cold non-alcoholic beverages are considered recognized costs under Article 5 of the Corporate Income Tax Act (all expenses related to the taxpayer's activities or resulting from the activities are recognized).

General provisions on the conditions for recognition of input tax in Article 131, paragraph 1 of the Ordinance on value-added tax stipulate that taxpayers who make taxable supplies of goods and services have the right to deduct input tax if the supply to the taxpayer was made for the purposes of its economic activity.

The above regulations governing income tax from employment, corporate income tax, and value-added tax clearly show that the costs of purchasing drinking water and hot and cold non-alcoholic beverages for consumption by employees on business premises are tax-deductible expenses.

However, the opinion of the Ministry of Finance dated December 8, 2005, CLASS: 410-18/05-01/127 regarding a specific inquiry as to which income to employees is

considered a tax-recognized expense of the employer and for which income to employees is input tax on purchases allowed stated that the input tax on purchased water intended for employees' drinks during working hours, regardless of whether it is water from the water supply network or water that has been purified and packaged, may be used in its entirety, while other purchases of items under the inquiry (among other things, juices..), the consumption of which the employer allows during office hours, are considered as income in kind, for which input tax may not be used.

Following the above, AmCham proposes to equalize the VAT treatment of the purchase of other hot and cold beverages (except beverages containing alcohol) with the VAT treatment of the purchase of water intended for drinking, which the employer can provide at its expense to employees in its business premises because they are considered expenses incurred and related to the performance of economic activity and are regulated as a single entity in the provisions of Article 7, paragraph 41 of the Ordinance on personal income tax.

The primary intention of the VAT Act is to tax final consumption. In this sense, the drinks served inside employers' business premises aim to satisfy the basic physical needs of employees and thereby stimulate employee productivity; they are not intended for final consumption by employees in their free time. In accordance with the above, AmCham believes that employers should be permitted to deduct input tax for the purchase of the mentioned beverages.

Increase in the tax-free amount of payments to the Croatian Tourist Card

The Tax Administration's data on applicants, acquirers and tax-free income amounts for 2023 clearly show that the total fees for settling the costs of hospitality, tourist, and other services intended for workers' vacations according to the regulations of the Ministry of Tourism amount to EUR 1,470,379.31, or 0.07% of the total tax-free income amount.

Furthermore, since the 2020 introduction of this type of tax-free income, the amount has increased from EUR 331.20 to EUR 400 as of January 1, 2024, which, taking into account the growth of total inflation of 26.2% (Jan 2019 - Jan 2024), is insufficient to be able to fully achieve the goals of higher domestic tourism spending or to ensure sufficient attractiveness of this instrument. Extracted data on inflation in tourism-related sectors clearly shows that the prices of services grew at a higher rate than overall inflation. For example, the price of accommodation services in the third quarter of 2023 was higher by 148% compared to 2015, while a year earlier, in the same quarter, it was higher by 41% compared to the base period.

Given that the purpose of the Croatian Tourist Card is to pay for accommodation or hospitality services and that the prices of these services have increased multiple times in relation to the general increase in prices, AmCham believes that the maximum amount of tax-free income should also be increased. An increase in the non-taxable part of income, for example, up to EUR 2,000.00, would result in greater use of this program, thus achieving the goal of higher domestic tourism spending. Moreover, this instrument ensures that tax-free income is spent in the

Croatian economy, so that additional tax revenues indirectly go to the state budget, which will *de facto* result from this tax-free income.

Increase in bonuses and compensations

AmCham welcomes the implemented increase in tax-free amounts of awards and benefits and suggests additional and continuous increases in such items, especially those that have not been changed for a long time and inflation has made insufficient (e.g., per diems for business trips abroad).

Changes in calculation and amount of per diems

Cases where trips involve travel through several countries result in an extremely complicated calculation of per diems if the paid per diem is to be considered non-taxable. Also, no tool/application/program can correctly calculate a tax-free per diem, which prevents the digitization of the entire process. For this reason, we propose simplifying the calculation method for the purpose of digitalization, leaving the amount non-taxable. The more straightforward calculation would use a 24-hour per diem, i.e., the per diem would not be calculated based on the total number of hours spent on a trip but by looking at each day individually, which would enable the full digitization of the travel order in its entirety.

Two calculation options are proposed:

6–8 hours = 25% of per diem 8–12 hours = 50% of per diem 12–24 hours = 100% of per diem	or	8–12 hours = 50% of per diem 12–24 hours = 100% of per diem

Deductions for meals can remain the same as before.

Taxing income from bonuses in the form of allotment of shares and share option purchases

From January 1, 2024, onwards, all income based on bonuses in the form of allotment of shares and equity interest purchases has the same tax treatment, i.e., it is considered investment income in kind, and the applicable tax rate is 24%. AmCham welcomes these changes. However, practice has revealed some illogicalities regarding the prescribed rate and the methodology of calculating the income in kind, which require regulation.

