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I. GENERAL PROVISIONS

Article 1

- (1) Profit tax is assessed and paid in accordance with the provisions of this Act and the legislation passed thereof.
- (2) The distribution and allocation of profit tax revenues are stipulated in a separate Act.

1. Taxpayer

Article 2

- (1) Entrepreneurs are liable to pay profit tax.
- (2) The term "entrepreneur" as used in this Act, is defined as a legal entity or a natural person independently and permanently engaged in a business activity for the purpose of gaining profit, and is obliged to keep business books and submit financial reports in accordance with the legislation on accountancy and other relevant legislation.
- (3) Resident branch offices of non-resident entrepreneurs are liable to pay profit tax. Entrepreneurs whose residence and head office are not located in the Republic of Croatia are considered as non-resident entrepreneurs.
- (4) Entrepreneurs who manage shares in capital are liable to pay profit tax, unless the object of the capital invest-

ment is an entrepreneur who is himself liable to pay profit tax.

- (5) An entrepreneur who is a natural person earning income in accordance with the provisions of the Income Tax Act is liable to pay profit tax, if he declares that he intends to pay profit tax instead of income tax and keeps business books in accordance with the legislation on accountancy procedures.
- (6) An entrepreneur who is a natural person is liable to pay profit tax, if:
✓ u.c. f. i. c. v. e. . .
 1. his total revenue in the preceding calendar year was in excess of 500,000 DM in Croatian dinars; -or
 2. his income in the preceding calendar year was in excess of 75,000 DM in Croatian dinars; or
 3. if he has durable property whose value exceeds 500,000 DM in Croatian dinars; or
 4. if in the preceding calendar year he employed more than 30 employees on average.
- (7) If several persons jointly engage in a business activity, their liability to pay profit tax is computed pursuant to conditions stipulated in Items 1 to 4 of the preceding Paragraph, for the entire business.
- (8) The profit tax liability and the obligation to keep business books in accordance with the legislation on accountancy procedures of the entrepreneur specified in Paragraphs 5 and 6 of this Article commences at the beginning of the business year following the ruling of the Tax Administration on profit tax liability. The liabilities and obligations expire at the end of the business year in which the Tax Administration rules that the profit tax liability and the obligation to keep business books in accordance with the legislation on accountancy procedures no longer apply.

- (9) Institutions, in the sense of this Act, are not liable to pay profit tax if they engage in the activities for which they have been founded. Likewise, non-profit organisations and similar legal entities are not liable to pay profit tax, in the sense of this Act, unless they have been established for the purpose of gaining profit.
- (10) If institutions or non-profit organisations and other similar legal entities engage in other activities from which they gain profit, they become liable to pay profit tax for these activities.

2. Taxable Base

Article 3

- (1) The taxable base for the computation of the profit tax is the difference between the entrepreneur's own capital invested in the business activity (of the entrepreneur) at the end and the beginning of the tax period, increased or reduced in accordance with the provisions of this Act.
- (2) The taxable base for the computation of profit tax is profit gained in Croatia and abroad.
- (3) The taxable base for resident branch offices of non-resident entrepreneurs is the profit gained in Croatia.
- (4) Profit gained from liquidation, sale, change of legal status and partition of the taxpayer also enters the taxable base.
- (5) The assessed amount of profit tax is not deducted from the taxable base for profit tax.
- (6) Equity, in the sense of Paragraph 1 of this Article is the net value of the property, calculated by subtracting liabilities from assets.

Article 4

- (1) The taxable base defined in Article 3 of this Act is reduced by the receipts and entries arising from shares and dividends and by profit from disposing of shares.
- (2) The taxable base defined in Article 3 of this Act is increased by write-offs arising from shares and losses incurred in disposing of shares.
- (3) The provisions of Paragraphs 1 and 2 of this Act do not apply to shares with entrepreneurs which are themselves liable to pay income tax.

