

Chapter 4

COMPARISON AND HARMONISATION OF THE CROATIAN TAX SYSTEM WITH THE TAX SYSTEMS IN THE EUROPEAN UNION

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ABSTRACT

This paper analyses the EU tax system and its main components qua conditions for the accession of the Croatia to the European Union as well as the current degree of adjustment of Croatian taxation regulations with the corresponding regulations in the EU. As a result of this analysis, proposals for further procedures on the part of the creators of taxation policy in Croatia are made. After the tax reforms started in the 1990s, after the achievement of independence, the Croatian tax system was comparable with the tax systems of EU member countries. All the essential taxes correspond conceptually to the same kinds of taxes in EU countries. However, there is still space for further adjustment, above all in connection with value added tax, and it is desirable that this should be carried out

as soon as possible. However, adjustments in the area of profit tax and adjustments of some rates of excise duties should be put off until the moment when they will have to be done for the sake of joining the Union, because the maintenance of the current situation, which is not in line with the provisions of European regulations, but nevertheless not in contravention of general rules regulating the area of taxation, is in the interests of Croatia. In the area of the taxation of income no adjustment or coordination is needed, for members are allowed to settle the taxation of income in their countries independently, as long as the fundamental principles of the single market are not threatened (the free movement of goods, people, services and capital).

Key words:

European Union, Croatia, taxes, profit tax, income tax, value added tax, excise duties, adjustment, harmonisation

INTRODUCTION

From its outset, the EU has been founded on the four freedoms, as they are called, the free movement of people, goods, services and capital, essential conditions for the existence and successful operation of the united European economic area. For this reason the basic tasks of the taxation policy of the EU in recent years have been tightly connected with the development of the internal market, the reinforcement of monetary union and economic integration. As far back as the early 1990s, the regulation of the internal market led to a definition of the legal framework for the area of indirect taxes (value added tax and excise duties) while in the area of direct taxes (income and profit tax) no legal background was clearly defined. For the improvement of the coordination and harmonisation of tax policy among the member countries, in 1997 the basic directions of tax policies were set out (COM (97) 495); these should encourage the stabilisation of member states' tax revenues, the obviation of difficulties in the functioning of the internal market, employment.

However, the disparateness of tax systems was a constant roadblock in the way of full accomplishment of these objectives, the solution of which has to be attained via continued harmonisation of the tax systems of the member countries. It has turned out, however, that this kind of harmonisation is very difficult to achieve in the area of taxation as a whole. Nevertheless, fairly significant results in the harmonisation of the diverse systems have been obtained in the area of indirect taxes. Within the framework of direct taxes, the effects have been much

weaker. Certain aspects in the area of the taxation of income are not anyway subject to harmonisation and every member has the discretionary right to regulate it in its own way, while certain results have been obtained in the area of profit tax.

The legal instruments for harmonisation among the members in the area of taxation are the directives. They are used to prescribe the settlement of certain relations, and members are obliged to put into their legislation provisions through which to achieve the objectives defined in the directives can be attained.

In the process of the approach to fully-fledged EU membership, Croatia should harmonise its legislation with that of the EU. For this reason, the purpose of this paper is to sketch out, in the most important lines, what happened in the 1990s with the tax systems of the EU, to what extent Croatia has already made adjustments to these changes, and what remains to be done.

This work is composed of six parts. After the introduction, in the second part the situation and trends in taxation in the EU and in Croatia are presented, in the third profit tax is discussed, in the fourth VAT, in the fifth excise duties, and the sixth part offers conclusions and recommendations.

TAXATION IN THE EU AND IN CROATIA: THE CURRENT SITUATION AND THE TRENDS

Tax revenue as a percentage of GDP

The objective of this paper is to offer a general overview of the basic trends of development and the current state of the tax systems of EU members. Because of limitations of space it is not possible to comment on all the diversity of the tax systems of the individual countries.ⁱ Thus only the most important and most marked changes of the last decade in the tax systems of the EU are shown, that is, the changes in tax revenue as percentage of GDP, in the structure of the tax systems, in the highest rates and the number of brackets for income tax, in the tax base and in the basic rates of profit tax and the standard rate for VAT.ⁱⁱ

During the 1990s, in most EU countries, there was a continuous rise in total tax revenues (including contributions) expressed as a percentage of GDP. For example tax revenue collected rose from 39% of GDP in 1990 to almost 42% of GDP in 1999 (Table 1). The reason for

this can be found mainly in the larger expenditures for health and retirement insurance and for public welfare (because of the ageing of the population) (Rosen, 1999: 18, 19). Also mentioned as causes for this increase are a rise in the interest rates, which means outgoings for the public debt, increased governmental aid for government owned corporations and the implementation of major public infrastructure projects (Joumard, 2001: 7).

