Recommendations for the Tax System Reform in 2023

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American Chamber of Commerce in Croatia Američka gospodarska komora u Hrvatskoj

Contents

Introduction

AmCham welcomes the previous tax relief measures introduced through previous rounds of tax reform and draws particular attention to income tax relief measures for natural persons (by expanding the gross base for the lower tax bracket and lowering income tax rates in general), as well as the introduction of additional options for the payment of non-taxable compensation to employees.

AmCham also welcomes amendments to regulations related to equity plans (for which it proposes a certain additional, clearer legislative regulation nonetheless).

Tax relief for so-called small entrepreneurs (lower corporate income tax rate and higher threshold for VAT application based on collected amounts) is also very well received.

It is also very significant that the legislature recognized the need to introduce special measures in extraordinary circumstances of COVID-19 to protect jobs, and this helped numerous employers survive while doing business in difficult economic circumstances.

On the other hand, AmCham is not satisfied with the introduction of a windfall tax, in terms of the way the tax is introduced, the taxable persons covered and the rate of tax.

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 greater competitiveness of Croatian employers 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 welcomes the practice of the Ministry of Finance 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.

Equal treatment and certainty in the conduct of tax authorities

The business of taxable persons is sometimes made more difficult by different actions taken by different levels of tax authorities (branches, regional offices, including auditing departments, Central Office) in the same or similar cases. It is essential to ensure uniform procedure at all levels of tax authorities to ensure legal certainty.

With this aim, AmCham proposes that a **provision be restored to the Tax Administration Act, prescribing that the opinions, instructions and operational methodologies issued by the Central Office of the Tax Administration be binding on all organizational units of the Tax Administration.**

It would also be preferable to have a different arrangement for issuing the opinion of the Central Office of the Tax Administration to taxable persons outside the system of binding opinions issued in a special procedure provided for that purpose. There were cases where the Tax Administration took years to issue its opinions in response to inquiries. Therefore, it is necessary to work on significantly speeding up the issuance of opinions.

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 12.b 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 is aware that a major project is underway to relieve the burden placed on taxable persons and the Tax Administration based on further digitalization and automation of the entire system (modernization of the Tax Administration’s 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 that would be 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 in the implementation of 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 profit can be covered by the loss carryforward, and corporate income tax must be paid on the remaining 50%.

Adjustment of tax liability due to bad debt

The Croatian tax legislation does not provide for VAT exemption in the case of bad debt, and there are no options of a unilateral VAT adjustment without the written confirmation of the purchaser on the performed adjustment of input tax in the VAT records. Many purchasers are unwilling to make an adjustment and provide the necessary confirmation. AmCham finds that the Croatian Tax Administration should **enable a unilateral VAT adjustment for bad debts** by reconciling the Croatian VAT legislation with the EU regulations.

The key reasons for the urgent need to amend Croatian VAT legislation stem from the recent case law (judgment) of the Court of Justice of the European Union (CJEU). The Court recognized the right of taxable persons to reduce the tax base in case of non-payment, even in cases where EU Member States do not allow such a reduction, as is the case in Croatia (and Member States' tax authorities must comply with court rulings). Among other things, from the Court's case-law, it follows:

- that a ban on reducing the tax base in the event of non-payment would be contrary to the principle of tax neutrality,
- that all Member States may prescribe the conditions for the reduction of the tax base with the aim of preventing tax evasion and tax avoidance, but not with the aim of the permanent prevention of VAT liability adjustments in cases of bad debt.

Those measures must be limited to the attainment of those objectives and should have the least possible effect on the principles of the VAT Directive, and in particular, on the principle of neutrality. In the case of non-payment in particular, these conditions should be limited to the taxable person obtaining evidence that the consideration for a supply of goods or services to the purchaser will not be collected. The taxable person may reduce the tax base after it is finally determined that the purchaser will not pay the full price for the supply of goods or services or when the taxable person can show with reasonable probability that the debt will not be settled.

Legislative provisions provide Croatian taxable persons with the possibility of adjusting their VAT liability in relation to bad debts, but the procedure makes this amending more difficult for taxable persons. An adjustment is not possible without the purchaser's cooperation.

Good practice in the field exists in other European countries. For example, the UK tax system imposes an automatic and legal obligation on purchasers to refund input tax to the Tax Administration if they have failed to pay their suppliers within six months of receiving the goods or services. AmCham believes that the Croatian Tax Administration should, by harmonizing regulations, also be involved in the process of collecting bad debts and prescribe a deadline within which taxable persons must correct their input tax if they have not paid their suppliers on time. This would facilitate the amendment process for taxable persons that were unable to collect payments for the delivered goods and performed services while at the same time having to pay VAT at their own expense.

Many EU countries allow VAT exemptions for bad debts and prescribe certain formal requirements in this regard. For example, in the Czech Republic, France, Greece, Italy, the Netherlands, and Slovenia, the adjustment of VAT liability for bad debts generally requires the debtor to initiate bankruptcy proceedings or other prescribed debtor insolvency proceedings, often with additional restrictive conditions for the adjustment of the VAT liability (e.g., modified supplier invoice or approval, court decision, etc.).

