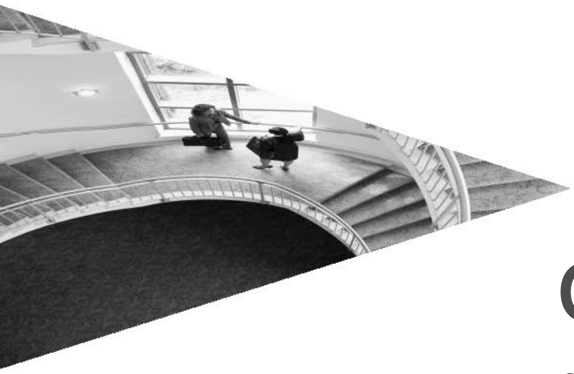
March 2012

# HR and tax alert



# Croatia

## Changes to personal income tax and mandatory social security contributions

**Executive summary**
In March 2012, Croatia changed rules for monthly tax withholding on employment income, introduced taxation of dividends and foreign pensions, and reduced the employer's element of mandatory social security contributions.

**Background**
In March 2012, a number of changes have been introduced to the Croatian Personal Income Tax Act and the Act on Mandatory Contributions.

*Changes to Personal Income Tax Act*
The employee's monthly personal allowance has increased from HRK 1,800 / EUR 240 to HRK 2,200 / EUR 293 (for retirees up to HRK 3,400 / EUR 453 per month).

New tax brackets apply on employment income:

| Lower in HRK / EUR | Upper in HRK / EUR | Tax rates |
|---|---|---|
| 0 / 0 | 2,200 / 293 | 12.00% |
| 2,200 / 293 | 8,800 / 1,173 | 25.00% |
| 8,800 / 1,173 | above | 40.00% |

The annual tax brackets are generally determined as being 12 times the monthly brackets. Exceptionally, for 2012 the annual brackets are averaged over the whole calendar year due to the change in the monthly tax brackets in March:

| Lower in HRK / EUR | Upper in HRK / EUR | Tax rates |
|---|---|---|
| 0 / 0 | 26,400 / 3,520 | 12.00% |
| 26,400 / 3,520 | 43,200 / 5,760 | 22.83% |
| 43,200 / 5,760 | 105,600 / 14,080 | 25.00% |
| 105,600 / 14,080 | 129,600 / 17,280 | 37.50% |
| 129,600 / 17,280 | above | 40.00% |

Dividends (and shares in profit) paid from profits realized from 2001 onwards are subject to a 12% withholding tax (plus city tax), although personal allowances and deductions are not taken into account when this withholding tax is levied. These allowances and deductions (which can be up to HRK 12,000 / EUR 1,600 per year) will be taken into account only if an annual tax return is filed. However, in such cases dividends may be taxed at higher rates (up to 40% plus city tax). In the case of foreign dividends, monthly tax reporting and payment is a taxpayer's personal responsibility. Dividends which are used to increase share capital are not taxable.

Pensions income received from abroad by Croatian residents is taxable at the same progressive tax rates as employment income (a basic personal allowance up to HRK 3,400 / EUR 453 may be applied). Making monthly tax payments and reporting income is a taxpayer's personal responsibility.

*Changes to Act on Mandatory Contributions*
Health insurance contributions for employees (payable by the employer on top of the gross salary) will decrease from 15% to 13%. This will apply to salaries earned after 30 April 2012.

**Effects**
Due to increase of personal allowance and change in tax brackets, changes to employee's net salaries are expected.

Dividends will be subject to a 12% withholding tax. The filing of annual tax returns may impact final taxation (HRK 12,000 / EUR 1,600 non taxable; possible higher tax rates applied on the taxable balance).

Total salary cost will be reduced, as the employer's part of mandatory contributions is decreased by 2%.

Foreign pension income will be taxable at progressive tax rates and brackets. The obligation will be on individuals to comply with the monthly tax reporting and payment requirements.

**Next steps**
Employers based in Croatia should review the impact of the changes to ensure they comply with the new withholding rules and lower health insurance contribution.

Croatian taxpayers should assess whether to file an annual tax return in light of the differing dividend taxation on annual tax return filing, and ensure that they meet the appropriate filing requirements where they have foreign dividends or pensions.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