Table 1. Total tax revenue as percentage of GDP

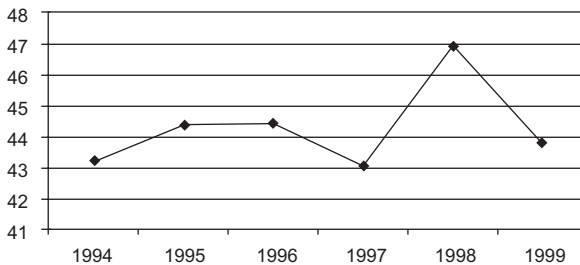
Unweighted average	1990	1995	1999
EU 15	39.2	40.0	41.6

Source: OECD (2001)

As against the clear picture of growth of total tax revenue as percentage of GDP in the EU countries, a glance at Graph 1 will not give a simple answer to the question about what was happening at the same time with total tax revenues as a percentage of GDP in Croatia. It is clear only that there was a large jump in the growth of tax revenue as percentage of GDP in 1998, when VAT was introduced. The introduction of VAT, that is, because of the expansion of the tax base and the reduction of tax evasion, led to a relatively large rise in the tax revenue expressed as a proportion of GDP.

From 1994 to 1999, tax revenues in Croatia came on average to about 44.3% of GDP. After a comparison of data for Croatia with equivalent data for the EU it can be said that throughout the whole of the period up to 1999, the total tax burden was greater in Croatia than in the countries of the EU.

Graph 1. Tax revenue as a percentage of GDP in Croatia from 1994-1999



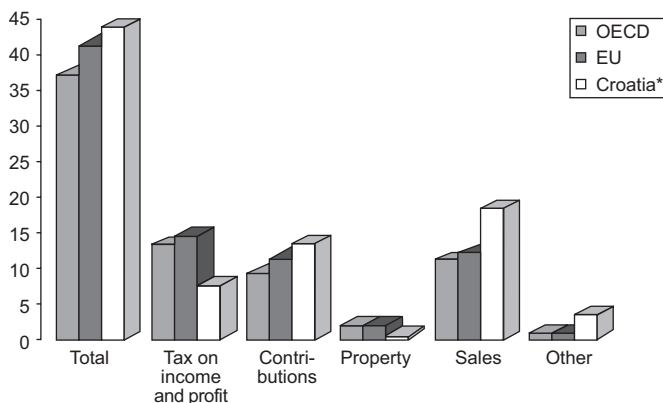
Source: MF Republic of Croatia (2001)

Tax structure

Messere (1997) states that in most industrial countries at the end of the 1980s and at the beginning of the 1990s, tax policy was mainly redirected from the taxation of income and profit to the taxation of consumption. For this reason a comparison of Croatia with the countries of the EU and the OECD, shown clearly in Graph 2, demonstrates that Croatia too is keeping up with this trend. In Croatia much less revenue is collected from income tax and profit tax and much more from sales tax. For example, in 1999 Croatia collected as much as 18.5% of GDP from turnover tax, and only 7.6% of GDP from income and profit tax.

It does not fit in with the trend towards redirecting taxation towards consumption only because Croatia collects the greatest amount via contributions: 13.6% of GDP in 1999 as against 11.4% in the EU in 1998. But from the beginning of the implementation of reforms in retirement and healthcare insurance, it is expected that obligatory contributions as share of GDP will start to fall (Kesner-Škreb, Kuliš, 2001).

Graph 2. Taxation as a percentage of GDP in 1998 total



* Croatia – data for 1999.

