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Bronić, Mihaela

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PRESS RELEASE

The ease of paying taxes in Croatia, 2010/11

MIHAELA BRONIĆ, PhD, Institute of Public Finance, Zagreb

In 2010/11, Croatia ranked 32nd out of 183 economies on the ease of paying taxes by domestic medium-sized companies. While this position was still high, it deteriorated compared with the period 2009/10, when Croatia ranked 30th. In order to prevent further deterioration, reforms are called for, especially in the social security contributions area.

The *Doing Business* Project

The World Bank's *Doing Business* project has been implemented in an increasing number of countries for nine consecutive years now¹. The latest, covering the period from June 2010 to May 2011, was carried out in 183 economies. The project is aimed at measuring how easy it is for a domestic entrepreneur in a particular country to start and operate a medium-sized company in accordance with business regulations. For this purpose, a number of internationally comparable indicators of ten types of regulations are calculated on an annual basis (e.g. on starting a business, getting credit, paying taxes, etc.). This year the project has expanded to include indicators on the ease of getting electricity connections. Due to some methodological changes and the introduction of new indicators, the last year's results have been recalculated in order to be comparable with this year's figures.

The *Doing Business* Project also includes measures of the ease of paying taxes for domestic medium-sized companies on the basis of the following indicators:

1. the number of single payments of all taxes by a company;
2. time needed to comply with tax requirements for three major taxes²; and
3. the share of total taxes in the corporate profit (total tax rate)³.

¹ World Bank and International Finance Corporation, 2011. „*Doing Business 2012 – Doing Business in a More Transparent World*“, 20 October 2011. Available at: <http://www.doingbusiness.org/>

² The three major taxes are the corporate income tax, VAT or consumption tax and labour taxes (personal income tax and payroll taxes including all types of social contributions). The time necessary to comply with these tax obligations includes the time for data preparation, completion of relevant tax returns and tax payment.

³ Taxes collected by a company on behalf of the Tax Administration, which do not constitute the company's tax burden (such as VAT or personal income tax), are not included. Included are, however, all other types of taxes constituting the company's tax burden, e.g.: corporate income taxes, labour taxes and compulsory social security contributions paid by employer, property taxes, turnover taxes and other taxes (such as fees paid to municipalities/cities, and motor fuel taxes). More details about the methodology available at: <http://www.doingbusiness.org/methodology/paying-taxes>

Cross-country comparison of the ease of paying taxes

In the reference period, paying taxes was easiest on Maldives and most difficult in Venezuela. Croatia took the high 32nd position among 183 countries, preceded e.g. by Macedonia (26th position), while lower rankings were given to Kosovo (46), Slovenia (87), Montenegro (108), Bosnia and Herzegovina (110) and Serbia (143).

Table 1. The ease of paying taxes indicators, 2010/11, (selected country groups)

Indicator	Croatia	Non-weighted averages			
		OECD	EU*	SE Europe**	All countries
1. Number of payments	17	13	17	42	29
2. Compliance time (hours)	196	186	211	288	277
3. Total tax rate (%)	32.3	42.7	43.5	24.2	44.8
Corporate income tax	11.4	15.4	12.0	8.3	16.0
Labour taxes and contributions	19.4	24.0	28.4	12.7	16.2
Other taxes	1.5	3.2	3.1	3.1	12.6

* Malta is not included in this survey.

** The SE European countries include Albania, Bosnia and Herzegovina, Macedonia, Montenegro, Kosovo and Serbia.

Source: World Bank and International Finance Corporation data, 2011 processed by author

According to Table 1, Croatia ranks higher than the average of most observed countries, because its medium-sized companies make 17 tax payments per year. Only in OECD member states were medium-sized companies required to make less tax payments on average (13). In the EU, as in Croatia, 17 tax payments, per year, were required.

In Croatia, a medium-sized enterprise spent 196 hours (24.5 working days) per year to comply with all the regulations governing the three major taxes. Higher ranked than Croatia were only OECD member countries, in which medium-sized companies spent less time to comply with all the observed taxes (186 hours or 23.5 working days on average). Interestingly, Croatia's ranking on this indicator was even better than the average in the EU.

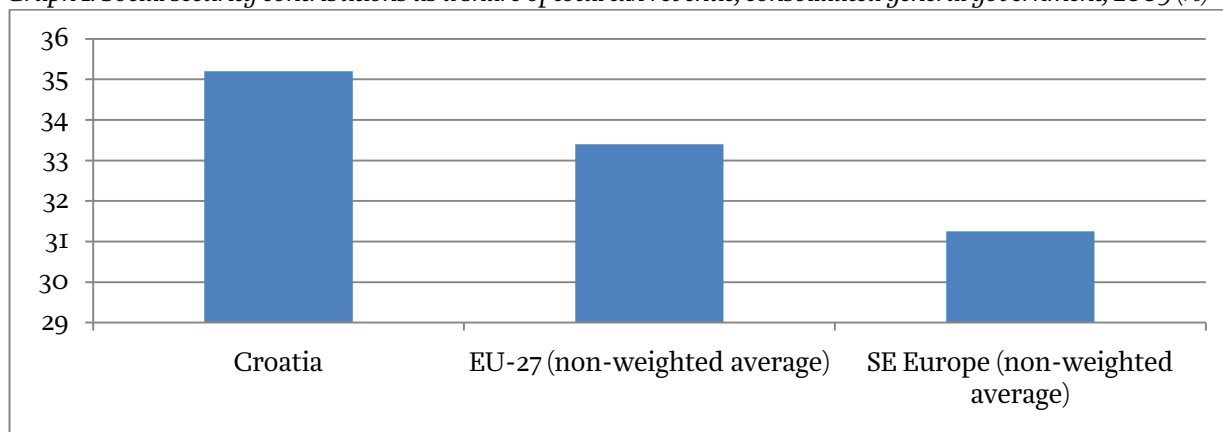
The share of all taxes in the total profit of a Croatian medium-sized company amounted to 32.3%. The shares of labour taxes and compulsory contributions, corporate income tax and other taxes in total corporate profits was 19.4%, 11.4% and 1.5% respectively. Again, Croatia ranked higher than the average of most observed country groups. Only in the SE European countries, was the total tax rate lower on average (24.2%) than in Croatia (32.3%).