Article 5

- (1) The taxable base is increased by payments and take-outs, and is decreased by the amount of investments.
- (2) The term "payment" as used in Paragraph 1 of this Article includes payments made pursuant to internal regulations of the taxpayer on profit sharing (public) and other (hidden) payouts of the profit. The term "payment" as used in the previous sentence does not refer to the salary paid out to an entrepreneur who is a natural person, which is subject to employment income tax.
- (3) The term "take-out" as used in Paragraph 1 of this Article includes taking outs of products, goods and services for the purpose and use of the owner and other purposes which are not directly linked to the business activity.
- (4) The term "investment" as used in Paragraph 1 of this Article includes increase of equity in accordance with the legislation in this field.

Article 6

- (1) The taxable base defined in Article 3 of this Act is increased by:

1. the amount of depreciation which exceeds the maximum tax-allowable rate, in accordance with the special permissible method of calculation;
 2. the amount of excessive interest on debt, if the creditor is not a resident taxpayer liable to pay profit tax;
 3. payments to employees in compensation for the material and other expenses, as allowances and bonuses in excess of the minimum amounts stipulated by general collective agreement;
 4. per diem allowances, travelling expenses abroad, in excess of the stipulated limit;
 5. entertainment expenses (entertaining, gifts, vacations, sports, recreation and leisure, leases on cars, boats, aircraft, vacation houses and the like);
 6. fines and all payments of a punitive nature;
 7. 30% of the expenses (costs) incurred in the use of cars and other means of transport by the entrepreneur, managers and other employees, including car hire charges.
- (2) The taxable base is increased by all other costs which are not directly related to the realisation of profit.
 - (3) The Tax Administration may audit the expenses claimed by the branches of the non-resident taxpayer which are liable to pay tax in the Republic of Croatia, whose head office is located abroad. Among the expenses subject to the audit are the costs of purchase of goods and services, management, consulting, registered trade marks, patents, licenses, loans and other compensations or investments which may be a kind of profit transfer operation.
 - (4) If the Tax Administration considers that these transactions are part of clandestine profit transfer operations, the balance of acquisition prices and average market prices on the domestic or foreign market will be added

to the taxable profit of the resident section of the non-resident entrepreneur.

Article 7

- (1) Protective interest is deducted from the taxable base defined in Article 3 of this Act.
- (2) The protective interest referred to in Paragraph 1 of this Article is obtained by calculating interest on equity using the protective interest rate defined in Article 9 of this Act.
- (3) If the equity is a liability, the amount of interest charged is added to the profit.
- (4) Interest is charged on payments, take-outs, expenses specified in Paragraph 1, Items 2 to 7 and Paragraph 2, Article 6 of this Act, investments in the course of the year and the book value of acquired and disposed shares with other taxpayers, only for the period in which the equity has been increased or decreased.
- (5) When interest is charged on payments, expenses and investments, payments and expenses are treated as if they were made at the beginning of the month, and investments are treated as if they were made at the end of the month.

Article 8

For the purposes of calculating protective interest, equity is defined as the book value of equity at the beginning of the tax period:

1. from which the book value of shares with other taxpayers at the beginning of the tax period has been deducted, and
2. from which the book value of the shares with other taxpayers acquired or disposed during the tax period has been deducted or added, respectively.

Article 9

- (1) The protective interest, for the purposes of this Act, is calculated by increasing the rate of growth of the manufacturing prices of industrial products by three per cent.
- (2) The rates of growth of the manufacturing prices of industrial products, referred to in Paragraph 1 of this Article are published monthly and annually by the National Institute for Statistics.

3. Deduction of the Tax Loss

Article 10

- (1) If a loss is declared following the deduction of protective interest from the taxable base pursuant to Article 7 of this Act, the loss is carried over to the following tax period and interest is charged on it.
- (2) A taxpayer who fails to earn the taxable base, i. e. the amount subject to profit tax in five years, forfeits his right to have the tax loss, referred to in Paragraph 1 of this Article, deducted. A taxpayer who declares tax loss must be audited by the Tax Administration.

4. Tax Period

Article 11

- (1) Profit tax is assessed for the business year, parts of the business year and for the liquidation period.
- (2) As a rule, the business year is the same as the calendar year.
- (3) The following are considered as "parts of the business year":

1. the period from the day of the registration of a taxpayer, or a section of a non-resident taxpayer, to the beginning of the following business year;
 2. the period from the relocation of the head office or of the management from abroad to Croatia, to the beginning of the following business year;
 3. the period from the end of the previous business year to the date when the head office or management was relocated abroad;
 4. the period from the end of the previous business year to the disposal.
- (4) The liquidation period is the period from the end of the previous business year to the completion of the liquidation procedure.

