Tax reform
02/2016
Contents

The most important amendments of the Value Added Tax Act ............................................................. 3
The most important amendments of the Corporate Income Tax Act .................................................. 4
The most important amendments to Personal Income Tax Act and Act on Social Security Contributions ................................................................. 6
The most important amendments from new General Tax Act .............................................................. 8
The most important amendments of the Real Estate Transfer Tax Act (“RETT“) .................................... 9
The most important news from the new Local Taxes Act ................................................................. 9
The most important amendments of the Special Tax on Motor Vehicles Act ..................................... 10
The most important amendments of the Tax Administration Act ..................................................... 10
The most important news from the new Act on Administrative Cooperation in the Field of Taxation ......... 11
The most important amendments of the Act on Fiscalization ............................................................ 11
The most important amendments of the Act on Administrative Fees ............................................. 12
Tax thought leadership online ............................................................................................................ 13
Contacts ........................................................................................................................................... 14
The most important amendments of the Value Added Tax Act

Amendments that will take effect from 1 January 2017

1. New VAT rates for certain types of supplies
   VAT rate of 25% is decreased to 13% for following supplies: children's car seats, supply of electricity, collection of certain types of waste, urns and coffins, seedlings and seeds, fertilizers and pesticides, animal feedstuffs except pet food.

   Instead of 13%, 25% VAT rate applies to: food preparation, catering and serving and preparing non-alcoholic beverages, wine and beer in restaurants and bars, supply of white sugar from cane and sugar beet which is put on the market in a crystal form.

   Further to the amendments of VAT rates, companies should make an inventory count of goods for which the VAT rate was amended and should adjust their accounting systems respectively.

2. Small taxpayers whose taxable supplies do not exceed threshold may also apply for VAT registration, however, once registered, such taxpayers will be obliged to remain in the VAT system for the next three years, instead of currently prescribed five years.

3. Option to tax supplies of immovable property
   Further to the VAT Act which is currently in force, an option to tax is available for supplies of immovable property which are VAT exempt if the buyer is fully entitled to input VAT deduction on basis of its business activities. Further to the amendments of the VAT Act, in order to opt for taxation it is sufficient that buyer is able to fully deduct input VAT on that particular purchase of the real estate.

4. Liability of the taxpayer
   The provisions related to liability of the taxpayer are amended in a way that, among others, the taxpayer’s right to input VAT deduction may be denied if objective circumstances show that the taxpayer knew or should have known that due to the fraudulent activities, part or entire output VAT for the received supply, or any previous or next supply of the same goods or services, will remain unpaid.

5. Small taxpayers who pay VAT on supplies subject to reverse charge further to the Article 75, Paragraph 2 of the VAT Act (supplies from the taxpayers that have no establishment, domicile or habitual residence in Croatia) may submit VAT returns in paper form.

6. New reporting obligation is introduced to Croatian taxpayers who act as VAT representatives of foreign taxpayers involved in the customs procedures 42 and 63. The form of the report will be defined in the VAT Bylaw.

Further to the above mentioned amendments of the VAT Act, Amendments to the VAT Bylaw are expected in the first quarter of 2017.

Amendments that will take effect from 1 January 2018

It will be possible to deduct 50% of input VAT related to purchase and lease of personal vehicles and other means of personal transport including all related costs (except for VAT related to purchase of means of transport in amount above HRK 400,000 per each vehicle).

The threshold for VAT registration (small taxpayers) will increase from HRK 230,000 (approximately EUR 30,000) to HRK 300,000 (approximately EUR 40,000).

In order to allow for VAT relief to the taxpayers importing certain machinery and equipment amounting above HRK 1million, VAT due would not need to be actually paid to the Customs Authority; instead reverse charge mechanism would apply (no cash flow). To apply for such procedure, taxpayer should first obtain approval from the Customs Authority.

Amendments that will take effect from 1 January 2019

The amendments to the VAT Act define the VAT treatment of purchase of goods and services by using single-purpose and multi-purpose vouchers.
The most important amendments of the Corporate Income Tax Act

Amendments to the Corporate Income Tax Act are generally applied to tax periods from 1 January 2017, except for specifically stated parts.