On the other hand, the adjustment of the VAT liability on account of bad debt in Belgium requires only the condition that bad debt must be shown in the financial statements and other reporting obligations, such as the issuance of a corrective document that includes specific information related to bad debt at the time when the supplier can prove that the claim is considered lost. Similar conditions allowing for a wider scope of VAT liability adjustment for bad debts apply, for example, in Austria, Cyprus, Denmark, Ireland, Latvia and Poland, with the additional condition of issuing a written notice of the supplier to the purchaser, on the basis of which the purchaser has the obligation to amend (i.e., reduce) their input tax. AmCham believes that there is no obstacle to introducing such a solution in the Croatian tax system.

Therefore, in order to adapt its regulations to the positive practices in other EU countries, **AmCham proposes** that the current Article 33, paragraph 7 of the Croatian VAT Act be amended as follows: "If the tax base subsequently changes due to revocation, various discounts or inability to collect, then the taxable person that supplied the goods or services may correct the amount of VAT if the taxable person to whom the goods or services were supplied is notified in writing of the amount of VAT for which the recipient has no right to deduct".

AmCham also proposes that the following paragraphs be added to Article 33:

"(8) The taxable person may also adjust (reduce) an appropriate amount of VAT charged if, after a final court decision on the completion of bankruptcy proceedings or the successful completion of the compulsory settlement procedure, the taxable person's claim has not been collected or has not been fully collected. The taxable person may act in the same way if they receive a final court decision terminating the enforcement proceedings or another document showing that at the end of the enforcement proceedings their claim has not been collected or has not been fully collected. The same applies to a taxable person to which the debt has not been repaid or 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 taxable person subsequently receives a payment or partial payment for the supply of goods or services, the taxable person must amend (reduce) the amount of unpaid VAT on that base, i.e., must pay the appropriate amount of VAT into the state budget."

Further rules on the reduction of the VAT liability due to the inability to collect prescribed in Article 43, paragraph 1 of the Ordinance on VAT remain unchanged: "If the compensation is subsequently reduced due to various types of discounts given by the supplier to the recipient, such as discounts due to earlier payment, rebates and other types of approval or due to inability to collect, then the tax base shall be reduced in the manner prescribed by Article 33, paragraph 7 of the VAT Act."

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

Croatian tax legislation provides for very short annual deadlines for filing personal income tax 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 income tax and corporate income tax returns is found in Annex 1*.**

It is essential to point out that it is often impossible to obtain information from abroad (for both natural and legal persons) 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 taxable persons (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 income tax and corporate income tax** 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. Furthermore, in terms of the deadline for submission of information on receipts from abroad and accounting of tax paid abroad, we propose to keep the deadline 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 using a simplified manner prescribed in advance if the data from abroad are 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 profit is the starting point for determining the corporate income tax liability. This means that taxable persons 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 the annual financial statements by the deadline for filing a corporate income tax return.

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

AmCham's proposal

Accordingly, AmCham proposes **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 taxable person, to determine the taxable person'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 taxable person 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 taxable person is obliged to settle the tax liability in the amount determined by the incorrect decision.

Often, the amounts of such tax liabilities are extremely high, so the taxable person has to get into debt in order to raise the funds and avoid enforcement, which the Tax Administration initiates in the shortest possible time for larger sums. Only after the appeal is over can the taxable person get their funds back, which can take a long time.

AmCham particularly refers here to the fact of a mismatch of deadlines when issuing a temporary tax decision within a special procedure. Namely, after the issuance of a temporary tax decision, the taxable person 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 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 aforementioned inconsistency of deadlines and the fact that the appeal does not delay execution to be 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 taxable person, all for the purpose of issuing a single decision.

Accordingly, 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 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 authorities usually refer to Article 87, paragraph 1 of the General Tax Code, i.e., to the fact that the taxable person 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 taxable persons must pay significant tax liabilities determined by the (incorrect) tax decision.

In order to avoid such situations, AmCham proposes adding a provision to the General Tax Code based on which: "*Appeal submitted against the decision on income tax liability based on the submitted voluntary filing of receipts from abroad from Article 12.b(1) of the General Tax Code postpones the execution of the decision*."

Personal income tax and mandatory contributions – reducing deductions at source

Despite significant progress in reducing the taxation of labor, AmCham believes that there is more room for further reduction of 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.

An overview of tax rates and contributions in the Croatian and competing markets is found in Annex 2.
The table found in Annex 2 shows that Croatia is insufficiently competitive when it comes to the tax burden on labor, particularly in the area of higher salaries. At the same time, Croatia has the highest consumption taxation rate among the listed countries and it is near the top in terms of taxation of corporate income. Therefore, the tax burden is still relatively high in all areas. This 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.

AmCham proposes **three key measures**:

- Increase of non-taxable personal deductions to EUR 650;
- Decrease of income tax rate from 20% to 10% and from 30% to 25%;
- The application of the maximum monthly and maximum annual bases in the calculation of healthcare insurance contributions.

The increase of non-taxable personal deductions to EUR 650, together with the proposed changes in personal income tax rates, would provide the working population with a higher disposable income, along with the expected increase in consumption and greater economic activity.

Increase of non-taxable personal deductions

The non-taxable part of income (i.e., personal deductions) has already been increased several times. However, AmCham believes that a further increase to EUR 650 would be beneficial for a large section 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 EUR 650 (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 this measure would have require no further explanation.

Reduction of the tax rate from 20% to 10% and from 30% to 25%

AmCham believes that reducing the personal income tax rates from 20% to 10% and from 30% to 25% would have a strong impact on the Croatian economy and would increase the purchasing power of a large number of workers.

The above 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). 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.

