

Improving Competitiveness through the Tax System

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

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Introduction

During preparations for accession to the European Union (EU), Croatian legislation underwent numerous rapid changes to ensure timely compliance with the EU acquis.

The first few years of Croatia's membership have also been characterized by numerous amendments to its legal framework. After three years of membership, it is time to take a structured look at the tax system, since it significantly determines the country's attractiveness in terms of investment and doing business through its tax rates and policies.

The American Chamber of Commerce in Croatia (AmCham) proposes an evaluation of the existing tax system and comprehensive tax reform through broad public debate that would include stakeholders from the business community and civil organizations.

This document focuses on principles guiding enforcement of tax rules by the tax authorities and specific tax measures that we believe can improve Croatia's competitiveness and attractiveness in terms of entrepreneurship and investment.

AmCham would welcome the opportunity to exchange views on best tax practices and further contribute to improving the quality of tax legislation in Croatia.

„Better Regulation“

The evolution of the Croatian tax system has been characterized by practices which produce unwanted or less than favorable outcomes, such as tax system instability or mismatches between the planned and real outcomes of the tax initiatives.

These practices have involved, but have not been limited to:

- Sudden and frequent tax changes;
- Inadequate analyses of the current situation and best possible directions for achieving desired outcomes of the tax intervention;
- Lack of focus on possible unintended effects of tax interventions.

“Better regulation” is therefore needed for designing and implementing good tax legislation, which in turn is crucial for a stable business climate that will promote investments and enable sustainable economic growth in Croatia.

“Better regulation” means designing policies and laws so that they achieve their objectives at minimum cost. It is a way of working to ensure that political decisions are prepared in an open and transparent manner, informed by the best available evidence and backed by the comprehensive involvement of stakeholders.

Long term measures

AmCham encourages the Government to use the Impact Assessment Strategy to create the administrative setup for impact assessment implementation in Croatia. This should specifically include the following:

- Designating a special institution responsible for carrying out proper impact assessments and evaluations for all tax proposals based on fiscal plans;
- Ensuring that “better regulation” applies to all tax related regulatory changes, from legal acts to ordinances;
- Allowing for the possibility of outsourcing impact assessment and evaluation work to qualified external experts, according to clearly set rules of engagement.

These measures would finally result in tax initiatives being announced well in advance, and formulated by taking into account contributions from interested stakeholders included in the initiative preparation process.

Short term measures

AmCham proposes additional specific short term measures:

- Following the analysis of the tax system, the Government should produce a fiscal plan and communicate it in an informative and transparent manner.

- In its Impact Assessment Strategy, the Government should commit to including relevant interested parties (e.g. business/consumer associations) at all stages of the tax proposal drafting process. By being part of a working group or at least in a position to express their views prior to the public consultation, key stakeholders would be in a position to more significantly contribute to the quality and ensure relevance of the proposed tax initiatives.
- Public consultations on tax related legal proposals should be open for at least one month, in order to give all interested parties adequate time to submit their comments and proposals. In addition, the institution that has launched the public consultation should be obliged to reply to inputs received, with replies including an adequate elaboration on the decision made. In current practice, it is not unusual to see replies such as “rejected” without further explanation.
- The Government should commit to increasing the share of laws passed via regular, instead of emergency parliamentary procedure, by agreeing to meet progressive yearly goals, for example a 10% increase of laws passed via regular procedure every year. This approach has been successful in Romania.
- A rule for the deferred entry into force of the new tax proposals should be introduced. For example, in Germany any new law or regulation with tax implications passed before June 1 of year X comes into effect after January 1 of the following year, and anything passed after June 1 comes into effect after January 1 of the next year (i.e. 18 months), in order to bolster stability.
- All changes of tax rates should be introduced by amending existing or introducing new legal acts, accompanied by a proper impact assessment. The Government should remove the possibility of amending tax rates via ordinances until such time when “better regulation” procedures will be required for all regulatory changes (laws, ordinances etc.).

