

# Recommendations for Tax Reform in 2019

*Zagreb, August 2019*



---

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

# Contents

<b>Introduction.....</b>	<b>3</b>
<b>General Recommendations .....</b>	<b>4</b>
<b>Better legislation.....</b>	<b>4</b>
<b>Tax authorities as partners to the business community.....</b>	<b>4</b>
<b>Separation of first- and second-level tax authorities .....</b>	<b>5</b>
<b>Obligation to pay arising only after the administrative dispute.....</b>	<b>5</b>
<b>Introducing voluntary reporting of undisclosed tax liabilities.....</b>	<b>6</b>
<b>Issuing certificates by the Tax Administration on the absence of tax debts promptly and on the basis of the current situation .....</b>	<b>6</b>
<b>Administrative measures for facilitating business operations of entrepreneurs and the Tax Administration .....</b>	<b>7</b>
<b>Extending the period of tax loss carryforward .....</b>	<b>7</b>
<b>Correction of tax liabilities due to uncollectible receivables .....</b>	<b>7</b>
<b>Extension for Personal income tax and Corporate profit tax filing deadlines .....</b>	<b>11</b>
<b>Income tax - reducing the tax burden on labor contributions .....</b>	<b>16</b>
<b>Increase of non-taxable personal deductions .....</b>	<b>17</b>
<b>Decrease of income tax rate from 24% to 12%.....</b>	<b>17</b>
<b>Decrease of the 36% income tax rate .....</b>	<b>18</b>
<b>Raising bonus payments for work results .....</b>	<b>19</b>
<b>Reducing the tax burden on some employee income.....</b>	<b>19</b>
<b>Taxation of receipts from the stock awards and stock option plans...</b>	<b>19</b>
<b>Allowances for workers' health .....</b>	<b>20</b>
• <b>Allowance for workers' meals .....</b>	<b>20</b>
• <b>Allowance for sports activities.....</b>	<b>20</b>
• <b>Tax breaks for additional health insurance .....</b>	<b>21</b>
• <b>Supplementary health insurance .....</b>	<b>21</b>
• <b>Organization of team building activities .....</b>	<b>22</b>
<b>Allowance for accommodation and food for temporarily posted workers .....</b>	<b>22</b>
<b>Use of taxi services during a business trip .....</b>	<b>23</b>

---

# Introduction

---

According to AmCham's *Survey of the Business Environment in Croatia*, taxation of labor and the tax burden are seen as one of the main limiting business factors in Croatia, but for the first time, the effect of the previous tax unburdening has been noted.

**Main limiting for doing business in 2017:**

- 1) Long and complex administrative procedures
- 2) Unstable regulatory framework
- 3) Taxation of labor
- 4) Lack of adequate workforce

**Main limiting for doing business in 2018:**

- 1) Lack of adequate workforce
- 2) Unstable regulatory framework
- 3) Taxation of labor

The biggest disadvantages of doing business in Croatia compared with CEE countries (2017) were slow administration, tax burden, lack of long-term government strategy and a small market. In 2018, the tax burden is no longer among the three main disadvantages of Croatia compared to other Central and Eastern European countries, even though it is still one of the main limiting business factors.

AmCham has welcomed tax unburdening to date, presented through three rounds of tax reform, and particularly highlights last year's measures related to:

- Stock options
- Uniform VAT rate for medicinal products
- Raising the monthly gross amount with an income tax rate of 24%
- Introducing opportunities to reward employees through a non-taxable amount of up to HRK 5,000.

AmCham believes that further tax unburdening is necessary, and it is contributed by continued economic growth.

The American Chamber of Commerce in this position paper sets out recommendations for the further reduction of the tax burden aimed at attracting investment and greater competitiveness of Croatian employers in attracting and retaining the workforce.

# General Recommendations

---

## ***Better legislation***

Frequent changes and amendments to tax regulations is one of the key features of the Croatian tax system. Frequent, unpredictable, and non-standardized changes to the tax system, regardless of content, are not good for the economy. The announcements by the Ministry of Finance that there will be no tax changes in the current year if they had not been agreed on in the previous year, as well as the practice of planning tax regulations in the previous year, AmCham sees as a positive move, but it is important to keep this principle in the future.

## ***Tax authorities as partners to the business community***

AmCham members often report on 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 advisors to the business community. If it is clear that an error was unintentional, it is sufficient and far more useful to issue a warning with a plan to rectify the error.

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

In accordance with the best practices of tax authorities in developed countries, when entrepreneurs voluntarily inform the tax authorities of previously miscalculated taxes or other procedural errors, the Croatian Tax Administration should take their initiative and openness into consideration, mitigate possible adverse consequences (additional liabilities and penalties), and cooperate with the entrepreneur on solving the problem.