Source: OECD (2000); MF, Republic of Croatia (2001)

Income tax

In most EU countries there was a cut in the highest rates of income tax and a reduction in the number of brackets for the taxation

of the income of natural persons, the objective being to lighten the tax burden on the income of natural persons. Sandford (2000) says that the reason for these reforms in the income tax system was the tendency to reduce the tax burden and improve the competitiveness of the economy and economic growth. Then he states reasons such as the achievement of greater equity and neutrality in the tax system. The reason for reducing the number of brackets is an attempt at simplifying income tax system and improving the efficiency of tax collection (Messere, 1998).

The results of reducing the highest rates of income tax and the reduction of the number of brackets in the taxation of natural persons in 2002 are shown in Table 2. The same table shows what the situation was in Croatia in 2002. Since a basic objective of the EU is the long-term reduction of the tax burden (European Commission, 2002b: 25), and in comparison with the unweighted average of EU countries Croatia has the lowest maximum rate of tax on income and the smallest number of tax brackets, it may be concluded that the rates and the number of income tax brackets in Croatia are thus harmonised with the aims of the EU.

Table 2. Rates of income tax in 2002

Country	Highest rate (%)	Number of brackets	Country	Highest rate (%)	Number of brackets
Austria	50	5	Ireland	42	2
Belgium	55	6	Luxembourg	38	17
Denmark	*	*	Netherlands	52	4
Finland	36	5	Spain	48	6
France	52,75	7	Portugal	40	6
Germany	48,5	4	Sweden	25	3
Greece	40	5	UK	40	3
Italy	45	5			
EU average					
14**	43.7	5.6	Croatia	35	3

* In Denmark there are no tax brackets, rather six different tax bases are taxed with different tax rates. The rates range from 5.5 to 30%.

** Unweighted average.

Source: IBFD, 2002

Profit tax

Messere (1998) says that in the 1990s a broadening of the tax base was seen in the area of profit tax. The reason for this was in the abolition and reduction of the number of tax incentives, and the reduction of the basic rate of profit tax in most of the EU countries. In the short period in which the new tax system has existed, from 1994 until the present day, the profit tax rate has been reduced in Croatia, from 35 to 20%. From Table 3 it can be seen that in 2002 only Ireland within the EU had a lower rate of profit tax than Croatia. Since the basic objective of the EU is the long-term reduction of the tax burden, it would seem that, at least as far as the rate of profit tax is concerned, Croatia has achieved this objective better than most countries in the EU, and even before becoming a member.

Table 3. Basic rates of profit tax in 2002

Country	%	Country	%
Austria	34	Ireland	16
Belgium	39	Luxembourg	22
Denmark	30	Netherlands	34.5
Finland	29	Portugal	30
France	33.33	Spain	35
Germany	25	Sweden	28
Greece	37.5	UK	30
Italiy	36		
Average EU 15*	30.6	Croatia	20

* *Unweighted average.*

Source: IBFD, 2002

Value added tax

During the 1990s there was a practically universal increase in the standard rates of VAT (Messere, 1998). VAT was introduced in Croatia in 1998 and there has been no change in the amount of the standard rate. However, there were changes in zero rate taxation (Ott et al., 2001). The key regulation in the EU in the area of the harmonisation of taxation of consumption via the implementation of a general consumption tax is the Sixth Directive, as it is called (for a detailed analysis of the harmonisation of VAT with the provisions of the Sixth Directive, see later in the text). Table 4 shows that in 2002 the standard rate of

VAT in Croatia (22%) was greater than the unweighted average for the 15 countries of the EU (19.47%).

Table 4. Standard rates of VAT (2002)

Country	%	Country	%
Austria	20	Ireland	21
Belgium	21	Luxembourg	15
Denmark	25	Netherland	19
Finland	22	Portugal	17
France	19.6	Spain	16
Germany	16	Sweden	25
Greece	18	UK	17.5
Italy	20		
Average EU 15*	19.47	Croatia	22

* *Unweighted average.*

Source: IBFD, 2002

In conclusion, it can be stated that in the period from 1994 to 1999 the total tax burden in Croatia was greater than in the countries of the EU. For this reason it needs reducing, through reductions in contributions, which were greater in Croatia than the OECD countries. In the area of income tax and profit tax, the Croatian tax system is harmonised with the tax changes in the EU. Only for VAT are changes necessary in connection with tax exemptions.

PROFIT TAX

This section presents the state of the harmonisation of the tax systems of members in the area of profit tax, the particular problems of corporate taxation. One problem lies in the fact that dividends that a subsidiary firm from one member country of the EU pays to the main company in another EU member are taxed twice. Another problem is the double taxation burden that is the consequence of corporative restructuring of firms that are taxpayers in various different member countries.

