I. Country information

Croatia borders four countries - Bosnia and Herzegovina to the South, Slovenia to the North, Hungary to the Northeast, and Yugoslavia to the Southeast. There are three distinct regions in the country: Pannonian (55% of the total area), Adriatic (31%) and Dinaric (14%). Forests cover 36% of the area. The climate is Mediterranean on the coast and continental inland.

Croatia is spread across 56,542 sq. km with a population of 4.501 million. The capital is Zagreb (population of 900,000), the other main cities being Split, Rijeka, Osijek, and Vukovar. Croatian is the official language.

Natural resources: oil, coal, bauxite, iron ores, calcium, silica, clays, salt.

II. Economic overview

2.1. General economic overview

<table>
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<tr>
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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1. GDP in USD bil</td>
<td>11,680</td>
<td>14,234</td>
<td>18,817</td>
<td>19,734</td>
<td>20,169</td>
<td>21,322</td>
<td>20,169</td>
</tr>
<tr>
<td>2. GDP per capita, USD</td>
<td>2,440</td>
<td>2,900</td>
<td>4,028</td>
<td>4,392</td>
<td>4,598</td>
<td>4,833</td>
<td>4,440</td>
</tr>
<tr>
<td>3. Economic growth rate, %</td>
<td>-8.0</td>
<td>5.9</td>
<td>6.8</td>
<td>6.0</td>
<td>6.5</td>
<td>2.7</td>
<td>-0.3</td>
</tr>
<tr>
<td>4. Industrial production growth rate, %</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>6.8</td>
<td>3.8</td>
<td>-1.4</td>
<td></td>
</tr>
<tr>
<td>5. Annual inflation rate, %</td>
<td>1,149.7</td>
<td>3.0</td>
<td>3.7</td>
<td>3.4</td>
<td>4.0</td>
<td>5.9</td>
<td>4.2</td>
</tr>
<tr>
<td>6. Annual unemployment rate, %</td>
<td>14.8</td>
<td>14.5</td>
<td>14.5</td>
<td>16.4</td>
<td>17.5</td>
<td>17.2</td>
<td>19.1</td>
</tr>
<tr>
<td>7. Revenues, HRK min</td>
<td>-</td>
<td>-</td>
<td>43,283</td>
<td>48,397</td>
<td>53,345</td>
<td>65,111</td>
<td>67,542</td>
</tr>
<tr>
<td>8. Expenditures, HRK min</td>
<td>-</td>
<td>-</td>
<td>28,696</td>
<td>31,592</td>
<td>35,006</td>
<td>42,552</td>
<td>48,879</td>
</tr>
<tr>
<td>9. Balance of current account, USD bil</td>
<td>-</td>
<td>-</td>
<td>-1.1</td>
<td>-2.3</td>
<td>-1.5</td>
<td>-1.6</td>
<td></td>
</tr>
<tr>
<td>10. Current account balance, % of GDP</td>
<td>5.6</td>
<td>5.7</td>
<td>-7.7</td>
<td>-5.8</td>
<td>-11.6</td>
<td>-7.1</td>
<td>-7.7</td>
</tr>
<tr>
<td>11. Base interest rate for demand deposits, %</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>4.2</td>
<td>4.4</td>
<td>4.1</td>
<td>4.2</td>
</tr>
<tr>
<td>12. External debt, USD bil (end of year)</td>
<td>2.49</td>
<td>2.82</td>
<td>3.34</td>
<td>4.81</td>
<td>6.66</td>
<td>8.49</td>
<td>9.9</td>
</tr>
<tr>
<td>13. Foreign currency reserves, USD min</td>
<td>616</td>
<td>1,405</td>
<td>1,895</td>
<td>2,314</td>
<td>2,539</td>
<td>2,816</td>
<td>3,025</td>
</tr>
</tbody>
</table>

Source: Central Bureau of Statistics, Croatian National Bank

2.2. Foreign trade

In the course of preparations for Croatia’s accession to the WTO, a new legal framework that is completely harmonised with the WTO rules has been prepared. This includes the Trade Act and the new Customs Act that came into force on 1 January 2000.

2.2.1. Customs regime, export and import quota and license system, tariffs

The customs duty is the only import duty payable on the import of goods, while no customs duties are foreseen for exports. Customs duties range form 5% to 25%, as set in the Customs Tariff.

Croatia has harmonised its Customs Tariff Act in accordance with the WTO rules and regulations, and gradually reduces the customs protection level. During a five-year transition period (from 2000 to 2005) Croatia is obliged to reduce customs duties for the most sensitive industrial products by the same percentage every year. The average tariff rate at the end of this period will amount to 5%, instead of the current 10% level.

