



Tax&Legal Highlights

Croatia

Amendments to the tax legislation from 1 January 2019

The Croatian Parliament voted in the amendments to the Corporate Income Tax ("CIT") Act, Value Added Tax ("VAT") Act, Personal Income Tax ("PIT") Act and Real Estate Transfer Tax ("RETT") Act on 21 November 2018. The amendments will be in force from 1 January 2019.

CIT amendments

The proposed amendments mostly relate to the implementation of the Anti Avoidance Tax Directive ("ATAD") rules, i.e. limitations to the deductibility of financing expenses and controlled foreign company ("CFC") rules. Additionally, there are also important amendments to the definition of a permanent establishment ("PE"), to rules on "Lex Agrokor" receivable write-offs and to withholding tax ("WHT") provisions. We present a summary of these amendments below.

Permanent establishment

The definition of a PE is deleted from the CIT Act and taxpayers are instead referred to the General Tax Act provisions. The General Tax Act provisions take over the existing PE definition but extend it in line with ATAD by, as an example, adding the anti-fragmentation rule.

"Lex Agrokor" receivable write-offs

A write-off of receivables made in line with the regulations on bankruptcy applicable to special interest entities, e.g. the so called "Lex Agrokor" statute, is tax deductible. This provision will also apply to the FY 2018 CIT return.

Financing expense deductibility

Taxpayers that have financing expenses may have an additional restriction on their deductibility, regardless of whether the expenses are to related parties or not. An exemption from the rule applies to taxpayers that have no related parties or to financial institutions. The financing expense definition is wide and includes not only interest but also all other expenses related to obtaining the financing, e.g. exchange rate differences, financing fees, etc. Taxpayers will be able to deduct their net financing expenses for tax purposes at up to 30% of their EBITDA with a de minimis threshold of EUR 3 million. The exceeding amount of the net financing expenses will be tax non-deductible but can be carried forward for up to 3 years. This amount will be reduced for tax non-deductible interest assessed under the thin capitalization rule and/or the related party statutory prescribed interest rate rule.

CFC rules

CFC rules have the effect of re-attributing the income of a low-taxed controlled subsidiary to its parent company. The parent company is taxed on the attributed income in Croatia where it is resident for tax purposes. A CFC is considered to be any legal entity or permanent establishment located in another country if the following conditions are met:

- the taxpayer or a group of related taxpayers holds more than 50% of the voting rights or more than a 50% share in the foreign entity or if they are entitled to more than 50% of the foreign entity's profits and
- the actual CIT paid by the entity abroad is less than the difference between the CIT which would be payable if assessed by applying the Croatian CIT rules and the actual CIT paid by the foreign entity

If the foreign entity is considered a CFC, the Croatian parent is required to declare its profit in its tax return, if that profit is generated from the following categories of income:

- interest or other income from financial assets
- licence or other intellectual property income
- dividends/shares in profit
- financial leasing, insurance, banking and other financial activities
- sale and purchase of goods and services procured with related parties with little or no economic value added.

An exemption is available if a CFC carries out substantial economic activity through engagement of staff, equipment, property and buildings, as evidenced by relevant facts and circumstances.

Additionally, if the income listed above makes up one third or less of the total foreign entity's income, the foreign entity will not be considered a CFC.

WHT

Fees paid to foreign enterprises for performance of non-resident artists, entertainers and sportspersons will be subject to WHT at a 15% rate. No obligation to calculate personal income tax and social security contributions for the individual performer will be in place if such WHT is paid.

All service fees and all other fees that are subject to WHT (i.e. interest, royalties and dividends) paid to entities in countries that are listed as non-cooperative for tax purposes (i.e. tax havens) and which have not concluded a Double Tax Treaty with Croatia will be subject to WHT at the 20% rate, as opposed to regular 12 or 15% rates.

VAT amendments

Use of company cars for private purposes

The Act clarifies that the use of company cars for private purposes is not to be seen as non-business use to which VAT should be charge, even if input VAT was partially deducted upon purchase or lease, irrespective of the period of deduction.