It is important to stick to the principle of proportionality. Family run farms or small businesses often do not have a permanently employed accountant and it is not justifiable to have the same expectations and demands from them as from larger companies with accounting departments. Examples of practices show inconsistent conduct of tax officers, who often have requests that cannot be met within the set deadlines.

AmCham invites the Tax Administration to be more proactive in the area of preventive measures, instead of issuing additional tax liabilities and fines in cases of mere oversights (such as not submitting a blank VAT form).

### ***Separation of first- and second-level tax authorities***

The Tax Administration, which is responsible for tax decisions, and the appellate body, i.e. the Independent Sector for Second-Instance Administrative Procedure, should be strictly separated not only formally, but in practice as well. Further progress must be made in the area of reaching higher levels of expertise and experience of second-instance body experts.

The current appellate body often only confirms tax decisions made at first instance. In these circumstances, appeals against first-instance decisions seem meaningless and often only prolong the process.

Specialization of administrative judges for finance (primarily tax) law is also necessary. As a rule, judges dealing with a very wide range of administrative disputes from different legal areas also decide on highly sophisticated financial and tax cases, and their judgments, as a rule, have significant financial consequences.

### ***Obligation to pay arising only after the administrative dispute***

According to the existing legislation, the order of activities and obligations is as follows:

- Tax audits are performed by the Tax Administration or (e.g. in the case of special taxes on motor vehicles) the Customs Administration;
- After an audit, a record is made followed by a tax decision, against which the legal entity may appeal before the Independent Sector for Second-Instance Administrative Procedure;
- If the second-instance body confirms the decision, the legal entity is entitled to initiate an administrative procedure before the Administrative Court, but this does not delay the collection of the tax liability determined by the decision.

The Tax Administration can thus cause damage difficult to repair to the legal entity in a very short period of time, e.g. cause it to become insolvent or bankrupt, while the legal entity depends on the agility of the Administrative Court where disputes usually last several years.

## ***Introducing voluntary reporting of undisclosed tax liabilities***

The General Tax Act and other tax regulations related to the determination, calculation, and reporting of certain types of taxes prescribe penalties for tax misdemeanors and calculation of default interest on late liability payments. According to the provisions of the General Tax Act, interest is charged starting from the due date of a particular tax liability, and the maturity of a particular type of tax is determined by special laws. As a rule, a tax liability becomes due on the day the tax liability arises.

In the tax systems of some EU member states, “voluntary disclosure of undisclosed tax liability” has been introduced. Its purpose is to encourage taxpayers to voluntarily disclose undisclosed tax liabilities before the Tax Administration determines these undisclosed tax liabilities during a supervisory procedure within the statute of limitations deadlines. In return, the Tax Administration, depending on the amount of the undisclosed tax liability and the circumstances that led to the failure to disclose on time (with or without the intent to evade), reduces the penalty and interest rates in percentages depending on the circumstances that are specifically defined.

The introduction of the proposed measure would create a positive environment in relations between taxpayers and tax authorities and serve as an incentive for taxpayers to voluntarily approach the Tax Administration and disclose tax liabilities that were not disclosed on time, while at the same time being aware of the material consequences of such an act, which should be less than in the case when the Tax Administration determines the liability itself.

## ***Issuing certificates by the Tax Administration on the absence of tax debts promptly and on the basis of the current situation***

Issuing certificates on the status of tax debt is facilitated by the good functioning of the ePorezna system, which AmCham welcomes. However, despite this system, the accuracy of the data on the tax debt status depends on timely data entry, which is performed by the Tax Administration. It is important to continue to increase efficiency in this respect.

For the purpose of further facilitating the participation of entrepreneurs in public tenders for which they regularly need confirmation that they do not have tax debts, it is suggested that debts of up to a reasonable amount, e.g. of up to HRK 1,000, should also be treated as the absence of tax debt. This can easily be achieved in the system in a way that debts below this particular amount do not appear at all on the tax debt print-out, as if there is no tax debt at all.

## ***Administrative measures for facilitating business operations of entrepreneurs and the Tax Administration***

Entrepreneurs often complain about a high level of bureaucracy, i.e. a large number of administrative requirements they have to fulfill for their tax and related liabilities. Further relief is proposed based on the digitization and automation of the entire system (modernization of the Tax Administration IT system), which would contribute to the increase of transparency, equal treatment, and simplifying processes, and would be more environmentally friendly ("paperless business"). A large number of forms does not contribute to easier business operations. In addition, forms should be simplified. For example, what presents a difficulty is a large number of codes used in "JOPPD" forms or a large amount of data in VAT returns (e.g. the UK VAT form contains 5 to 7 fields, while the Croatian one has more than 20), the "RPO" form (taxpayer registration) and the like.