In this respect, AmCham proposes a reduction of the 20% personal income tax rate, applicable to annual income (from employment, from independent work, and other income), income from allotment of shares, income on the basis of property rights, and disposal of assets to 10% thus equaling it to the rate applicable to other income on the basis of capital and assets (dividends, interest, lease, etc.) introduced through legislative amendments which took effect in January 2021. This would also provide further relief to low- and medium-income earners.

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 possibility of relief in terms of deductions at source and mandatory insurance contributions. Given that some employees are already exempt from paying income tax (and surcharges), changes only to the tax system will not affect the lowest wages. Taking this into account, it is only by reducing contributions that labor cost relief can be achieved at all salary levels.

At the same time, AmCham is keeping in mind the current situation where funds collected through contributions are insufficient for the pension and healthcare system needs and are financed using state budget funds raised through taxation instead.

In this respect, a momentary reduction of the general rate of contribution over a short term is not realistic (even though it would also have to be reduced in the future as part of a wider 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 (prescribed in the amount of 6 average gross monthly/annual salaries), 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 as the base and other receipts on the basis of employment, which significantly increases labor costs of these workers.

On the other hand, even though their employers are paying unlimited contributions for them, the rights arising from the healthcare insurance used by the workers are essentially limited for various reasons:

- Payment of a supplemental contribution is required for full healthcare service;
- The healthcare service is not available in a realistic time when a need arises – insufficient capacity of the public healthcare system (waiting lists);
- Certain medicines and treatments are not covered by CHIF, so employees pay extra for them, even though the contribution is unlimited.

As a consequence, those persons cover most of the healthcare needs, including exams and treatment, from private healthcare service providers at their own expense.

In addition, sources of cash benefits (during sick leave) should also be taken into account. Namely, even though employees are entitled to salary compensation during sick leave, as a rule, the said compensation is not financed from the collected mandatory contributions for health insurance (which are not limited), but the mentioned cost for "regular" sick days up to 42 days is borne by the employer. This puts employers in an additional disadvantageous position, because in addition to reimbursing the salary of an employee who is prevented from working (sick leave up to 42 days), they also have to calculate mandatory contributions on the full amount of compensation.

That is why AmCham proposes limiting the healthcare insurance contribution liability, the same way pension insurance contribution liability is limited, i.e., to the amount of 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 receipts, 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 employees 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.

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

		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
Receipt		**1.300,00**	**3.300,00**	**6.600,00**	**13.000,00**	**1.300,00**	**3.300,00**	**6.600,00**	**13.000,00**
Tax and surtax (18%) total		**120,15**	**497,75**	**1.211,34**	**3.363,44**	**46,02**	**234,82**	**661,09**	**2.454,51**
Net receipt		919,85	2.142,25	4.068,66	7.995,94	993,98	2.405,18	4.618,91	8.904,87
Healthcare insurance contribution	16,50%	214,50	544,50	1.089,00	2.145,00	214,50	544,50	1.089,00	1.353,51
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**	**14.353,51**
Effect for the worker									
Net salary increase						74,13	262,93	550,25	908,93
Net salary increase percentage						**8,06%**	**12,27%**	**13,52%**	**11,37%**
Effect for the employer									
Salary cost reduction						0,00	0,00	0,00	791,49
Salary cost reduction, percent						**0,00%**	**0,00%**	**0,00%**	**-5,23%**

***Source: KPMG**

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 taxable persons, for 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 are 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 taxable person can exercise their rights to the increased personal deduction for health 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 name of the taxable person, i.e., on the basis of fiscal receipts issued by a health institution or a healthcare professional in private practice which are authorized/registered to provide healthcare in the Republic of Croatia in accordance with a separate regulation.

The assumption is that citizens who have high incomes and whose salaries are currently burdened with a significantly higher cost of health insurance contributions, which is not commensurate with the higher standard of health services and the greater scope of rights from compulsory health insurance, would use this relief. On the other hand, the number of these citizens is not significant, so these changes in regulations are not expected to have significant direct impacts on the revenues of the State Budget.

Changes to the tax treatment of "remuneration in kind"

The Personal Income Tax Act lays down that any remuneration paid by the employer to its worker which is not in cash falls under the definition of remuneration in kind and represents the worker's taxable remuneration (apart from certain exceptions laid down in the Act and Ordinance).

In practice, this means that the realized receipt represents the net value, whereby the base must be increased by the corresponding taxes and contributions (so-called gross-up). Such a calculation method leads to an extremely large tax burden, i.e., in an effective tax rate that can reach as much as 125.43% (if the person is 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 employee:

- If they are paid by the employer, apart from the expense itself for obtaining a remuneration in kind, such a tax burden discourages employers from enabling any kind of 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 that they must pay is higher than what they receive from the employer; therefore, the employee simply has no financial motive to accept such remuneration.

We note that this issue was partially regulated in the past by the Income Tax Ordinance NN 140/03, Article 17, paragraph 11, from which we interpret that there was no obligation to "gross up" when the tax liability was borne by the worker. The re-introduction of this provision would represent a good basis for further positive upgrading of regulations.