Principles of Tax Rules Enforcement

Tax authorities as partners to the business community

AmCham members often report the impression that tax inspectors' main focus is on identification of mistakes with the goal of penalizing companies. We believe that the inspectors and the Tax Administration should position themselves as advisors to the business community. If it is clear that a mistake is unintentional, it is sufficient and far more useful to issue a warning with a plan to rectify the situation.

In a considerable number of cases tax inspectors discover an error in the books and build a case around it in order to penalize companies, leaving them with the sole option of going through years of litigation. Such behavior by the tax authorities directly affects the business and investment climate in the country.

In accordance with the best practices of tax authorities in developed countries, when a company voluntarily informs the Croatian Tax Administration of previously miscalculated taxes or other procedural errors, the Administration should take their initiative and openness into consideration, reduce any penalties and cooperate with the company on solving the problem.

AmCham invites the Tax Administration to be more proactive in its preventative activities, instead of issuing fines in cases of mere oversight (such as not submitting a blank VAT form).

Separation of first- and second-level of tax authority

The first level of the Tax Administration, responsible for tax decisions, and the second level, i.e. the Independent Sector for Second-Instance Administrative Procedure, should be strictly separated with experts of the second-instance authority having a higher level of expertise and experience.

Currently, the second level generally simply confirms tax decisions made at first instance. In these circumstances appeals against first-instance decisions seem meaningless and often only prolong the process.

General Recommendations

Amendments and additions to the General Tax Act in relation to deadlines for the correction of tax returns

For the correction of the tax return, the taxpayer is given a twelve-month deadline from the expiry of the deadline for filing the tax return, while tax authorities are given a longer deadline (3 years from the end of the year in which the taxpayer had to determine the tax liability).

It is recommended that balance and equal treatment of all parties involved is ensured with the following amendments to the General Tax Act; more specifically, to set the same conditions and deadlines, with the same rights and responsibilities, for the correction of the tax return at the request of tax authorities and when made by the taxpayer himself:

| Existing text | Proposed Amendment |
|---|---|
| <u>Correction to the tax return, Article 66</u> (3) The taxpayer can make the correction of the tax return referred to in paragraph 1 of this Article within twelve months at the latest from the expiry of the deadline for filing the tax return. (4) As an exception from paragraph 3 of this Article, the correction of the return can be made at the request of tax authorities within the period determined by tax authorities. | (3) The taxpayer can make the correction of the tax return referred to in paragraph 1 of this Article until the expiry of the statute of limitations period for determining tax liability. (4) As an exception from paragraph 3 of this Article, the correction of the return can be made at the request of tax authorities within the period determined by tax authorities, within the statute of limitations period for determining tax liability. |

In our opinion, current preferential application of regulations does not contribute to the protection of the country economy or the promotion of a positive and secure business environment. It puts taxpayers in an unfavorable position compared to tax authorities regarding rights and responsibilities arising from the same issue.

We believe that by preventing the taxpayer to correct the tax return by himself within the same deadlines as those in which tax authorities can request a correction of the return violates the principle of fairness and equality of the tax system, as well as the principle of non-discrimination. These principles are part of the Constitution of the Republic of Croatia.

Different deadlines harm the taxpayer in two ways. Firstly, following the expiry of the twelve-month deadline, it is impossible to correct the return if the taxpayer identifies a mistake to his own disadvantage due to which an excessive amount of tax has been determined. On the other hand, tax authorities can always during the tax inspection request the correction which increases the established amount. Secondly, the taxpayer cannot immediately correct the identified mistake without the intervention of tax authorities, even if he could be legally liable for an inaccurate tax return.

Obligation to pay arising after the administrative dispute

According to existing legislation, activities and obligations are scheduled as follows:

- Tax audits are performed by the Tax Administration or in some cases the Customs Administration (e.g. special tax on motor vehicles);
- After an audit, a tax decision is made which the legal entity may appeal against before the Independent Sector for Second-Instance Administrative Procedure;
- If the second-instance authority confirms the decision, the legal entity has the right to initiate an administrative procedure before the Administrative Court, but this does not postpone the collection of the determined unpaid taxes and any penalties.