The average customs protection level for industrial products has been reduced from 10% to 6.6% in 2000. For 50% of the total number of tariff headings (the majority of industrial products) the tariff rate ranges from 5% to 10%; it totals 0% for 25% of tariff headings, whereas the highest tariff rate of 20% is applied to 4.8% of the products (petroleum derivatives, textile products). The customs protection level for agricultural and food products will be reduced from the current average rate of 33.7% to an average rate of 16.4% within a seven-year period. Customs duties will be reduced gradually by identical annual percentages and adapted to the protection level of other European countries. The average customs protection level for agricultural and food products is 24.3%.

For the import of equipment, machinery, appliances, vehicles and their parts, that have components manufactured in Croatia, the government may determine a lower tariff rate or may be exempt from customs duties.

The import and export of goods are, as a rule, free, with the exception of qualitative restrictions or protective levies that may be introduced in accordance with the WTO rules and regulations. If the balance of payments experiences disturbances or if the import of certain goods threatens to damage or damages the domestic industry, import quotas may be introduced.

In order to implement international contracts, to secure state safety, to protect the lives and health of people, animals and plants, as well as the environment, to control the import and export of works of art and of certain precious metals, certain goods are imported and exported on the basis of a license, issued by the appropriate Ministry.
In order to facilitate dealings abroad, all of the usual transport definitions apply according to the Unique Rules for Interpretation of Commercial Expressions INCOTERMS 2000. When dealing with American business partners, transport definitions according to the Revised American Foreign Trade Definitions (R.A.F.T.B.) apply.

### 2.2.2. Exports and imports

<table>
<thead>
<tr>
<th>Year</th>
<th>Exports (FOB), USD bn</th>
<th>Imports (CIF), USD bn</th>
</tr>
</thead>
<tbody>
<tr>
<td>1993</td>
<td>3.9</td>
<td>4.7</td>
</tr>
<tr>
<td>1994</td>
<td>4.3</td>
<td>5.2</td>
</tr>
<tr>
<td>1995</td>
<td>4.6</td>
<td>7.5</td>
</tr>
<tr>
<td>1996</td>
<td>4.5</td>
<td>7.8</td>
</tr>
<tr>
<td>1997</td>
<td>4.2</td>
<td>9.1</td>
</tr>
<tr>
<td>1998</td>
<td>4.5</td>
<td>8.4</td>
</tr>
<tr>
<td>1999</td>
<td>4.3</td>
<td>7.8</td>
</tr>
</tbody>
</table>

Source: Croatian National Bank, Central Bureau of Statistics

### 2.2.3. Major trade partners

The top trade partners in 1999 have been Germany (15.7% of exports and 18.5% of imports), Italy (18.0% of exports and 15.9% of imports), Slovenia (10.6% of exports and 7.9% of imports), Austria (6.2% of exports and 7.1% of imports), Russia (8.6% of imports), Bosnia and Herzegovina (12.8% of exports), France (2.4% of exports and 5.0% of imports), USA (2.0% of exports and 3.1% of imports), UK, Hungary, etc.

### 2.2.4. Structure of foreign trade by regions (imports and exports)

#### Exports by country groups (1999)
- European Union: 48.8%
- EFTA: 3.3%
- Other developing countries: 4.4%
- CEFTA: 13.6%
- Other European transition countries: 19.5%
- Other: 10.2%

#### Imports (1999)
- Manufactures classified by material: 16.1%
- Machinery and transport equipment: 34.8%
- Chemical products: 12.1%
- Mineral fuels and lubricants: 11.0%
- Food, beverages and tobacco: 8.0%
- Crude materials, except fuels: 2.2%
- Other: 15.8%

#### Imports by country groups (1999)
- European Union: 56.5%
- EFTA: 2.8%
- Other developing countries: 7.5%
- CEFTA: 13.9%
- Other European transition countries: 12.2%
- Other: 7.3%

#### Exports (1999)
- Chemical products: 12.0%
- Manufactures classified by material: 13.4%
- Machinery and transport equipment: 29.1%
- Food, beverages and tobacco: 9.2%
- Mineral fuels and lubricants: 7.8%
- Crude materials, except fuels: 5.7%
- Other: 22.8%

#### Exports by country groups (1999)
2.2.6. Free zones

The Law on Free Zones (Narodne novine No. 44/96, 5 June 1996) allows the establishment of free zones. According to the Law, a company in a free zone may engage in manufacturing, wholesale, foreign trade and provision of financial services. Goods that are not intended for trade on the domestic market or for consumption in Croatia, are fully exempt from customs duties or taxes.

