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Source / Izvornik: **Press releases, 2008, 1, 1 - 3**

Journal article, Published version

Rad u časopisu, Objavljena verzija rada (izdavačev PDF)

Permanent link / Trajna poveznica: <https://um.nsk.hr/um:nbn:hr:242:728544>

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Download date / Datum preuzimanja: **2024-11-26**



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Croatia's Tax Success

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Croatia is the top reformer in Europe. Early in June, Croatia was presented a World Bank award as the top reformer in Europe and the second top reformer worldwide. The award was received on the basis of a comprehensive survey entitled "Doing Business 2008" conducted by the World Bank since 2004, which has attracted increasingly intense media attention. This year, the World Bank's survey covered 178 economies. Croatia ranks 97th in this large and heterogeneous group of countries. Relative to 2007, there is an improvement in the rankings by 23 places. Positive movements were observed in eight out of ten topics set by the World Bank. One of the key breakthroughs was made in the "paying taxes" topic. Croatia's ranking in this respect improved by 12 places compared with 2007. Therefore, this topic obviously deserves some more attention.

Croatia ranks third in the region on 'paying taxes topic'. Out of 28 countries of Eastern Europe and Central Asia, Croatia is the third top economy in paying taxes behind Latvia and Estonia. It is followed by Czech Republic, Poland, Hungary and Slovakia, which have long ago left behind the hardships of transition.

Measuring tax payment. The World Bank uses three indicators of successful tax payment: 1) the number tax payments per enterprise; 2) the number of hours spent in preparing tax data, completing tax returns and paying taxes; and 3) the share of total taxes due to government in business profits. Croatia ranks above the regional average on all the three indicators, whereas its score on the 'total tax rate indicator', is even better than those of the OECD countries.

Paying taxes

| Indicator | Croatia | Eastern Europe and Central Asia | OECD |
|-----------------------------|---------|------------------------------------|-------|
| 1 Number of tax payments | 28 | 46.3 | 15.1 |
| 2 Time to comply (in hours) | 196 | 451.5 | 183.3 |
| 3 Total tax rate (%) | 32.5 | 50.8 | 46.2 |
| Profit tax (%) | 11.4 | 11.2 | 20.0 |
| Contributions (%) | 19.4 | 28.7 | 22.8 |
| Other taxes (%) | 1.7 | 10.8 | 3.4 |

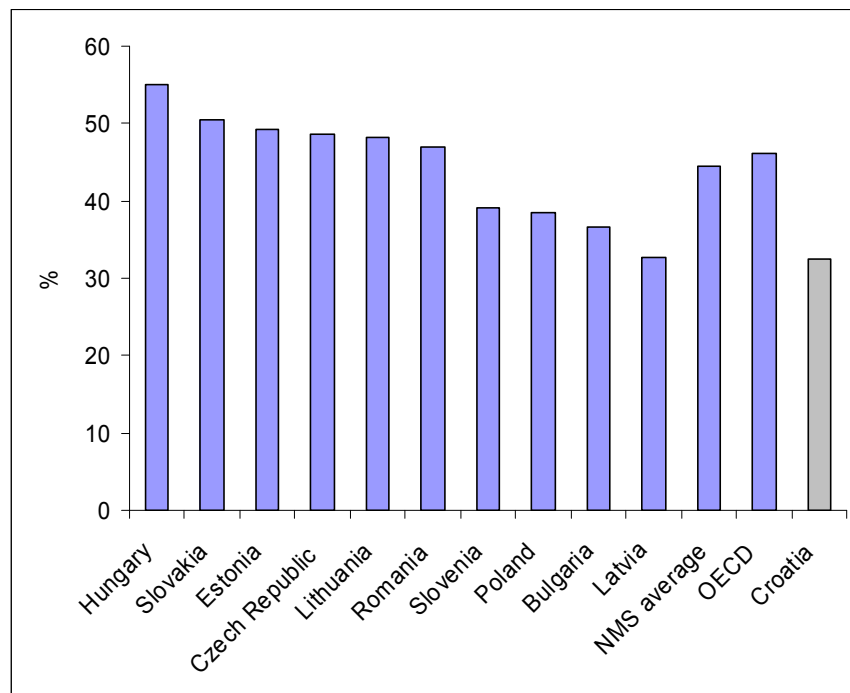
Source: «Doing Business 2008», available at: <http://www.doingbusiness.org/>.

1) *Number of tax payments.* In Croatia, an entrepreneur makes 28 payments of various taxes to government per year. This includes the payments of profit tax, contributions and various minor taxes. Although Croatia's performance in the number of payments is twice as good as that of other economies in the region, it is two times worse than that of OECD countries. Consequently, there is still room for improvement, despite a drop in the number of payments from 37 in 2007 to 28 in the current year.

2) *Time to comply.* In Croatia, an entrepreneur spends 196 hours per year in preparing and filing tax returns and paying taxes. So, Croatia's performance on this indicator is twice as high as that in other economies in the region, and almost as good as those in OECD member countries. The time spent by entrepreneurs in dealing with taxes remained unchanged from 2007, so that Croatia made no improvement in ranking on this indicator.

3) *Total tax rate.* This rate includes all taxes paid by enterprises, i.e. profit tax, social contributions, turnover taxes, tax on company name, etc. It is expressed as a percentage of all these taxes in commercial profits of an enterprise. As it includes all taxes, this indicator provides a more illustrative and comprehensive picture of an enterprise's tax burden than profit tax. In this category, Croatia, with its lowest rate, ranks well ahead of other economies in the region, and even ahead of OECD countries. The total tax rate stands at 32.5% in Croatia, as much as 18.3 percentage points below the average in the region and 13.7 percentage points below the OECD average.

Total Tax Rates for Enterprises



Source: "Doing Business 2008", available at: <http://www.doingbusiness.org/>

The problem of Croatia's competitiveness does not lie in taxes. The above figure shows total tax rates in the new EU Member States. Croatia is very successful relative to these economies, representing the most competitive country compared with all new EU accession states. The total tax burden on profits stands at 44.5% on average in the new EU Member States, whereas in Croatia it is lower by approximately one fourth, 32.5%. As

indicated by the survey results, the problem with Croatia's competitiveness does not lie with total tax burden on enterprises.

Is there room for further reforms? The survey demonstrates that tax reforms are always controversial and subject to stormy political debate. The usual perception is that lower tax rates bring more votes in the elections, which is why all political efforts are concentrated on tax rates. However, this may be different in practice, as tax reforms can be carried out in a number of areas. Based on the analysis of 90 reforms implemented by 65 countries in the post-2005 period, the World Bank came to a conclusion that the most successful of these reforms included the following measures: the introduction of electronic filing of tax returns, consolidation of taxes with the same tax base, facilitating the tax administration procedures and, finally, reducing tax rates and broadening tax bases. Therefore, countries are encouraged to concentrate their reforming efforts on reducing the number of taxes and on the simplification and transparency of their tax systems, in order to achieve maximum simplicity in the assessment and collection of taxes, and minimum tax evasion. This could, of course, also provide a guideline for further improvement of the Croatian tax system.