The Tax Administration can thus cause irreparable damage to the legal entity in a short period of time, e.g. cause it to become insolvent or bankrupt, while the legal entity may prove that it was wronged and that the obligation to pay the additional amount did not exist only by going through years of litigation.

Introducing the option of out-of-court settlements between the Tax Administration and companies

The general opinion is that tax authorities take advantage of the fact that legal proceedings take several years. The potential requirement of returning funds to companies is seen as being far in the future, with tax authorities therefore not motivated to resolve disputes early.

AmCham suggests the following measures:

- Establishing a separate authority for out-of-court settlements;
- Using mediation in tax disputes.

The Tax Administration should promote the use of mediation in tax disputes, for example through employee training and internal guidelines, regardless of whether the separate authority for out-of-court settlements is established. Compared to court litigation, the advantages of dispute resolution through mediation procedures include cost reduction and time savings. Other advantages include confidentiality, flexibility, and informality. Out-of-court settlements would lead to fewer court proceedings and faster resolution of tax disputes.

Urgent issuing of certificates on absence of tax arrears on the basis of existing situation

We believe that an acceptable existing situation should include debts up to a certain amount, e.g. 10 kn.

There have been cases in which the Tax Administration has refused to issue a certificate to a regular payer due to a debt of less than 1 kn. Among other things, companies require certificates on the absence of tax arrears in order to participate in public procurement tenders, which normally have very short deadlines.

On a number of occasions in 2016 the Tax Administration informed companies that it could not issue these certificates until further notice, since it had not yet processed the tax returns for the previous year and it had until autumn to do so. Such an approach is not considered appropriate for a public administration providing a service to companies.

Administrative measures to facilitate business

Measures that would facilitate the conducting of business for companies and their (often outsourced) accountants include the following:

- Eliminating the rule that the "JOPPD" form (used to report salary payments) must be submitted on the day wages are paid. This deadline is too short and requires close coordination between accounting and the person responsible for the payments, while not being necessary except to fulfill the administrative requirement of the Tax Administration.
- Eliminating numerous codes in payment order reference numbers. An example of an administrative difficulty this creates is a situation when the accountant prepares an order for salary payments for one day, but the company does not manage to process them (for example if there is no Internet connection), meaning that the accountant has to prepare a different payment code for the following day. This requirement is complex and unnecessary.
- Eliminating or simplifying the Specification of Unrelated Payments (SNU) application (where tax payers balance their tax liabilities, resolve any errors that occur, perform transfers from one tax account to another, as well as all other tasks previously done by the Tax Administration).
- Simplifying the VAT form (e.g. the UK VAT form contains 5 to 7 fields, while the Croatian one has 20).
- Quick response to submitted requests for the opinion of the Central Office. An illustrative example is a response provided at the end of the year to a request made on 6 August. In comparison, in the UK the same company received a response immediately by phone. Eliminating account liquidation or leaving it up to companies to decide how to control and liquidate their own accounts.

- Eliminating interests on arrears charged by the Tax Administration for overdue advance payments of income tax. Advance payment is money that belongs to the company left to accumulate zero interest on the state account. However, if the advance payment is overdue, the Tax Administration charges interest.

The proposed measures would lead to improved investment climate by lowering costs and simplification of doing business.

Reducing the tax burden on wages

The below table by Ernst & Young (EY) provides an overview of tax rates in Croatia and competing markets.