Users engaged or participating in infrastructure construction within the free zone, in projects with a value exceeding HRK 1 million, are exempt from paying any profit taxes during the first 5 years of business activities. Other users in the zone pay a profit tax equal to 50% of the standard rate in Croatia.

Established free zones in: Krapina, Osijek, Rijeka, Sibenik, Zagreb, Obrovac, Split, Ploce and Pula.

2.3. Foreign exchange regulations

Foreign currency transactions are based on the Foreign Currency System, Foreign Currency Transactions, and Trade in Gold Act, which states that the foreign currency is freely available and trade in foreign currency must be carried out through the foreign currency market. Non-residents may acquire Croatian currency through the purchase of domestic currency for foreign hard currency, by reimbursement in domestic Croatian currency of imports to Croatia and transfer of gains earned from investment of capital in Croatia and alike. Deposits on the non-residents’ domestic Croatian currency accounts are freely transferred abroad.

Non-residents may hold their hard currency accounts with a domestic Croatian bank licensed for international banking activities. They freely dispose of their foreign exchange, held as deposit on their accounts with Croatian banks in order to effect payments abroad. No restrictions are imposed for capital transfers abroad from the non-residents’ hard currency accounts maintained with banks domiciled in Croatia. Nevertheless, restrictions are imposed on the transfer of capital from abroad to these deposit accounts in Croatia. Effective hard currency is deposited to the accounts of non-residents - foreign legal persons - with Croatian banks in limited amounts. In this regard, a non-resident person may deposit effective hard currency only up to the amount of USD 20,000 monthly. Depositing larger amounts would require an approval by the National Bank of Croatia.

Domestic legal and natural persons may keep convertible foreign currency in foreign exchange accounts or foreign exchange savings accounts with authorised banks. Domestic residents may freely draw foreign exchange from their foreign exchange accounts and foreign exchange savings accounts, but are allowed to use them exclusively for payments abroad for current international transactions. The above foreign exchange cannot be transferred abroad without the prior approval of the National Bank of Croatia. Capital transfers on deposit accounts of domestic residents are not subject to capital restrictions. Domestic banks may keep foreign exchange in foreign exchange savings accounts without the approval of the National Bank of Croatia, but all other domestic legal persons only with the above mentioned approval of the central bank.

Capital restrictions in Croatia are implemented basically on transfers between residents’ accounts and non-residents’ accounts. In Croatia, however, capital restrictions are not implemented on transfers taking place between non-residents’ accounts in domestic currency and non-residents’ accounts in convertible currencies. Non-residents - foreign natural persons - may conduct all capital transfers without being subject to restrictions.

2.4. Privatisation

The process of privatisation started in 1991, based on the Law on Transformation of Socially Owned Enterprises (April 1991), under which 2,600 enterprises were transformed into joint stock companies. The Croatian Privatisation Fund mostly handled the privatisation process. The techniques of privatisation at this first stage were:

- Management and employees buyout;
- Public offering of shares;
- Public auctions of the shares on the Zagreb Stock Exchange.

To improve the speed and effectiveness of privatisation, a new Ministry of Privatisation was created in November 1994. A Privatisation Law was adopted in March 1996, introducing the mass privatisation method for a certain category of individuals. The Law states that public enterprises or private companies in which the Republic of Croatia holds 100% of the shares, as well as the public institutions are to be privatised.

The privatisation of large SOEs and rehabilitated banks is expected to be completed by 2001.
2.5. Foreign investment

2.5.1. Foreign investment by years and by type of investment

The cumulative amount of FDI has reached USD 3.4 billion between 1993-1999 (statistical data before 1993 is unreliable).

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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>FDI, USD mln</td>
<td>120</td>
<td>117</td>
<td>114</td>
<td>504</td>
<td>510</td>
<td>884</td>
<td>1,141</td>
</tr>
</tbody>
</table>

Source: Croatian National Bank
Note: * Estimate

2.5.2. Foreign investment by countries

The EU member countries are the biggest investors in Croatia with a 62.5% share, the top investors being Germany (USD 986.8 mln), Austria (USD 706.3 mln) and Netherlands (USD 137.5 mln), followed by the UK (USD 94.6 mln), Sweden (USD 93.4 mln), France (USD 67.0 mln), etc. However, the biggest investor is USA with USD 1,003.7 mln. Slovenia (59.4) and Switzerland (USD 55.0 mln) also rank high.