Simplified triangulation conditions

Conditions for the application of simplified triangulation for the second party involved in the supply chain, when the final destination of goods is Croatia, change. The simplified triangulation will also be available to a non-resident taxpayers who are registered for VAT purposes in Croatia, which is not allowed under the current legislation.

Place of supply of services

A supply threshold is introduced in taxation of telecommunications, broadcasting and electronically supplied services to non-taxable persons.

The main rule for the place of supply of telecommunications, broadcasting and electronically supplied services to non-taxable persons is in the place where the customer has its headquarters, residence or habitual residence.

However, from 1 January 2019, the place of supply of those services is, exceptionally, in the Member State of the supplier, if their value does not exceed HRK 77,000 (VAT excluded) in the current and the preceding calendar year

The purpose of the amendment is to simplify the provision of service for the supply, as the place of supply in these circumstances would be its country and it would not be required to register for VAT purposes in the customer's country.

Nevertheless, the supplier can opt to apply the country of the customer rule immediately and will in this case be bound by this decision for two calendar years.

VAT rates

The scope of the reduced rates is extended, so reduced rate of 5% applies to all prescription and over the counter medicines. Reduced rate of 13% will apply to supply of baby diapers and certain categories of foodstuffs (live animals, fresh or frozen meat, fresh or frozen sausages and similar products, meat or blood, live fish, fresh or frozen fish, mollusks and other aquatic invertebrates, fresh or frozen crayfish, fresh or frozen vegetables, roots and tubers, fresh and dried fruit and nuts, fresh poultry eggs in shell). The rate of 13% will also apply to copyright and similar author's fees paid to authors, composers and performers who are members of the organizations for the collective exercise of rights that are engaged in these activities under special regulations and with prior approval of the central state authority for intellectual property.

From 1 January 2020, the standard rate will be reduced from 25% to 24%.

Deduction of VAT on passenger cars

The threshold of HRK 400,000 prescribed for the deduction upon purchase or lease of passenger cars is abolished so the taxpayers can deduct 50% of VAT charged on purchase or lease of passenger cars and related goods or services, irrespective of the car's purchase value. Passenger cars are considered to be motor vehicles intended for the carriage of persons having, in addition to the driver's seat, a maximum of eight seats.

Application of local reverse charge mechanism

Non-resident taxpayers who are registered for VAT purposes in Croatia will no longer be eligible to apply local reverse charge mechanism from the Article 75 (2) of the VAT Act to their local supplies. In other words, from January 1, 2019, VAT registered non-resident's will have to charge VAT on local supplies. Local reverse charge will still apply to local supplies of non-resident's that are not registered for VAT purposes in Croatia.

The scope of application of local reverse charge mechanism to the supplies between domestic taxpayers (Article 75 (3) of the VAT Act) is extended is extended, and from 1 January 2019 will also apply to the supply of concrete steel and iron and products thereof.

Additional monthly reporting obligation

All taxpayers registered in VAT register will be obliged to electronically submit, together with VAT return, ledger of incoming invoices. The ledger's format and content will be prescribed by the VAT Regulations, whose amendments are expected.

VAT on import as reporting category

The reporting of VAT liability on import of machinery and equipment worth more than HRK 1,000,000 and categorised in the prescribed Combined Nomenclature codes through VAT return will be available only upon import of tangible fixed assets.

Registration for VAT purposes

In case of doubts about the justifiability of the VAT identification number assignment, the Tax Authorities may request the applicant to provide the insurance instrument (collateral) for a period of up to 12 months. If the taxpayer fails to submit the insurance instrument, the Tax Authorities will terminate the VAT identification number.

Small enterprise

A small enterprise is defined as legal entity with head office, permanent establishment, and private individual with residence or habitual residence in Croatia whose value of goods delivered or services performed in the previous or current calendar year does not exceed HRK 300,000. In other words, newly established companies that exceed the threshold of HRK 300,000 have to register for VAT immediately and not from 1 January of next year as it was prescribed before.

