5. CORPORATE INCOME TAX

THE CHANGES OF THE CORPORATE INCOME TAX
At the end of 2004 a new Corporate Income Tax Act was passed, and entered into force on the 1 January 2005 (NN 177/04). This Act was changed twice. For the first time in 2005 (NN 90/05) when incentives for areas of special national concern, hill and mountain areas, the City of Vukovar and free zones were transferred to the acts which regulate these matters. After that, in 2007 (NN 57/06) the remaining tax relief (incentives for employment, research and development, education and professional improvement of employees and professional rehabilitation and employment of disabled persons) were abolished. Investment incentives are regulated by the new Investment Incentives Law (NN 138/06). But a separate legislation was passed in 2007 in order to continue to apply tax relief for research and development, and education and training. For the alignment of the Croatian corporate income tax with the European legislation the law was changed in the area of merger or splitting of the companies and taxation of interest and royalties (NN 146/08).

WHO PAYS CORPORATE INCOME TAX
A taxpayer shall be:
- a company or another legal or natural person resident in the Republic of Croatia, who is permanently and independently engaged in an economic activity for the purpose of deriving a profit, an income or revenue or other assessable economic benefits.
- a resident permanent establishment of a non-resident entrepreneur.
- a natural person who derives income pursuant to the income tax regulations, if he/she declares that he/she intends to pay corporate income tax instead of personal income tax.
- an entrepreneur – a natural person who derives income from small business or the activities equalised therewith, if:
  1. his/her total revenue in the preceding tax period exceeded of HRK 2,000,000 or
  2. his/her total income in the preceding tax period exceeded of HRK 400,000 or
  3. the value of his/her fixed assets exceeds HRK 2,000,000, or
  4. he/she employed more than 15 employees on average during the preceding tax period.

WHICH ENTITIES ARE NOT LIABLE TO PAY CORPORATE INCOME TAX
The following entities are not liable to pay corporate income tax:
- bodies of national, regional and local administration,
- the Croatian National Bank,
- national institutions, institutions of local government, non-profit organisations, such as national institutes, religious communities, political parties, unions, chambers, civic associations and foundations, and a like,
- open-end investment funds established and operating in accordance with the law, pursuant to which they have been established.

THE TAXABLE BASE
The tax base shall be the profit determined pursuant to the accounting regulations as the difference between revenues and expenditures. For a resident taxpayer, this is the
total profit made in Croatia and abroad; for a non-resident taxpayer it is the profit that is made in Croatia. Any profit made during a liquidation procedure is also included in taxable base.

WHAT WILL REDUCE OR INCREASE THE PROFIT
The law defines separately all those items that increase or reduce profit. Only on the taxable base obtained by having the profit reduced or increased by given items is the tax rate applied in order to obtain the amount of the tax liability.

The tax base shall be **increased** by:
1. the expenditures for value adjustment of shares and stakes (unrealised losses), if these were included in the tax base,
2. the amount of depreciation in excess of the prescribed amounts,
3. 70\% of entertainment expenses,
4. 30\% of the costs, except insurance and interest costs, incurred in connection with own or rented motor vehicles or other means of personal transportation of employees,
5. the costs related to the private life of shareholders and company members, as well as employees,
6. hidden profit distribution,
7. the costs of forced collection of tax and other levies,
8. fines imposed by competent bodies,
9. penalty interest accumulated between associated persons,
10. privileges and other types of economic benefits granted to natural or legal persons for the purpose of causing or preventing a certain event,
11. gifts in excess of the prescribed amounts,
12. interest not recognised as expenditure,
13. other expenditures.

The tax base shall be **reduced** by:
1. revenues from dividend and profit sharing,
2. revenues from value adjustment of shares and stakes (unrealised gains), if these were included in the tax base,
3. revenues from collected written-off claims that were included in the tax base in the previous tax periods, but not excluded from the tax base as recognised expenditures,
4. the amount of depreciation not recognised in the previous tax periods, up to the prescribed amount,
5. the amount of tax exemption or relief according to special state aid regulation.