It is also desirable to differently arrange the issuing of the Central Tax Administration Office's opinion to the taxpayers, outside the system of binding opinions issued within a special procedure. An illustrative example is the question asked on August 6, to which the response was received at the end of the year. In comparison, in the UK, the same entrepreneur received a response within a few days.

It is important to implement measures aimed at improving the investment environment through a cheaper and simplified way of doing business.

### ***Extending the period of tax loss carryforward***

Existing regulations on the five-year loss carryforward do not encourage long-term investments, especially not investments in high-tech. 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. We believe that this period in Croatia should be extended from 5 to 10 years. A good example could be the solution implemented by Slovenia, where there is no time limit for the tax loss carryforward, but every year only 50% of the realized profit can be covered by the loss carryforward, and for 50% corporate tax needs to be paid.

### ***Correction of tax liabilities due to uncollectible receivables***

Croatian tax legislation does not provide for bad debt VAT relief, nor is there a possibility of unilateral VAT adjustment without the customer's written confirmation of having adjusted input VAT in its VAT records. Many customers

are not willing to perform the adjustment and provide the required confirmation. AmCham believes that the Croatian Tax Administration (CTA) should allow for unilateral VAT adjustment for bad debts by adjusting Croatian VAT legislation to align with EU rules.

The key reasons for an urgent need for the change in the Croatian VAT legislation arise from the recent practice (judgments) of the CJEU (Court of Justice of the European Union). The Court is in favor of the taxpayers' entitlement to reduce the taxable amount in case of non-payment even in cases where EU Member States do not allow such reduction as is the case in Croatia (and the tax authorities of the Member States have to follow the Court's judgments). Amongst other, it comes from the practice of the Court that:

Forbidding the reduction of the taxable amount in case of non-payment would be contrary to the principle of tax neutrality, Member States may prescribe conditions for reduction of the taxable amount with the aim to prevent tax evasion or avoidance. However, these measures have to be limited to achievement of these goals and should interfere as little as possible with principles of the VAT Directive, especially with the principle of neutrality. Particularly in case of non-payment, these conditions should be limited to taxpayer obtaining the proof that the consideration charged to the buyer for the supply would not be received.

The taxpayer can reduce the taxable amount once it is definitive that the customer will not pay the full price for the supply or when the taxpayer can show with reasonable probability that the debt will not be honored.

Legislative provisions provide Croatian taxpayers with the possibility of amending obligations on the basis of VAT in relation to bad debts, but the amending is made more difficult for the taxpayer due to the procedure involved. Namely, one of the conditions for amendment is that the taxpayer who has supplied the goods or performed a service must have a written statement from the recipient of the delivery that they have amended the input tax deduction in their business books and records. In other words, an amendment is not possible without the customer's cooperation.

For example, the UK tax system imposes an automatic and legal obligation on customers to refund input tax to the Tax Administration if they have not paid their suppliers within six months of delivery of goods or service received. The American Chamber of Commerce also believes that the Croatian Tax Administration should, by changing the legal regulations, also be involved in the process of collecting bad debts and prescribe a deadline for taxpayers to make an amendment of the input tax if they have not paid their suppliers on time. This would facilitate the amendment process to taxpayers who were unable to



collect payments for the delivered goods and performed services, while at the same time having to pay VAT with their own funds because they could not collect their debts from customers. The burden of amendment would also be shifted from the taxpayer to the Tax Administration, which is considered a more appropriate and effective procedure.

Many EU countries allow bad debt relief from the VAT perspective and prescribe certain formal requirements in this regard. For example, in the Czech Republic, France, Greece, Italy, the Netherlands and Slovenia, for the application of the bad debt relief it is generally required that the debtor enters a formal bankruptcy or other insolvency procedures as defined by the law, often with additional limiting conditions for the application of the bad debt relief (e.g. amended supplier invoice or credit note, court ruling, and similar).

On the other hand, the application of a bad debt relief in Belgium lays down only the condition that a bad debt has to be reported in financial statements and other reporting obligations, such as the issuance of a corrective document that includes specific information with regards to the bad debt at the moment when the supplier is able to prove by all means that the receivable is to be considered as lost. Similar conditions that enable a wider scope of application of the bad debt relief are also applied, for example, in Austria, Cyprus, Denmark, Ireland, Latvia and Poland, with an additional condition of issuance of a written notification by the supplier to the customer (purchaser), based on which the customer has an obligation to adjust (i.e. reduce) its input VAT. AmCham believes that there are no obstacles to implementing such a solution in the Croatian tax system.

