

Setting up your Business in Croatia

Issues to consider



The business environment in Croatia is very favourable for investors. An excellent geographical location enables access to the market of 650 million people and the labour force in Croatia is effective, motivated and innovative. Croatia has developed a modern infrastructure which is a proof of fast technological development of the country. Stable economic growth and Croatia being granted membership of the EU in 2013 confirms the security of the business environment.

However, there are a number of issues which you must consider when you are looking to set up your business in Croatia. This document takes you through some of the common questions we come across and gives you practical information about the issues you need to consider.

What type of Business Structure should we use?

There are advantages and disadvantages to all of them, and there is no one correct answer, it's all dependent on your specific business circumstances and needs. A brief overview of the main structures is below:

Establishment (a branch of your overseas business)

- Not a separate legal entity but an extension of the overseas parent company
- No limited liability or ring-fencing of the Croatian operations
- If have a permanent establishment in Croatia then profits from this PE are liable to Croatian Corporation tax
- Must file parent company accounts, prepared under Croatian Company Law
- The start-up and operation of branch offices owned by foreign companies are governed by the same regulations that apply to the establishment of branches by domestic companies.
- The branch office operates under its own name. The name should indicate both the branches' and the founder's registered office.
- If the same founder intends to establish several branch offices, the establishment procedure is carried out separately for each branch.

Limited Company:

- Provides limited liability and ring-fencing to operations
- Gives a perception of a local business, with longevity
- Corporation tax to be paid on company profits
- The company is liable for its debts with all its assets. Shareholders are not liable for the debts of the company.
- Authorized capital and shares must show par value in the currency of the Republic of Croatia. The minimum amount of authorized capital is HRK 200,000.
- The basic document for a public limited company is the articles of association, as it specifies the internal organization of the company.
- Accounts require auditing if in **group as a whole** Revenues > HRK 30m (€ 4m) p/a

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Limited Liability Partnership:

- Members (partners) have limited liability
- Profits are allocated to members who then pay Income Tax on these profits personally
- The tax residence of the member, and where the profits in the LLP originated will determine in what jurisdiction and how these profits are taxed
- The initial authorized capital of a private limited company must be shown in Croatian currency – Kuna (HRK). The minimum amount of initial authorized capital may not be below HRK 20,000.
- The company is liable for its debts with all its assets.

How much Corporation Tax will the business pay?

Tax losses may be carried forward for up to 5 consecutive years. Tax losses may not be carried back.

The Croatian law provides for rules on transfer pricing, thin capitalization and interest deductibility. There are no provisions on group taxation.

Tax rate (%)	Taxable profit (Cur)
20%	Residents are taxed on their worldwide income; non-residents are taxed only on Croatian-source income. Foreign-source income derived by residents is subject to the same corporate tax rules as Croatian-source income. The corporate tax base is the difference between revenue and expenditures assessed in the profit and loss statement under the accounting rules, which is then increased and reduced for tax-specific items under the accounting rules, which is then increased and reduced for tax-specific items under the corporate tax provisions.
12%	Dividends and profits based on share in capital.
25%	Income from the allocation of own shares.

What if we use Croatia to set up our holding company?

From the day of the accession of the Republic of Croatia to the European Union withholding tax on dividends and corporate income (profit) shares shall not be paid when dividends and corporate income (profit) shares are distributed to a company taking one of the forms that are subject to the common taxation system applicable to parent companies and their subsidiaries from different EU Member states provided that:

- the recipient of dividend or share of corporate income (profit) has a minimum holding of 10% in the capital of the company distributing dividend or share of corporate income (profit),
- the lowest percentage as referred to in item 1 is held for an uninterrupted period of 24 month.

Dividends paid to a non-resident entity are subject to a 12% withholding tax unless the rate is reduced or exempt under a tax treaty. An exemption from withholding tax will apply on dividend payments between related parties within the EU.

What if we make cross-border transactions between group companies?

Croatia follows internationally recognised **Transfer Pricing (TP)** rules where cross-border trading and financial transactions between affiliated entities have to be conducted on an arm's length basis. The price and terms should be the same as if the transactions had been between completely independent parties.