III. Establishing business in Croatia

<table>
<thead>
<tr>
<th>Company Regime</th>
<th>Legal Framework</th>
</tr>
</thead>
<tbody>
<tr>
<td>General partnership (tavno togovsko društvo) (t.d.); Limited partnership (komanditno društvo) (k.d.); Limited liability company (društvo s ogranicenom odgovornošću); Joint-stock company (dionicko društvo) (d.d.) In addition the Law on Commercial Companies permits silent partnerships and economic interest groupings.</td>
<td></td>
</tr>
</tbody>
</table>

- **Types of Companies**

- **Partnerships**

- **Limited Liability Company**

- **Joint-Stock Company**

- **Branches**

The top investors include Deutsche Telekom (Germany), Ericsson (Sweden), Hofmann & Pankl (Austria), Suisse de Ciment (Switzerland), Interbrew SA (Belgium), RWE (Germany), Enron (USA), ABB (Sweden), Elektro-Gerate A.G. (Switzerland), etc.
3.2. Foreign investment regime

**Forms of investments**
The Law on Commercial Companies provides some basic provisions in the field of foreign investment in the Republic of Croatia. Foreign person may:
- invest capital in a company, bank, savings bank or an insurance company;
- open a handicraft business or act as a sole proprietor;
- obtain a concession for the exploitation of natural and other resources of interest in Croatia.

**National treatment**
In their operations within the territory of the Republic of Croatia foreign companies and individual tradesmen are assured treatment equal to that of domestic persons. The only condition imposed on them in carrying out business activities is that they establish a branch office in the Republic of Croatia. In addition to branch offices, foreign persons may also establish representative offices in the Republic of Croatia.

**Legal guarantees for the investments**
The Croatian Constitution guarantees that rights acquired by investing capital cannot be diminished by law or by any other legal act.

**Profit and capital repatriation**
The Constitution of the Republic of Croatia guarantees to foreign investors free transfer of profits and free transfer of their invested capital if they reduce or terminate their investment. Transfer of profit resulting from investment of capital in the Republic of Croatia, transfer of capital that belongs to investors after termination of investment, and transfer of proceeds from sale of shares or contributions are free and are permitted after any liabilities prescribed by the law have been discharged.

**Ownership rights over real estate**
According to the Croatian legislation individuals with no Croatian citizenship and entities with registered seat abroad may acquire ownership rights on real estate with prior approval of the Ministry of Foreign Affairs based on approval of the Ministry of Justice. In case of refusal the foreign person may request for approval for the same real estate in 5 years since the day the first request has been submitted.

For protection of interest and security of Croatia, foreign persons may not acquire real property in certain territories designated by Law. Pursuant to the Law on Agricultural land foreign persons may not acquire agricultural land.

Notwithstanding the above stated, companies owned by foreign persons that are registered in Croatia are considered domestic and may acquire ownership rights with no limitations.

Croatian immigrants may acquire real estate under separate provisions of the Law.

**Incentive for investments in equipment**
As part of the Croatian legal environment to encourage foreign investment, the fiscal system enables a foreign investor to import equipment free of customs duty, regardless of whether such equipment is manufactured in the country or not. The equipment imported on the basis of a foreign person's investment is exempted from duty (and tax) if the foreign person's investment is for at least 5 years, and if the foreign person's contribution is no less than 20 % of the total equity capital. The tariff schedule has been fully adjusted to conform to international nomenclature.

**Employment of foreign nationals**
Foreign nationals may be employed by Croatian enterprises in accordance of the Law on Employment of foreign nationals (Narodne novine No 19 / 1992, last amended 52/1994). The basic requirements for employment of foreign nationals are a labour permit and a valid long-term or permanent residence permit. The Employment Office upon employer's request issues the labour permit, usually for one-year period. In case of issued permanent residence permit, the labour residence may be issued for an unlimited period of time. Labour permits for foreign nationals performing activities based on foreign investment or foreign trade, are issued on the basis of their contractually arrangements with Croatian enterprises. In such cases, the duration of the permit corresponds to the contractually foreseen duration of their stay.
Labour permits for foreign nationals performing activities based on foreign investment or foreign trade, are issued on the basis of their contractual arrangements with Croatian enterprises. In such cases, the duration of the permit corresponds to the contractually foreseen duration of their stay.

3.3. Legislative framework of concessions and public procurement
The rights to exploit natural resources and other resources, and to conduct certain other business activities are granted by concession (Law on Concession Rights). The decision on whether to grant a concession is made by the Croatian Parliament or the Government. A concession cannot be granted for the exploitation of forests or other assets regulated by special laws if they are state owned. A concession may be granted to a domestic or a foreign legal entity or natural person on the basis of the results of public tenders or bid invitations for a period of up to 99 years (40 years for agricultural land).