**Decrease of the tax rate**

New Corporate Income Tax Act reduces the CIT rate of 20% to 18%. Additionally, it introduces a reduced CIT rate of 12% for taxpayers who have realized revenue of less than HRK 3 million in previous tax period.

**Determining the tax base according to the cash principle**

A possibility to determine the tax base based on a cash principle is introduced for taxpayers who have realized revenue less than HRK 3 million in the previous tax period. Act provides detailed rules how to determine such tax base (corrected for certain non-cash transactions and unrealized profits/losses and certain financial transactions and realized profits and losses).

Taxpayers who are also VAT payers will be entitled to choose cash principle determined tax base if they have, based on VAT legislation, already chosen to pay VAT based on collected income.

An application in the form of statement about changing the method of determining the tax base has to be submitted no later than 15 days after the beginning of the tax period and will have to be applied at least for three tax periods.

**Lump sum taxation of economic activity of non-profit sector**

In accordance with the Corporate Income Tax Act currently in force, certain persons are not taxpayers (public administration authorities, institutions, associations and similar non-profit organizations) unless they perform certain economic activity whose non-taxation would result in acquiring unjustified benefits on the market.

In order to simplify bookkeeping of business events for persons who in principle apply non-profit accounting, they are enabled to determine the tax base in a lump sum. Such taxation could be used by persons who in the previous period based on economic activity did not realize revenue higher than the amount prescribed for entry in the VAT system.

The above persons cannot apply lump sum taxation if they perform only activity on the basis of which they are corporate income taxpayers or based on that activity realize more than 50% of total revenues.

**Amendments in tax incentives**

Amendments to the Act abolish the reinvested profit relief that was applied from 2012.

Also there are changes in tax incentives for supported areas. Taxpayers who perform business activities in the field of municipalities classified in the I. group of level of development (according to special regulation of regional development of Republic of Croatia), and who employ more than 5 employees for an indefinite period (with more than 50% of employees who have residence and stay in the supported area in the I. group, or in the city of Vukovar), pay 50% of the prescribed rate of corporate income tax (so far have been exempt from paying corporate income tax).

Relief from payment of 50% of the prescribed rate of corporate income tax which was valid for taxpayers who perform activity in the field of local municipalities in the II. group by level of development is now abolished.

**Tax deductible entertainment and cars costs**

Amendments to the Act bring changes in the percentage of tax deductible expenses of entertainment and cars. The tax base will from now on be increased for 50% of entertainment costs and 50% of car costs. Compared to entertainment costs of the current Act, non-deductible costs of entertainment will be reduced from 70% to 50% while non-deductible car costs will be increased from 30% to 50%. Change in percentage for car costs will apply from 1 January 2018.

In the definition of the entertainment costs, the word “entertainment” is excluded from the wording “cost of vacation, sports, recreation and entertainment” and the related costs will not be recognized under the entertainment costs. It is expected that the Tax Authority will provide detailed interpretations of what is meant by “entertainment”.

4 | EY Tax and legal news 02/2016
Value adjustment of receivables
Amendments to the Corporate Income Tax Act introduced tax deductible write-off of overdue receivables of up to HRK 200 from unrelated individuals whose debt is not created on the basis of craftsmen activities (and equivalent activities), if total receivables per each person on the last day of the period does not exceed that amount.

Furthermore, the Act currently in force prescribes that the value adjustment of receivables is tax deductible if the receivable is booked as revenue and if all actions have been performed to secure payment of the debt, with necessary due care. Amendments to the Act prescribe that as an exception to the above provision write-off of receivables booked as income from unrelated persons will be considered tax deductible if the taxpayer demonstrates that the costs of initiating the procedures of collection exceed the amount of the receivables or if demonstrates that with due care it initiated certain actions with a view to collect the receivables, while it established final inability to collect the amounts written-off.

In addition, the amended Act introduces a tax-deductible write-off under special legislation on consumer bankruptcy.

Market interest rates on loans to related companies
Amendments to the Act introduced the possibility of determining the interest rate on loans between related companies, except on the basis of the interest rate prescribed by the Minister of Finance, in accordance with the methods for determining transfer prices from Article 13 of Act: comparable uncontrolled price method, resale price method, cost-plus method, profit-split method, transactional net margin method, provided that the taxpayer applies such method to all contracts.

