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How Easy Is It to Pay Taxes in Croatia?

Mihaela Bronić, PhD.

In 2009, Croatia ranked 42nd among 183 economies on the ease of paying taxes by small and medium-sized enterprises. Despite this still high position, Croatia went down from 2008, when its score was 39. This suggests a need for reforms, such as the simplification of regulations governing the payment of social insurance contributions.

About the *Doing Business* project

The World Bank's *Doing Business* project has been running in an increasing number of countries for nine consecutive years¹. The 2009 study covered 183 countries. The Project is aimed at assessing how easy it is for a domestic entrepreneur to start and operate a small or medium-sized enterprise in accordance with the business regulations in force. For this purpose, a number of internationally comparable indicators are calculated, relating to nine regulatory areas (e.g. starting a business, getting credit and paying taxes). The Project results provide objective indicators enabling the authorities to make the regulations more efficient and thus facilitate the operation of enterprises.

The *Doing Business* project also includes the calculation of the *Paying Taxes* indicator that measures the ease of paying taxes for domestic small and medium-sized enterprises on the basis of the:

1. number of payments of all taxes payable by an enterprise;
2. time needed to comply with tax requirements for three major taxes²; and
3. percentage of profits paid out in all types of taxes (total tax rate)³.

International comparison

Maldives were the easiest, and Belarus the most difficult places to pay taxes in 2009. Croatia took the high 42nd position among 183 economies. Ahead of Croatia were some countries in the neighbourhood, e.g. Macedonia (33rd position) and Kosovo (41st position), whereas lower-ranking economies were for example Bosnia and Herzegovina (127), Serbia (138) and Montenegro (139).

¹ The World Bank Group and PricewaterhouseCoopers „*Doing Business 2011 – Making a Difference for Entrepreneurs*“, 4 November 2010. Available from: [<http://www.doingbusiness.org/>].

² These include profit tax, VAT or consumption tax and labour taxes (income tax, payroll tax and all kinds of social contributions). The time needed to comply with all tax requirements includes the time for preparing the data, filling in and submitting the prescribed tax returns and paying taxes.

³ Taxes collected by enterprises on behalf of the tax administration that do not constitute the tax burden on enterprises (e.g. VAT) are not included.

Table 1 Ease of paying taxes indicators, 2009, (selected country groups)

Indicator	Croatia	Averages			
		OECD	EU*	SE Europe**	All countries
1. Number of payments	17.0	14.2	17.5	51.8	29.9
2. Time to comply (in hours)	196.0	199.3	221.8	285.8	282.2
3. Total tax rate (%)	32.5	43.0	44.2	25.2	47.8
Profit tax (%)	11.4	16.8	13.1	8.1	17.9
Income tax and contributions (%)	19.4	23.3	28.4	14.0	16.3
Other taxes (%)	1.7	3.0	2.7	3.1	13.7

* Malta is not included in the survey.

** South-East European countries include Albania, Bosnia and Herzegovina, Macedonia, Montenegro, Kosovo and Serbia.

As shown in Table 1, small and medium-sized enterprises in Croatia made 17 payments of taxes in 2009. Croatia ranked higher than the average of most surveyed countries. Only in OECD, small and medium-sized enterprises made less tax payments on average (14.2) than in Croatia (17).

A Croatian small or medium-sized enterprise spent 196 hours (24.5 working days) on complying with all tax requirements for the three major taxes. Consequently, Croatia's performance on this indicator was better than the average of all surveyed country groups (OECD, EU, South-East Europe and all 183 countries).

The share of all taxes in total profits of a small or medium-sized enterprise in Croatia was 32.5%. The share of income tax and compulsory contributions in total corporate profits was 19.4%; profit tax participated with 11.4% and other taxes with 1.7% in total profits. Again, Croatia ranked higher than the average of most surveyed country groups. Only in the South-East European economies, total tax rate for small and medium-sized enterprises (25.2%) was lower than that in Croatia (32.5). The fact is that the South-East European countries apply lower profit tax and income tax rates (Table 2).

Table 2 Tax rates in selected countries, 2010 (%)*

	Profit tax	Income tax
Croatia	20	up to 40
Albania	10	10**
Bosnia and Herzegovina	10	up to 10
Kosovo	10	up to 10
Macedonia	10	10**
Montenegro	9	9**
Serbia	10	up to 15

* The social contribution rates are not shown. It is difficult to show them in a simple manner, because they differ radically for particular groups of taxpayers. Besides, the data for some countries are not available.

** This figure stands for flat income tax.

Source: Ola van Boeiijen Ostaszewska (ed.). *European Tax Handbook 2010*. Amsterdam: IBFD, 2010.

According to the World Bank's *Doing Business* project from June 2010, many surveyed countries reduced tax rates (most frequently the profit tax rate). Why did they do so? Obviously, to facilitate the operations of enterprises. Moreover, a recent research on a sample of 55 economies showed that in developing countries with a large number of small enterprises partly operating in the unofficial economy, reducing the profit tax rate could help reduce black economy, increase the number of profit taxpayers and boost revenues from this tax⁴. Korea, for example, wishing to spur economic growth, reduced the profit tax rate from 25% to 22% in 2009, with the intention of making further cuts. Korea's profit tax revenues surged 11% in 2009, and the number of registered businesses within the profit tax system went up 7%.

⁴ Hibbs and Piculescu, 2010. "Tax Tolerance and Tax Compliance: How Governments affect the Propensity of Firms to Enter the Unofficial Economy". *American Journal of Political Science*. 54 (1). Available from: <http://onlinelibrary.wiley.com/doi/10.1111/j.1540-5907.2009.00415.x/full>.

Conclusion

Despite its high ranking, Croatia failed to implement tax reforms in 2009 to facilitate tax payment, and its rank deteriorated from 39 in 2008 to 42 in 2009. To avoid further deterioration of its position, Croatia needs to carry out tax system reforms, following the example of the higher-ranking countries.

Given the problems with the financing of government spending, Croatia can only consider cutting profit tax rate if the Ministry of Finance believes this would considerably reduce the unofficial economy, increase the number of profit taxpayers and boost revenues from this tax (as it did in Korea).

Moreover, the relatively high rates of income tax and social contributions are hard to reduce without the cuts in government spending, primarily on pension and health insurances. Given the results of the World Bank's *Doing Business* project, suggesting that the largest number of tax payments (12) and the largest amount of time to comply (96 hours) in Croatia relate to the payment of social security contributions, it is obvious that the least thing to do is to simplify the relevant regulations (e.g. by enabling the on-line payment of social security contributions).