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REPORT

From:	General Secretariat of the Council
To:	Delegations
Subject:	Code of Conduct Group (Business Taxation) - Report to the Council

Croatia's Investment Promotion Act (2022) (HR020)

1. Background

In 2022 standstill notification, Croatia informed the Group that the Croatian Parliament adopted the New Act on Investment Promotion (OG, No. 63/22) which replaced the previous Act on Investment Promotion (OG, No. 102/15, 25/18, 114/18, 32/20, 20/21). The New Act on Investment Promotion came into force on 4 July 2022. In the part that lays down the tax incentives, there are no changes compared to the tax incentives prescribed in the previous Act on Investment Promotion (OG, No. 102/15, 25/18, 114/18, 32/20, 20/21) (HR019).¹

2. Tax Incentives in the New Act on Investment Promotion

The following tables give an overview of the tax incentives prescribed in Articles 12, 13 and 20 of the New Act on Investment Promotion.

Table 1 summarises the tax benefits according to Articles 12 and 13 of the New Act on Investment Promotion. There is a profit tax rate reduction of 50%, 75% or 100% according to the invested amount in fixed assets. In addition, a certain number of new jobs needs to be created for a certain period of time.

¹ Annex 1 contains an unofficial translation of the new Act on Investment Promotion (HR020)

Investment amount (€ mil.)	Number of newly employed	Period of employment (years)	Profit tax rate reduction	Period (years)
0,15 -1 (>0,05 for micro and for centres developing information and communication systems and software*)	5 (3 for micro, 10 for centres developing information and communication systems and software*)	3 (SME's), 5 (large)	50%	10 (5 for micro)
1-3	10	3 (SME's), 5 (large)	75%	10
>3	15	3 (SME's), 5 (large)	100%	10

Table 1: Overview: Profit Tax Incentives

* Centres for development of information and communication systems and software for: development and application of information systems; separation of information systems management; development of telecommunication-network operations centres; and the development and application of new software solutions.

2.1 Tax Incentive for Modernisation of Business processes – automation, robotisation and digitization of production and manufacturing processes

Table 2 refers solely to investment projects in production and manufacturing industries, according to Article 20 of the new Act on Investment Promotion.

Also, here the tax benefit is a profit tax rate reduction of 50%, 75% or 100% according to the invested amount. The minimum amount of investment in fixed assets is EUR 500,000. In addition the numbers of workers needs to be maintained throughout the period of utilising the aid, and the level of productivity per worker needs to be increased by more than 10% after 3 years.

Table 2: Overview Incentive for Modernisation of Business Processes

Investment Amount (€ Mil.)	Differences in Productivity Level per Worker after 3 Years	Tax Incentives for Modernisation** of Business Processes (Reduction of Profit Tax Rate)
0.5 – 1	>10%	50%
1 – 3	In relation to the level of productivity per worker in a one-year period prior to registering the investment project	75%
> 3		100%

** Modernisation, meaning a fundamental change in production and manufacturing, implies transferring fixed assets such as equipment/machinery into ownership of investment aid beneficiaries, where such assets are categorized as a technologically more advanced generation of high-tech equipment/machinery (fixed assets) compared to the long-term assets being modernised, such as specialized robots, robotic systems and robotic stations, equipment/machinery for automation and self-control of production processes, automatic production management systems and equipment/machinery for digitization of production and production processes. Also, modernisation, meaning a fundamental change in the production and processing, implies transferring long-term intangible assets to the ownership of investment aid beneficiaries, where such assets are categorized as a technologically advanced generation of high-tech intangible fixed assets compared to fixed assets being modernised such as: the latest generation of automated management software production processes in the manufacturing industry, software for the digitization of production processes and production, software for the development of self-controlling systems, logic controllers and automated production process lines and software for machine learning, artificial intelligence development and system visualization. For large enterprises, the eligible costs for a fundamental change in the production process for which support for the modernization of business processes is granted must exceed the value of depreciation of assets related to the activity being modernized during the previous three tax years.

3. Analysis

In substance, the tax incentives of the New Act on Investment Promotion are the same as in the previous Act on Investment Promotion (OG, No. 102/15, 25/18, 114/18, 32/20, 20/21). They concern a reduction of the corporate tax rate by 50%, 75% or 100%, depending on certain conditions, such as the amount of investment made.

In the Standstill Assessment², the measure did not meet the substance requirements. The measure consists of granting a reduction of the corporate income tax rate when a company has made an eligible investment. As a result, the tax benefit is not linked to a reduction of the tax rate applicable

² WK 9304 2022 REV1

to profits from the specific investment made, but rather it affects the rate on all profits earned by the company, including profits linked to passive income, such as royalties and interests.

In addition, the measure is not designed as a specific patent box, but it may have similar effects, as the tax benefit is available for investments made in intangible assets, such as software, trademarks and patents. Although some restrictions apply, the measure does not meet the modified nexus approach.

On the basis of these findings, the Code of Conduct Group decided to put the Standstill procedure on hold as Croatia committed, by letter of 15 July 2022, to amend its legislative framework within 18 months and to bring the Investment Promotion Act in line with Code of Conduct criteria. Furthermore, it committed to keep the Group informed on progress regarding the legislative framework³.

As the New Act on Investment Promotion was adopted on 27 May 2022, it could not have taken into account the commitment, considering that it was made subsequently.

It is therefore suggested that the findings of the assessment of the previous Investment Promotion Act (HR019) are applied by analogy to the New Investment Promotion Act (HR020). Consequently, the assessment will be put on hold and Croatia will apply the rollback to which it has committed by letter of 15 July 2022 to both measures (for HR019 see also below).

Follow-up:

- The Group agreed that the assessment of the previous Investment Promotion Act (HR019) shall be applied by analogy to the New Investment Promotion Act (HR020).

³ Follow-up note after the Code of Conduct Group meeting 20 September 2022 (WK 12483 2022 INIT) and the Code of Conduct Report to the Council for the 2nd half of 2022 (WK 14674 2022 INIT)