Advanced pricing agreement
The amended Act introduces the possibility of concluding an advance pricing agreement between the taxpayer and Ministry of Finance – Tax Authority and tax authorities of other countries (where related parties or permanent establishments are residents) in the area of transfer pricing and contractual relations between related parties.

Advance pricing agreement about transfer prices for certain transactions between related parties, establishes a set of criteria – methods, comparables, adjustments, key assumptions relating to future events - to determine transfer pricing for those transactions over a certain period before starting the transactions.

Advance pricing agreement is binding for the taxpayer and Ministry of Finance, Tax Authority during the period for which it was concluded. Costs of concluding the advance pricing agreement should be born by the taxpayer.

Details on conclusion of the agreement, content, the period of validity and the payment will be prescribed in the bylaw.

Write-off of receivables for credit institutions
The amended Act prescribes the possibility for credit institutions which write-off of receivables for principal and interest, that are classified as partially irrecoverable and absolutely irrecoverable placements, to:

- Treat as tax deductible the expense arising because the amount of the write-off of receivables is higher than the amount of tax deductible value adjustments from previous period and
- treat as taxable the income that arises when the amount of the write-off is less than the amount of tax deductible value adjustments from previous periods

The credit institutions will be able to benefit from these possibilities if the following conditions are cumulatively fulfilled:

- receivable which is being written off is booked partly recoverable and absolutely irrecoverable placement until 1 December 2015
- receivable which is written off was value adjusted until 31 December 2015 based on the decision from Paragraph 1 of this Article
- receivable is written off based on forgiveness of debt in terms of a special regulation regulating civil obligations, and is generated based on a written statement of credit institution about the fact that the debtor obligations in the specified amount are ceased, as well as obligations of the guarantor, because it waives the right to demand fulfillment and the borrower agreed with this statement
- debtor who is released of the debt is not a related party in terms of Corporate Income Tax Act and special regulation of credit institutions
- expense is presented in Profit and Loss Tax Act and special regulation of credit institutions
- expense is presented in Profit and Loss Account of the period in which the receivable was written off

Taxpayer is obliged to file the overview of write-off of receivables per individual placement and debtors, together with income tax return for 2017.

Other

- It is defined that the prepayments for next year will be calculated in a way that the tax liability for previous period is divided by the number of months of that period
- The amended Act adds a new misdemeanor provision according to which a legal entity and natural person will be penalized for repeated offenses in the amount of HRK 3,000 to HRK 300,000, while the responsible person will be penalized with HRK 3,000 to HRK 30,000.
The most important amendments to Personal Income Tax Act and Act on Social Security Contributions

New Personal Income Tax Act will enter into force as of 1 January 2017.

New tax brackets, rates and personal allowances
So far personal income tax on employment income has been calculated based on three tax brackets:
- tax rate of 12% was applied on taxable incomes up to HRK 2,200
- tax rate of 25% was applied on taxable incomes between HRK 2,200 and HRK 13,200
- tax rate of 40% was applied on taxable incomes exceeding HRK 13,200.

As of 2017 this will be replaced with two new tax brackets and rates:
- tax rate of 24% will be applied on taxable incomes up to HRK 17,500
- tax rate of 36% will be applied on taxable incomes exceeding HRK 17,500.

Basic personal allowance has been increased from HRK 2,600 to HRK 3,800. Allowance for supported family members has been increased as well (e.g. personal allowance for first child is increased from HRK 1,300 to HRK 1,750, for second child is increased from HRK 1,820 to HRK 2,500, etc.).

Below are calculation examples which show impact of the changes to net payout for an employee residing in Zagreb and using basic personal allowance.

