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Croatia 2008 Progress Report: the Taxation Chapter

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On 5 November the European Commission released the Croatia 2008 Progress Report covering the period from 1 October 2007 to 3 October 2008.¹ The report evaluates Croatian efforts to adopt the Community acquis, i.e. the body of rights and obligations for all member states in the EU. The progress of the country is measured in terms of decisions taken, legislation adopted and measures implemented. Although the Croatian government presented the report to its citizens as a very favourable one, promising a rapid progress towards EU integration “provided that we do our part of the job”, experts acquainted with taxation can hardly be as optimistic.

The acquis is a set of principles to be incorporated in a member country’s legislation. It evolved over time and today it comprises thirty-three chapters that candidate countries negotiate with the EU, taxation being only one of them. The acquis on taxation, i.e. Chapter 16, covers essentially indirect taxation; direct taxation; administrative cooperation and mutual assistance, as well as operational capacity and computerisation.

Unfortunately, but not surprisingly for anybody acquainted with the issue, the report on the taxation chapter is catastrophic. It says exactly the following:

- No progress can be reported in the area of indirect taxation.
- No progress has been made in the area of direct taxation.
- No progress can be reported on administrative cooperation and mutual assistance.
- There was some progress with operational capacity and computerisation.

It concludes with the following: “There has been very limited progress on this chapter. No progress was made on legislative alignment. Even though the overall structure of the tax legislation is similar to the acquis, substantial efforts are required in all areas. Croatia has agreed with the Commission a solution for eliminating the discriminatory taxation of cigarettes. Substantial further efforts are also required to strengthen the administrative capacity, including regarding information technology interconnectivity.”

If it were the first time that the Commission evaluated the progress on the taxation chapter in this way it would probably not be so tragic. But all previous Commission reports stated the same thing, using more or less the same words: “very little progress seen” (2005),

¹ The report is available at: http://ec.europa.eu/enlargement/pdf/press_corner/key_documents/reports_nov_2008/croatia_progress_report_en.pdf.

“limited progress made” (2006) and “very limited progress” (2007).² Besides the slow progress, the main problems recurring from year to year lie in administrative capacity and information technology interconnectivity.

According to the latest available data from August 2008, provided by the Mission of Croatia to the EU, the negotiations on the taxation chapter are lagging behind those on other chapters. This means that 21 chapters are in more advanced stages, whereas the negotiations on only 10 chapters are lagging behind the taxation negotiations.³ As the taxation chapter is not deemed particularly difficult among chapters, the delay in the negotiations on this chapter points to the weaknesses of the Croatian tax administration.

It is obvious that the tax administration should make much more efforts not only to speed up but also to deepen the necessary reforms. Irrespective of the demanding, but rather technical EU requirements, more efforts should be made to work out consistent and successful strategies and reforms and to implement them. It will also be necessary to lessen the strong political, i.e. lobbyist influences, to insist on expert rather than political appointments in the tax administration, on the transparency of its work and a better access to more reliable information and data. Only professionally competent and dedicated tax administration can make good analyses and assessments of the current needs and insist on the implementation, enforcement and coordination of reform measures.

This text will not elaborate on the concrete measures necessary to satisfy the requirements of the taxation chapter; the reader can find them in various issues of the Institute of Public Finance’s newsletters.⁴ However, this text should single out the main problems (among many) constraining the tax administration capacity, such as the inadequate system of rewarding and promoting employees, lack of consistent education and training of employees, and poor possibilities and lack of encouragement for employees to improve the activities of the tax administration. These problems could be solved by excluding the tax administration from the general public administration structure, giving it a status similar to that of the central bank and by changing the rules that regulate hiring and firing, and salaries and rewards in the tax administration.

Without the fulfilment of the above recommendations, the Croatian tax administration might end up ill-prepared for achieving the basic goals of the taxation acquis, like controlling enterprises’ cross-border activities and combating tax evasion and fraud.

One should also be aware that the circumstances are quite different from those when twelve new states joined the Union. In the meantime, the EU became aware of the problems that persisted in the new member states and of the obstacles these problems are posing to the smooth functioning of the common market. Croatia is joining the EU individually, and it will therefore be much easier to monitor it closely than if it were in a group of countries. Compared to a group of Central and East European countries, or big individual countries like Poland, Croatia as a small country is not a particular asset to the common market. Finally, the attitudes, moods and even institutional circumstances in the EU, regarding further enlargements, are less favourable today than before the last enlargement.

The government, the tax administration and the Ministry of Foreign Affairs and European Integration should be aware of the above circumstances and should sincerely and objectively inform citizens about the topics of, and problems and developments in the negotiations, as well as about the stance taken. Instead of that, the poor evaluation of the taxation chapter,

² Previous reports are available at: http://ec.europa.eu/enlargement/archives/pdf/key_documents/2005/package/sec_1424_final_progress_report_hr_en.pdf; http://ec.europa.eu/enlargement/pdf/key_documents/2006/nov/hr_sec_1385_en.pdf; http://ec.europa.eu/enlargement/pdf/key_documents/2007/nov/croatia_progress_reports_en.pdf.

³ The progress of the EU-Croatia accession negotiations by chapter, including the negotiation process for each particular chapter is available at: <http://www.eu-pregovori.hr/files/Progress%20in%20EU-Croatia-accession-negotiations-2008-08-26.pdf>.

⁴ The IPF newsletters are available at: <http://www.ijf.hr/eng/index.php?ime=28>

or the report itself, is not even mentioned on the tax administration's web site. The web site of the Ministry of Foreign Affairs and European Integration is also surprisingly uninformative. The last entries on the "news and events" part of that Ministry's English website dedicated to EU integration are from April! Among the "news and press releases" of the Ministry's general web site the report is not mentioned at all. Maybe the lack of proper information is not a part of some plot to deny information to citizens, but just another proof of the necessity to strengthen administrative capacity, and not only in the tax administration.