



News

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TAX SYSTEM REFORM

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The new Croatian government presented the proposal for a wide scope tax reform at its first session. It should be emphasized that the reform measures, presented below, are at a proposal stage, subject to a public hearing and should not be viewed as binding amendments to the relevant legal provisions. Significant deviations from the proposed changes may yet be implemented.

Enclosed are the most important changes to the tax system that will affect individuals and enterprises, as announced by the Minister of Finance.

Corporate income tax

The changes to the corporate income tax legislation should, to a certain extent, bring down the administrative and financial burden on enterprises. This is expected to create a basis for increased investment levels and strengthen the competitiveness of the Croatian business environment. The changes to corporate income tax legislation should take effect from **1 January 2017**.

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Proposed amendments:

- Reduced tax rate, from 20% to **12%**
 - Applicable to small enterprises with annual revenues below HRK 3 million and to farmers
- Reduced tax rate, from 20% to **18%**
 - For other taxpayers
- Elimination of the relief for reinvested profits and free zones, while maintaining relief for areas of special national concern and the city of Vukovar, education and training, research and development and relief under the Investment Incentives Act
- Flexibility in selecting the business method:
 - Small traders meeting the threshold for corporate tax registration can now choose to continue with the existing system or opt to enter the corporate tax system
 - Small enterprises and taxpayers in the cash accounting VAT scheme can opt to either to pay corporate income tax based on their cash flow or based on the accrual system
- Option for non-profit organizations to select the taxation method, until they exceed the VAT system registration threshold of HRK 300,000
 - Either through regular bookkeeping or based on a pre-set tax liability
- Entertainment expenses will be deductible at 50% of the cost as opposed to the current 30%
- More flexible rules for deduction of bad debt write offs and impairments
- Advance pricing agreements for transfer pricing will become available

Personal income tax

The most anticipated change for most citizens, both employers and employees, is the increase of the tax-free allowance and the reduction of the top tax rate on personal income. The reduction of the payroll tax burden is expected to improve the Croatian economy and investment climate, considering that, until now, Croatia has had one of the highest progressive tax rates in the region. Under the proposed reform, changes to personal income tax should take effect from **1 January 2017**.

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Proposed amendments:

- Increase of the non-taxable personal monthly allowance from HRK 2,600 to HRK **3,800**
- Reduction of personal income tax rates from 25% and 40% to **24%** and **36%**; abolition of the lowest tax rate of 12%
- Implementation of single monthly tax bracket from HRK 0 (after non-taxable allowance) to HRK 17,500 taxed at the 24% tax rate (income over HRK 17,500 will be taxed at the 36% rate)
- Increase of monthly personal allowances for children and other supported family members
 - Adults – 0,7 of HRK 2,500
 - 1st child – 0,7 of HRK 2,500
 - 2nd child – 1,0 of HRK 2,500
 - 3rd child – 1,4 of HRK 2,500
- Additional allowance of 50% of the tax liability for retired individuals, individuals residing in special state care areas and in the city of Vukovar (pension and employment income only)
- Property income, capital income and insurance income remains taxed at 12%
- Implementation of synthetic taxation of other income
- Application of social security liabilities to certain non-employment income at reduced rates – 10% instead of 20% for health insurance contributions and 7.5% instead of 15% for pension insurance contributions.

Value added tax

The announced changes to the VAT system are indicated through redefined reduced rates on goods and services that, for the most part, are widely purchased.

Proposed amendments from 1 January 2017:

- Reduced VAT rate on certain goods and services from 25% to **13%**
 - Agricultural raw materials (seeds, seedlings, fertilizers and pesticides)
 - Electricity supply
 - Child car seats
 - Waste collection
 - Caskets and urns

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- Reduced rate of 13% will be replaced with the **25%** rate
 - Hospitality services and sugar
- Reduced rate of 5% will be replaced with the **13%** rate
 - Cinema tickets

Proposed amendments from 1 January 2018:

- Simplification of the system with two rates
 - Standard rate **24%**
 - Reduced rate **12%**
- Application of billing method of VAT settlement to imports of machinery and equipment
- Increasing the threshold for entering the VAT system up to HRK 300,000
 - Administrative simplification for small taxpayers
- Deduction of input VAT on personal cars and other related costs is now available at **50%** of the total tax amount

Real estate transfer tax and introduction of real estate ownership tax

The introduction of the tax on real estate ownership is a project planned to be introduced from **1 January 2018**. No details have yet been released on the tax rates or the tax base. Real estate transfer tax (payable on real estate purchases in some cases) will be reduced from 5% to **4%** from **1 January 2017**.

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