In order to reduce the tax burden and simplify income taxation based on participation in option plans, it is recommended that the following amendments to the tax regulations stipulate that:

- The value of said income is considered gross income.
  That is, regulations state that income from participation in an option plan is considered net income (income in kind), so the effective rate, due to the prescribed requirement for conversion to gross, amounts to 31.58%. As this is a significantly higher actual rate than the one apparently prescribed by law (a single rate of 24%), AmCham proposes that income from option plans be considered gross income from capital.

- The tax rate on optional remuneration, as a type of capital income, is equal to the tax rates of other types of income from capital such as dividends, interest, and capital gains of 12%.
  That is, a special rate on income from capital applies only to optional remuneration (if excluding the rate for the exclusion of assets and the use of services at the expense of the company, which is considered a penalty rate). Given that these are related types of income, AmCham believes that, in this sense, it is necessary to apply the same tax rate. Also, a lower tax burden would represent an important tool for Croatian employers in retaining and rewarding their workers in Croatia.

By implementing these two important changes in the taxation of option plans, Croatia would become a more attractive destination for foreign investments, primarily for establishing regional offices of foreign and domestic companies in Croatia.

Introduction of tax relief for investments in domestic high-tech companies

As a rule, newly established high-tech companies (start-ups) begin to generate income and make a profit only after a few years because they require time to develop and distribute a high-tech product. Considering this, the survival of these companies in the initial period primarily depends on "business angels" (people willing to finance start-ups).

Namely, due to their structure and specificity, start-ups, as a rule, cannot use traditional forms of financing (loans from commercial banks/bonds, etc.). In practice, it has been observed that the biggest reason for the failure of start-ups is the lack of funds in the initial period and not a lack of quality ideas and projects. Therefore, start-ups turn to people – business angels – who are willing to invest their financial resources, regardless of the risks that accompany such investments and the potentially unfavorable final result.

Many European countries have recognized the importance of start-ups, as well as the importance of ensuring their continuous financing during a period in which these companies do not generate an income sufficient to finance their costs. That is why, in order to ensure an ecosystem that fosters and enables the development of start-ups, many countries have offered different models for facilitating this type of financing through tax relief. The most popular model among them is a tax relief based on the reduction of the tax liability for the amount invested in the start-up.

Considering the evident increase in the number of start-ups in Croatia, especially in the information and communication (ICT) sector, and taking into account the fact that even without a stimulating ecosystem for newly founded companies, Croatia has two "unicorns" in the ICT sector, AmCham considers it essential to foster further investments in start-ups.

Accordingly, AmCham proposes to consider **applying a model for fostering investment in start-ups through tax relief based on the reduction of the tax liability for the invested amount**, which would consist of the following:

- Tax relief in the form of a reduction of the tax liability would be applicable to all natural persons who made a "qualified investment" and who generate income;
- The amount of the total reduction of the tax liability would be limited to 35% of the "qualified investment" or EUR 200,000 (the lower threshold is taken into account);
- A reduction of tax liability would be possible for the tax period in which the investment was made, as well as for the five tax periods following the tax period in which the investment was made.

The proposal is that this relief be prescribed by the provisions of the Income Tax Act, while a separate regulation on grants under the competence of the Ministry of Economy would resolve the remaining issues related to the regulation of investments in start-ups, such as the definition of start-ups for the purposes of tax relief, defining "qualified investment," etc.

All this should produce positive outcomes related to investments in newly established domestic high-tech companies, as already recognized in the study "*Effectiveness of tax incentives for venture capital and business angels to foster the investment of small- and medium-sized enterprises and start-ups*," which was financed by the European Commission, which include:

- job creation;
- increasing research and development, as well as innovation;
- choosing "good" investments;
- professionalization of companies;
- redistribution of capital; and
- increase in resilience to crises.

The proposed introduction of tax relief based on investments in domestic high-tech companies would lead to a reduction in the tax liability of "business angels" and, consequently, to a reduction in income based on personal income tax. On the other hand, it should be taken into account that the loss of public revenues on this basis would be compensated by an increase in public revenues (mandatory contributions and personal income tax) on the basis of newly employed persons, and later on the basis of the corporate income tax of start-ups. Namely, due to the nature of the business of these companies, especially companies from the ICT sector, a significant part of the received investments (according to some research, around 80%) would be spent on the salaries of new employees.

Accordingly, the expectation is that, taking into account the proposed incentive model, the gap created in the expenditure side of the budget should be fully covered by a short- to medium-term increase in employment and the payment of benefits (mandatory contributions and taxes) on salaries and all the benefits arising from keeping a high-tech company with export potential in Croatia.