The parent - subsidiary directive

When a subsidiary firm in a given state pays a dividend to its parent firm in a second state, two tax situations can arise in consequence:

- the dividend is subject to taxation in the state in which the subsidiary firm that pays out the dividend is located;
- the dividend that is obtained by the parent company is also the base for taxation of this dividend in the state in which the parent company is a taxpayer.

This double taxation prevents the free movement of capital, and the Directive is a measure through which this obstacle is removed. This is achieved by the prescription of obligatory procedures on the part of member countries towards corporations that are qualified to have the Directive applied to them.

Qualified corporations

These are those corporations that meet these conditions (Survey of the Implementation of the EC Corporate Tax Directives, 1995):

- takes one of the forms listed in the Annex to the Directive;
- according to the tax laws of a Member State they are considered a resident in that state for the tax purposes;
- are subject to one of the taxes listed in the Directive.

Two additional conditions are contained in Article 3:

- in order to be considered a parent or a subsidiary, a parent company must hold at least 25% of the capital of the subsidiary company, or at least 25% of the voting rights in the subsidiary company;
- a Member State may refuse to apply the privileges defined in the Directive if the parent company has not been the owner of 25% of the capital of the subsidiary company for at least two years uninterruptedly.

Methods for avoiding double taxation

Methods for avoiding the double taxation of dividends must be applied by both the country in which the taxpayer is the parent company and the country in which the taxpayer is the subsidiary company.

1. The Directive allows the country in which the taxpayer is the parent company a choice of methods (Terra and Wattel, 1993):
 - non-taxation of a dividend that is paid by a subsidiary, or
 - the taxation of a dividend that is paid out, with the parent company being authorised to deduct from its profit tax the amount of profit tax that has been paid by the subsidiary.
2. The country in which the taxpayer is the subsidiary must not tax the dividend the subsidiary pays to the parent in another EU member.

Merger directive

In many countries the consequence of mergers or reorganisations of corporations can be an increase in the tax liability, i.e., the occurrence of capital gains in connection with the increased value of the fixed and intangible assets and the possible loss of the amounts of tax losses that are carried forward. The task of the Directive is to obviate these obstacles if the merger, division or reorganisation is carried out among firms that are located in various different member countries. The objective is achieved in such a way that the liability to pay the tax is deferred until the sale of the assets to a third party.

The Directive defines four kinds of transactions to which the provisions about the deferral of taxation have to be applied (Terra and Wattel, 1993).

- Legal merger – one or more corporations transfer their assets and liabilities to some other corporation. The firm to which the assets and liabilities have been transferred issues new shares to the shareholders of the disappearing corporation(s) according to the “share for share” principle.
- An existing firm transfers all its assets and liabilities to two or more new or existing firms. The firm that has transferred its assets and liabilities ceases to exist. In exchange for the transferred assets and liabilities the company issues new shares to the shareholders of the defunct firm on the “share for share” principle.
- One corporation transfers all its operations to another firm or one or more branches are transferred to the parent company or another cor-

poration. Equity in the company to which the operations or the branch is transferred is given in exchange for these transfers.

- One corporation acquires a major holding in another firm from the owners of the equity in this other corporation. In return, the owners of the shares in the firm that has been obtained by the acquiring firm become shareholders in the acquiring firm (share swap) (Survey of the Implementation of the EC Corporate Tax Directives, 1995).

The working of the Directive

According to the provisions of the Mergers Directive, member states have to defer the taxation of capital gains arising in connection with the cross-border mergers described, but do not have to give up on taxing these gains altogether. After the firm to which the assets and liabilities have been transferred has alienated the assets, the difference between the sale price and the value of the assets can be taxed. Members may pass anti-evasion provisions annulling the privileges of the Directive if it is determined that one of the main objectives of the merger or the division is the legal or illegal evasion of tax liabilities.

Qualified firms

Like the Parent-Subsidiary Directive, the Merger Directive too provides for subjects to which it applies the deferral of the payment of taxes. In order to be able to claim this privilege, corporations must have the status of corporation of a Member State, i.e., have to meet certain conditions. These conditions are the same as in the Parent - Subsidiary Directive.