| 2014 tax system overview | Croatia | Bulgaria | Czech Republic | Romania | Serbia | Slovak Republic |
|--|---|---|---|---|---|---|
| Corporate tax rate (general) | 20% | 10% | 19% | 16% | 15% | 22% |
| VAT rate (general) | 25% | 20% | 21% | 24% | 20% | 20% |
| Personal income tax rates (salaries) | 12%, 25%, 40% + City tax up to 18% (top rate applied on annual taxable income above EUR 13,900; EUR 20,800 in 2015) | 10% | 15% (+ solidarity surcharge of 7% applied on income exceeding EUR 45,000) | 16% | 10% (+ 10% applied to income between EUR 18,500 and EUR 55,500) + 15% applied to income exceeding EUR 55,500) | 19% (25% if the annual income exceeds EUR 35,000) |
| Mandatory social security contributions (salaries) | Employee: 20% (partially capped) Employer: 17,2% (uncapped) | Employee: 12,9% (capped) Employer: 17,8% to 18,5% (capped) | Employee: 11% to 13% (partially capped) Employer: 34% (partially capped) | Employee: 16,5% (capped) Employer: 27,75% to 28,45% (capped) | Employee: 19,9% (capped) Employer: 17,9% (capped) | Employee - 13,4% (partially capped) Employer - 35,2 % (partially capped) |

Source: EY, from AmCham's position paper „Recommendations for positioning of IT industry as a strategic industry in Croatia“, April 2015. Overview based on publicly available data and may not be fully up to date (details should be reconfirmed with respective country tax experts)

The table demonstrates that Croatia is not competitive when it comes to the tax burden on labor, particularly in the area of higher incomes, where the highest rate of 40% applies. This is one of the reasons why a large number of propulsive sectors in Croatia are experiencing the problem of the lack of qualified workers, a fact especially evident in the ICT industry as well as tourism and other sectors.

We believe that the threshold for applying the income tax rate of 40% should either be eliminated or greatly increased. Such a high rate is the reason why managerial staff from multinational corporations has been relocating outside of Croatia. Often

not only managerial staff, but entire regional centers responsible for leading operations and employing a large number of people are relocated to neighboring countries with a significantly lower tax burden on labor.

The proposed measures would lead to an increase in net income with the same cost for the employer, i.e. the creation of a large number of jobs for the same cost. From a macroeconomic standpoint, these measures would have a positive impact on the budget:

- Increased spending due to higher net incomes (VAT, excise duties);
- A higher number of employees in the ICT sector, as well as other sectors that pay large sums in contributions;
- A positive effect on the demographic situation, as more competitive incomes would keep a large number of people from going abroad – an immeasurable opportunity benefit;
- Growth of higher added value sectors, faster growth and exports – all contributing to the GDP and balance of trade of the Republic of Croatia.

Another important benefit is the possibility of opening international companies' regional centers in Croatia, as paying top managers would be less expensive. This would enable Croatia to establish itself as a regional business center.

Reducing the tax burden on other types of income

The most competitive industries, which are often industries with high added value, attract their labor force with various benefits that are taxed as remuneration in kind. Apart from very limited benefits that may be provided tax-free, most benefits are currently treated as taxable net income (e.g. coffee and other beverages available in the workplace), and as a result taxes and social security contributions for these benefits amount to approximately 170% of their net value.

We believe that in addition to wages, the tax burden on other sources of income, such as employee stock options (especially from parent companies), should be reduced as well. We also propose the elimination of income tax on dividend payments, which would enable the rewarding of highly qualified workers, investment in high-tech industries and the relocation of companies' regional centers to Croatia.

For this reason AmCham proposes amending the Croatian Income Tax Act and Profit Tax Act, whereby the following employer expenditures would be considered deductible expenses and would not be taxed as remuneration in kind: employee

stimulation through share ownership, acquiring equipment for additional facilities, financing gyms, kindergartens, team building activities, etc. These measures would contribute towards a simplification of the tax system, which would make Croatia a more attractive investment destination.

Excluding e-commerce from the obligation of fiscalization of receipts paid by credit cards

Croatian employers are faced with the administrative burden of fiscalization when conducting business online. The obligation of fiscalization complicates e-commerce as it requires the addition of other technical solutions (for direct fiscalization within e-commerce), or other activities (subsequent printing of fiscal receipts), which may lead to a transfer of business to other countries within the new European digital single market.