The basic method of procurement is “public tendering” of goods and works. If less than three tenderers take part in the tendering, the whole procedure must be repeated. The so-called “preliminary tendering” requires pre-selection of qualified tenderers based on their qualifications. "Tendering on request" is a direct way of inviting tenderers, and may be initiated only with a prior approval of the Ministry of Finance. "Tendering upon invitation for services" is used for direct invitations to at least three tenderers for procurement of services.

3.4. Dispute settlement
Croatia has acceded to all important conventions, such as the Geneva Protocol on Arbitration Clauses (1923), the Geneva Convention on Execution of Foreign Arbitral Awards (1927), the New York Convention on Recognition and Enforcement of Foreign Arbitral Awards (1958), and the European Convention on International Commercial Arbitration (1961). The Croatian legal system allows local companies to submit applications to foreign jurisdictions (either foreign courts or international arbitration) for the settlement of commercial disputes, if one of the contractual parties in the conflict is either a natural person with permanent residence abroad or a foreign legal person.

IV. Taxation

4.1. General overview
Croatia’s tax year is, in most cases, the calendar year. The country’s tax structure includes both direct taxation through income taxes and profit taxes, and indirect taxation through value added tax. In addition, there are excise taxes, real estate tax and local taxes. Income taxes are assessed on individuals. The profit tax is essentially a corporate tax. The current Croatian tax system includes the following main taxes:
- Personal income tax
- Profit tax
- Value added tax
- Special tax (excise duty)
- Real estate transfer tax

4.2. Personal Income Tax

4.2.1. Taxpayer
Personal income tax in Croatia is paid on a world-wide income in case of tax residency in Croatia. The applicable tax rate is 20% to the first amount HRK 3,750 per month and 35% thereafter. On the total amount of the so calculated tax, surtax is charged in certain municipalities (e.g. in Zagreb - 18%). Each individual has the right to personal non-taxable monthly allowance of HRK 1,250, as well as further similar allowances for dependent spouse and children residing in Croatia.

Croatian law distinguishes between resident and non-resident taxpayer. The person becomes resident taxpayer by registering the residence in Croatia and if it can be concluded that he/she intends to spend more than 183 days over the period of two years in Croatia. Non-resident taxpayers are taxed on their income earned in Croatia.

4.2.2. Taxable base
Tax is based on the income earned by a taxpayer for paid work (salaries and pensions), for independent activities (freelance work, crafts, agriculture, and forestry), and for property rights (e.g., renting or trading in real estate and certain intellectual property rights). Taxable income from a rent lease is the total revenue received minus 30% for expenses, or 50% if rooms or beds are rented.

Income tax is not levied on interest on hard currency and Croatian kuna current and savings accounts, dividends on shares, gains from the disposal of financial property, and the costs of various kinds of social care.

A law on tax breaks in areas of special interest reduces the tax rates applied to those resident in such areas through higher personal allowances, income tax exemption of earnings from agriculture and forestry, and higher depreciation rates for long-term capital invested in property.

The tax legislation provides for certain capital gains, which are not subject to income tax.
4.2.3. Fringe benefits
Employers may give employees certain benefits that qualify as non-taxable earnings under the tax regulations.

If any of these benefits exceed the quoted limit, the excess is fully taxable (contributions, income tax, surtax).

4.3. Profit tax

4.3.1. Taxpayers
Taxpayers are defined as entrepreneurs. Entrepreneurs are legal entities and physical persons who are independently and permanently engaged in business activity with the purpose of gaining profit.

An entrepreneur is liable to pay profit tax in the following cases:

- if in the preceding calendar year his total revenue exceeded HRK 2 million,
- if in the preceding calendar year he had income exceeding HRK 300,000; or
- if he has fixed assets of value exceeding HRK 2 million,
- if in the preceding calendar year he employed on average more than 30 employees.

A domestic business organisation set up by a foreign entrepreneur is also subject to profit tax.

4.3.2. Taxable base
The taxable base is the difference between the own equity invested in the business at the end and at the beginning of the tax period increased or reduced according to the Profit Tax Act.

Resident taxpayers are subject to tax on their world-wide income. Non-resident taxpayers e.g. branches are subject to tax only on their Croatian-source income.

4.3.3. Factors resulting in increase of tax base (non-deductible items)
The base for Profit Tax is increased by losses from shares and dividends, losses from disposal of shares, write-offs from shares; public pay-outs and disbursements; concealed profit payments; amount of depreciation in excess of the maximum allowed for tax purposes; excess interest on debts/too little interest on credits; certain non-deductible tax expenditures; all other expenses not directly connected with generating profit; negative differences from changes in legal status; and, "protective interest" on reductions in "own capital" during the tax period.