VALUE ADDED TAX

The provisions of the Sixth Directive are contained in the Croatian taxation law system, for VAT that is in terms of legal standards shaped according to the European model has been introduced into it.

The taxpayer, the tax base and the rate

In the regulation of the institutes of the taxpayer, base and rate, the Croatian Value Added Tax Act (known as ZPDV for short) is to a very high degree harmonised with the Sixth Directive. To do with the rate of tax, the Sixth Directive prescribes three levels: the standard rate, which may not be lower than 15%, one or two reduced rates, for goods specially stated in Annex H of the Directive, which may not be lower than 5%, and the zero rate. The original conception of the Croatian rules in the regulation of the tax rates, which meant a one-rate system, with a zero rate and refunding of pre-payment of tax, was theoretically even more consistent than the Sixth Directive. Before the alterations of the ZPDV passed in 1999, it was precisely the conception described that was applied. The introduction of a zero rate for the delivery of a certain number of goods, which was explained by social reasons and actually dictated by political pressures (the imminent parliamentary elections), made inroads in the theoretical consistency of the precious solution and also, more importantly, made the system of taxing sales more complex, and hence pushed.

Tax exemptions

An analysis of the harmonisation of the Croatian value added tax system with the provisions of the Sixth Directive shows that there are three groups of exemptions (Jelčić et al., 1999):

- tax exemptions in line with the provisions of the Sixth Directive (the rent of residential property)
- tax exemptions that are not consistent with the provisions of the Sixth Directive (banking services and insurance service),
- tax exemptions that are partially consistent with the provisions of the Sixth Directive (other exemptions inside the country).

Because the law on the exemption of the rental of residential premises in the Croatian taxation law system is harmonised with European solutions and hence is not a problem in the context of the project of which this paper is a part, the continuation of this text will be concerned with the exemptions stated in Items 2 and 3.

Banking and insurance services

The Sixth Directive prescribes that banking and insurance services be exempt from VAT, irrespective of who performs them. The ZPDV, however, prescribes tax exemptions for these services only if they are carried out by given institutions, that is, banks, savings banks and savings and loan organisations, insurance and reinsurance firms. From this, it derives that the Croatian approach, as compared with the Sixth Directive, is discriminatory towards firms that carry out these services without being one of those that are expressly exempt from the tax. Hence, this approach in Croatia should be harmonised with the solution found in the Sixth Directive.

Other inland exemptions

According to the Sixth Directive, all establishments that carry out the activities of organising special games of chance, preschool education, elementary, secondary and tertiary education, culture, health care, welfare and religious services have the right to be exempted from VAT. But subjects carrying out these activities in Croatia can claim the right to be exempted only if they have been founded according to the Institutions Act, and if they are financed from the Budget (Jelčić et al., 1999). In other words, institutions and communities in these activities founded by natural and legal entities in order to make a profit do not have the right to exemption (Jelčić et al., 1999). This makes a discriminatory approach standard, unlike the approach of the Sixth Directive. For this reason, without any additional conditions, all persons that carry out these activities should be exempted from VAT.

EXCISE DUTIES

This part will discuss taxation by excises (special sales taxes) in Croatia and in the EU. Because of the relatively large number of these taxes, the directives that relate to them are numerous, as proved by the complexity of the harmonisation process in the Union itself. Nevertheless, as in VAT, the Croatian tax system has conceptually not fallen behind the European model.

Excises in the EU and in Croatia

Although in the EU countries a varying number of products are taxed by excise duties, what is common to all countries is the taxation of alcoholic beverages and beer, tobacco products and mineral oils. There is an endeavour to standardize the tax structures via harmonisation, while the greatest lack of harmony can still be seen within the tax rates.

In the EU the taxation of alcoholic beverages, tobacco products and mineral oils is ordered by the general agreement for products subject to excise duty and on the holding, movement and monitoring of such products (92/12/EEC, 92/108/EEC, 94/74/EC, 96/99/EC). Members may retain already existing or introduce new excises on some other products, on condition that the movement of these products does not require special customs formality on border crossings and that these goods are allowed freedom of movement (including non-taxation by excise duties) in the cross-border trade among the members. This kind of freedom of movement is conditional upon the existence of bonded warehouses and appropriate customs/tax documents that have to accompany these products in cross-border trade. The basic principle is the taxation of these products in the consuming country according to the rates that are applied in this country. The agreement defines minimum rates, although there are considerable differences in the rates among the member countries, which creates a fair amount of difficulties in trade across the border (cross-border shopping smuggling).

