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# CROATIA

## OVERVIEW OF THE TAX SYSTEM

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### I. INTRODUCTION

In actual fact Croatia has only had its own tax system since 1 January 1994. Although an independent state, Croatia continued to apply the tax system and regulations of the former Yugoslavia. However, on 1 January 1994 the Income Tax Law and the Profit Tax Law came into force, thus paving the way for the future development of the Croatian tax system. However, both laws were substantially amended in 1994.

Croatia levies the following taxes:

- Income tax
- Profit tax
- Tax on the transfer of goods and tax on the rendering of services
- Excise taxes
- Tax on the transfer of property
- Various local taxes, such as inheritance and gift tax, motor vehicles tax, tax on vehicles for water transport, entertainment tax, etc.

This article overviews the various taxes levied in Croatia.

### II. TAX ON INCOME OF INDIVIDUALS

The income tax was initially introduced by the Income Tax Act applicable as of 1 January 1994<sup>1</sup> and subsequently amended<sup>2</sup> applicable from 1 January 1995. This new unified income tax system replaces the schedular tax system which taxed each kind of income separately.

#### A. Taxpayers

All natural persons are subject to income tax. Since income tax liability is based on the worldwide principle, the law defines resident and non-resident taxpayers. A resident taxpayer is one whose domicile or habitual place of abode is in Croatia for at least 183 days.<sup>3</sup> A non-resident taxpayer is one who has neither domicile nor a habitual place of abode in Croatia.

#### B. Taxable base

The taxable base for resident taxpayers is the total income earned by the taxpayer in Croatia and abroad from employ-

ment, self-employment, property and related rights, reduced by the personal allowances (for the taxpayer, spouse, children, taxpayer's and spouse's parents, etc.), as well as any losses incurred.

The taxable base of non-resident taxpayers is the same as for resident taxpayers insofar as the sources are concerned, but differs in respect of deductions. A non-resident taxpayer is only entitled to the basic personal allowance in addition to deduction of losses incurred.

The taxable period is a calendar year, and the taxable base may be computed either for the calendar year, or for a shorter period. The shorter assessment period may be used if during the calendar year a non-resident taxpayer becomes a resident taxpayer or vice versa, or if tax liability commences or terminates during the year due to the birth or death of the taxpayer.

#### C. Exemptions

The following income is exempt from tax in Croatia:

- interest on domestic and foreign currency savings accounts, on domestic and foreign currency current accounts, on loans and credits, on securities, dividends and profit shares from enterprises liable to the profit tax, on profits arising from the disposal of financial assets and on profit shares in foreign enterprises which are subject to the Profit Tax;
- certain amounts received as benefits, allowances, bonuses and welfare, and income received from insurance companies.<sup>4</sup>

1. Published in the Official Gazette No. 109 of 7 December 1993, and came into force on 15 December 1993.

2. Published in the Official Gazette No. 95 of 27 December 1994, and came into force on 4 January 1995.

3. A Croatian citizen who is neither domiciled nor has a habitual place of abode in Croatia, but who is employed as a civil servant of Croatia is also subject to income tax.

4. For example, invalids' support, support for immediate family members of soldiers killed in the war between the former Yugoslav states, compensation for destruction and damage of property caused by war, natural disasters and other force majeure events, child benefits according to special legislation, amounts received by the disabled according to health and retirement security regulations, with the exception of salaries, pensions, and state awards.

## D. Employment income

Income from employment includes wages, salaries, pensions, certain allowances, benefits and bonuses exceeding amounts stipulated by the Minister of Finance, as well as all other income arising from the employment regardless of whether it is paid in cash or in kind.

## E. Income from self-employment

Income from self-employment comprises income from handicrafts, professional work, agriculture, forestry and any activities which are permanently or occasionally undertaken for the purpose of earning income.

Any individual who is liable to pay tax on income from handicrafts or income from professional work may opt to pay profit tax rather than income tax. To exercise this option, the taxpayer must submit a request to the tax authorities. As from 1 January 1995, a taxpayer who has exercised this option to pay profit tax may revert to income tax liability by submitting a written request to the tax authorities.<sup>5</sup>

The taxable base for income from handicrafts and income from professional work is the difference between total receipts and total expenditure. Business receipts include assets (money, objects, material rights, services rendered and other) derived by the taxpayer during the tax period. Business expenditure comprises expenditure directly related to the earning of income; for example, write-offs of fixed assets which have been sold or disposed of in the course of the business or upon liquidation of the business. Losses may generally be carried forward for five years.