Informative research carried out by KMPG in August 2020 in several neighboring countries (Austria, Hungary, Slovakia, Slovenia) indicates that, apart from having established taxation exemptions regarding certain categories of remuneration in kind, countries generally do not treat remuneration in kind as net, but rather gross remuneration, particularly if the taxes are paid by the employees. A short list of taxation method by country* can be found below:

Hungary	Hungary has implemented various models of remuneration in kind which employers may grant their employees without paying personal income tax (even though they must pay the mandatory contributions), provided that the funds are paid for a specific purpose (accommodation, entertainment, leisure) and that they are spent exclusively with Hungarian service providers. The amount is limited to (approximately EUR 2,280 annually per employee). Moreover, there are certain types of remuneration that are completely exempt from taxes and contributions, such as tickets for sports and cultural events.
Slovakia	Slovakian regulations define two types of remuneration in kind: monetary benefits and non-monetary benefits. Monetary benefits are treated the same as a salary (gross remuneration), while non-monetary benefits are grossed up for the purpose of calculating taxes and contributions.
Austria	As a rule, Austria treats remuneration in kind as gross for the purpose of calculating taxes and contributions.
Slovenia	Slovenian regulations do not require remuneration 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, September 2020*

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 remuneration in kind because it makes such remuneration extremely uncompetitive and administratively complex to implement. Instead, we propose that the authorities consider **defining the market value of the remuneration in kind as the gross value for the purpose of tax and contribution payment.**

Increase in bonuses and compensations

AmCham welcomes the implemented increase in the non-taxable amount of "monetary rewards for work results and other forms of additional employee remuneration" (additional salary, supplement to monthly salary, etc.), but also proposes an increase in non-taxable benefits that have not been changed for a long time, so have been made insufficient by inflation. Namely, in view of the overall significant increase in prices last year and this year, it is suggested to consider the increase of amounts of non-taxable benefits such as, for example, per diems for official trips within the country and abroad.

Relieving contributions on individual employee remuneration

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

From January 1, 2019 onwards, all remuneration based on bonuses in the form of allotment of shares and share option purchases have the same tax treatment, i.e., they are considered to be investment income in kind, and the applicable tax rate is 20% (since January 1, 2021).

AmCham welcomes these changes. However, some situations were observed in practice that would necessitate further regulation, so that this very good and significant change in the Personal Income Tax Act would have a full impact on the Croatian economy and labor market.

Namely, in order to achieve this favorable tax treatment for **limited liability companies** as well (and not only for joint-stock companies), we propose that the regulation be amended to ensure a **more favorable tax treatment of allotment of equity** for them unequivocally and **incentivize implementation of equity plans in those companies too**.

In addition, in order to relieve the tax burden and simplify the taxation of remuneration based on participation in option plans, it is recommended that the following amendments to the tax regulations stipulate that the **value of this remuneration is considered gross proceeds**, as opposed to the current regulation which prescribes that it is a net remuneration that needs to be converted to gross proceeds, which results in an increase in the effective tax rate.

Also, it is proposed to provide further tax relief and further **reduce the rate** to **10%** (equalization of the tax rate with that of dividends and interest). More details are provided below.

Including limited liability companies ("d.o.o.") in the implementation of options plans

The current wording of the Personal Income Tax Act explicitly provides for more favorable tax treatment for the allotment of **shares** or share option purchase, but does not prescribe such treatment for allotment of **equity interest**. As a consequence, an interest of limited liability companies has emerged to provide their employees with a more favorable tax treatment of participation in the company's capital.

As a result of the tax reform and more favorable taxation of option awards for employees, many companies began implementing this model to increase their competitiveness on the European market and retain their employees. In some industries such as IT and start-ups, such models are key for the continuation of their operations in Croatia. However, a vast majority of such companies in Croatia have the form of a limited liability company.

AmCham sees no justification for diverging tax treatments of allotment of shares and equity interest to workers:

- Shares and equity interest yield equal membership rights;
- Distribution of income based on shares (dividends) and equity interest are taxed equally, at a flat tax rate of 10%;

- A limited liability company is a form of organization of for-profit corporations, and as such, receipts on the basis of allotment of equity interest are taxed as investment income;
- Most of the companies generating additional economic growth in Croatia are small and medium-sized companies that are, as a rule, limited liability companies, so it is discriminatory, in comparison to the acquisition of shares, to apply a different tax treatment to the acquisition of equity interest in them;
- Insisting on transforming a limited liability company to a joint-stock company only for the purpose of more favorable taxation of the employee-share scheme would be merely pro-forma since there would essentially be no other changes – neither within the company (apart from the formality) nor in terms of the labor law.
- The sole challenge lies in assessing the value of allotted equity interest to determine the tax base. However, AmCham also deems that issue easy to address by requiring an assessment by an authorized expert. However, presently, the same problem also exists for all joint-stock companies whose shares are not actively traded.

An amendment to the Personal Income Tax Act is therefore proposed, whereby it would be prescribed that, apart from the allotment or purchase of own *stock*, the **allotment and acquisition of interest in a limited liability company** are also considered investment income. If the legislative framework were regulated in that sense, this would help the development of small and medium-sized companies and start-ups in Croatia.

The need for these changes is urgent and particularly necessary in certain sectors of significant interest to the Republic of Croatia, for instance, the IT industry experiencing a large-scale outflow of employees to foreign countries.