<table>
<thead>
<tr>
<th>Rules in 2016</th>
<th>Gross 1</th>
<th>Pension contribution</th>
<th>Personal allowance</th>
<th>Tax and city tax (Zg)</th>
<th>Net payout</th>
</tr>
</thead>
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<tr>
<td>HRK</td>
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<td>2,600,00</td>
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<table>
<thead>
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<th>Rules in 2017</th>
<th>Gross 1</th>
<th>Pension contribution</th>
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<tr>
<td>HRK</td>
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<td>Gross 1</td>
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<td>Gross 1</td>
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</table>

| Difference in Net payout | 141,60 | 42,48 | 66,08 | 113,28 | 195,88 | 1,323,96 | 2,095,94 |
| Difference in Net payout (%) | 3,72% | 0,80% | 0,98% | 1,18% | 1,59% | 7,99% | 8,31% |
Additionally, tax rates on other sources of income have been changed as well. The tax rate of 25% has been reduced to 24% (applies to e.g. “other income”) while tax rate of 40% has been reduced to 36% (applies to e.g. for shareholder’s withdrawals).

**Income subject to annual taxation**

Employment income, self-employment income and most of “other income” jointly make annual tax base.

The annual personal income tax will be subject to annual tax rates and brackets as follows:

- tax rate of 24% will be applied to taxable income up to HRK 210,000 (approximately EUR 28,000)
- tax rate of 36% will be applied to taxable income exceeding HRK 210,000.

Annual taxation will be processed via annual tax returns filed personally by the taxpayers (e.g. self-employed taxpayers) or via special procedure applied autonomously by the Croatian tax authorities based on information available in their IT system, without taxpayer having to personally file the annual tax return (e.g. taxpayers who receive employment and “other income”).

**Income subject to final tax**

Income from property and property rights, capital, insurance, income subject to lump-sum taxation (“paušal”) and “other income” which will be considered as final (e.g. “other income” arising from refund of pension contributions paid above annual cap).

Such incomes will not be subject to annual taxation. The tax liability on such incomes will be determined and paid during the year (based on cash principle) and will be considered as final. Exceptionally, if such incomes have been taxed abroad, it is expected that double taxation may be avoided via new procedure which will be defined by new Bylaw to the Personal Income Tax Act.

**Capital gains taxation**

Realized capital gains from financial assets will not be subject to taxation if financial assets were held for at least two years. To remind you, taxation of realized capital gains was introduced in Croatia in 2016 (the tax rate of 12% remains unchanged) and the exemption from taxation was applied if the financial assets were held for at least three years.

Additionally, the new law stipulates that taxpayers can opt to use services of Central Depository & Clearing Company Inc, (“SKDD”) for maintaining evidences on their financial assets, determining taxable incomes, and calculating and reporting tax liability on behalf of the taxpayer.

**Foreign income**

Deadline for reporting and paying tax on foreign incomes has been extended from 8 (eight) days to 30 (thirty) days.

**Decrease of pension contribution on “other income” and extension of base**

Pension contributions on “other income” will be decreased from 20% to 10% in total. Also, liability to pay social security contributions (pension and health) will be introduced for author’s fees and retirees.
The most important amendments from new General Tax Act

New General Tax Act (GTA) is published and will enter into force on 1 January 2017. Most significant areas regulated by the new GTA are the following:

Statute of limitation
- Provisions on relative statute of limitation period of 3 years are annulled and unique statute of limitation period is introduced in duration of 6 years
- According to the transitional and final provisions of the new GTA, proceedings initiated based on the old GTA will be finished in line with the old GTA
- For proceedings for which relative statute of limitations of 3 years expires on 1 January 2017, old GTA applies, while the new GTA applies for proceedings for which absolute statute of limitations expires on 1 January 2017

Tax audit
- Tax audit can be initiated during 3 years as of the beginning of statute of limitation period
- Exceptionally, tax audit can be initiated after 3 years as of beginning of statute of limitation, if statute of limitation for determination of the tax liability has not yet occurred:
  1. in the case of rights abuse in tax-debt relationship regarding tax guarantee
  2. in proceedings of determination of the difference between the acquired assets and proven resources for the acquisition of these assets according to the Personal Income Tax legislation
  3. in proceedings to combat tax frauds
  4. in proceedings initiated by other authorities

Chronology of payments
- It is now clearly prescribed when the tax authorities owe the taxpayer tax refund, Tax Authority will firstly return the interest and then the principal amount