E-commerce is extremely important to Croatian entrepreneurs. Croatia ranks third in Europe with 25% of its small and medium-sized businesses using e-commerce.¹ Making this type of business more difficult puts constraints on a large number of businesses that are the driving force of growth and employment.

In May 2015, the European Union adopted the Digital Single Market strategy, which encompasses a wide range of targeted measures that are to be implemented by the end of next year.² It is built on three pillars:

- Better access for consumers and businesses to digital goods and services;
- Creating a level playing field for digital networks and innovative services;
- Maximizing the growth potential of the digital economy.

We propose excluding e-commerce from the fiscalization system. We would also like to point out that amendments to the Fiscalization Act should be considered to exclude card payments from being treated as cash payments.

The proposed measures would drive the development of the digital economy in Croatia and full implementation of the aims of the Digital Single Market strategy.

Reinvesting profits – recognition of investments towards creating new jobs

Almost all countries have elaborate tax benefits systems. Croatia offers tax benefits on reinvested profits and certain benefits under the Investment Promotion Act.

¹ Croatian Chamber of Economy: „Croatia in third place in e-commerce use in Europe “, 12 May 2015, downloaded at: http://www.hgk.hr/djelatnost/gosp_trgovina/konferencija-povodom-obilježavanja-svjetskog-dana-zastite-potrosaca-na-temu-internet-trgovine-i-potrosaca

² European Commission: „A Digital Single Market for Europe: Commission sets out 16 initiatives to make it happen“, 6 May 2015, downloaded at: http://europa.eu/rapid/press-release_IP-15-4919_en.htm

Unfortunately, the Croatian service industry is discriminated as the aforementioned tax benefits can only be used by companies that invest in equipment and buildings, while the service industry invests in human capital. Profits can be reinvested only up to the amount of investments made into long-term assets in the current year; however this does not apply to intangible assets created through internal development. For example, ICT companies have no significant yearly investments into long-term assets, and reinvesting smaller amounts is not worthwhile due to high expenses (audit, court registry, etc.).

AmCham considers it necessary to amend the Croatian Profit Tax Act and enable companies that have increased their number of employees to reinvest their profits.

Revising the amount of daily and field allowances

The current “business trip” period of 30 days should be extended. Many exporting companies negotiate projects abroad, which require sending an employee to the client site for a period of several months. The cost of living abroad is high, and is not covered by the legally prescribed non-taxable daily allowances, field allowances, or separation allowances that apply after 30 days.

Recognizing representation, car-related and other business expenses as tax deductible expenses

We consider it necessary that tax prepayments are applicable for the use of personal vehicles and representation expenses for business purposes. We thereby propose returning to the state preceding 1 March 2012, when tax prepayments were considered tax deductible in the ratio of 70:30.

Moreover, tax deductible and non-deductible expenses are currently diversified and completely segmented, which makes accounting very impractical. For example, if a company takes a business partner to lunch during a business trip, it has to exclude expenses for items related to its employee from the receipt, since the employee has already received his or her daily allowance. If the bill is paid using a corporate credit card, a complicated book-entry procedure follows whereby part of the receipt is deductible as a company expense, while the part pertaining to the employee that is manually added up is accounted for separately as company claims towards the employee. After that, the entry is closed with a clearing of the daily allowance expenses.

Therefore, a business lunch bill paid using a corporate card requires a disproportionate amount of time for book-entry. The cost of book-entry is often higher than the cost of the actual business lunch, and is certainly higher than the corporate income tax saved on the exempt 30% of such a bill, given that 70% of the bill is non-deductible.

Introducing tax exemptions for investments in innovative companies

Access to capital for the purpose of developing innovative products and services is fairly difficult for small companies in Croatia. Many developed countries encourage natural persons and companies to invest in the capital of businesses that are dedicated to research and development by reducing the tax liability on their investments.

The new draft of the Small Business Development Promotion Act foresees this measure, and we believe the process of its adoption should be expedited. The measure would encourage the creation of new innovative companies and the development of innovative high-tech projects, as it would ensure their financing, especially in the early, high-risk stages, which are the most difficult to finance.