Therefore in order to adjust its regulations to positive practices in other EU countries, AmCham suggests that current Article 33 (7) of the Croatian VAT Act, is changed in the following way "if the taxable amount is subsequently changed due to revocation, various discounts or the inability to collect, then the taxable person who supplied the goods or services may correct the VAT amount if it informs the taxable person for whom the goods were supplied or services performed in writing of the amount of the VAT for which the buyer does not have the right for deduction".

AmCham also suggests that the following paragraphs are added to the Article 33.

(8) The taxpayer can also repair (reduce) the amount of VAT charged if after a final court decision on the completion of bankruptcy proceedings or the successful completion of the compulsory settlement proceedings the taxpayer's receivable has not been repaid or not repaid in full. A taxpayer can act in the same way if it obtains a final court decision terminating the enforcement

proceedings or other document which shows that the completion of the execution procedure it's receivable has not been repaid or not repaid in full. The same applies to the taxpayer which has not been repaid or it has not been repaid in full because the debtor has been deleted from the register or registers or other relevant statutory records.

(9) Notwithstanding the preceding paragraph, if the taxpayer subsequently receives a payment or a partial payment for the supply of goods or services, the taxpayer must correct (reduce) the amount of the accordingly unpaid VAT, i.e. pay the respective amount of VAT to the state budget.

Further rules regarding the reduction of the VAT obligation due to inability to collect as prescribed by the Article 43 (1) of the VAT Rulebook remain the same: "If the remuneration is subsequently decreased due to various discounts which the supplier approves to the buyer, such as discounts due to earlier payments, rebates and other types of bonuses, or due to inability to collect, the taxable amount is decreased in accordance with Article 33 (7) of the VAT Act.".

## ***Extension for Personal income tax and Corporate profit tax filing deadlines***

Croatian tax legislation provides for very short annual PIT and CPT filing deadlines, often leading to incomplete submissions due to lack of information. AmCham believes that the Tax Administration CTA should allow filing deadline extensions.

### **a) *Personal income tax***

<b>Personal Income Tax reporting dates<sup>1</sup></b>			
	<b>Deadline*</b>	<b>Extensions</b>	
<b>Croatia</b>	<b>28 February</b>		
Bosnia and Herzegovina	28 February		
Slovakia	31 March	30 June	30 September <sup>1</sup>
Czech Republic	01 April	01 July	01 November <sup>2</sup>
Austria	30 April	30 June <sup>3</sup>	
Poland	30 April		
Serbia	15 May		
Hungary	20 May	20 November <sup>4</sup>	
Slovenia	31 May	31 July <sup>5</sup>	
Germany	31 July	28 February <sup>6</sup>	
Italy	31 October		

\*in the current year for the previous year

<sup>1</sup> June if the tax authorities have received a notification for extension. September for individuals who receive foreign source income.

<sup>2</sup> July if filing with the assistance of a tax advisor. November for individuals who receive foreign source income.

<sup>3</sup> June for individuals who file electronically, but only if they earn over a minimum amount from sources other than their employment or are employed by more than 1 employer at once.

<sup>4</sup> If taxpayer is not personally accountable for lack of the information for submission.

<sup>5</sup> Only if individual does not receive the calculation from the government by 31 May.

<sup>6</sup> If filing with the assistance of a tax advisor, for the second following year (e.g. 28 February 2020 for 2018 tax return)

Croatian PIT legislation provides very short annual PIT filing deadlines, which are 31 January (INO-DOH form) and the last day of February (ZPP-DOH form) of the current year for the income received in the previous year. In practice, this often

<sup>1</sup> [https://www.ey.com/Publication/vwLUAssets/ey-2018-19-worldwide-personal-tax-and-immigration-guide/\\$FILE/ey-2018-19-worldwide-personal-tax-and-immigration-guide.pdf](https://www.ey.com/Publication/vwLUAssets/ey-2018-19-worldwide-personal-tax-and-immigration-guide/$FILE/ey-2018-19-worldwide-personal-tax-and-immigration-guide.pdf) On 24.7.2019.

leads to incomplete documentation being submitted, especially for individuals who receive income from abroad. Namely, at the moment of submission, these individuals do not have full information on income received from abroad; or on foreign tax liabilities which can be utilized as a tax credit against Croatian tax liabilities and, in some cases, even on their tax residence position.

AmCham recommends that the Croatian PIT legislation be amended so that:

the deadline for annual PIT filling is 31 March of the current year for income received in the previous year.

individuals, who on 31 March do not have full information on income received from abroad and foreign tax liabilities, may request an "automatic" extension of the PIT filling deadline to 30 November of the current year for income received during the previous year.

In accordance with AmCham's proposal, the general deadline for annual PIT filling will be 31 March of the current year for the income received in the previous year (instead of the current applicable deadlines of 31 January and the end of February).