Namely:
- Most start-up companies are established as limited liability companies;
- They are characterized by relatively rapid growth and a strong need for capital and a highly educated workforce; in the early stage, the focus of the business is not on changing organizational forms or listing on the stock market to become a joint-stock company (often companies at this stage of growth simply do not qualify or have the means and resources to finance such a move);
- They are constantly faced with a shortage of staff, which is a characteristic of the IT sector in particular. In such situations, it is difficult to retain employees in the company just relying on regular remuneration (salary). Instead, it is necessary to implement a tax incentive form of long-term rewarding of employees through participation in capital and thereby in company profit, which guarantees stay in the company;
- Salaries and similar remuneration in Croatia compared to other countries are still more burdened by public contributions, which is why these employees (who are otherwise very mobile and easily employable) are quick to go abroad;
- Based on our experience with foreign markets, for such employees, the standard part of the compensation package involves inclusion in the membership structure of the company through option awards.

In June 2021, KPMG conducted a survey in that context in nine European countries aimed at determining if those countries have different systems of taxation of option plans in joint-stock companies and limited liability companies and the method of determining the market value of the allotted equity interest *(details of the conducted survey are found in Annex 3)*.

The survey revealed that most of the countries provide tax incentives for option awards *regardless of the form of the company*. Also, some countries have prescribed methods for the valuation of companies (assessments) for determining the tax base, including:

- A prescribed form used for the assessment;
- An option to reach an agreement on the assessment with the Tax Administration for the purposes of option plans;
- A simplified criterion for determining company value according to specific accounting values (NAV).

Net vs. gross remuneration with regard to option plans and further rate reduction

Tax regulations stipulate that remunerations based on participation in the option plan are considered net remuneration, so the effective rate, due to the prescribed requirement for conversion to gross, is 30.89% (for a taxable person residing in Zagreb).

Since this is a significantly higher actual rate than the one seemingly prescribed by law (a flat rate of 20%), AmCham proposes changes to Croatian personal income tax legislation so that:

- remuneration from bonuses in the form of allotment of shares/equity interest and share/equity interest option purchases are considered as **gross proceeds from capital**; and
- instead of the current flat rate of 20%, a **flat rate of 10%** is applied, which is currently applicable to dividends, interest, and capital gains,

which would eliminate the need to convert to the gross amount and emphasize the effective tax rate, and would enable the retention and attraction of highly skilled labor in Croatia. Also, Croatia would thus become a more attractive destination for foreign investment, primarily for the establishment of regional headquarters 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 the specified time to develop and distribute a high-tech product. Considering this, the survival of these companies in the initial period primarily depends on the so-called "business angels" (people who are willing to finance start-ups).

Namely, due to their structure and specificity, start-ups as a rule cannot use classic forms of financing (loans from commercial banks/bonds, etc.), and in practice it has been observed that the biggest reason for the failure of start-ups is the lack of financial resources 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 fostering 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 identified in the study "Effectiveness of tax incentives for venture capital and business angels to foster the investment of small medium 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 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 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 (NN 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 capital income 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, which leads to doubts as to whether taxable income has occurred at all and what is the basis for calculating taxes, i.e., what is the capital gain.

Regarding the issue of the occurrence of a tax event, the general rule is that capital gains are not taxed if more than two years have elapsed between the acquisition and disposal of financial assets. However, the provisions of the Personal Income Tax Act regulate differently the beginning of the calculation of a period of two years, depending on whether it is a gift, disposal between relatives, or inheritance. Namely, it is not uncommon for certain financial assets to be repeatedly disposed of during a certain (shorter) period, for example, financial assets were first gifted, then inherited, or vice versa. Accordingly, there are doubts as to which date is relevant for the start of the two-year period and which value should be taken as the initial cost.

In order to avoid these doubts, AmCham considers it necessary to **standardize the beginning of the calculation of the period**, regardless of the method of acquiring financial assets.

In addition, in practice, there are problems in determining the amount of capital gain on the disposal of shares in the capital of the company that are not transferable in the capital market.
Namely, in the above cases, the tax liability is determined by a decision of the Tax Administration. However, the 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 taxable person corresponds to actual market values.

The lack of clear provisions by which the tax authority could act may lead to an arbitrary determination of the tax base, which does not correspond to the actual market value and the actual 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 further 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), but through the mechanisms available in the 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 338.81 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 taxable persons 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 depends on 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 a tax relief (increase of the personal deduction) based on the cost of interest on housing loans to help the taxable person's 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 enough 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 issue 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 taxable person's housing), and which also have all the data on the cost of interest on such bank loans.

The increase of the personal deduction on this basis could be used on an annual basis (via the ZPP-DOH form), on the basis of evidence that the credit institution (bank) would prepare and send to each taxable person 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 with 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 a standard in modern management of organizations and human resources management, and taxing recreational activities makes it difficult for employees to follow the most modern business trends in Croatia.

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.

We draw attention to the fact that the Occupational Safety Act prescribes that the employer is required, taking into account jobs and their nature, to assess the risks for the life and health of workers, including, among other issues, the psychological work-related burden and other risks which are present 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 determined 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.

In the event that expenditures for taxi services relate to transport in the location of the business trip, the said expenditures should 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 vehicles

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

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

The result of the business activity of a legal person, company or other person liable for corporate income tax ("company") is usually taxed at the level of that person. This income after tax may then be:

- Paid to the investor, i.e., the member of the company, in the form of dividends or participation in profit, 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 of a company they have invested in are reflected either as income from dividends and participation in profit (if net profit is paid) or as an increase in the value of their shares/equity interest in the company resulting from additional investment financed using retained profit.

The rules on exemption from taxation of investment income ("the 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 corporate income through an exemption from taxation of income based on dividends and participation in profit 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 4.