If there were a tax exemption for companies aimed at reducing the corporate income tax obligation in an amount equal to what a company invests in an innovative company, more businesses would opt for such investments. In the short term, the state budget would lose this share of corporate income tax, but it would benefit in the long term.

High tech companies, especially ICT companies, invest 80% of their research and development costs through employee wages, and the highest tax rates and contributions are known to be imposed on this type of expenditure.³ We therefore believe that the proposed measure would increase employment rates in the short term, significantly benefit investments in research and development (which are several times lower in Croatia than in the EU), and would ultimately benefit the state budget in the short term.

Extending the period of tax loss carryforward

Existing regulations on the five-year loss carryforward do not encourage long-term investments, especially not high-tech investments. We propose an extension of 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. We believe that the loss carryforward period in Croatia should be extended to 10 years.

Eliminating taxation on foreign pensions

Pensioners who receive pensions from other countries while residing in Croatia for more than 183 days (according to the Act of 1 March 2012) pay income tax on their foreign pension.

³ Croatian Independent Software Exporters – CISEx, June 2016

We propose eliminating this tax and returning to the previous state of affairs, which would encourage both spending and the return of Croatian diaspora to Croatia.

This would also enable the development of medical tourism in Croatia, as foreign insurance companies would direct their patients and pensioners to use health services in Croatia.

Prompt VAT returns

A taxpayer who has the right to a tax prepayment deduction in a particular billing period, the amount of which is greater than their tax return, has the right to reimbursement in the amount of the difference within 30 days of filing the tax return.

Although there has been some progress in the promptness of the Tax Administration concerning VAT returns, there is still some evidence of non-uniform practice and delays in individual branch offices. We therefore invite the Tax Administration to make its practice uniform and ensure prompt VAT returns.

Sector-specific Recommendations

Amendment of the Act on Excise Duty on Coffee and Non-alcoholic Beverages

We propose the amendment of the Act on Excise Duty on Coffee and Non-alcoholic Beverages relating to:

- Lowering of the tax base for non-alcoholic beverages from the current 40 kn/hl (0.4 kn/l) to 30 kn/hl (0.3 kn/l);
- Lowering of the tax base for syrups and concentrates from 240 kn/hl (i.e. 24 kn/l) to 180 kn/hl (or 1.8 kn/l).

Producers of non-alcoholic beverages in Croatia are in general burdened with high taxes. The current unfavorable tax situation is additionally exacerbated by the Act on Excise Duty on Coffee and Non-alcoholic Beverages. Adoption of the Act in 2013 was characterized by the unexpected change in the Ministry of Finance's position, when it made a last minute decision not to reduce the amount of the excise duty on non-alcoholic beverages from 40 kn to 30 kn per hectoliter of beverages. This was in contrast to their initial proposal to the industry representatives, which had focused on tax cuts and encouraging domestic production growth and development.

The significant impact of the Act on Excise Duty on Coffee and Non-alcoholic Beverages on business operations can be seen in the example of the Coca-Cola system in Croatia.

Under current circumstances, the conditions of production in Croatia are much less favorable than those in the countries in the broader surrounding area, making maintaining competitiveness of the business more difficult. In Croatia, production costs of a liter of beverage exceed the same costs in neighboring countries and are higher than in many other European countries. A large part of these costs result from a large number of tax and non-tax levies. It is evident from the points mentioned below that there is a lack of competitiveness in comparison with other Coca Cola subsidiaries in the countries in the broader surrounding area.

- Excise duties on non-alcoholic beverages, environmental fees and concessions – make one third of the total costs;
- Total costs of production per beverage crate are twice as high in Croatia as the average cost in 14 other analyzed subsidiaries of Coca-Cola' systems;
- If we exclude excise duty on non-alcoholic beverages in total, the overall cost of production per beverage crate produced in Croatia is 45% higher than the average cost in the remaining 14 subsidiaries. Upon complete exclusion of the excise duty, Croatia is still the fourth most expensive subsidiary (after Ireland, Switzerland and Cyprus);

- Due to these indicators the Croatia subsidiary had to close the plants in Solin and Gotalovec in the midst of the economic recession, which reduced the cost of production to about 10% above the average excluding the excise duty on non-alcoholic beverages.