An individual who receives income from abroad and does not have full information on income from abroad received in previous year and foreign tax liabilities, will notify the CTA and request an extension of the deadline. This notification is to be submitted by 31 March of the current year for income received in the previous year (AmCham suggests that the notification's content and form is prescribed by PIT legislation). Once the individual will have full information on income received from abroad and foreign tax liabilities he/she will file Croatian annual forms, but not later than 30 November of the current year for income received during previous year.

This proposal is in line with the current PIT provisions which prescribe that a certificate on tax paid abroad is to be provided to the CTA by 30 November of the current year for income received in the previous year.

It is expected that this will have a positive impact on both the individual's and the CTA's administrative capacities, i.e. it will reduce additional administration on both sides:

Individuals receiving income from abroad will not be required to submit incomplete documentation (due to lack of information) in order to meet the filing deadline and to submit the documentation once the information is received, through amendments to the previously submitted incomplete documentation (in order to report the respective income and foreign tax liabilities correctly).

The CTA will not receive non-accurate incomplete documentation, which it needs to process when received, on foreign income and foreign tax liabilities, which might lead to wrong PIT refund planning.

This proposal will also significantly ease the administrative burden and improve the compliance / reporting timetables for individuals receiving income from abroad which will be a positive development for:  
those Croatian individuals deriving income from abroad; and  
those foreign individuals working and doing business in Croatia.

## **b) Corporate profit tax**

<b>Corporate Profit Tax reporting dates<sup>2</sup></b>			
	<b>Deadline*</b>	<b>Extensions</b>	
<b>Croatia<sup>1</sup></b>	<b>30 April</b>		
Bosnia and Herzegovina <sup>2</sup>	31 March		
Slovakia <sup>3</sup>	31 March	30 June	30 September
Czech Republic <sup>4</sup>	31 March	30 June	
Poland <sup>5</sup>	31 March		
Slovenia <sup>5</sup>	31 March		
Austria <sup>6</sup>	30 April	30 June	31 March / 30 April
Hungary <sup>7</sup>	31 May		
Germany <sup>8</sup>	31 May	31 December	
Serbia <sup>9</sup>	30 June		
Italy <sup>10</sup>	30 September		

\*in the current year for the previous year

<sup>1</sup>Or 4 months after the company's year end.

<sup>2</sup>In Federation of Bosnia and Herzegovina; In Republika Srpska and Brčko District 90 days after company's year end.

<sup>3</sup>Or 3 months after the company's year end. June if the tax authorities have received notification for extension. September if the company received income from foreign sources.

<sup>4</sup>June automatically if the taxpayer is subject to a statutory audit. Otherwise extension can be granted at the discretion of the tax authorities.

<sup>5</sup>Or 3 months after the company's year end.

<sup>6</sup>June if filed electronically. 31 March / 30 April of the second following year if a taxpayer is represented by a certified tax advisor.

<sup>7</sup>Or 5 months after the company's year end.

<sup>8</sup>December if a licensed tax consultant prepares the return.

<sup>2</sup> [https://www.ey.com/Publication/vwLUAssets/ey-2018-19-worldwide-personal-tax-and-immigration-guide/\\$FILE/ey-2018-19-worldwide-personal-tax-and-immigration-guide.pdf](https://www.ey.com/Publication/vwLUAssets/ey-2018-19-worldwide-personal-tax-and-immigration-guide/$FILE/ey-2018-19-worldwide-personal-tax-and-immigration-guide.pdf) On 24.7.2019.

<sup>9</sup>Or 6 months after the company's year end.

<sup>10</sup>Or 9 months after the company's year end.

Under the Croatian Corporate Profit Tax Act, the deadline for filing a corporate income tax return is four months after the end of a business year. This deadline is final and no option of extension is provided for.

Many countries in the region allow for a longer deadline for filing a corporate income tax return, and in addition, many countries allow taxpayers to request an extension of the deadline.

Taxpayers who have business units and pay corporate income tax abroad are usually unable to obtain the necessary documentation for calculating the tax paid abroad by the prescribed deadline and are therefore forced to subsequently correct the filed corporate income tax return.

Furthermore, according to the Accounting Act, the deadline for the preparation and submission of (unconsolidated) annual financial statements is six months from the end of a business year. Annual financial statements are the basis for the preparation of a corporate income tax return, i.e. accounting profit 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 the purpose of 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, many taxpayers have a problem with finalizing the annual financial statements by the deadline for the submission of a corporate income tax return, which is particularly the case in medium-sized and large enterprises, that is, enterprises that are subject to audit (and other companies that carry out audits of their financial statements). In practice, it is very demanding to close the business books, prepare the annual financial statements and audit the annual financial statements 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 in order to correct the errors identified by the taxpayers themselves or because of audit findings. Even though, in such cases, taxpayers prepare and submit their annual financial statements for public release, they are forced to make a subsequent correction of the corporate income tax return.