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

- Income based on dividends and participation in profit is fully exempt and is deducted from the corporate income tax base,
- Due to the use of the share method, the tax treatment of an increase in the value of equity interest in accounting records is the same as the treatment of income based on dividends and participation in profit. The increase is also non-taxable and deducted from the corporate income tax while
- In case of sale, the taxable person'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 other words, Croatian tax rules incentivize the disbursement of profit by prescribing income tax exemption while simultaneously "penalizing" retention of profit by taxing any increase of value of the share held in the company through taxation of capital gains upon sale.

This way, our tax system sends the message that the disbursed profit has a more favorable tax treatment and is the preferred option compared to retaining the profit for further investment. Such tax rules incentivize Croatian companies, when investing in other Croatian companies or expanding business abroad, to distribute profit earned by their subsidiaries and avoid additional investments, especially if divestment of the particular 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 Croatian tax legislation already meets the 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: at the level of the investee company, and then again at the investor level. The same is also prescribed on the side of expenditure; it is not tax-deductible if that would result in a double deduction or double tax loss, once at the investor level and the second time at the investee company level.

Furthermore, if one compares corporate income tax with 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 to expand the application of the exemption in Croatia to capital gains based on 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 based on dividends and share in profit, 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 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 amounts 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 in equity 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."*

*(*percentage of the shares should be determined; AmCham has not made a proposal for now)*

As in cases of income on the basis of dividends and participation in profit, application of the rule could be conditional and limited to equity interests in those companies which:

- are taxable persons within the meaning of corporate income tax or an equivalent form of taxation in the Republic of Croatia or the country of origin / tax residency, and
- have a legal form comparable to a limited company (joint-stock company or a limited liability company) and/or other commercial companies, taxable persons within the meaning of corporate income tax in the Republic of Croatia.

Additionally, in compliance with the rules of other countries found in *Annex 4*, the application of the exemption may be additionally limited by:

- Prescribing the amount of equity interest in a subsidiary that should be owned to qualify for the exemption. For example, Austria, the Czech Republic, Slovakia, etc. prescribe that the investor must own more than 10% of equity interest or voting rights in the subsidiary to qualify for application of the exemption;
- Prescribing the minimum required period of retention of the equity interest before it is sold to qualify for the exemption. Countries prescribe the minimum period of retention of the equity interest required to apply the exemption – usually one year;
- Prescribing that the exemption may only be applied to companies performing actual business activities and not to passive companies such as holding companies or companies owning real property not used for the performance of business activities;
- Not permitting application of the exemption to acquisitions within the framework of trading activities;
- Restricting application of the exemption regarding sales among related persons within the same group of companies, performed as part of group restructuring; or
- Prescribing a proportion of capital gains to be tax-exempt and charging tax to the balance. This rule is prescribed, for example, in Italy, France, and Germany, where the tax exemption is applied to about 88-95% of capital gains,
- etc.

By implementing some of the rules, the Tax Administration may limit the possibility of misuse of the exemption in Croatia.

Positive effects on retention of profit for further investments are as follows:

- The existing tax regulations communicate that distribution of profit is more acceptable than retaining the profit for further investments;
- By expanding the scope of the PEX rules to capital gains, investors would be incentivized 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.

When considering where to establish an investment company, investors consider the tax treatment of income based on dividends and participation in profit as well as the tax treatment of capital gains in cases of sale of equity interest in companies and divestment. Currently, divestments subject Croatian corporate income taxable persons to taxation like any other form of income, making Croatia less competitive as a base for investment companies in comparison with other EU Member States where both distribution of profit and capital gains and exempt from tax. Expanding the rule to capital gains should allow tax-free divestments without prior distribution of profit, which might attract investors, in contrast to the present situation, to base investment companies for regional investments more often in Croatia than in other countries with more acceptable PEX rules. Croatia would thereby become more competitive in comparison with other countries in the region and in the European Union.

By prescribing a tax exemption also for gains based on the sale of equity interest in companies, basing investment companies in the Republic of Croatia would appear more attractive, especially for investments in the region. Those companies would be corporate income taxable persons required to draw up financial statements and pay other taxes and public contributions, thereby increasing the income of the state budget. Those companies would hire employees to perform managerial and ownership functions, increasing the proportion of employed persons in the Republic of Croatia with a positive impact on the budget through payment of personal income tax and contributions while reducing unemployment benefits and potential social welfare payments.

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 the that exemption and prevent misuse.

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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	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 taxable person 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)

[1] research.ibfd.org – Country Tax Guides; Accessed: February 28, 2023

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]	March 31	June 30	
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]April 31 if submitted electronically. June automatically if the taxable person 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 taxable person 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: February 28, 2023
research.ibfd.org – Country Tax Guides; Accessed: February 28, 2023

Annex 2 – Overview of tax rates and contributions in the Croatian 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 995,421.06 18% – for generated revenue equal to or greater than EUR 995,421.07	10%	19%	16%	15%	21% 15% for micro-undertakings whose taxable profit does not exceed EUR 49,790 per year
VAT rate (general)	25%	20%	21%	19%	20%	20%
Personal income tax rates (salaries)	20%, 30% + surtax up to 18% (the highest rate applies to the annual taxable income above EUR 47,780.28	10%	15%-23% (depending on level of income)	10%	10% (+ 10% for annual incomes from EUR 31,702.40 to EUR 63,396.40, or +15% for incomes above EUR 63,396.40)	19% (25% for annual income exceeding EUR 41,445.46) 15% for micro-undertakings whose taxable profit does not exceed EUR 49,790 per year
Salary contributions	Employee: 20% (partially limited) Employer: 16.5% (unlimited)	Employee: 13.78% (limited) Employer: 19.02% to 19.72% (limited)	Employee: 11% (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: 35.2% (partially limited)