5. Disposal, Change of Legal Status, Partition and Liquidation

Article 12

- (1) If the entrepreneur ceases to operate (due to liquidation, disposal, change of legal status or partition), the equity defined in Article 3 of this Act is assessed in accordance with the market value of the assets.
- (2) If the entrepreneur's assets from Paragraph 1 of this Article are taken over by the entrepreneur on the basis of his share of capital, the balance of the value of the assets which have been taken over and the book value of the share is considered as a change in capital and is exempt from tax.
- (3) If a taxpayer is liquidated, profit or loss are calculated for the liquidation period, which begins at the end of the previous business year. The initial balance sheet for the liquidation period shows the assets of the taxpayer in the balance sheet at the end of the previous business

year. If such a balance sheet does not exist, the items are subject to an estimate. The final balance for the liquidation period shows the assets to be divided, liquidation profit or liquidation loss.

- (4) If objects and rights are taken out from the assets, or investments are made in these assets in the course of the disposal, partition, change of legal status or liquidation, the provisions on payments and investments apply.

II. TAX RATE

Article 13

- (1) Profit tax is paid at the rate of 25% of the assessed taxable base.
- (2) In order to encourage reconstruction and development of certain areas, the Government of the Republic of Croatia may issue a decree whereby some taxpayers are exempt from paying profit tax or the tax rate defined in Paragraph 1 of this Article is decreased.

III. ASSESSMENT AND COLLECTION OF PROFIT TAX

1. Relevance of Business Books and Financial Reports

Article 14

- (1) The computation of the taxable base for profit tax is based on business books, which are kept in accordance with the legislation on accountancy, and on financial reports (balance sheet, profit and loss account).

- (2) Business books must be kept accurately and must be updated regularly.
- (3) Expenses which have not been accurately and promptly entered and properly documented cannot be admitted for tax purposes.
- (4) If it is ascertained, following the profit tax return or in the course of the audit, that business books are not kept accurately and up-to-date, the Tax Administration may order that the taxpayer produce certain accounts and eliminate ascertained faults. If the taxpayer fails to comply with the order, the Tax Administration may change the taxable base. The Tax Administration must keep a record on the changes made.

2. Profit Tax Assessment

Article 15

- (1) Taxpayers liable to pay profit tax must do so in the way and by the time stipulated by this Act and the legislation passed thereof.
- (2) Profit tax is assessed after the end of the calendar year (tax assessment period) on the amount of profit made by the taxpayer in that period.

Article 16

- (1) Taxpayers liable to pay profit tax pay prepayment tax computed on the basis of their tax return for the previous year.
- (2) Taxpayers liable to pay profit tax pay prepayment tax in the way and by the time stipulated by this Act.

Article 17

- (1) The Tax Administration assesses the prepayment tax to be paid by taxpayers who have just started business or

who have forfeited the right to carry over their tax loss until they file their first tax return on the basis of the estimated potential profit. The estimate of the potential profit is made after three months of operation on the basis of the financial results.

Article 18

- (1) The taxpayer must file a profit tax return for the tax period.
- (2) The taxpayer must submit the profit tax return with the assessed tax and the proof of payment of that tax to the Tax Administration four months after the end of the tax period for which the tax was assessed.
- (3) The Minister of Finance stipulates the form of the profit tax return.

Article 19

- (1) Profit taxpayers pay prepayment tax monthly in proportion to the level of their tax liability referred to in Articles 16 and 17 of this Act, by the end of the month for which prepayment tax is paid.
- (2) The amount of the monthly prepayment tax referred to in Paragraph 1 of this Article is increased by the index of growth of manufacturing prices of industrial products for the previous month.

Article 20

- (1) If, after the tax return has been filed, it is found that insufficient tax has been paid, interest is charged on that balance at the rate of growth of manufacturing prices of industrial products for the period from 31st December to the date when the tax return was filed.
- (2) If the taxpayer has prepaid excess tax, he can claim a refund on the amount overpaid; alternatively, the amount

is deducted from the tax for the next tax period, with interest charged on it pursuant to Paragraph 1 of this Article.