Consequently, the extension of the deadline for filing a corporate income tax return would to some extent reduce the administrative burden of taxpayers, and indirectly the Tax Administration.

Accordingly, AmCham proposes that the deadline for the filing of a corporate income tax return should be extended to six months after the end of a business year (i.e. to be equal to the deadlines for submitting annual financial statements for public release) or that taxpayers at least have the option of requesting an extension of the deadline for filing a corporate income tax return.

# Income tax - reducing the tax burden on labor contributions

In the Survey of the Business Environment in Croatia that AmCham presented at the beginning of 2019, there is visible progress in terms of the reduction in the taxation of labor. AmCham believes that the Government should continue to work on further reducing the taxation of labor in order to make it more competitive compared to other Central and Eastern European countries and for it to focus on retaining the workforce in Croatia.

The KPMG table below provides an overview of tax rates and contributions in Croatia and competing markets.

Overview of tax systems in 2019	Croatia	Bulgaria	Czech Republic	Romania	Serbia	Slovakia
Corporate tax rate (in general)	12% - for generated revenue of up to HRK 3,000,000.00 18% - for generated revenue of HRK 3,000,000.01 or greater	10%	19%	16%	15%	21%
VAT rate (in general)	25%	20%	21%	19%	20%	20%
Income tax rates (wages)	24%, 36% + surtax up to 18% (the highest rate is applied to annual taxable income above HRK 360,000.00, or EUR 48,000.00 in 2018)	10%	20.1% - 23.35% depending on income level	10%	10% (+10% for annual income from EUR 20,938.00 to EUR 41,875.00, or +15% for incomes above EUR 41,875.00**)	19% (25% if annual income exceeds EUR 36,256.37)
Contributions on wages	Employee: 20% (partially limited)  Employer: 16.5% (unlimited)	Employee: 13.78% (limited)  Employer: 18.92% to 19.62% (limited)	Employee: 11% (partially limited)  Employer: 33.8%* (partially limited)	Employee: 35% (unlimited)  Employer: 2.25% (unlimited)	Employee: 19.9% (limited)  Employer: 17.15% (limited)	Employee: 13.4% (partially limited)  Employer: 35.2% (partially limited)

\* Applicable from 1 July 2019

\*\*These tax categories refer to 2018. The applicable annual tax levels for 2019 will be published in 2020

Source: KPMG, June 2018

The table shows that Croatia is not competitive when it comes to the tax burden on labor, particularly in the area of higher incomes. This is one of the reasons why a large number of propulsive sectors in Croatia are experiencing problems with a lack of qualified workers, a fact especially evident in, for example, the ICT industry and tourism.



Reducing the tax burden on labor would contribute to the opening up of regional centers of international companies in Croatia, since due to the reduction of the public imposts burden on wages it would be more affordable for entrepreneurs to pay the best managers. This would enable Croatia to establish its position as a regional business center, where its membership in the EU and its geographical position would be of help, and expensive employment is a hindrance.

AmCham proposes three key measures:

- Increase of non-taxable personal deductions to HRK 4,800
- Decrease of income tax rate from 24% to 12%
- Decrease of the 36% income tax rate

The increase of non-taxable personal deductions to HRK 4,800, together with the proposed changes in income tax rates, would provide the working population with a greater disposable income, along with the expected increase in consumption and greater economic activity.

### ***Increase of non-taxable personal deductions***

The increase of the non-taxable part of income (i.e. personal deductions) from HRK 3,800 to HRK 4,800 would be beneficial for a large scope of the working population in Croatia by lowering the total tax burden and increasing net income for persons with high and middle incomes.

It would also open up space for employers of persons with net income of up to HRK 3,800 (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 24% income tax would have to be applied to the part of the increased salary if personal deductions remained the same.

The social effects this measure would have require no further explanation.

### ***Decrease of income tax rate from 24% to 12%***

Lowering the 24% income tax rate to 12% would have a very strong impact on the Croatian economy and increase the purchasing power of a large number of working population.

The measure is proposed to further unburden relatively low or “medium” incomes. With the same cost for employers, employees receive higher net income, which

increases their economic power and capacity for consumption, i.e., it increases their living standards. This indirectly positively impacts economic growth in Croatia. Over the past few quarters, the greater economic power of the population stemming from the implemented reduction of the tax burden has led to higher rates of economic growth generated significantly by personal consumption. AmCham believes that lowering the 24% income tax rate would contribute to further economic growth due to higher consumption of citizens who would have a higher disposable income.