Source: KPMG, March 2023

Annex 3 – Preferential tax treatment of option awards in limited liability companies in European countries

Country	Does preferential tax treatment of option awards exist in your country?	Is it possible to participate in option awards if equity interest is acquired instead of shares? More specifically, can a share in the ownership of a limited liability company be the basis for an option award even though the limited liability company has no publicly listed shares?	If you answered YES to the preceding question, is the applicable tax treatment equal to the tax treatment of option awards of shares? If your country has a preferential tax treatment of option awards for joint-stock companies, is the same also applicable to a share in the ownership of a limited liability company?	If option awards exist for equity interests in limited liability companies in your country, what is the method used to determine the market value of an equity interest allotted to an employee?
United Kingdom	In the United Kingdom, there are multiple variants of preferential tax treatment, which allow tax benefits to employees and benefits for social contributions for the employees, as well as for their employer.	The above option exists for limited liability companies and for joint-stock companies.	The tax treatment is identical regardless of whether the company is a limited liability company or a joint-stock company.	An estimate is made by an independent appraiser. In individual cases, it is possible to reach an agreement with the United Kingdom's tax authority.
Germany	Yes, there are three different, more favorable tax schemes: 1) "Fünftel-Regelung" – a special tax calculation method eliminating progression in the taxation of income not belonging to the highest tax bracket; 2) Exemption from taxation of certain plans if specific conditions are met. It is possible to exempt from tax the amount of EUR 1,440.00 per year; 3) Deferred taxation – a new regulation from July 2021 deferring taxation of this type of receipt for small and medium-sized start-up companies.	From the viewpoint of taxation, there should be no distinction between limited liability companies and joint-stock companies.	The same tax treatment is applied.	Market value must be determined.

Hungary	Existing	Existing	Yes, tax treatment is the same for all forms.	Company valuation must be performed.
Italy	Yes, the law distinguishes between two different types of plans: 1) Plans for work results – these plans are exempt from payment of mandatory contributions; 2) Plans for all employees – a non-taxable part of receipt is prescribed for this type of plan, and it currently amounts to EUR 2,065.00 with the condition of retention of shares for 3 years.	Yes, Italian regulations do not distinguish between joint-stock companies and limited liability companies.	Yes, tax treatment is the same for all forms.	Share value is calculated by calculating the net asset value (NAV) by an authorized Italian appraiser.
Serbia	It exists, and a person may be exempt from tax if conditions prescribed by local tax regulations are complied with in the period of 2 years from the day of acquisition until the day of sale.	Yes.	May also be applied to a share in the ownership of a limited liability company.	The market price is the price paid by the employee when they acquire equity interest in the limited liability company. However, if it cannot be documented, then the price is equal to the percentage of net assets acquired by the employee.
Romania	It exists if the award plan complies with the criteria prescribed by Romanian regulations. The moment of taxation occurs when the equity interest is sold, and the costs incurred by the company in relation to the option award are recognized as eligible costs for the purpose of taxation.	Yes, because an amendment to legislation allowed employees to participate in option awards regardless of the scheme involving equity interest (limited liability companies) or shares (joint-stock companies).	If the option award is based on equity interest, i.e., in cases of limited liability companies, there is a possibility of full exemption from payment of contributions.	The value is assessed through a value assessment report.
Poland	Existing	There are no restrictions to participation.	Preferential tax treatment is possible only for share awards. Equity interest in a limited liability company would be subject to a progressive tax rate of 17% to 32%.	An official evaluation should be performed. The tax administration may verify the evaluation, or it may make an evaluation itself.
Slovenia	Does not exist	According to Slovenian regulations, the above income is	N/A	N/A

		treated as income from employment, and it is subject to tax as income from employment.		
Slovakia	There is no preferential tax treatment (the tax rate in Slovakia is 17% up to EUR 37,981.94 and 25% for amounts above this limit)	It is not possible to acquire equity interest.	N/A	N/A

The survey was performed by KPMG Croatia in nine countries in October 2021

Annex 4 – Review of the income investment taxation rules by country for 2020

ITALY

- 95% of receipts from the sale of equity interest in companies are exempt from tax if the following requirements are met (Article 87 of the T.U.I.R. – Italian Tax Code):
1) the shares must not be qualified as "trading activities" on the company balance sheet;
2) the minimum retention period is 12 months;
3) tax residency in one of white listed countries (this requirement should be confirmed at the level of the company whose equity is owned);
4) the company whose equity is owned performs active business (under certain circumstances, application of the rule of tax exemption is excluded by law, such as in the case of companies that own real property).
- Losses from the sale of equity interests are not fully recognized for the purposes of tax
- 95% of income on the basis of dividends is not taxable if (Article 89 of the T.U.I.R – Italian Tax code):
a) the company where the equity interests are held is a tax resident in a white listed country;
b) the equity interests are not qualified as "equity interests held for the purpose of 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

- 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.
- Income on the basis of dividends of domestic companies is normally not subject to tax without any conditions (no requests regarding the minimum share and 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).