This proposal is in accordance with the Digital Croatia Strategy for the period until 2032 (OG 2/2023) in the chapter Digital Transition of the Economy.

Normative regulation of provisions governing the taxation of income on the basis of capital gains

Taxation of income from capital on the basis of capital gains was introduced on January 1, 2016. In practice, it has been noticed that certain provisions are not regulated precisely enough, leading to doubts as to whether taxable income has occurred at all and how to determine the base for calculating taxes, i.e., the capital gains. An example is the insufficiently explained investment in "portfolios" (Article 67, paragraph 6 and paragraph 7 of the Personal Income Tax Act).

Moreover, practical challenges arise in determining the capital gain amount from the disposal of equity interests in companies that are not tradable on the capital market. Namely, in the above cases, the tax liability is determined by a decision of the Tax Administration. However, the Personal Income Tax Act and Ordinance do not provide clear guidance on how the Tax Administration will assess the purchase and sale value of an equity interest to determine whether what is reported by the taxpayer corresponds to actual market values.

The lack of clear provisions by which the Tax Administration could act may lead to an arbitrary determination of the tax base, which does not correspond to the actual market value and capital gain. This creates a certain legal uncertainty, and accordingly, AmCham believes that this issue needs to be regulated in an agreed manner, especially since these are often high-value transactions.

Additionally, because of the growing role played by cryptocurrencies, AmCham suggests normative regulation of the tax treatment of capital gains on the basis of cryptocurrency trading (currently, the only source of law is an instruction issued by the Tax Administration in 2018) as well as on the basis of the potential use of cryptocurrencies for payments for goods and services.

Compensation intended for the health of workers

AmCham proposes stimulating employers through **tax-free payments** for **certain costs intended for workers' health.** According to the Explanation of the financial plan of the Croatian Health Insurance Fund for 2023 and the projection of the plan for 2024 and 2025, which is publicly available, CHIF revenues from contributions should amount to approximately EUR 3.7 billion this year. In comparison, corporate income tax revenues in 2023 should amount to approximately EUR 1.6 billion. In order to reduce the pressure on the cost side of the CHIF (in terms of payments for sick leave, treatment, medication, etc.), AmCham proposes non-taxable benefits for certain costs that employers would cover, such as the costs of certain specific medical examinations, medication costs, but also the costs of some sports and health activities, which would reduce sick leave, or generally improve the health of the working population (e.g., sports activities, gyms, etc.). In this way, the employer would increase work efficiency and reduce absenteeism, workers would receive activities whose costs they finance themselves, and consequently, the pressure on the healthcare system would be reduced (both in terms of costs and in terms of capacity).

Further tax reform will also have to take into account contributions (pension and health). However, through the mechanisms available in personal income tax, such as

non-taxable treatment of certain expenditures, the desired results can be achieved in a relatively short period of time.

Tax breaks for additional and supplementary health insurance

AmCham has welcomed the introduction of the possibility of non-taxable payments of premiums of supplementary and additional health insurance for employees up to EUR 500 a year per employee and, in accordance with earlier recommendations, it proposes the maximum amount of the supplementary and additional health insurance tax relief of up to EUR 1,000 per year. Such tax relief could be used by taxpayers who themselves bear the burden of the cost of additional and supplementary health insurance on an annual basis by submitting the ZPP-DOH form. This would further encourage the use of private health services, thereby relieving the burden on the public health system. AmCham believes that with the introduction of this measure, the administrative burden on the Tax Administration should not be significant, as data on paid insurance premiums can be easily collected from insurance companies.

An example of a country applying tax breaks to health insurance premiums is Portugal, where the health insurance premium is used as a tax deduction in the calculation of personal income tax. The deduction is limited; it is determined depending on other tax breaks and the level of taxable income, with the maximum tax break amounting to EUR 1,000.

Introduction of tax relief based on the cost of interest on housing loans

AmCham proposes the introduction of tax relief (increase of the personal deduction) based on the cost of interest on housing loans to help the taxpayer secure housing, either through the purchase of a home or the construction/addition/reconstruction/completion of housing.

Such benefits were abolished several years ago, with the explanation that the Tax Administration does not have sufficient resources to process all such requests. Considering the general increase in inflation, which is most evident in the housing sector, such a measure would significantly contribute to encouraging young families to resolve their housing issues and stay in Croatia.

AmCham believes that by introducing such a measure, the administrative burden on the Tax Administration should not be significant since data on the conditions for the tax relief can be obtained from credit institutions (banks) which, when approving such loans, collect all relevant information about the purpose of the loan (i.e., whether it resolves the issue of the taxpayer's housing), and which have all the data on the cost of interest on such bank loans.