Tax return amendments
- Longer deadline of three years following the date when the tax return was initially submitted is being prescribed for amendments of the tax return
- In case that during tax audit it is assessed that an adjustment of other taxes (for more or less than already paid) will have to be made, Tax Authority may ask the taxpayer to amend its tax return

Appeal
- If the Second Level Body determines that the disputed tax assessment is illegal, it will annul the tax assessment and decide on the merits of the case itself, while the subject will be forwarded to the First Level Body for repeated procedure only should this be necessary due to the nature of subject

Gathering information
- Tax Authority may gather information and data in electronic form not only from taxpayers’ business documentation and evidences but from other types of data as well (network data, web based data, saved computer records – regardless where based), for which the taxpayers are required to provide access to

Tax assessments delivery
- Taxpayer will be able to prove that he did not receive a certain tax assessment
The most important amendments of the Real Estate Transfer Tax Act ("RETT")

New RETT Act, which will enter into force as at 1 January 2017 has not changed in substance, instead its aim is, among others, to simplify the procedure of reporting the transfer of real estate in that the tax resolutions are issued only when the tax is being assessed.

**Tax return submission**
The acquirer of the real estate is no longer obliged to report the tax liability. Under the new RETT Act, the transfer of real estate is considered to be reported by notaries, courts and other bodies, which make decisions on disposal of real estate, by electronic means.

However, if the respective documents are not delivered as stated above, the acquirer of the real estate is still obliged to report the transfer of real estate to the competent Tax Authority's office. Furthermore, the Tax Authority may require from the taxpayer to present facts relevant for taxation which have been unavailable to the Tax Authority.

The real estate exempted from RETT will from now on only be recorded in the Tax Authority’s system without issuing the tax resolution.

**Tax rate**
RETT rate is reduced from 5% to 4%.

**RETT exemption**
The new RETT Act introduces the RETT exemption for any capital contribution of the real estate regardless of whether the contribution is performed into share capital or capital reserves. Namely, according to current RETT Act, exemption is provided only for the contribution into share capital or increase of the share capital.

**The abolition of the RETT exemption**
To avoid further unequal treatment of individuals that resolve their residential status by acquiring the real estate subject to VAT to which the VAT exemption may not apply, RETT exemption on purchase of the first real estate for resolving residential status is being abolished. On the other hand, the Government is working on the proposal of the Act on Subvention of Housing Loans further to which one could apply for the subvention until 31 July 2018. Purchasing of flat or a house would be subsidized to up to 50% of the loan installment for at least first four years of the loan repayment, to citizens younger than 45 resolving their residential status, if other prescribed conditions are met.

The most important news from the new Local Taxes Act

New Local Taxes Act introduces provisions as follows:

- as of 1 January 2017, notaries are obliged to report inheritance and gifts to Tax Authority and inheritance and gift tax rate is reduced from 5% to 4%
- as of 1 January 2017 taxation of motor vehicles will be performed during the registration of motor vehicles at stations for technical inspection, and no longer debited by the Tax Authority
- as of 1 January 2017, tax on trade name is being abolished for all entrepreneurs
- as of 1 January 2018, taxation of real estate is being introduced. From then onwards, monument contribution annuity, tax on holiday houses and communal contributions will be abolished. Real estate tax shall be calculated on the total net floor area of the property (taxable area). Annual amount of tax per m2 of taxable area of the property is determined by multiplying the point value, the purpose coefficient, area coefficient, condition coefficient and age coefficient.
The most important amendments of the Special Tax on Motor Vehicles Act

Amendments to Special Tax on Motor Vehicles (STMV) Act, which are entering into force as of 1 January 2017, are as follows:

- the institute of authorized dealer of used motor vehicles is being introduced and their position is being equalized with position of dealer of new motor vehicles, i.e. system of deferral of STMV payment is now available to the aforementioned dealers
- STMV does not need to be paid for motor vehicles which are exclusively run by electric-powered motor, motor vehicles whose carbon monoxide emission is 0 grams per kilometer and motor vehicles produced 30 or more years ago, which are, according to special regulations, categorized as classic (old-timer) vehicles
- instead of rate based on CO\textsubscript{2} emissions, as one of the component of STMV calculation, absolute amount of STMV, which is dependent on the level of CO\textsubscript{2} emission, is being introduced. Therefore, STMV rate is no longer dependent on the value of the car
- the Government is given the authority to determine the STMV level by regulation