Taxpayer's responsibility

The Customs or the Tax Authorities will be allowed to request from the taxpayer acquiring the used means of transport from another Member State, prior to its registration, provision of insurance instrument for the fulfilment of VAT obligation arising from the acquisition of the used means of transport.

RETT amendments

RETT is to be reduced from 4% to 3%.

PIT amendments

Amendments to the Personal Income Tax Act, Social Security Contributions Act and General Tax Act will be applicable from 1 January 2019. Amendments to the Personal Income Tax Regulations have already become effective from 1 December 2018. We present a summary of these amendments below.

Personal Income Tax Regulations – applicable from 1 December 2018

Based on the amendments to the Personal Income Tax Regulations, an award for work results (e.g. bonuses) can be paid up to HRK 5,000 per employee per annum as non-taxable receipt. The provision regulating the payment of annual non-taxable payments in the amount up to HRK 2,500 such as Christmas bonus, Easter bonus, holiday allowance, etc. has remained unchanged. This means that the total non-taxable award that can be paid to an employee increased from HRK 2,500 to HRK 7,500 annually.

Personal Income Tax Act – applicable from 1 January 2019

- Based on the amendments to the Personal Income Tax Act, there will be an additional decrease of the tax burden for taxpayers with higher earnings. Namely, the tax base taxable at 24% is increased from HRK 17,500 to HRK 30,000 on a monthly basis. The tax base above HRK 30,000 will be taxable at a rate of 36%. The change is also reflected in the annual tax band rates.
- The novelty is that the benefit in kind based on granting and option purchase of shares which the employers and payers of income provide to employees is no longer considered as employment income. Such income is now considered as capital income, which is taxed at a rate of 24%. This novelty will potentially encourage companies to introduce a system or extend the existing system of rewarding employees through granting or optional purchase of shares.
- Some changes to the Personal income Tax Act led to an increase in the tax burden for one part of taxpayers, i.e. private accommodation providers who pay tax per bed or accommodation unit. Based on these changes, the amount of flat-rate tax per bed or per accommodation unit in the camp is determined by cities and municipalities. Such tax cannot be less than HRK 150 or higher than HRK 1,500.
- In relation to income realized abroad, such income will be treated as it is envisaged by the sourcing country. For example, if a benefit in kind is considered as gross income in the country of source and in Croatia as net income due to the Croatian local legislation, such income will no longer have to be grossed up for tax purposes in Croatia, as it was the case so far.
- Taxpayers realizing income from abroad, which is considered as self-employment income in Croatia, are not required to keep business books according to the Croatian legislation anymore.
- In case of granting a loan to an employee (or non-employed individual), the difference between favourable interest rate (lower than 2% p.a.) provided and the interest rate of 2% p.a. is considered as benefit in kind (3% p.a. up to now).

Mandatory social security contributions

The amendments to the Social Security Contributions Act further simplify the contribution system from an administrative and financial perspective by abolishing two types of contributions payable on top of salary (employer's contributions). Specifically, the contribution for unemployment of 1.7% and contribution for injury at work of 0,5% are abolished. The contribution rate for health insurance contribution is increased from 15% to 16.5%. Thus, the total cost of social security contributions decreased from 37.2% to 36.5%.

For the board member employed with the company the employer is obliged to pay the social security contributions. The novelty is that the lowest base for calculation of social security contributions for the employed board member on an annual level is prescribed. In case there is a difference between the social security contributions paid on the base on which the board member is registered with the relevant authorities and the lowest prescribed base for the board member (average salary x 0.65) on the annual level, the board member is obliged to settle the social security contributions difference.

General Tax Act

Based on the changes to the General Tax Act, in cases where the taxpayer is resident both in the Croatia and abroad, it will be considered that the taxpayer has a permanent residence in the country where his family resides. For the taxpayer-single person for which his or his family's residence cannot be determined, it is considered that his residence is in the country from which he engages in work activities or in which he predominantly resides. In this way the local legislation was harmonized with the OECD model tax convention.

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