The increase in the personal deduction on this basis could be used on an annual basis (via the ZPP-DOH form) based on evidence that the credit institution (bank) would prepare and send to each taxpayer and beneficiary of the loan and to the Tax Administration.

Organizing team-building activities

Working requires a certain amount of mental and physical effort on the part of each employee. At the same time, individual workers are usually part of a specific organizational unit or team within which they solve and perform tasks through common business operations.

In line with the trends of developed economies, Croatian employers are increasingly organizing activities to strengthen the team, i.e., team-building activities. Joint activities of business colleagues lead to better development of their team spirit and a sense of belonging to the team and contribute to better mutual knowledge, trust, understanding, and respect, which results in significantly better individual and collective business results.

Currently, paying for the costs of this type of activity is subject to taxation, which is a significant cost to employers, who often give up on organizing recreational activities for employees or reduce the scope and quality of planned activities in order to reduce costs. Organizing team building is standard in modern organizational and human resources management, and taxing recreational activities for employees in Croatia makes it difficult to align with contemporary business trends.

AmCham believes that not taxing team-building activities (e.g., up to EUR 550 per year per worker), i.e., clearly prescribing the treatment of the costs of these activities in tax terms, would have multiple positive effects on the mental and physical well-being of employees, but also on better productivity of individuals, companies, and ultimately the Croatian economy.

It is important to highlight that the Occupational Safety Act prescribes that the employer is required, taking into account jobs and their nature, to assess the risks to the life and health of workers, including, among other issues, the psychological work-related burden and other risks in order to prevent or mitigate these risks. On the basis of the risk assessment, the employer is required to apply occupational safety rules and preventive measures, organize and implement work and production procedures and/or methods, and implement other activities to prevent and reduce the exposure of its workers to the determined risks in order to eliminate the likelihood of workplace injuries, occupational diseases, or work-related diseases or reduce it to a minimum, and to ensure a better level of occupational safety at all levels of organization of work and management.

Following the above employer obligation, AmCham proposes that a certain non-taxable amount should be stipulated to make the described measure equally accessible to all employers, thereby ensuring this option for all workers.

Use of taxi services on a business trip

If the worker has used a taxi or other means of transport for transportation from the airport to the place where they are sent on a business trip, these expenses are not considered transport in the location of the business trip and are recognized as business travel expenses. This is a case of being transported to the location of the business trip, as opposed to *local travel in the location of the business trip*, so they

can be reimbursed to the employee without paying personal income tax and contributions.

If expenditures for taxi services relate to transport in the location of the business trip, the expenditures must be paid from the per diem. If the employee is nevertheless reimbursed, remuneration in kind would have to be calculated for the said expense.

As a rule, workers try to make the most of their time in their business trip location. In situations where multiple meetings and business activities are organized in one day, it is common to use taxi services to avoid slowing down the daily plan or unnecessarily prolonging the stay. The use of taxi services for business purposes is an operating expense and should not be covered by workers' per diems.

AmCham considers that the use of taxi services on a business trip should be treated as the cost of the business trip without calculating the remuneration in kind, i.e., that the per diem should be intended only to cover the cost of drinks and food during the business trip. This is especially important at a time of significant increases in all expenses (like now), where tax-free amounts of per diems are hardly enough to cover the costs of food and drinks, for which per diems are primarily intended.

Introducing a tax relief for the private use of official plug-in and electric vehicles

If a company owns plug-in vehicles (BEV and PHEV) or electric vehicles and its workers use them privately as well, AmCham proposes considering an option to exempt such use from private income tax applied to income in kind by following the examples found in the Republic of Slovenia, United Kingdom, and the Netherlands and thus contribute to the efforts aimed at reducing CO_2 emissions and achieving EU climate goals.

Also guided by the example of neighboring Slovenia, AmCham proposes to further encourage the purchase of environmentally friendly vehicles by allowing full deduction of input VAT and recognition of all costs for corporate income tax purposes.

Widening the scope of the exemption from taxation of income derived from investments in subsidiaries

The result of the company's business activity is usually taxed at the level of that person. This profit after tax can then be:

- Paid to the investor, i.e., the member of the company, in the form of dividends or equity interest, or
- The company may retain the profit and use it for further investments, thereby increasing the value of the company.

At the investor level, good business results are reflected either as income from dividends and equity interest or as an increase in the value of their equity interest/shares in the company resulting from additional investment financed using retained profit.

The rules on exemption from taxation of investment income (PEX rules) are used to protect such investment income against double taxation at the level of the company in which the investment was made and at the investor level, and they include an exemption from taxation of:

- Paid profit through exemption from taxation of income from dividends and equity interest at the investor level, and
- Retained profit through exemption from taxation of capital gains earned through the sale of shares of or equity interest in subsidiaries.

Review of the income investment taxation rules by country is found in Annex 3.