**Depreciation or write-off**
Depreciation or write-off means the reduction of the value of the real property that with time or use becomes physically or economically depleted. Each enterprise must, each year, set aside the depreciation resources for buildings, equipment and intangible assets that it uses in its operations. The point of this setting aside is to ensure adequate resources for the replacement of assets once they have become worn out. Usually, in all tax legislation, the amount of the depreciation that can be allowed as tax deductible is defined. In Croatia, taxpayers liable to personal income tax and corporate income tax
Depreciate long-life material and intangible assets (i.e., things and rights the individual cost of which is greater than HRK 2,000 and the life of which is longer than one year). That is, depreciation is carried out for buildings, equipment, orchards, vineyards, hop gardens, herds and long-life intangible assets. Depreciation is not carried out for land, forests, financial assets, and monuments of culture and works of art. The amount of the depreciation is fixed such that to the revalued (i.e., inflation adjusted) acquisition cost prescribed rates of depreciation are applied.

The rates of depreciation and the life of depreciation are given in the following table:

<table>
<thead>
<tr>
<th>Depreciation life (years)</th>
<th>Depreciation rates (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Buildings and ships of more than 1000 BRT</td>
<td>20</td>
</tr>
<tr>
<td>2. Basic herd, personal motor vehicles</td>
<td>5</td>
</tr>
<tr>
<td>3. Equipment, vehicles and machinery</td>
<td>4</td>
</tr>
<tr>
<td>4. Computers, software, mobile phones</td>
<td>2</td>
</tr>
<tr>
<td>5. Other assets</td>
<td>10</td>
</tr>
</tbody>
</table>

**WHAT A TAX LOSS IS**

A tax loss occurs when the expenditures are greater than the revenues recognised for tax purposes, i.e., when the base for the calculation of the tax is negative. Such tax losses can be carried forward to a period of five years, so that in each year the base for the corporate income tax is reduced.

**THE RATE OF CORPORATE INCOME TAX**

At the beginning of its implementation in 1994, corporate income tax was a charge on the profit of resident and non-resident taxpayers at a single rate of 25%. But with changes at the end of 1996, the tax rate was increased to 35%, so as to be the same as the upper of income tax rate. But after the year 2000 the rate of corporate income tax is 20%.

**DETERMINING CORPORATE INCOME TAX**

Corporate income tax is determined for the business year that is as a whole the same as the calendar year and according to the profit that the enterprise has made during this period. Those liable to corporate income tax pay advances of the tax over the whole year, on the basis of the tax return for the previous year. The final calculation of the corporate income tax is carried out according to the tax return that the taxpayers have to submit to the TA by 30 April for the preceding business year. Alongside the tax return, the balance sheet and the profit and loss account are also submitted.

**TAX RELIEF, EXEMPTIONS AND INCENTIVES**

As with the taxation of income, there are many kinds of tax relief with corporate income tax. They are not part of the Corporate Income Tax Act, but of the acts regulating other areas. There are tax relief, exemptions and incentives that reduce the amount of corporate income tax or the amount of tax base.
1. Tax relief, exemptions and incentives that **reduce the corporate income tax**:
- Taxpayers who carry out their business in agriculture and fishery in the **areas of special national concern** and permanently employ more than five workers, with more than 50% of them living in the area, up to the date when Croatia will join the EU pay corporate income tax at a rate that can be 0, 25 or 75% of the prescribed rate depending of the area. Other businesses pay tax according to rates from 0 to 85% of the prescribed rate depending of the area. Rates differ also by periods from 2008 to 2017.\(^1\)
- Taxpayers who are engaged in agriculture and fishery in the **City of Vukovar** area and permanently employ more than five employees, with more than 50% of the employees living in the City of Vukovar area, or hill and mountain area or an area of special national concern shall be exempt from corporate income tax up to the date when Croatia will join the EU. Other businesses pay tax according to rates from 0, 25 and 75% of the prescribed rate. Rates differ also by periods from 2008 to 2016.\(^2\)
- Taxpayers who are engaged in agriculture and fishery in the **hill and mountain areas** and permanently employ more than five employees, with more than 50% of the employees living in the hill and mountain area or an area of special national concern shall pay the corporate income tax in the amount of 75% of the prescribed tax rate up to the date when Croatia will join the EU. Other businesses pay tax in the amount of 75% of the prescribed rate in the period 2008-2010.\(^3\)
- User of the **free zones** (i.e., the founder of the zone and other resident and non-resident legal and natural persons) pay corporate income tax in the amount of 0, 50, 75 and 100% of the prescribed rate depending of their location and periods from 2008-2017. Up to the date when Croatia will join the EU deliveries of goods in the zone and within the zone are exempt of the VAT.\(^4\)
- There are also special **investment incentives**. The privileged rates of corporate income tax depend on the amount of the investment and the number of new employees. The privileged rate can be used during the period of 10 years from the beginning of the investment. The opportunities for making use of the privileged rates are shown in the table.\(^5\)