BULGARIA

- Income generated by the sale of shares is generally taxed at the corporate income rate of 10%. Income from the sale of shares listed on and executed through transactions at an organized market in Bulgaria or one of the EEA countries is exempt from taxation.
- **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 share held in the payer.**

CZECH REPUBLIC

- Income on the basis of **sales and dividends is 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 which 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 - Income from the sale of equity interests is exempt from corporate income tax if the parent company (the seller) **possesses at least** 10+% of equity interest in the entity for a minimum period of 24 consecutive months before the sale. - **Dividends paid to a company holding** (at the moment of distribution) 10+% of interest in the payer's registered equity are exempt from withholding tax / corporate income tax under the Slovakian law.
FRANCE - 88% of income from sale is exempt from tax (12% of the income is subject to tax at the standard corporate income tax rate). The following equity interests are qualified for the above exemption: 1) equity interests, dividends distributed on grounds qualifying for an exemption, i.e., shares representing at least 5% of the subsidiary's equity, provided that the parent company also possesses at least 5% of voting rights in the company; 2) equity interests acquired within the framework of a public sale; 3) equity interests qualifying as participating equity interests for accounting purposes, i.e., equity interests acquired on a mid- or long-term basis for strategic (more than financial) reasons. Equity interests representing more than 10% of a subsidiary's equity are deemed participating interests for accounting purposes; 4) The equity interests must be in possession, inter alia, for at least 2 years to qualify for the exemption. - Income from the sale of equity interests not qualifying as participating interests is entirely subject to tax in the regular way. - **Tax exemption** of 95% of income on the basis of dividend if the parent company holds at least 5% equity interest in the subsidiary's equity for a period of 2 years.
GERMANY - 95% of income from sale is exempt from tax (5% of the income is added to taxable income as a cost not recognized for the purposes of taxation). The exemption is provided for both direct and indirect holding of the equity interest (e.g., through a partnership) and 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. - **95% of income on the basis of dividends is exempt from tax if the parent company directly holds at least** 10% of the equity of the subsidiary. There are no conditions prescribed in relation to a retention period.
HUNGARY - Income from sales: an exemption is applied to equity interests registered within 75 days following acquisition with Hungarian tax authorities and held for 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: the exemption is applied to income on the basis of dividends without any requirements regarding a retention period. The exemption is not applied to dividends received from controlled foreign companies (CFC).
IRELAND - Income from sales is exempt from corporate income tax when a company, resident in Ireland, sells equity interests in a company which is also resident in Ireland, another EU Member State, or a country which has concluded an Agreement for the Avoidance of Double Taxation with Ireland (section 626B TCA 1997). In order to qualify for the exemption, the **company must possess at least** 5% of the equity of the subsidiary. The value of the equity interest must not stem from real property in Ireland and must be held for a continuous period of 12 months within two years preceding the sale. The subsidiary must pursue a commercial activity or, from an overall perspective, be the parent company of a group of companies pursuing a commercial activity. - **Dividends distributed by residents of Ireland are exempt from corporate income tax.** Dividends distributed from the operating income of companies resident in the EU or a country with whom Ireland has an Agreement for the Avoidance of Double Taxation in effect (or a country with which Ireland has ratified the Convention on Mutual Administrative Assistance in Tax Matters) may be taxed at the rate of 12.5% if a request is submitted. - Dividends received by Irish companies from abroad, while they are in possession of at least 5% of equity and voting rights in the foreign company, shall be exempt from corporate income tax in cases where the income on the basis of the dividend would have been subject to tax as income on the basis of performance of commercial activity.
LUXEMBOURG - Income from the sale of qualified equity interests held by companies which may apply an exemption regarding taxation of equity interests is exempt from tax provided that (i) it possesses at least 10% of the total equity or that the acquisition price was at least EUR 6 million, and (ii) the selling company held or plans to hold the qualified equity interests for a period of at least 12 months. - The exemption from taxation of the income derived from dividends may be applied if the following conditions are met: 1) the company distributing the dividend is a company that qualifies for the application of the EU Parent-Subsidiary

Directive, a joint-stock company with its registered seat in Luxembourg which is fully subject to taxation and does not have any one of the forms set out in the Luxembourg Income Tax Law (LITL), or a non-resident joint-stock company fully required to pay a tax corresponding to the Luxembourg income tax in the country of its residence; 2) the company receiving the dividend is resident in Luxembourg, fully subject to taxation, and has one of the forms listed in the Luxembourg Income Tax Law; a joint-stock company resident in Luxembourg, fully subject to taxation and not having one of the forms listed in the LITL; a domestic business unit of a company which may apply the Parent-Subsidiary Directive; a domestic business unit of a joint-stock company, resident in a country with which Luxembourg has concluded an Agreement for the Avoidance of Double Taxation, or a domestic business unit of a joint-stock company or a cooperative company, resident in a European Economic Area (EEA) member state (that is not an EU Member State); 3) on the day when the income was made available, the recipient directly held (or through a transparent company), in an unbroken period of at least 12 months, at least a 10% interest in the equity of the subsidiary, or the acquisition price was at least EUR 1.2 million.
ROMANIA - **Income from sale: 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. - Income on the basis of 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 the share in the distributing company for an unbroken period of at least a year.

Source: Zagrebačka banka d.d. and UniCredit Group, November 2021