Currently, **applicable Croatian tax regulations prescribe a partial exemption**:

- income from dividends and equity interest is not taxed, nor is
- an increase in the value of equity interest in the accounting records due to the use of the equity interest method, while
- in case of sale, the taxpayer's capital gains on the basis of disposal of shares and equity interest, defined as the difference between the market price of the shares/equity interest and the initial investment cost, are taxed at the standard corporate income tax rate.

In line with this tax system, the profit paid out has a more favorable tax treatment and is the preferred option compared to retaining the profit for further investment.

Such tax rules encourage the payment of profits and discourage additional investment, especially if the sale of the subsidiary is planned or possible at any time. This also **discourages foreign investors from basing holding companies in the Republic of Croatia.**

We would like to point out that there are legal prerequisites for full exemption from taxation of investment income since **Article 9, paragraph 4 of the Ordinance on corporate income tax** prescribes that investment income will not be taxable if such

tax would result in double taxation of the same income. The same is also prescribed on the expenditure side; it is not tax-deductible if that would result in a double deduction or double tax loss.

Furthermore, if one compares corporate income tax with personal income tax, capital gains of natural persons from the sale of financial assets held for more than two years are not taxable. Such exemption from corporate income tax is not currently foreseen.

Therefore, **AmCham suggests expanding the application of the exemption in Croatia to capital gains from the sale of equity interest in subsidiaries.**

The suggestion pertains to the inclusion of new provisions in the Corporate Income Tax Act whereby, **in addition to income from dividends and equity interest, corporate income determined as the difference between the sale price and the cost of investment in the particular subsidiary would be exempt from tax and the corporate income tax base reduced.** Accordingly, capital loss from a sale could not be recognized as a tax-deductible expense.

Therefore, we propose to add item 6 to Article 6, paragraph 1, to read as follows:

"Article 6
(1)The tax base referred to in Article 5 of this Act shall be reduced:
…..
6 by any amount of capital gains realized by a shareholder or a company member through the sale of shares and equity interest in companies where they hold, before the sale, at least xx% of shares or equity interest or voting rights over a continuous period of at least xx months. Capital losses generated on the same grounds shall not be recognized for the purposes of taxation."*

Positive effects on retained profit for further investments are as follows:

- the payout of profit ceases to be a more acceptable option than its retention for further investment;
- incentivizing investors not to distribute income generated by subsidiaries but to use it to finance further investment without additional tax on the newly generated value of the company,
- providing a tax-free exit from the investment by selling equity interest **could attract investors to establish companies for regional investments more often in Croatia than in other countries with more acceptable PEX rules**, making it more competitive compared to other countries in the region and the European Union,
- these holding companies would be liable for corporate income tax and other taxes; they would hire locally for management and ownership roles, which would have a positive effect on the budget through the payment of income tax and contributions.

On the other hand, implementation of these measures **should not have any significant adverse impact on state budget income** because, due to the unfavorable tax treatment, sales of companies are either avoided or made as tax-effective as possible through prior distribution of profit. Any unfavorable impact on

the budget may be additionally mitigated by restricting the application of the capital gains tax exemption when equity interests are sold by prescribing conditions for its application. That would limit the number of companies qualified for that exemption and prevent misuse.

Abolition of the indefinite restriction on prohibiting share capital reduction for taxpayers who used the profit reinvestment benefit until 2016

Tax relief for profit reinvested in fixed capital was introduced by the Act on Amendments to the Corporate Income Tax Act 22/12; these provisions were partially amended by the Act on Amendments to the Corporate Income Tax Act OG 143/14 and were abolished by the Act on Amendments to the Corporate Income Tax Act OG 115/16.

The tax relief for reinvested profit was also regulated by the provisions of the Ordinance on corporate income tax, whereby the provisions on this tax relief were introduced into the Ordinance on corporate income tax by the Ordinance on amendments to the Ordinance on corporate income tax OG 61/12, and were subsequently amended by the Ordinance on amendments to the Ordinance on corporate income tax OG 146/12, Ordinance on amendments to the Ordinance on corporate income tax OG 157/14 and Ordinance on amendments to the Ordinance on corporate income tax OG 137/15, and finally the Ordinance on amendments to the Ordinance on corporate income tax OG 01/17, which repealed the provisions of the Ordinance on corporate income tax that referred to this tax relief.

For tax periods after January 1, 2017, the tax relief could no longer be used in the calculation of corporate income tax, but it remained in effect with the amendments to the Corporate Income Tax Act OG 115/16 in Article 15, paragraph 3 within the framework of transitional and final provisions and the Ordinance on amendments to the Ordinance on corporate income tax OG 01/17 in Article 22, paragraph 3 within the framework of transitional and final provisions.