### ***Decrease of the 36% income tax rate***

In order to fully spark investments, attract regional Headquarters and boost higher paid professions in Croatia income tax rate of 36% should be significantly lowered. Alternatively, the 36% rate should be applied only for gross monthly salaries higher than 75.000 HRK.

For professions that are relatively “better” paid, the 36% tax rate (increased by a city surtax, where applicable) represents a significant burden on income and reduces the competitiveness of Croatian employers compared to other comparable countries. Reducing this tax rate makes it possible to create/attract jobs for highly educated employees who create high added value (e.g. IT, tourism, financial sector, pharmaceuticals...). Croatia needs to keep up with the trend of employee role change in companies operating in several countries where these employees are in charge of markets in several countries. An attractive income taxation system, with a lower burden for a comparatively higher income, will attract such companies and enable Croatian tax residents to get regional roles (not necessarily managerial, but highly qualified) because these employees would have a higher net income at the same salary cost. For that reason, AmCham suggests lowering the higher tax rate or further increasing the threshold of the higher tax bracket. Both measures have a positive impact on increasing net income at the same cost.

# Raising bonus payments for work results

---

AmCham suggests increasing the non-taxable amount of “bonus payments for work results and other forms of additional reward for workers (additional salary, bonus on the monthly salary, etc.)” from HRK 5,000 to HRK 12,000 (Ordinance on personal income tax, Article 7, paragraph 2)

The measure provides an optimal net effect for employees and employers in the circumstances when employers have the option of additionally rewarding their workers. AmCham believes that an appropriate amount for this is HRK 1,000 per month.

This measure would not influence revenues of the local authorities which would make it easier to adopt without objections by other stakeholders.

# Reducing the tax burden on some employee income

---

## *Taxation of receipts from the stock awards and stock option plans*

As of 1 January 2019, all receipts based on stock awards and stock option plans have equal tax treatment, i.e., are considered as a capital benefit-in-kind, subject to a 24-percent tax rate (increased for city surtax, if any).

However, in practice there are different interpretations of the new Personal Income Tax Law provisions: whether a value of the receipt from the stock awards and stock option plans is to be considered as a net benefit (which has to be grossed-up for taxation purposes) or a gross benefit (without a gross up requirement).

Based on the interpretation adopted the effective tax rate may vary:

- if the value of the respective receipts should be considered as net benefit in kind (with gross up requirement) the effective tax rate is 39,51% (for taxpayers residing in the City of Zagreb).
- if the value of the respective receipts is to be considered as a gross benefit in kind (without gross-up requirement), the effective tax rate is 28,32% (for

taxpayers residing in the City of Zagreb), which is still above the average effective tax rate in Central and Eastern Europe region.

AmCham's recommendation:

We propose to amend the Croatian Personal Income Tax legislation so that receipts from the stock awards and stock option plans are considered as a gross capital benefit, subject to a 12-percent tax rate (increased for city surtax, if any).

The 12% tax rate is the currently the applicable tax rate for dividends, interest and capital gains so reducing the tax rate from 24% to 12% would be in line with these tax rates.

In accordance with AmCham's proposal the effective tax rate applicable on the respective receipts will be 14,16% (for taxpayers residing in City of Zagreb). This would lead to a decrease of the overall tax burden on employee stock awards and employee stock option plans, which would make Croatia a more favorable country for foreign investments, primarily for setting up regional headquarters, from which the entire Croatian economy would benefit.

If the PIT legislation would contain provisions which strictly prescribe that receipts from the stock awards and stock option plans are considered as a gross capital benefit (without gross up requirement), different interpretations of the current PIT provisions which arise in a practice will be avoided.

### ***Allowances for workers' health***

- ***Allowance for workers' meals***

AmCham proposes to introduce the possibility of payment of a non-taxable reasonable daily allowance for workers' meals (per working day), e.g. HRK 30–35. This amount should not be subject to contributions for compulsory social insurance. This would encourage employers to relatively cheaply provide their workers the additional benefit of easier financing their meal in a working day. Also, for low income activities, such a measure would also play an important role in reducing social disparities, i.e. the prevention of poverty.

- ***Allowance for sports activities***

Due to a high number of sick days, obesity of a part of the population, healthcare costs and damages to the economy and the state in general that have arisen from this, AmCham proposes the introduction of the possibility of non-taxable financing

of employees' sports activities, with an aim to improve their general health (e.g. monthly or annual gym and city pool membership, sports fields time slots, etc.).

For easier administration, AmCham suggests that the non-taxable amount for sports activities can be paid directly to the service provider.

- ***Tax breaks for additional health insurance***

AmCham suggests recognizing entire premiums for additional health insurance as a tax-recognized expense, and that it is non-taxable.