4.3.4. Depreciation. Valuation, reserves and provisions

Only the straight-line basis of depreciation is allowed for tax purposes. Depreciation rates are determined for different kinds of tangible and intangible assets, by the Rules on Depreciation.

A taxpayer is allowed to depreciate long-term assets in a shorter period than stipulated by law. The standard depreciation rate is increased by 100% (e.g. cars are depreciated for tax purposes at a rate of 20% p.a. over 5 years, and you can write them off for tax purposes over 2.5 years at a rate of 40% p.a.).

Valuation of inventory is based on the international Accounting Standards. Reserves and provisions are deductible for tax purposes.

4.3.5. Incentives
In order to encourage reconstruction and development of certain areas, the Government of Croatia may issue a decree, whereby certain taxpayers are exempt from the tax or the tax rate is reduced.

In addition, taxpayers having their seat in the territory of a region under the special government protection may apply a higher protective interest rate (20% or 15%) under certain conditions. A New Investment Law has been passed by the Croatian Parliament and is in effect from July 29, 2000. The new Law provides new incentive measures and tax benefits, related to investments in Croatia.

4.3.6. Allowances
The base for Profit Tax is reduced by gains from shares and dividends, gains from sale of shares, write-ups from shares; positive differences arising from changes in legal status; investments increasing equity; parts of depreciation which were not previously recognised; "protective interest" on own capital at the beginning of the tax period; "protective interest" on certain increases in own capital during the tax period; and, losses brought forward, increased by "protective interest".

4.3.7. Capital gains, losses and tax rate

- Capital gains - capital gains are not taxable.
- Losses - tax losses may be carried forward, with protective interest, for a maximum of a five years. There is no losses carry-back.
- Profit tax rate - Profit tax is payable at the rate of 35% on the assessed taxable basis.

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1 The rate of protective interest is determined by adding 5% to the rate of growth of industrial producer prices. In other words, interest on capital invested in a company is treated in the same way as interest on capital deposited in a bank. For 1999 the protective interest rate was 11.20% (5 + 6.20).

2 These increases are - investment during the year; Profit Tax refunds; income from disposal of shares in companies; positive differences arising from changes in legal status; and, other gains arising from shares in companies.
4.4. Withholding taxes
There are no withholding taxes on dividends, interest, royalties, or technical fees, these items being dealt with domestically within the profit tax rules.

4.5. Indirect taxation - Value Added Tax

4.5.1. VAT System
VAT came into effect on 1 January 1998, replacing the retail sales tax. The VAT rate is zero or 22%. Exemption at zero rate applies only to medical, cultural and educational goods and services. The zero rate applies to educational books, bread, milk, medical products and drugs on the Health Fund List on 1st November 1999.

The VAT system is a consumption form of VAT, which is neutral in its effect on enterprises through the "input" and "output" mechanism, the burden being borne by the end consumer. Payment of the difference between "input" and "output" VAT must be made within the period provided for making the monthly returns. Where the amount of "input" VAT exceeds "output" VAT, a taxpayer is entitled to a refund of that difference or may choose to use that difference as an advantage against future VAT payment obligations.

However, if an invoice has been issued, the liability to pay tax commences regardless of whether or to what extent the delivery has been completed. On imports of goods, the liability to pay tax commences on the same day as the liability to pay customs duties. Regarding advance payments, liability arises at the end of the tax period in which they have been received.

4.5.2. Taxpayers
Taxpayers are those "entrepreneurs" who deliver goods or perform services in Croatia. Taxpayers are also the domestic enterprises receiving imported services from foreign enterprises and legal entities/individuals who issue invoices or receipts including VAT without authorisation.

4.5.3. Tax base
The tax base for domestic deliveries of goods or services is the consideration for which the goods are delivered or the services rendered. In cases of exchange and similar transactions, the tax basis is the value of the goods or services, which are the subject of the exchange.

The tax base of imports is the customs value of the goods imported according to customs regulations, increased by customs duties, other import duties, special taxes and other costs paid during customs formalities.

4.5.4. Objects of taxation
The taxable transactions include delivery of goods and provision of services for consideration within Croatia (excluding a free-trade zones) and the import of goods.

4.5.5. Imports of goods and services
VAT paid to the customs office at the time of import is creditable as "input" VAT against other domestic, non-import VAT. If goods are import duty exempt, they are also VAT exempt.