According to the Ministry of Finance, collected excise duty on non-alcoholic beverages in 2015 amounted to 123,125,507 kn, out of which Coca-Cola HBC Croatia, paid 51,119,296 kn based on production and imports. This amounts to 41% of total government revenues from the excise duty on non-alcoholic beverages.⁴

The proposed reduction in the excise duty on non-alcoholic beverages would drive the improvement of the competitiveness of the company's local production as well as the improvement of the business climate on the domestic market.

Coca-Cola wants to continue with a policy of investing in the Croatian market and through market recovery strongly contribute towards further development of the Croatian market. However, just like other Croatian producers who have exhausted internal measures to improve efficiency, it requires tax reliefs in order to be able to achieve this. Only then its market prices will be competitive and it will be able to ensure growth and investment.

Amendments to the Motor Vehicles Special Tax Act

We propose amending the Motor Vehicles Special Tax Act to allow for the special tax to be charged solely on the basis of CO2 emissions.

The existing calculation method is complicated and consists of two parts:

- The first portion is calculated on the basis of vehicle price;
- The second is calculated on the basis of CO2 emissions.

This type of calculation encourages the import of vehicles that are over 10 years old, because the buying price for such vehicles is normally under 100,000 kn, which makes them exempt from the first part of taxation.

Special tax systems for motor vehicles in other European countries (Germany, Scandinavian countries) are mostly based on CO2 emissions, and taxes are commonly charged based on the age of the vehicles throughout their service life. On the other hand, in Croatia this takes the form of a lump-sum tax charged at the moment the vehicle is put on the road. The European method also encourages drivers to opt for "cleaner" vehicles in accordance with EU legislation.

⁴ Coca-Cola HBC Hrvatska d.o.o., June 2016

Measures for development of the direct selling industry

Direct selling provides important benefits to individuals who desire an opportunity to earn an income and build a business of their own, as well as to consumers who enjoy an alternative to shopping centers, department stores or the like.

Industry information shows that more than 99.5 million people around the world are engaged in direct selling, that the industry has an annual turnover of almost 183 billion dollars and that global trends show an increase of sales in the amount of 6.4 % on an annual level.⁵ However, the situation in the Republic of Croatia is dramatically different with 14.4% of decrease of sales in the period 2011 – 2014.⁶

AmCham therefore recommends the following measures:

- Introduction of a threshold in order for low levels of earnings from occasional activities (up to the amount of e.g. 37,500 kn or some other annual amount) are not burdened by taxes and contributions – a similar model already exists in the Income Tax Act for some activities, e.g. students not being taxed up to the amount of 50,000 kn p.a., artists not being taxed up to the amount of 20,000 kn p.a., high school students practice and amateur sportsmen not being taxed up to the amount of 1,600 kn per month (i.e. 19,200 kn p.a.). Due to the relatively low amounts of earnings, we are of the opinion that the possible effect on the state budget as a result of loss of income would not be significant, while the benefits from decreased administration, increase of business activities of unemployed persons (especially women who represent 80% of direct sellers) would be significant for the Croatian economy as a whole.
- Introduction of the possibility of taxing earnings above determined non-taxable amount upon deduction of incurred actual business expenses, or for example 30% of lump sum expenses and/or monthly personal deduction. We propose that a recognized tax expenditure on taxable income (income above non-taxable threshold of 37,500 kn) should be established. Namely, persons engaged in direct selling, by nature of activities have travelling and telephone expenses, expenses of presentation of products to clients and similar. We therefore suggest to recognize tax expenditure for incurred actual costs (pursuant to practice established in Slovakia and the Netherlands) or certain lump sum expenses (similar to the applied 30% deduction for authors' fees, journalists' and sports persons' activities and similar).
- Introduction of the possibility that all administration (delivery of forms and payment of due amounts) related to the taxable income should be the responsibility of the company engaged in direct sales activities.