According to current legislation, the only tax-deductible part of the additional health care insurance refers to the preventive systematic examination, while the employer is obliged to pay all related taxes and contributions for the supplementary health insurance premium. With such a measure, employers would certainly make the decision to award such an option to their employees more easily as it would have a number of positive effects on improving health and productivity, but it would also contribute to reducing the rate of sick leave. Such a measure would have a positive impact on reducing of waiting lists and unburdening on the Croatian public health system.

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 personal income tax. The deduction has a set limit that is determined depending on other tax breaks and depends on the level of taxable income, with the maximum tax break amounting to EUR 1,000.

- ***Supplementary health insurance***

In 2018, the Croatian Health Insurance Fund (HZZO) recorded an average of 4,203,382 compulsory insured persons. On December 31, 2018 the number of insured persons paying for supplementary health insurance to the HZZO amounted to 1,676,787 which is only 39.9% of the total number of compulsory insured persons.<sup>3</sup>

If those who have supplementary health insurance covered at the expense of the state budget, other insurance companies or persons under 18 who are not obliged to pay participation are added to those who have supplementary health insurance with the HZZO there is still some 15% of the population does not have a supplemental health insurance policy.

---

<sup>3</sup> Croatian Health Insurance Fund (2019), *Report on the Operations of the Croatian Health Insurance Fund for 2018*, Zagreb

AmCham proposes enabling a non-taxable payment of supplementary health insurance by employers for employees. This would contribute to a better healthcare system and financing of health services and increase of availability of health protection and satisfaction of workers. The introduction of non-taxable payment of supplementary health insurance by employers for employees would increase the number of payments and increase the share of employees with supplementary health insurance.

- ***Organization of team building activities***

Work requires a certain psycho-physical effort of every employee. At the same time, individual workers are most often part of an organizational unit or a team with whom they solve and complete tasks.

In line with the trends of developed economies, Croatian employers increasingly organize team building activities. Joint activities of coworkers lead to a better team spirit, sense of belonging to a collective and contribute to better mutual trust, understanding and respect, resulting in significantly better individual and collective business results.

Currently, this type of activities are subject to taxation, which is a significant cost to employers who often decide not to organize recreational activities for employees or to reduce the scope and quality of planned activities in order to reduce costs. Organization of team building is a standard in the contemporary organization management and human potential management. Taxing recreational activities for employees makes it difficult to keep up to date with the most contemporary business trends for employers in Croatia.

AmCham believes that non-taxation of team building activities, more specifically the clear regulation of the tax treatment of team building activities, would have multiple positive effects on the psychophysical benefit of employees, but also on better productivity of individuals, companies and ultimately the Croatian economy.

***Allowance for accommodation and food for temporarily posted workers***

It is necessary to equalize the rights of all taxpayers in a similar/same category. The recent amendments to the income tax regulations allowed the non-taxable allowance for accommodation and food for tourism workers, thus boosting the mobility of the workforce and assisting tourism workers who temporarily moved from their place of residence because of work in covering the cost of accommodation and other expenses that are related to that change.

However, there is no reason to have this option available only in tourism. For example, the company Mirna, a member of the Podravka Group, has a sardine factory in Rovinj and the need to send a certain number of workers to work in that factory. Paying for accommodation and food for these temporarily posted workers is subject to taxes and contributions, which increases the cost of their work and therefore reduces business competitiveness. AmCham therefore proposes that the aforementioned legal provisions on seasonal workers related to the tourism sector apply to all industries.

### ***Use of taxi services during a business trip***

If a worker uses taxi services or some other mean of transportation for transportation from the airport to the destination of business trip, these expenses are not considered to be transportation in the destination of the business trip and are recognized as transportation cost of the business trip. It is considered as transportation to the destination of the business trip, not within the destination of the business trip, so the cost can be compensated to the employee without paying income taxes and contributions.

In case where expenses for the taxi services are related to the transportation within the destination of the business trip, mentioned expenses should be paid from the amount of the daily allowance. However, if expenses are reimbursed to the employee, they should be taxed as salary in kind.

In principle workers are trying to maximize use of their time during a business trip. In case where there are multiple meetings and business activities organized in a single day taxi services are usually used to avoid slowdown and unnecessary prolongation of stay. Use of taxi services for business purposes is a business expenditure and should not be covered from a worker's daily allowance.

AmCham considers that the use of taxi services during a business trip should be treated as the cost of the trip, without being treated as salary in kind, meaning that the daily allowance should only be used to cover the cost of drinks and meals during a business trip.

---

For additional information, please contact:  
The American Chamber of Commerce in Croatia  
Andrea Doko Jelušić,  
Executive Director  
T: +385 1 4836 777  
E: [andrea.doko@amcham.hr](mailto:andrea.doko@amcham.hr)