As well as the need to harmonise the rates, it is also to a certain extent necessary to harmonise other essential questions of tax structure. Although a series of harmonisation documents have been passed and adopted (Committee on Excise Duties has been founded for the sake of implementing the common policy), in the future, especially because of the acceptance of new members, considerable efforts will have to be made so that any very great differences in the tax structures among the countries can be reduced to the smallest possible measure.

From 1994 to 1999, eight excises were introduced in Croatia (on coffee; mineral oils; alcohol and alcoholic beverages; tobacco products; beer; non alcoholic beverages; passenger cars; other vehicles; vessels and planes; luxury products). The number of excises in Croatia is considerably smaller than those in most of the countries of the EU, where in some of them up to 20 different products are taxed in this way (Denmark, France) (OECD, 2000).

Table 5. Total revenue from excise duties in 2000

	As percentage of total tax revenue	As percentage of GDP
EU	10.3	4.2
RC	18.9	4.8

Source: MF Republic of Croatia, 2002; OECD, 2002

This table shows that in Croatia excise duties as a share in GDP is close to the European average, while in total tax revenue it is almost 80% higher than the average in the countries of the EU. Excises are paid in Croatia by both producers and importers, and since 1 January 2002, the tax procedure has been carried out by the Customs Administration.

Excises that have been defined in common for EU countries have been introduced into Croatia; below we shall give a more detailed comparison of the European and the Croatian systems. This is at the same time about the most important excises in Croatia (on mineral oils, on tobacco products and alcohol beverages), by which almost 90% of all revenue from excises is collected.

Excise on tobacco products

The Common Taxation of Tobacco Products Agreement which has been in force since 1993 determines the common tax structure in the member countries, the minimum rates and the harmonisation of procedures for the keeping and moving of taxable products. The taxable items are cigarettes, cigars and cigarillos, smoking tobacco, fine-cut tobacco for the rolling of cigarettes, and other smoking tobacco.

- Excise duty on cigarettes (Directive 92/79/EEC, 99/81/CE) is calculated according to a special method (per unit of product, or on 1,000 items) and by the proportional method (ad valorem, calculated on the basis of the maximum retail selling price). Taking into consideration both methods of calculation, a minimum rate of 57% of the retail price is prescribed (including other taxes, e.g., sales tax or VAT) for the most popular category of cigarette, later called the “57% rule”. For the sake of avoiding the effect of inflation during the ad valorem calculation, the rate is set every 1 January according to the statistical data about the rise in retail prices.

- Excises on other tobacco products (Directives 92/80/EEC, 99/81/CE) are calculated either as a percentage of the retail price or per unit, or per kilogram.
- Member countries can choose the proportional method or the special method of calculation alone, or a combination of the two methods.
- Since the minimum rates have been set, individual countries can introduce excises greater than the minimal, and there are considerable differences among them in the tax burden and in the prices of these products. These differences lead to cross-border shopping (legal and illegal) and also have an impact on doing business of the tobacco industry.

Croatian excises on tobacco products are harmonised with the EU with respect to kinds of products that are taxed. However, the amount of excise on cigarettes expressed as a percentage of the retail price for the standard group of cigarettes comes to 49.1%, so less than the prescribed minimum excise according to the “57% rule”, although even inside the member countries there are countries (Austria 56.2% and Sweden 49.9%) which have rates that are lower than the set minimum rate. Excise on tobacco is considerably lower (5.2 euros/kg) than that prescribed in the EU (25 euros/kg), while for cigars and cigarillos it is higher, although it is hard to compare the figures since most countries calculate excise as a percentage of the retail price.

The taxation procedure is harmonised with EU procedures. Until delivery, the products are kept in bonded warehouses and after the payment of excise are marked with the control stamps, and are then delivered to the market. Products that are exported (with the existence of a formal export procedure) do not have excise levied on them because this will be calculated and charged in the importing country.