The most important amendments of the Tax Administration Act

The amendments of the Tax Administration Act renounce the previous consolidation of Tax Administration and introduce the return of the concept of tax offices at the county level (instead of the regional level). Also, the operation of the tax surveillance, collection and enforcement operations and operations for combating tax fraud are regulated in more detail. Independent Sector for Detection of Tax Frauds (“Porezni USKOK”), which has so far been an independent body within the Ministry of Finance, will, by the amendments to the Tax Administration Act, be positioned at the highest level in the organizational framework of the Tax Administration, and led by the Assistant to the Director of the Tax Administration.
The most important news from the new Act on Administrative Cooperation in the Field of Taxation

New Act on Administrative Cooperation in the Field of Taxation (Act) will enter into force on 1 January 2017, except for the provisions concerning Act on approval of the Agreement between the Government of Republic of Croatia and the US Government on FATCA (Foreign Account Tax Compliance Act), that enters into force at the date after the said Agreement entry into force.

Exchange of information and administrative cooperation which is prescribed by the new Act, so far partially prescribed by General Tax Act, relate to:

- administrative cooperation in the field of taxation between Croatia and EU Member States,
- automatic exchange of information, specially about:
  - financial accounts between Republic of Croatia and the EU Members States and other jurisdictions
  - previous tax opinions with cross-border effects and previous agreements on transfer pricing between Republic of Croatia and EU Members States and
  - reports by country (country-by-country reporting) between Republic of Croatia and EU Members States
- enforcement of Croatian-US Agreement about the improvement of filling tax liabilities at the international level and enforcement of FATCA

The Tax Authority and Customs Authority shall be in charge of administrative cooperation in the field of taxation and the Act includes all taxes prescribed by the EU Member States, except for VAT, customs and excise duties that are regulated by other EU acts on administrative cooperation.

Minister of finance will prescribe the respective bylaws relating to financial accounts and reports by country within 30 days as of the day the Act enters into force.

The most important amendments of the Act on Fiscalization

- as of 1 July 2017, the institute for small taxpayer for fiscalization purposes that has so far issued invoices through certified book of invoices is being abolished and the obligation to issue invoices through POS automated machines is being imposed
- as of 1 July 2017, the exemption from fiscalization for taxpayers who realise turnover from sale of tickets or token in passenger transport is being abolished, except for local public road transport of passengers in accordance with the decision of local self-government units and ticket or token sales in air, rail and coastal maritime transport
- as of 1 July 2017, every taxpayer liable to the fiscalization, as of commencement of the liability for fiscalization and before issuance of first invoices, is obliged to submit the relevant data via ePorezna. Amendments to the Act prescribe additional information to be submitted to the Tax Authority, such as:
  - information about manufacturer and/or maintainer of software,
  - type of activity performed in business premises,
  - opening date and closing date of business premises,
  - status of business premises

All taxpayers who are already covered by the fiscalization will be obliged to provide additional information no later than 31 July 2017.

- as of 1 January 2017, the provision prescribing treasury maximum is amended in a way that treasury maximum will depend on taxpayer’s classification as micro, small or medium entity, depending on the size of the entrepreneur as defined by Act on development of small entrepreneurs.
The most important amendments of the Act on Administrative Fees

The most important change of the new Act on Administrative Fees is the establishment of the “e-Fees” system (“e-pristojbe”) - a special system that enables the payment of administrative fees electronically. The e-Fees system will be managed by the Financial Agency - FINA. The operation of the system and payment methods will be regulated by a special act. Revenue stamps will remain as a means of payment for the fees up to HRK 100.

Among other changes it should be noted that the Tariff on Administrative Fees will no longer be comprised within the Act, but will be prescribed by the Croatian Government by a special decree. Finally, the Act extends the scope of exemptions from the payment of administrative fees, in the following fields: central state administration body responsible for veterans; applicants for international protection; asylum seekers and their family members; volunteers; and, in certain circumstances, humanitarian actions; and public needs in culture and media.
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