In the case of services, the general principle is that the point of rendering of a service is the headquarters of the provider of the service. Certain exceptions to this principle are prescribed, which are taxed according to the location of the headquarters of the buyer. These exceptions are broadly the same as are contained in the 1977 EU Directive.

The tax legislation provides for certain VAT exemptions, including exemptions for export and import.

4.6. Other indirect taxation - Special tax (Excise duty)
These are imposed at various fixed amounts and are payable by producers or importers. VAT is applied first, and thereafter the fixed amounts are added. The following list is not exhaustive. Excise duties are levied on oil derivatives; tobacco products; beer; alcoholic and non-alcoholic beverages; coffee; personal cars, motorcycles, boats, aircraft; and, luxury products.

4.7. Real estate transfer tax
A tax of 5% of the market value of real estate is imposed on the transfer of real estate ownership. The tax is payable by both domestic and foreign legal entities and individuals, unless an international treaty provides otherwise. Transfer of immovable property comprises any acquisition of immovable property in the Republic of Croatia. The tax base is the market value3 of real property at the moment of acquisition. The acquirer of real property is the one who is obliged to pay the tax.

According to the Law on Commercial Companies, real estate transfer tax is not payable when real property is contributed as a share capital into a company as well as when immovable property is acquired in the process of

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3 The agreed price of the immovable property but also the price that can be achieved on the market at the moment of the acquisition.
merger of companies or of disassociation of the company into several companies.

4.8. Tax treaties
In order to strengthen its relations with the foreign investors, Croatia has entered into a number of agreements with investors' home countries to provide mutual protection to investments and to avoid double taxation. According to the latest information received from Ministry of Foreign Affairs of the Republic of Croatia, Croatia has concluded Double Tax Treaties with the following countries:

Countries with which the Republic of Croatia has Double Tax Treaties

<table>
<thead>
<tr>
<th>Country of Residence of Recipient</th>
<th>Withholding Dividends</th>
<th>Tax Rates (%)</th>
<th>Interest Royalties</th>
</tr>
</thead>
<tbody>
<tr>
<td>Albania</td>
<td>10</td>
<td>10</td>
<td>10</td>
</tr>
<tr>
<td>Belgium</td>
<td>10.15</td>
<td>10</td>
<td>10</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>7</td>
<td>10</td>
<td>10</td>
</tr>
<tr>
<td>Canada</td>
<td>10</td>
<td>10</td>
<td>10</td>
</tr>
<tr>
<td>China</td>
<td>5</td>
<td>10</td>
<td>10</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>6</td>
<td>10</td>
<td>10</td>
</tr>
<tr>
<td>Denmark</td>
<td>5.15</td>
<td>5</td>
<td>10</td>
</tr>
<tr>
<td>Finland</td>
<td>5.15</td>
<td>5</td>
<td>10</td>
</tr>
<tr>
<td>France</td>
<td>5.15</td>
<td>5</td>
<td>0</td>
</tr>
<tr>
<td>Germany</td>
<td>15</td>
<td>4</td>
<td>10</td>
</tr>
<tr>
<td>Great Britain and Northern Ireland</td>
<td>5.15</td>
<td>10</td>
<td>10</td>
</tr>
<tr>
<td>Greece</td>
<td>5.10</td>
<td>10</td>
<td>10</td>
</tr>
<tr>
<td>Hungary</td>
<td>5.10</td>
<td>4</td>
<td>10</td>
</tr>
<tr>
<td>Italy</td>
<td>10</td>
<td>10</td>
<td>10</td>
</tr>
<tr>
<td>Macedonia</td>
<td>5.15</td>
<td>5</td>
<td>4</td>
</tr>
<tr>
<td>Malta</td>
<td>5</td>
<td>5</td>
<td>4</td>
</tr>
<tr>
<td>Norway</td>
<td>15</td>
<td>4</td>
<td>10</td>
</tr>
<tr>
<td>Poland</td>
<td>5.15</td>
<td>5</td>
<td>10</td>
</tr>
<tr>
<td>Romania</td>
<td>5</td>
<td>10</td>
<td>10</td>
</tr>
<tr>
<td>Russian Federation</td>
<td>5.10</td>
<td>10</td>
<td>10</td>
</tr>
<tr>
<td>Slovak Republic</td>
<td>5.10</td>
<td>10</td>
<td>10</td>
</tr>
<tr>
<td>Sweden</td>
<td>5.15</td>
<td>5</td>
<td>0</td>
</tr>
<tr>
<td>Switzerland</td>
<td>5.15</td>
<td>5</td>
<td>4</td>
</tr>
<tr>
<td>South Africa</td>
<td>5.10</td>
<td>10</td>
<td>5</td>
</tr>
<tr>
<td>The Netherlands</td>
<td>5.15</td>
<td>5</td>
<td>10</td>
</tr>
<tr>
<td>Turkey</td>
<td>10</td>
<td>10</td>
<td>10</td>
</tr>
<tr>
<td>Ukraine</td>
<td>5.10</td>
<td>10</td>
<td>10</td>
</tr>
</tbody>
</table>

4 Interest/royalties arising in one contracting state and paid to the resident of another contracting state is taxed in that other state, provided that the resident is the actual recipient.