The problem of illegal sales, contraband in tobacco products and tax evasion that is a concern to EU countries exists in Croatia too, leading to the loss of a large part of budgetary revenue. It is estimated that cigarette smuggling leads to the loss of up to 400 million kuna being lost to the national Budget (Vecernji list, 7 June 2002). This is one of the reasons for the launch of the major international customs campaign for the prevention of cigarette smuggling called “Bulldog 2” on 15 June 2002, patronised by the South East European Cooperation Initiative (SECI). The campaign will be run by the Croatian customs administration and its headquarters is located in Bucharest.

Excise duties on alcohol and alcoholic beverages

Beers, wines and other alcoholic beverages are taxed with excise duty on alcoholic beverages (Directives 92/83/EEC, 92/84/EE), while the minimum rates, which are reconsidered and adjusted according to need every two years, are set within range from 0 to 1,000 euros per hectolitre.

In Croatia, excise duty on alcohol is calculated per litre of absolute alcohol in ethyl alcohol, distillates and alcoholic beverages at a temperature of 20°C and comes to 816 euros/hl, which fits in with the European average. Wine is taxed at a zero rate, as in most European countries that are important wine producers. The owners or users of agricultural land and the owners of the components for the production of alcohol or alcoholic beverages that produce drinks for their own consumption up to 20 litres of absolute alcohol a year per farm household do not have to pay the tax.

Excise on beer in the EU is set by the regulations for the taxation of alcoholic beverages. Standard and reduced rates have been introduced. Because of the differences in the concentration of alcohol and the concentration of extract in the malt of beer, within given countries there are a large number of rates, and the differences between countries are still greater. The brewing industry will have a considerable influence on the rate of tax and the rates in countries with substantial brewing industries (Ireland, Germany and Belgium) are much lower.

Excise on beer in Croatia (27 euros/hl) is higher than in most EU countries. Non-alcoholic beer is taxed in only four EU countries, and in Croatia the rate (8 euros/hl) is two and a half times as greater as the highest rate introduced elsewhere (Portugal, 2.96 euros/hl). Brewers who produce beer for their own consumption in Croatia, up to 15 hectolitres annually, do not pay the tax. In the EU a reduced rate is applied to small producers with an annual production of up to 200,000 hectolitres.

Excise duties on mineral oils

From 1993 harmonisation of the structure of excise on mineral oils has been under way, as has the definition of exemptions and reduced rates (Directives 92/81/EEC, 92/108/EEC, 94/74/EC). Products that are taxed are defined for all members by the Common Nomenclature. The tax base is 1,000 litres or kilograms of product at a

temperature of 15°C. The directive also defines the place of taxation and exemptions, and the procedure for applying rates and exemptions. A decision of the Council (95/510/EEC) approved deviations from the agreed on system for the implementation of exemptions and reduced rates within the member countries.

In the early phase of working out documents about the taxation of mineral oils the Commission, in line with the Internal Market programme, proposed an absolute harmonisation based on average rates because “in this area there is a much greater risk of competitive distortion of prices than for alcohol and tobacco products (1987h, COM (89) 525). Still, in 1992, minimum amounts of tax for leaded and unleaded petrol, diesel fuel, gas oil, liquid petroleum gas and kerosene were set, in a range of from 0 to 227 euros per litre or kilo.

In 1997 the Council passed a new Energy Products Directive (COM/97/30), which the European Parliament adopted in 1999 (A4-0171/1999). The basic intention of this Directive was that the taxation of all energy products (including the taxation of electricity) should lead to the implementation of the EU ecological policy, which emphasised the need to stabilise the emission of gases (CO₂, methane). Thus tax policy became an important instrument in the implementation of:

- energy policy (balance in the use of various sources of energy),
- environmental protection policy (differences in the taxation of leaded and unleaded petrol),
- transport policies (differential taxation of transport),
- agricultural policy (specially reduced rates for fuel obtained from agricultural, bio-fuels),
- employment policy (increase of tax revenues from the use of raw materials and energy, and reduction of the tax burden on labour).

Although a minimum excise duty was set, member countries were allowed to introduce complete or partial exemptions, or to introduce preferential taxation for given products. Particularly important is the autonomy of each country freely to determine exemptions for renewable sources of power, bio-fuels, ecologically more acceptable fuels, natural gas and so on. Council decision 2001/224/EC adopted the introduction of reduced rates and exemptions for some mineral oils for special purposes in all member countries for a six-year period (up to 31 December 2006).