As a result of the above, taxpayers who, before January 1, 2017, used the tax relief on the basis of reinvested profit are still subject to the condition under which tax relief would not be recognized in the event of a reduction of equity increased by reinvested profit, i.e., if the taxpayer subsequently reduces equity that was increased by reinvested profit and makes payments to the members of the company and/or if the reduction of equity is carried out to increase or decrease other items of capital and reserves that enable the payment of profits in future tax periods.

AmCham understands that the legislator's intention was to allow the taxpayer to use the tax relief conditionally as long as equity is preserved at the required level after reinvestment. However, from today's perspective, the question can be raised about

the justification and expediency of such a provision to preserve equity over an indefinite period of time.

AmCham believes that the current legal provisions governing the conditional maintenance of capital levels for businesses that used the tax relief for reinvesting profits until 2016 have, from today's perspective, become restrictive for entrepreneurship and the economy as a whole. Such provisions, which made it possible to reduce the company's share capital as relief for reinvesting profits, now seem to be out of line with the needs of the modern business environment. Investments that this mechanism was supposed to encourage have already been implemented since 2016, and the desired effects for taxpayers and the economy in general have already been achieved.

Removing the requirement for indefinite retention of share capital would facilitate the adaptation of legislation to the evolving market conditions and requirements. This proposal aims to ensure that legislation reflects current needs and changes in the economy and to ensure efficient and transparent business operations of companies in accordance with valid positive regulations governed by other laws, such as the Companies Act.

In this regard, AmCham proposes the abolition of the indefinite restriction on prohibiting share capital reduction for taxpayers who used the profit reinvestment benefit until 2016.

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Annexes

Annex 1 – Review of deadlines for submitting personal income tax and corporate income tax returns

a) Personal income tax

Personal income tax filing dates[1]			
	Deadline*	**Deadline extensions**	
Croatia	**February 28**		
Bosnia and Herzegovina[1]	March 31		
Slovakia[2]	March 31	June 30	September 30
Czech Republic[3]	April 1	July 1	November 1
Austria[4]	April 30	June 30	March 31 / April 30
Poland	April 30		
Serbia	May 15		
Hungary[5]	May 20	November 20	
Slovenia[6]	May 31	July 31	
Germany[7]	July 31	February 28	
Italy[8]	September 30	November 30	

*in the current year for the previous year

[1]In the Brčko District, the deadline is February 28.

[2]June if the tax authorities received notification of the extension. September for persons earning income from foreign sources.

[3]May 1 if submitted electronically. July if filed with the assistance of a tax advisor. November for persons earning income from foreign sources.

[4]June for persons submitting electronically, and March 31 / April 30 of the following year if persons are represented by an authorized tax advisor.

[5]If the taxpayer is not personally responsible for the lack of data to file.

[6]Only if the person does not receive a calculation from the government by May 31.

[7]If filed with the assistance of a tax advisor, the second following year (e.g., February 28, 2023 for a 2021 tax return)

[8]If the taxpayer is a non-resident and is unable to submit the application electronically by September 30

[1] research.ibfd.org – Country Tax Guides; Accessed: April 11, 2024

b) *Corporate income tax*

Dates for filing corporate income tax[2]			
	Deadline*		**Deadline extensions**
Croatia[1]	**April 30**		
Bosnia and Herzegovina[2]	March 31		
Slovakia[3]	March 31	June 30	September 30
Czech Republic[4]	April 2	July 1	
Poland[5]	March 31		
Slovenia[5]	March 31		
Austria[6]	April 30	June 30	March 31 / April 30
Hungary[7]	May 31		
Germany[8]	July 31	February 28	
Serbia[9]	June 30		
Italy[10]	November 30		

*in the current year for the previous year

[1]Or 4 months after the end of the company's financial year.

[2]In the Federation of Bosnia and Herzegovina; in the Republic of Srpska and the Brčko District, 90 days after the end of the company's financial year.

[3]Or 3 months after the end of the company's financial year. June if the tax authorities received notification of the extension. September if the company received income from foreign sources.

[4]May 2 if submitted electronically. June 1 automatically if the taxpayer has been subject to statutory audit. Otherwise, the extension may be granted at the discretion of the tax authorities.

[5]Or 3 months after the end of the company's financial year.

[6]June if submitted electronically. March 31 / April 30 of the following year if the taxpayer is represented by an authorized tax advisor.

[7]Or 5 months after the end of the company's financial year.

[8]If filed with the assistance of a tax advisor, the second following year (e.g., February 28, 2023 for a 2021 tax return)

[9]Or 180 days after the end of the company's financial year.

[10]Or 11 months after the end of the company's financial year.