Taxpayers who derive income from handicrafts or professional work are required to keep records for purposes of calculating their income. The law also contains specific rules on how records relating to fixed assets are to be kept.

## F. Income from farming and forestry

Income derived by individuals from farming and forestry is assessed to tax on the cadastral income (according to special regulations), or in accordance with special regulations applicable to taxpayers performing handicraft and professional work.

## G. Income from property and related rights

Income from property and related rights includes income from renting or leasing real estate or movable property, as well as copyrights and other property rights. Income derived from the disposal of immovable property and related rights also falls within this category of income if disposed of within three years of acquisition. Income from property and related rights is subject to income tax only if the taxpayer does not pay the profit tax or income tax on income from self-employment.

The taxable base is the income earned by renting or leasing real estate, movable property or the income earned by copyright or industrial property right holders.

## H. Personal allowances

Personal allowances are given in the form of deductions expressed as units of the minimum annual salary. Resident taxpayers are entitled to the following deductions:

- (1) a basic personal allowance of 700 kunas for each month of the assessment period;<sup>6</sup>
- (2) 0.3 percent of the basic allowance for a dependent spouse or other member of the taxpayer's immediate family, including the first child;
- (3) the allowance in (2) increased by 0.1 percent of the basic allowance for each additional child (i.e. for the second child 0.4 percent, for the third child 0.5 percent, etc.);
- (4) the allowance in (2) increased by 0.2 percent of the basic allowance for a dependent disabled member of the taxpayer's immediate family;
- (5) amounts paid for health insurance by a resident taxpayer up to the amount of the obligatory contributions for health insurance as paid by the employer and the employee, provided the taxpayer has no other forms of health coverage.

Non-resident taxpayers are entitled to the same basic personal allowance as for resident taxpayers and to deductions of contributions for national health insurance, up to the amounts set for employers and employees.

### i. Other relief

Non-coverable losses can be carried forward for five years. Such losses are deducted before personal allowances. The deduction of losses in the current tax period is permitted only if they could not have been deducted in previous tax periods. Carried over losses are deducted in the order in which they were incurred.

## J. Tax rates

Croatia imposes only two rates of tax: the lower rate is 25 percent, which is applied on the taxable base up to three times the basic personal allowance. The higher rate is 45 percent on taxable income exceeding three times the basic personal allowance. The taxpayer is additionally liable to a municipal surcharge, of which the taxable base is the amount of income tax paid.

## K. Assessment and payment of income tax

Income tax is assessed and paid on an annual basis. At the end of the tax period the taxpayer is required to file a tax

5. Both options are obligatory for three years, unless a shorter period is granted for good cause. It should be noted, however, that practice regarding these options remains unclear.

6. Retired persons are entitled to a personal deduction of 1.750 kunas.

return, unless the taxpayer's sole source of income was from salaries or pensions.

Prepayments of income tax are due during the year, but the final amount of tax due is assessed on the basis of the tax return. In the case of taxpayers deriving their income from salaries or pensions, the prepayments are considered a final tax; however, if a taxpayer in this category wants to claim personal deductions, he may file a tax return.

Employment income tax is in the form of a withholding tax. However, taxpayers receiving income from employment abroad are required to assess and make the prepayments within seven days following receipt.

### III. PROFIT TAX

The existing profit tax system has been in force since 1 January 1994, as amended, and is applicable as from 1 January 1995.<sup>7</sup>

#### A. Taxable person

Entrepreneurs are subject to the profit tax, i.e. legal entities and individuals who independently and permanently engage in activities for the purpose of making a profit. Entrepreneurs are required to keep business books and submit financial reports according to the accountancy regulations and other regulations.

All entrepreneurs who have a business seat or place of management in Croatia are considered to be resident entrepreneurs. A non-resident entrepreneur is one who has no business seat or place of management in Croatia.

As mentioned above, an individual who earns income subject to income tax may opt to pay the profit tax instead, provided he makes such a request to the tax authorities and maintains books in conformity with the rules on accountancy.

Further, the Profit Tax Law requires an individual entrepreneur to pay profit tax in the following cases:

- if in the preceding calendar year he had a total revenue exceeding 2,000,000 kunas; or
- if in the preceding calendar year his income exceeded 300,000 kunas; or
- if he has fixed assets with a value exceeding 2,000,000 kunas; or
- if in the preceding year he employed on average more than 30 employees.