- (3) The provisions of Paragraph 2 of this Article apply also to prepayments of profit tax referred to in Article 16 of this Act.

Article 21

- (1) If a resident profit taxpayer has paid tax on profit gained abroad, the amount of tax paid abroad is credited to the profit tax due, up to the amount of profit tax he would have paid in Croatia.
- (2) Paragraph 1 of this Article applies if there is no treaty on double taxation avoidance.

Article 22

- (1) If the taxpayer fails to pay tax due in the time indicated, the tax shall be collected forcibly, pursuant to the decree for forced collection.
- (2) Provisions on forced collection of income tax apply to the forced collection of profit tax.

Article 23

Regarding the procedures of appeal, reopening of the case, statute of limitations for tax assessment, collection and refund and the legal procedure in the case of violations, the relevant provisions of the Income Tax Act apply.

Article 24

The Minister of Finance is authorised to issue instructions and pass legislation for the enforcement of Article 2, Paragraphs 9 and 10, Articles 6, 7, 18, 20 and 21 of this Act.

IV. PENALTIES

Article 25

- (1) A taxpayer who fails to compute or pay the tax due within the stipulated time limit (Article 15, Paragraph 1 and Article 18, Paragraphs 1 and 2) shall be fined 500 to 20,000 DM payable in Croatian dinars.
- (2) A responsible person from the taxpayer shall also be fined for the violation referred to in Paragraph 1 of this Article with a fine of 100 to 1,000 DM payable in Croatian dinars.

Article 26

- (1) A taxpayer who fails to keep his business books accurately and to update them regularly (Article 14, Paragraphs 1, 2 and 3) shall be fined 1,000 to 25,000 DM payable in Croatian dinars.
- (2) A responsible person from the taxpayer shall also be fined for the violation referred to in Paragraph 1 of this Article with a fine of 200 to 2,000 DM payable in Croatian dinars.

Article 27

- (1) A taxpayer who fails to file a tax return on time (Article 18, Paragraphs 1 and 2) shall be fined 700 to 22,000 DM payable in Croatian dinars.
- (2) A responsible person of the taxpayer shall also be fined for the violation referred to in Paragraph 1 of this Article with a fine of 150 to 1,500 DM payable in Croatian dinars.

Article 28

The fines specified in Articles 25, 26 and 27 of this Act are payable in Croatian dinars according to the average exchange

rate for German Marks of the National Bank of Croatia on the day when the fine is decreed.

Article 29

- (1) The competent organ shall punish violations specified in Articles 25, 26 and 27 of this Act committed for the second time with a fine and suspension of the business license as a precautionary measure for up to six months.
- (2) The competent organ shall punish the violations committed for the third time with a fine and permanent revocation of the business license.
- (3) In exceptional cases, when the suspension or revocation of the business license pursuant to Paragraphs 1 and 2 of this Article would result in substantial damage and disturbance in the entire economy or in laying off large numbers of employees, second offenders may be punished only with a fine.

V. TRANSITIONAL AND FINAL PROVISIONS

Article 30

Profit realised up until the day when this Act took effect shall be taxed in accordance with the legislation which was in force at that time.

Article 31

Tax exemptions and tax reliefs granted in accordance with the Act on Direct Taxation before 1st January 1994 shall be valid until they expire.

Article 32

In exception to the provisions of Article 19, Paragraph 1 of this Act, prepayment of tax on profit for January, February and March of 1994 shall be computed so that the prepayment of tax on profit assessed for December 1993 is increased by the discount rate of the National Bank of Croatia.

Article 33

On the day when this Act takes effect, the Direct Taxation Act (*Narodne Novine*, No. 19/90, 28/90, 14/91, 73/91 and 25/93) and the Decree on the Changes and Additions to the Direct Taxation Act (*Narodne Novine*, No 59/93) cease to be valid. Likewise, Item 19 of the Decree on Continued Validity of the Legal Content and Effect of Certain Decrees of the Government of the Republic of Croatia Passed Pursuant to Its Legal Competence cease to be valid on the same day (*Narodne Novine* No 100/93).

Article 34

This Act comes into force on the eighth day after the day when it was published in *Narodne Novine*, and takes effect on January 1, 1994.