[2] research.ibfd.org – Country Tax Guides; Accessed: April 11, 2024

Annex 2 – Overview of tax rates and contributions in Croatia and competing markets

Overview of tax systems in 2021	Croatia	Bulgaria	Czech Republic	Romania	Serbia	Slovakia
Corporate income tax rate (general)	10% – for generated revenue up to EUR 1,000,000.00 18% – for generated revenue equal to or greater than EUR 1,000,000.00	10%	21%	16%	15%	21% 15% for micro-undertakings whose taxable income does not exceed EUR 60,000 per year
VAT rate (general)	25%	20%	21%	19%	20%	20%
Personal income tax rates (salaries)	15%-23.60% depending on the local government (25%-35.40% for the amount of taxable income above EUR 50,400.00)	10%	15%-23% for income higher than EUR 62,299.48)	10%	10% (15% for income higher than EUR 72,838.76)	19% (25% for annual income exceeding EUR 47,537.98) 15% for micro-undertakings whose taxable income does not exceed EUR 60,000 per year
Salary contributions	Employee: 20% (partially limited), especially the reduction of contributions for salaries between EUR 700 and EUR 1,300 Employer: 16.5% (unlimited)	Employee: 13.78% (limited) Employer: 18.92% to 19.62% (limited)	Employee: 11.6% (partially limited) Employer: 33.8%* (partially limited)	Employee: 35% (unlimited) Employer: 2.25% + 4% for difficult working conditions or 8% for special working conditions (unlimited)	Employee: 19.9% (limited) Employer: 15.15% (limited)	Employee: 13.4% (partially limited) Employer: 36.2% (partially limited)

Source: KPMG, April 2024

Annex 3 – Review of rules on taxation of investment revenues by country for 2024

ITALY

Capital gains

- 95% of capital gains from the sale of equity interest are exempt from tax if the following requirements are met (Article 87 of the T.U.I.R. – Italian Tax Code):

1) equity interest is classified as a long-term financial asset in the financial statements relating to the first tax period of uninterrupted ownership;

2) the minimum retention period is 12 months;

3) the majority of the subsidiary's income was not generated in a tax haven or a country with a preferential tax regime;

4) the company whose equity interest is owned actually performs a commercial activity (e.g., investments in companies that mainly manage their own real estate are not entitled to exemption).

Capital losses from the sale of equity interests are not fully recognized for tax purposes.

Dividends

- 95% of income from dividends is not taxable if (Article 89 of the T.U.I.R – Italian Tax code):

a) the company whose equity interests are held is a tax resident in a whitelisted country;

b) the equity interests are not qualified as "equity interests held for trading" (this requirement only applies to companies implementing the IAS/IFRS, such as UCI SpA).

RATIO: The tax exemption prescribed for the sale of equity interests and the exemption for dividends are two sides of the same coin. Income generated by sales is considered an "accumulated, undistributed dividend," and therefore, it calls for equal treatment of the sale of equity interests.

AUSTRIA

Capital gains and losses

- According to an international exemption from taxation of investments, both income and loss on the basis of the sale of equity interests in non-resident companies are entirely neutral for the purpose of taxation if an Austrian company owns at least 10% of the equity for a minimum period of a year (income and loss from the sale of equity interest in a domestic company, resident in Austria, is subject to tax as operating income at ordinary corporate income tax rates).

- However, in the year of acquisition, the investor may irrevocably choose taxation of income and loss resulting from the sale of each individual investment. The option pertains to income and loss of the sale only and does not affect the tax treatment of the distribution of dividends.

Dividends

- Income from dividends of domestic companies is normally not subject to tax without any conditions (no requirements regarding a minimum equity interest or retention period). Foreign company dividends are also exempt from tax if their parent company holds at least 10% of equity through a minimum period of a year (international exemption from taxation of investments).

SLOVENIA

Capital gains

- 47.5% of the capital gains from sale is exempt from taxation in the event that:

a) a taxpayer who realizes a capital gain participates in the capital or management of another **legal** entity in such a way that he is the owner of equity interest, shares, or voting rights;

b) a taxpayer who realizes a capital gain holds a minimum of 8% of equity interest, shares, or voting rights;

c) the duration of this participation in the capital or management is at least 6 months, and during that period, at least one person is employed continuously on a full-time basis;

d) the capital gain does not come from the countries listed in the "Dividends" section, paragraph (b).

The above does not apply to liquidation or termination of business.

Dividends

- Are 95% exempt from taxation if (Article 5 of the Ordinance on the implementation of corporate income tax):

a) the participating legal entity is a tax resident of Slovenia or an EU country;

b) the participating legal entity is not included in any of the lists below:

- A list of countries in which the general or average nominal rate of corporate income tax is lower than 12.5%, where these are not EU member states, and the minister responsible for finance puts such a country on the list, although it does not have to be on the list, which the Ministry of Finance and the Financial Administration of the Republic of Slovenia publish on their websites,

- EU list of non-cooperative jurisdictions that are unwilling to cooperate for tax purposes, published in the Official Journal of the EU.