#### B. Taxable base

The taxable base for the profit tax is the difference between the equity invested in the business at the end and at the beginning of the tax period, increased or decreased according to the Profit Tax Law.<sup>8</sup> The taxable base for profit tax liability includes the profit accruing from division, liquidation, sale and change of legal status of the taxpayer. Since resident tax-

payers are subject to profit tax on their worldwide profits, the taxable base includes profits realized in Croatia and abroad. The taxable base for foreign entrepreneurs is limited to profits derived in Croatia.

The taxable base is reduced by the following items:

- receipts and entries arising from shares and dividends;
- protective interests (by calculating interest on equity at the protective interest rate, i.e. industrial producer price increases, increased by 3 percent per annum in real terms); and
- investment (the increase of equity in accordance with regulations).

The taxable base is increased by the following:

- pay outs (payments based on internal regulations on profit sharing (public) and other (hidden) pay-outs of profit);
- exemptions, i.e. using products, goods and services for the owner's own purposes rather than for purposes directly related to the business activity);
- the amount of depreciation which exceeds the maximum allowable rates;
- excess interest paid;
- other expenses exceeding stipulated amounts, such as payments to employees for expenditures, allowances and bonuses, expenses for per diem costs and business travelling expenses abroad, representation expenses (e.g. for gifts, entertainment, sports, recreation, car rentals and similar expenses);
- fines and all payments of a punitive nature;
- 30 percent of expenses for personal automobiles and other vehicles for the transport of the entrepreneur, managers and other employed persons, as well as expenses for car rental services;
- all other expenses not directly related to the earning of profit; and
- the amount of interest charged when equity is negative.

#### C. Depreciation

Straight line depreciation may be taken on tangible fixed assets and intangible assets at specified rates.

#### D. Losses

Losses may be carried forward for five years.

#### E. Assessment and collection

The profit tax is assessed for a business year, for a part of a business year and for the liquidation period. Profit taxpayers are required to make prepayments of tax based on the previous year's tax return. The tax return must be submitted to the

7. Published in the Official Gazette No. 95 of 27 December 1994, and came into force on 4 January 1995.

8. The Profit Tax Law defines equity as the net value of the property calculated by subtracting total liabilities from assets.

tax authorities within four months after the close of the period for which the profit tax has been calculated.

toiletries, children's clothing and toys. These items are taxed at a rate of 5 percent.

## F. Rate of tax

The rate of profit tax is 25 percent on the taxable base.<sup>9</sup>

## IV. TRANSACTION TAXES

Transaction taxes are governed separately by the law on the sales tax on goods and the taxation of the supply of services.<sup>10</sup>

### A. Tax on the sale of goods

The sales tax on goods is levied on the sale of goods intended for final consumption. Taxable transactions include all sales of goods, unless otherwise stipulated in the legislation, and importation, including temporary importation.

#### 1. Taxable person

Legal entities and individuals who sell goods to final consumers are subject to this tax, and in certain cases specified by statute the buyer is liable to pay the sales tax.

#### 2. Taxable base

The taxable base is the sales price, which is the gross amount paid to the seller, including all ancillary expenses charged to the purchaser. The taxable base includes the excise tax paid in accordance with the special sales tax.

#### 3. Exemptions

The sales tax contains numerous exemptions for items such as foodstuffs, medicines, medical appliances, certain goods intended for export, imported goods exempt from customs duties, etc.

#### 4. Rate of tax

The table of rates for the sales tax on the sale of goods is divided into four "tariff groups", each dealing with a particular item or group of items. The tax rates are determined as a percentage of the taxable base, and reflect the so-called selective proportionate taxation:

Tariff 1: This category, taxed at 20 percent, includes all taxable sales of goods intended for final consumption.

Tariff 2: This category includes a variety of taxable objects, such as works of art, computer equipment, electrical power, films, video tapes and cassettes, petroleum products and natural gas and coal. These items are taxed at 15 percent;

Tariff 3: This category, taxed at 10 percent, includes the sale of construction products; and

Tariff 4: This category includes a broad range of goods such as agricultural goods, certain cosmetics and

### B. Tax on the sale of services

This tax liability arises in respect of services rendered for remuneration.

#### 1. Taxable person

Legal entities and individuals providing taxable services are subject to this tax. However, if an individual provides services for a legal entity, the legal entity pays the tax.