<table>
<thead>
<tr>
<th>Amount of investment (in million EUR)</th>
<th>Decease of the tax rate</th>
<th>Obligation to engage new employees</th>
</tr>
</thead>
<tbody>
<tr>
<td>up to 1.5</td>
<td>50%</td>
<td>at least 10</td>
</tr>
<tr>
<td>from 1.5 to 4</td>
<td>65%</td>
<td>at least 30</td>
</tr>
<tr>
<td>from 4 to 8</td>
<td>85%</td>
<td>at least 50</td>
</tr>
<tr>
<td>over 8</td>
<td>100%</td>
<td>at least 75</td>
</tr>
</tbody>
</table>

The taxpayer is allowed to benefit several tax relief simultaneously.

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\(^1\) Law on Areas of Special National Concern, NN 86/08.
\(^2\) Law on the Reconstruction and Development of the City of Vukovar, NN 44/01, 90/05 and 80/08.
\(^3\) Law on Hill and Mountain Areas, NN 12/02, 32/02, 117/03, 42/05, 90/05 and 80/08.
\(^4\) Law on Free Zones, NN 44/96, 92/05 and 85/08.
\(^5\) Investment Incentives Law, NN 138/06.
2. Tax relief, exemptions and incentives that reduce the tax base:
- Taxpayers realise the state aid for research and development by deducting the tax base for eligible costs in these percentages:
  - 150% of eligible costs for fundamental research,
  - 125% of eligible costs for applied research,
  - 100% of eligible costs for developmental research.\(^6\)

- State aid for education and training can be used by large, medium and small entrepreneurs. They can reduce the tax base for eligible costs in these percentages:
  - Large entrepreneurs – up to 50% in the case of general education and training, and 25% in the case of special education and training,
  - Medium and small entrepreneurs – up to 70% in the case of general education and training, and 35% in the case of special education and training,
  - Entrepreneurs engaged in maritime transport – up to 100% of eligible costs for education and training.
State aid can be additionally increased for users of regional aid.\(^7\)

<table>
<thead>
<tr>
<th>Withholding corporate income tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>Withholding tax is the tax on the corporate income derived by a non-resident in the Republic of Croatia. The withholding tax at the rate of 15% shall be paid on interest, as well as royalties and other intellectual property rights, on market research services, tax and business counseling and auditor services paid to non-residents.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Double taxation avoidance treaties</th>
</tr>
</thead>
<tbody>
<tr>
<td>Double taxation shows up in the international trade of goods and services. When a legal or natural person makes or income in a state in which it is non-resident, this income is taxable both in the state in which it is made, and in the state in which the receiver of the income is resident. In order to avoid an unjust taxation of the same income or assets in both the country in which it arises and in the state where the recipient is resident, treaties about the avoidance of double taxation are applied. Croatia had either signed new or taken over from the former Yugoslavia previously existing double taxation avoidance treaties with 46 countries.</td>
</tr>
</tbody>
</table>

**PENALTIES**
A taxpayer can be fined of from HRK 1,000 to 200,000 for an offence, and the responsible person of the taxpayer from HRK 500 to 20,000.

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\(^6\) Law on Science and High Education, NN 123/03, 198/03, 105/04, 174/04, 46/07 and Regulation on State Aid to R&D, NN 116/07.

\(^7\) Law on State Aid to Education and Training, NN 109/07, 134/07 and 152/08.
REGULATIONS
- The Corporate Income Tax Act, NN 177/04, 90/05, 57/06 and 146/08
- The Corporate Income Tax Regulation, NN 95/05, 133/07 and 156/08
- Law on Areas of Special National Concern, NN 86/08
- Law on the Reconstruction and Development of the City of Vukovar, NN 44/01, 90/05 and 80/08
- Law on Hill and Mountain Areas, NN 12/02, 32/02, 117/03, 42/05, 90/05 and 80/08
- Law on Free Zones, NN 44/96, 92/05 and 85/08
- Investment Incentives Law, NN 138/06
- Law on Science and High Education, NN 123/03, 198/03, 105/04, 174/04 and 46/07
- Regulation on State Aid to R&D, NN 116/07
- Law on State Aid to Education and Training, NN 109/07, 134/07 and 152/08