BULGARIA

Capital gains

- Generally taxed at the corporate income rate of 10%. Income from the sale of shares listed on and executed through transactions on a regulated market in Bulgaria or one of the EEA countries is exempt from taxation.

Dividends

- Dividends received by a resident are not included in the recipient's taxable income for the purpose of corporate income tax and are also not subject to withholding tax. The exemption is applied independently of the size of the equity interest held in the payer

CZECH REPUBLIC

Capital gains and dividends
- Exempt from taxation in the Czech Republic (regarding both withholding tax / corporate income tax) if the following conditions are met:
  - The parent company holds at least 10% of equity interest in the Czech Republic or another EU Member State for a period of 12 months; the requirement regarding retention of the equity interest may relate to both subsequent and previous periods;
  - The subsidiary is a tax resident in the Czech Republic or another EU Member State;
  - Both the parent company and the subsidiary are established in a form prescribed by the Annex to the EU Parent/Subsidiary Directive;
  - The parent company and the subsidiary are not exempt from corporate income tax; and they cannot choose exemption, and the applicable corporate income tax rate is greater than 0%.
- An investment-related tax exemption may also be applied if the subsidiary is a tax resident of a country that has concluded an Agreement for the Avoidance of Double Taxation with the Czech Republic, the subsidiary has a form similar to a limited liability company or a joint-stock company, pays corporate income tax at the nominal rate of at least 12% in the year when the dividend is paid, and at least 10% of equity interest is held for a period of at least 12 consecutive calendar months.

SLOVAKIA
Capital gains
- Exemption from corporate income tax applies if the seller is a Slovak tax resident or a Slovak tax non-resident entity that has a permanent business unit in Slovakia and that, among other conditions, continuously owns at least 10+% of equity interest in the entity for a minimum period of 24 months before the sale;
- Capital gains from the sale of equity interest in an entity located in Slovakia that do not meet the conditions for exemption from taxation should be taxedat a corporate tax rate of 21% in accordance with local legislation unless a double taxation treaty applies that gives the right to tax outside Slovakia (in the case of a seller who is a Slovak tax non-resident).

Dividends
- Dividends from profits earned after 2004 and distributed to a tax resident/tax non-resident should generally not be subject to tax; therefore, no withholding tax should be paid on such distribution unless such distribution is made to a state entity that is not included in the "permitted" (white) list of the Slovak Ministry of Finance. In such a case, a withholding tax rate of 35% should be applied.
- Dividends from profits made before 2004 are subject to withholding tax unless they are paid to an EU parent company that has (at the time of payment) 25+% of the equity interest of the payer (and vice versa), when an exemption from tax may apply under the legislation of Slovakia.

GERMANY
Capital gains
- 95% of the capital gain from the sale is exempt from taxation (5% of the gain is added to the taxable income as a non-taxable expense). The exemption is provided for both direct and indirect holding of the equity interest (e.g., through a partnership) and is independent of whether the company where the equity interests are held is a resident or not. No minimum percentage of the equity interest and no minimum retention period are prescribed except in certain restructuring-related situations (7 years). Income from equity interests held by banks, institutions for the provision of financial services, and commercial financial companies are not exempt from tax.

Dividends
- 95% of income from dividends is exempt from tax if the parent company directly holds at least 10% of the subsidiary's equity. There are no conditions prescribed in relation to a retention period.

HUNGARY
Capital gains
- The exemption applies to equity interest registered within 75 days of acquisition with the Hungarian tax authorities (with a transitional rule that allows for subsequent registration no later than May 31, 2024, if equity interest is not registered by December 31, 2023) and is held at least a year. No requirement regarding the minimum size of the equity interest is prescribed.
- The exemption is applicable to equity interests in foreign companies and in companies registered in Hungary, but it is not applied to equity interests in controlled foreign companies (CFC).

Dividends
- Dividends: the exemption is applied to income from dividends without any requirements regarding a retention period. The exemption does not apply to dividends received from controlled foreign companies (CFC).

ROMANIA
Capital gains
- An exemption is applied if the recipient holds at least 10% of the equity of the company whose equity interest was sold/transferred, with a retention period of at least a year.

Dividends
- Income from dividends received by a Romanian company from another Romanian company is not taxable.
- Dividends received by a Romanian company from a foreign company are normally included in its taxable income and are subject to the general rate of corporate income tax (16%). However, dividends received from companies from an EU Member State or a non-EU country with whom Romania applies an Agreement for the Avoidance of Double Taxation are exempt from tax if the Romanian recipient company holds at least 10% of equity interest in the distributing company for an unbroken period of at least a year.

Source: Zagrebačka banka d.d. and UniCredit Group, March 2024