#### 2. Taxable base

The taxable base is the remuneration received for the services, whether paid in cash or in kind.

#### 3. Exemptions

The tax on the sale of services is not payable on the following:

- services related to the granting of loans and taking deposits;
- various maritime services;
- health, veterinary and social welfare services;
- services provided by humanitarian organizations;
- educational and cultural services;
- services provided by religious institutions;
- services provided by bodies of the State;
- services connected with scientific research;
- services provided by legal entities and individuals to the Croatian army, police, the management of state reserves and to humanitarian associations;
- life insurance;
- export services as defined in the law;
- transportation services provided by domestic legal entities and individuals in international transport;
- certain construction services; and
- services provided by legal entities and individuals to diplomatic and consular representation and employees (under certain conditions).

#### 4. Rates of tax

The tax rate for all sales of services is 10 percent, unless exempt.

## V. EXCISE TAXES

Excise tax is levied on domestically produced and imported alcohol, non-alcoholic drinks, tobacco products, new cars and oil products and on the self-supply of such products. Per-

9. However, a tax exemption or tax relief may be granted in order to stimulate reconstruction and development of certain regions.

10. Published in the Official Gazette No. 95 of 27 December 1994, and came into force on 4 January 1995, applicable from 1 January 1995.

sons subject to excise tax are those persons producing or importing dutiable goods.

## VI. TAX ON THE TRANSFER OF PROPERTY

The tax on the transfer of property is levied on the seller at the rate of 5 percent of the market value of the property.

## VII. LOCAL TAXES

Taxes are also levied in Croatia at the county level, the commune level and the municipal level.

### A. County level taxes

#### 1. Inheritance and gift tax

This tax is levied on individuals and legal entities who have inherited property or received property as a gift in Croatia.<sup>11</sup> The taxable base is the market value of the property at the moment tax liability arises, after deducting debts and expenses related to the property. The Croatian inheritance and gift tax is levied at a flat rate of 5 percent.

#### 2. Tax on motor vehicles

Legal entities and individuals who own registered passenger automobiles and motorcycles are subject to this tax. The amount of tax due depends on the engine capacity and the year the vehicle was produced, and exemptions are granted for certain vehicles.<sup>12</sup>

#### 3. Tax on vehicles for water transport

Legal entities and individuals who own vehicles for water transport are subject to this tax. The taxable base depends on the length, type of equipment and year of production of the vehicle, and the rates of tax vary.

#### 4. Entertainment tax

Persons who organize performances such as movies, sporting events, etc. for which an admission is charged are subject to this tax. The rate of tax is 5 percent. Theatre performances, museums and other cultural performances are exempt from the entertainment tax.

### B. Commune and municipal level taxes

#### 1. Tax on "weekend houses"

Legal entities and individuals who own weekend houses are subject to this tax, which is assessed depending on the size (square metres) of the house.

#### 2. Advertising tax

Legal entities and individuals who place advertisements in public places are liable to the advertising tax, which is assessed at an amount not exceeding DM 200 per advertisement. Advertisements appearing in newspapers and public media are not liable to this tax.

#### 3. Firm tax

Legal entities and individuals liable to income tax or profit tax must pay the firm tax, which is levied at an amount not exceeding 500 DM.

### C. Tax on games of chance

Two taxes are levied in connection with games of chance. Natural persons are subject to tax on their winnings from games of chance. The taxable base is each winning and the applicable tax rate is 15 percent. Natural persons and legal entities organizing games of chance and other games on premises precisely defined in the law are liable to the profit tax – payable in varying lump sum amounts, depending on the types of table and slot machine, etc. They are also liable to a sales tax on services rendered levied at rates of 10 and 15 percent.

### D. Local surcharges

Municipalities having more than 40,000 inhabitants may levy a surcharge on the income tax up to 30 percent.

11. Certain heirs/donees are exempt from the tax, i.e. those related to the testator/donor in the first degree of kinship, former spouses, parents inheriting or receiving gifts from their children or other descendants in direct line, taxpayers ceding inherited or donated property without remuneration to the state or units of local government, Red Cross organizations, institutions, foundations and other humanitarian organizations.

12. For example, the following are exempt: vehicles used by the medical corps, Croatian military and police forces, fire-fighting units, undertakers as well as vehicles used for taxi services or other registered transportation activities.