⁵ World Federation of Direct Selling Associations, 29 May 2015

⁶ The Croatian Direct Selling Association, 9 June 2016

- Introduction of the possibility that individuals registered for the rendering of direct selling activities should be allowed to be „taxed by a lump sum“, as currently applied for crafts and individual activities of forestry and agriculture.

Proposed measures should be accompanied by the introduction of the definition and legal framework for direct selling activities in Croatia – primarily in the Trade Act and related regulations or bylaws, which is the approach already used for other types of retail sales, such as E-trade.

AmCham is of the opinion that the above proposed changes would result in:

- Increase of personal consumption – through increased earnings of persons engaged in direct selling activities;
- Increase of the number of self-employed persons and decrease of the number of unemployed persons;
- Increase of income of the state budget – through applied tax rates on increased number of sales of products and services.

Measures for the development of the tourism industry

Tourism accounts for 19% of direct contributions to Croatian GDP⁷, but its indirect effects are likely to be significantly higher. By extending the tourist season, Croatia can further develop its tourism sector and ensure additional revenues. The short main (summer) season negatively effects further development of the tourism sector competitiveness for a number of reasons:

- Inability to offer goods and services related to tourism throughout the year;
- Tourism workers do not have the opportunity to continually hone their skills, which leads to stagnation or loss of quality in the provision of services;
- Perceived instability makes the tourism sector a less desirable career choice, which is reflected in the loss of interest in tourism and related education;
- The loss of qualified workforce caused by young people leaving the country because of more competitive working conditions elsewhere, as well as financial reasons and the search for permanent employment.

All of the above leads us to conclude that extending the tourism season should be of strategic importance to Croatia. The aim is not only to increase state budget revenues but to steer the Croatian economy and education system towards a wide range of benefits arising from their natural link to the tourism industry.

⁷ Raiffeisenbank Austria d.d.: „Final GDP for first quarter confirms annual growth of 2,7 percent“, 8 June 2016, downloaded at: https://www.rba.hr/makroekonomija/-/asset_publisher/AO3yzAfisDxH/content/id/10755235

AmCham therefore proposes a set of measures to extend the tourist season and develop the tourism sector in Croatia:

- Harmonization of taxation of passenger transport with taxation methods in source markets;
- Reduction of the VAT rate in the tourism sector in line with rate in competitive markets;
- Changing the tax treatment of the costs of employee accommodation, meals and transport, from being treated as remuneration in kind to being recognized as tax deductions.

Harmonizing the VAT rate applicable to medicines and medical products

We propose the introduction of a uniform VAT rate on medicines and medical products, regardless of whether or not they are available over the counter (prescription/non-prescription) and regardless of who bears their cost (mandatory health insurance/beneficiary).

This would serve to avoid the different treatment of certain substances that may be given different status solely because of packaging size (prescription/non-prescription), which is contrary to EU tax regulations as it enables the same active substance to be subject to two VAT rates.

Almost all EU countries have a single rate, and the price of non-prescription medicines is higher in Croatia than its neighboring countries precisely because of its VAT rate. The VAT rate in Slovenia for these medicines is 15.5% lower, while it is 15% lower in Italy and Austria.⁸ Austria's experience has shown that an increase in consumption of self-administered medications is the direct result of lower VAT rates.

Tax exemption on remuneration in kind for personal use of company-provided EPV vehicles

The proposed measure would be an indirect incentive measure related to electrically powered vehicles (EPV) as part of the strategy to develop e-mobility in Croatia.

⁸ European Federation of Pharmaceutical Industries and Associations (efpia), The Pharmaceutical Industry in Figures – Edition 2014, 12 June 2014, downloaded at: <http://www.efpia.eu/uploads/Modules/Mediaroom/figures-2014-final.pdf>

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