It is still in the area of the taxation of mineral oils that there is the least degree of harmonisation, and this cannot be expected to be settled in the very near future.

Excises on mineral oils are lower in Croatia than in the countries of the EU. A considerable difference exists in the taxation of diesel fuel, the excise on which in Croatia (136 euros/hl) is almost half as much as the minimum excise in the EU (245 euros/hl), which is applied in France, and almost six times as little as the maximum (839 euros/hl), which is applied in the UK. In line with the directives the tax burden on leaded fuel is greater, as is a certain relief relating to the use of specially marked diesel fuel in agriculture and fisheries. This is the same with the lower price for heating gas oil. The greatest difference is in the taxation of kerosene and kerosene used as propellant which is taxed at the zero rate in Croatia, while in the EU there is a minimum rate of 245 euros for 1,000 litres. Products that are taxed are kept in bonded warehouses reported to the Customs Administration. If the products are exported, excise is not paid, rather the products are taxed in the importing country.

Excise duties in Croatia versus EU requirements

In line with EU requirements:

- products that are defined in common in EU countries (tobacco products, alcoholic beverages and beer, mineral oils) are taxed;
- supervision and collection are carried out by the Customs Administration;
- there are registered and controlled bonded warehouses from which products are delivered to the market;
- products that are exported are not taxed rather this is done in the importing country;
- for given taxes ecological, health and economic requirements are taken into consideration.

Deviation from EU requirements:

- as in most countries which are in the procedure for joining the EU, the rates are lower than they are in the EU, except for beer;
- the categorisation of products (alcohol and mineral oils) is not fully harmonised.

CONCLUSION

In this work we have given the results of comparisons and analyses made and made suggestions to the creators of tax policy in Croatia to do with the further harmonisation of the Croatian tax system with European requirements.

The basic objective of the tax policy of the EU is to support the constant development of the EU internal market. This objective is achieved by the accomplishment of sub-objectives: the removal of tax barriers for the realisation of the four freedoms and by measures that contribute to a lasting reduction of the total tax burden.

The key device for achieving the aims stated is the harmonisation of the tax systems of the member countries. The basic legal instrument prescribing tax policy at the European level is the directive. In the member countries, a number of legislative and other measures have been undertaken so that, according to the solutions of the standardised directives, taxation via direct or indirect taxes should be harmonised.

So far two directives from the area of profit tax, known by the abbreviated titles of the Parent-Subsidiary Directive and the Merger Directive have been accepted. The objective of the Parent-Subsidiary Directive is to do away with the possibility of double taxation of dividends that are paid to the parent firm in another member country. It is not advisable for Croatia to build the standards of this Directive into its legislation until the status of EU member has been achieved, for in this way Croatia would give up the taxation of dividends, rather tax would be paid on this dividend in the country from which the foreign investor in a Croatian corporation comes. The case with the Merger Directive is similar, and the recommendation for Croatia is the same. If it were to be adopted in the Croatian tax system, the takeover of Croatian corporations by foreign firms would be made easier without there being any reciprocity from the European side.

With reference to the harmonisation of legislation relating to value added tax, it is the Sixth Directive that is the most important. This regulates all the essential elements of the taxation of added value. Croatia too has built value added tax, founded on the approaches of the Sixth Directive, into its tax system. Still, there are certain inconsistencies, the most important being the discriminatory provision about the institutionally regulated tax exemptions for the services of banks and insurance companies. In this segment, then, it would be necessary to

harmonis the approaches of the Croatian legislation with the provisions of the Sixth Directive.

In the EU excises are regulated by a large number of directives. The regulations that relates in Croatia to excise is mostly harmonised with the requirements of the EU. An exception is to be found in the tax rates, which are lower than the minimum EU tax rates. The lack of harmonisation of the rates of excise duties, however, is a serious problem within the Union itself, because the Member States apply difference excise rates for the same products. Croatia has established a system of taxation via excises that in its conception is equivalent to the European and that will, when this is necessary for the sake of being accepted into the EU, be fairly easy to adapt to European standards.

ⁱ For more information see *OECD (2002) and IBFD (2000)*.

ⁱⁱ For more about tax trends in the OECD and in the EU, see: *Ott, K. [et al.] (2001), Messere (1998)*.

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