Many of the observed countries carried out reforms in the reference period, in order to facilitate the payment of taxes. As many as 33 of them simplified their tax payment regulations or reduced tax rates, and they most frequently introduced new electronic tax filing and payment systems or expanded the existing ones.

Despite its very high rankings on most tax indicators, Croatia failed to implement reforms to facilitate tax payment during 2011, as well as in the 2009/10 period, which is why its score dropped from 32 to

30. It seems that the most radical reforms in the future will be possible in the social security contributions area. According to the Project data, the most difficult to comply with for a Croatian company have been the regulations governing social security contributions, on which the bulk of the corporate profit was spent⁴. The International Monetary Fund data (Graph 1) also suggest that changes in the contributions area are possible. In 2009, the share of social security contributions in total tax revenue of the consolidated general government in Croatia was larger than the averages of EU-27 and the SE European countries.

Graph 1. Social security contributions as a share of total tax revenue, consolidated general government, 2009 (%)



* The SE European countries include Albania, Bosnia and Herzegovina, Macedonia, Montenegro, Kosovo and Serbia. The data on Bosnia and Herzegovina are not available. The data on Macedonia are from 2008.

Source: IMF data, 2011 processed by author

Consequently, social contributions should be reduced in order to ease the tax burden on labour. However, it is difficult to cut the relatively high social security contributions (Graph 1), without reducing the pension and health insurance expenditures. The room for reducing these expenses certainly exists, as the amounts currently paid for the insurances are high and the public services received in return are often not of high quality. As long as fake disabled persons are given disability pensions, there will be no possibility to provide higher-quality public services, and these costs will unjustly burden the companies⁵.

Private sector is the most important generator of long-term growth and employment. Government policies may either promote or inhibit the creation and maintenance of the private sector. The amount of taxes companies pay has effect on their growth and investment⁶. As shown by a recent study, higher tax rates are associated with fewer enterprises in formal sector and lower private

⁴ With respect to social security contributions, the tax was paid 12 times and the time to comply was 96 hours. The share of labour taxes and compulsory contributions constituting the company's tax burden in total corporate profit was 19.4%.

⁵ For more details about the fake disabled, see, e.g. Novak, T., Mamić, T. and Sever-Šeni, N. „Dr Rubala has arranged thousands of fake pensions; he builds beach apartments and hosts a folk-music TV show. *Jutarnji list*, 9 October 2011. Available at: <http://www.jutarnji.hr/-dr--rubala-je-sredio-tisuce-laznih-mirovina--gradi-apartmane-na-obali-i-vodi-narodnjacki-tv-show--/979653>, or Marijana Badun, 2011. *Why are there so many disability pension beneficiaries in Croatia?* Newsletter No. 56. Available at: <http://www.ijf.hr/eng/newsletter/56.pdf>

⁶ World Bank and International Finance Corporation, 2011. „Doing Business 2012 – Doing business in a more transparent world“, 20 October 2011. Available at: <http://www.doingbusiness.org/>

investment⁷. Similarly, recent studies in 123 countries reveal the companies' perception that high tax rates represent one of the three largest obstacles to doing business⁸. Hence, it is necessary to reduce expenditures for the pension and health insurance programmes and to simplify these regulations. It is also possible to introduce electronic filing and payment of social security contributions. All this could, and should make it possible to reduce social security contributions, improve the climate for private sector growth and raise the quality of public services.

Conclusion

Despite its high ranking, Croatia failed to implement tax reforms to facilitate tax payment in the period from June 2010 to May 2011, so that its rank deteriorated from 30 in 2009/10 to 32 in 2010/11. To avoid further backsliding, tax system reforms are called for, particularly as concerns the simplification of regulations on social security contributions and reduction of pension and health system expenditures.

⁷ Djankov, S. [et al.], 2010. The effect of Corporate Taxes on Investment and Entrepreneurship. *American Economic Journal: Macroeconomics*, July 2010. Available at: <http://www.economics.harvard.edu/faculty/shleifer/files/mac.2.3.pdf>

⁸ World Bank, 2011. *World Bank Enterprise Surveys - 2006-2010*. Available at: <http://www.enterprisesurveys.org/ExploreTopics/?topicid=1>