Typical transactions between affiliated entities that are covered by TP regulations are:

- Sale and purchase of goods
- Provision of management services
- Property rental charges
- Transfer of intangible assets e.g. trademarks, patents
- Sharing of knowledge, expertise, business contacts etc.
- Provision of financial support e.g. inter-group loans and charging a "market" interest on loans.

A business will need to prepare a Transfer Pricing Report proving the arm's length basis of transactions. The report will include a functional and risk analysis, analysis of the adopted pricing model and benchmarking of the arm's length basis.

SME's are not exempt from Croatia transfer pricing regime.

What Employment Taxes and Social Security will need to be paid?

If an individual is resident in Croatia then they are subject to Croatian tax laws. Non-residents are taxed only on Croatian-source income. An individual is resident if he/she has a permanent residence or habitual abode in Croatia. An individual is non-resident if he/she does not have a permanent residence or habitual residence in Croatia, but receives taxable income in Croatia.

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Current Personal Income Tax rates in Croatia are:

Band of taxable income (kn/month)	Tax rate (%)
0 – 2.200	12
2.200 – 13.200 (next 11.000)	25
Over 13.200	40

All tax payers are entitled to a personal allowance in the amount of HRK 2.600 per month, while taxpayers who support a spouse, children and other family members, can in addition to the basic personal allowance, also deduct from their taxable income the personal allowances for supported family members.

for dependents or ex spouse with alimentation	0,5
first child	0,5
second child	0,7
thirdly child	1
fourth child	1,4
fifth child	1,9
family members with disabilities	0,3
family members with 100% disabilities on one base.	1

Current Social Security rates are:

Name of security	Rate(%)
basic health contribution	15
additonal contribution for insurance against accidents at work and occupational diseases	0,5
contribution for employment	1,7
first pillar of pension insurance	15
second pillar of pension insurance	5

Employers and employees also have to pay Croatia social security, which consist of pension contributions and a health and employment contribution. Pension contributions are at a rate of 20% of gross salary, and a health and employment contribution is at a rate of 17,2% of gross salary.

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It is the employers' legal responsibility to pay over employee's tax and social security deductions to the Croatian tax authorities. Contributions are borne by the employee but withheld by the employer.

What is Value Added Tax (VAT) and should the business be registered?

VAT is a "goods and services tax" on supplies made, the standard rate of which is 25%. The reduced 5 % rate includes VAT on bread, milk, certain educational services and medical supplies, scientific magazines and tickets for movie theatres. The reduced 13% rate includes VAT on accommodation, making food, newspapers and edible oils. If a business makes taxable supplies in excess of HRK 230.000 in any 12 months then it **MUST** be registered for VAT.

There are three types of supply

- Taxable – must charge VAT on supplies, can reclaim input VAT
- Exempt – cannot charge VAT nor reclaim input VAT
- Outside the scope – not in the Croatia VAT system

The supply of most types of goods and services in Croatia would be classed as Taxable supplies. However when these supplies are made to companies which are outside of Croatia advice needs to be sought as to what rate of VAT, if any, to use.

If a Croatian entity sells goods or provides services to its non EU parent then there is no VAT chargeable on this overseas supply, however on the basis that the supply would be VAT'able if made in the Croatia then the entity will be able to reclaim all its input VAT.

Many companies see Share Option plans as being an important way of attracting, motivating and retaining key staff.

Croatia has a number of "approved" share option plans which give tax benefits to employees and employers alike and it is often possible to adapt an overseas stock option plan to fit into one of these "approved" plans.

However this is a very technically complex area and careful planning needs to be undertaken as soon as share option plans are being considered for implementation in Croatia.

How else can we compensate our employees?

Croatia has a very comprehensive range of compensation and benefit options available for companies to offer their employees.

Pensions, private medical insurance, life and disability cover are now commonplace benefits provided by many Croatian businesses to their workforce.

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To discuss your requirements please contact the International Office on +44 (0) 1245 449266 or [email](#) us directly.

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