GMS Flash Alert

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Croatia - More Reductions in Personal Income Tax, Social Security Burdens

There have been some significant amendments to Croatia's personal income tax system – including the taxation of "incentive compensation" – and social security regime in recent months.[1]

These changes continue a trend over the past few years – a steady reduction in the once-heavy tax burden faced by Croatian taxpayers.

This GMS *Flash Alert* highlights the modified tax brackets, new rules for the tax treatment of voluntary pension fund and life insurance fund income, the streamlined tax treatment of stock awards and stock option plans, and changes to the social security system, amongst other amendments.

WHY THIS MATTERS

These amendments will generally lead to lower personal income tax and social security contributions liabilities. As a result, for those assignees subject to Croatian tax law, employers could experience lower international assignment costs.

Simplified taxation of stock option plans should make such plans more attractive for purposes of rewarding key employees – this could also provide welcome incentives for employees to stay in Croatia.

In addition, employers will have the possibility to offer "tax free" rewards to their employees for their performance during a year up to a certain level of income.

And under new rules, taxpayers subject to Croatian tax law who receive foreign taxable income, will have greater flexibility in terms of satisfying their income tax liability with the option of reporting such income as determined in the country of source or determined as based on Croatian law.

Highlights of Personal Income Tax Amendments Effective as of 1 December 2018

- In addition to awards for special occasions (Christmas bonus, holiday bonus, etc.) which are non-taxable up to the amount of HRK 2,500 per annum, as of 1 December 2018, **employers may pay additional non-taxable awards** up to the amount of HRK 5,000 per annum to their employees for performance results.

Highlights of Personal Income Tax Amendments Effective as of 1 January 2019

- **New monthly[2] and annual[3] tax brackets** are applicable on employment income receipts, other income receipts, and self-employment income.

Monthly/annual tax base up to 31 December 2018	Monthly/annual tax base As of 1 January 2019	Tax rate
Up to HRK 17,500/210,000	Up to HRK 30,000/360,000	24%
More than HRK 17,500/210,000	More than HRK 30,000/360,000	36%

- **Receipts from voluntary pension funds (pillar III) and life insurance funds (with savings elements)** are not considered taxable income, that is, there is no withholding tax obligation for payments of such income by pension funds and insurance companies. Employers are still entitled to pay insurance premiums up to the amount of HRK 500/6,000 per month/annum free of tax on behalf of an employee to Croatian voluntary pension funds.

- **All receipts based on stock awards and stock option plans** will have equal tax treatment, i.e., will be considered as a capital benefit-in-kind, subject to a 24-percent tax rate (increased for city surtax, if any) regardless of whether:

  - they are provided to employees, board members (who are not the employees of the company), or other individuals; or
  - the company's shares are listed on an official stock market; or
  - individuals are receiving a company's own shares or shares of some other (connected) company.

  As capital income, these receipts are not subject to mandatory social security contributions.

- The **non-taxable grant for a new-born** is increased from HRK 3,326 to HRK 10,000.

- **Taxpayers who receive foreign taxable income** may choose how to report that foreign taxable income to the Croatian tax authorities. One option is to report foreign taxable income as determined in the country of source, whilst the second option is to report this income as determined based on Croatian legislation. Up to now, foreign taxable income was always reported as determined based on Croatian legislation.

Highlights of Social Security Contributions Amendments Effective as of 1 January 2019

— As of 1 January 2019, **unemployment contributions and injury at work contributions** (in the cumulative total amount of 2.2 percent) are no longer payable. At the same time, the health insurance contribution rate is increased by 1.5 percent. This will result in a decrease of overall employers' social security contributions by 0.7 percent.

Contribution	Until 31.12.2018.	As of 01.01.2019
Health insurance contribution	15%	16.5%
Injury at work contribution	0.5%	n/a
Unemployment contribution	1.7%	n/a
Total	**17.2%**	**16.5%**

— An **annual contribution liability is introduced for board members** who are employees of the company where they are appointed if they are contributing on a base which is below the base prescribed for full-time employment. This applies for all companies where the board member is appointed based on the employment contract. This will result in the application of the same minimum base for the calculation of social security contributions for all individuals who are appointed as board members based on an employment contract, regardless of whether their employment is defined as "full time" or "part time."

— **Payers of so-called "other income" can no longer apply the annual cap for pillar I pension insurance contributions**. If an overpayment of pillar I contributions occurs, the recipient is entitled to submit a request to the Croatian tax authorities to proceed with the refund of the overpaid pillar I pension insurance contribution. This request can be submitted as of 1 February of the year, for the previous year.

KPMG NOTE

Positive effects of the additional tax reliefs arising from the amendments discussed above are expected for many of KPMG's clients.

The significant simplification and reduced tax rate applicable to stock awards and stock options have resulted in many companies re-evaluating the efficacy of this element of compensation.

Although amendments in relation to social security contributions in most cases would lead to lower liabilities, for certain KPMG clients, third-country citizens who are only insured for health insurance on a "foreigner basis" could see their contribution liability increased.

It is not expected that amendments introduced for board members will affect many KPMG clients as most are not employed by the company where they are appointed, or their monthly salary is above the prescribed minimum for social security contributions.

FOOTNOTES:

1 See:
For the “Amendments on personal income tax law” (Official Gazette 106/18) (in Croatian), click here.

For the “Amendments on personal income tax bylaw” (Official Gazette 106/18) (in Croatian), click here.

For the “Amendments on personal income tax bylaw” (Official Gazette 1/19) (in Croatian), click here.

For the “Amendments on social security contributions act” (Official Gazette 106/18) (in Croatian), click here.

2 Applies to the calculation of personal income tax prepayment on employment income.

3 Applies to the annual income tax calculation on employment income, other income and self-employment income.

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Contact us

For additional information or assistance, please contact your local GMS or People Services professional or one of the following professionals with the KPMG International member firm in Croatia.

Paul Suchar
Tel. +385 1 5390 032
psuchar@kpmg.com

Kristina Grbavac
Tel. +385 1 5390 069
kgrbavac@kpmg.com

The information contained in this newsletter was submitted by the KPMG International member firm in Croatia.

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