5 Interest arising in one contracting state and paid to the resident of another contracting state is taxed only in that other state.

6 Interest arising in one contracting state and paid to the resident of another contracting state can be taxed in that other state.

7 Interest paid to the resident of one contracting state and arising from the source in another contracting state is taxed only in the first mentioned state.

8 Lower rate applies if the recipient has a stake of at least 25% in the distributing company.

9 Higher rate applies in all other cases.

10 Treaty signed, ratified, not yet in force.

11 Treaty concluded with former Yugoslavia applied.

12 Applies to income only.

13 Treaty signed, ratified, in force, text not available.

V. Audits and accounting

5.1. Accounting and audit regulation
Regulatory framework for accounting and auditing consists of the Accounting Law and Audit Law, both published in the Official Gazette of the Republic of Croatia No. 90 of 1992. Both laws are applied as of 1 January 1993 and have not been amended since then.

Persons obliged to keep books and prepare financial statements
Every entrepreneur whose registered office is situated in the Republic of Croatia shall ensure that business books are kept and financial statements are prepared in accordance with the basic principles of orderly bookkeeping, which shall be sufficient to show his/her business and state of affairs with respect to his/her assets.

Definition of an entrepreneur
For the purpose of the Accounting Law, entrepreneur is a legal entity managing a business undertaking for the sake of the profit. Entrepreneur is also a natural person who manages a business undertaking independently for the sake of the profit, if by separate statutory regulations it is subject to the payment of profit tax. The Law also applies to organizational units of the entrepreneur abroad, if foreign legislation does not require business books to be kept and financial statement to be prepared. Finally, the Law applies to organizational units (only a branch office and not a representative office) of a foreign entrepreneur operating in Croatia whose registered office is abroad.

The Accounting Law classifies entrepreneurs into 3 categories: small, medium-sized and large entrepreneurs.

Small entrepreneurs
Entrepreneur is regarded small if it does not exceed two of the following three conditions:
- total assets after deduction for losses expressed in the assets (loss above capital) - equivalent of DEM 2 million;
- total revenue in the 12 months prior to the drawing up of the balance sheet - equivalent of DEM 4 million;
- the average annual number of persons employed - 50 employees.
Medium-sized entrepreneurs
Entrepreneur qualifies as medium-sized if it exceeds two of the three conditions applicable to small entrepreneurs, but never exceeds two of the following three conditions:
- total assets after deduction for losses expressed in the assets - equivalent of DEM 8 million;
- total revenue in the 12 months prior to the drawing up the balance sheet - equivalent of DEM 16 million;
- the average annual number of persons employed - 250 employees.

Large entrepreneurs
Entrepreneur qualifies as large if it exceeds at least two of the three conditions applicable to medium-sized entrepreneurs.

For the purpose of the Accounting Law, banks, financial organizations, insurance and reinsurance companies shall be deemed as large entrepreneurs.

5.2. Accounting principles
International Accounting Standards are applied in Croatia.

The following fundamental accounting concepts are identified by the Accounting Law with which all accounts are required to comply:
- the going concern concept;
- the consistency concept;
- recognition of business changes in the moment they occur.

In preparation of financial statements the following general principles of item evaluation shall be adhered to:
- prudence;
- precedence of substance over form;
- value characteristics;
- individual evaluation;
- interconnection of balance sheet items in respect to time.

Business books
Business books shall be kept according to the principles of double entry book-keeping system.

Business books are:
- The journal. This book is used for recording transactions in the order in which they occur, both for the balance sheet and the off-balance sheet items;
- The ledger. This book is a systematic bookkeeping record of changes that occur in assets, liabilities, income, and expenses as well as in business result.

It consist of two separate parts for balance sheet and off-balance sheet records:
- Auxiliary records. They are organised separately.

Chart of accounts
The accounting records are based on a chart of accounts, which provides a format (by account title and number) for balance sheet, profit and loss and off-balance sheet accounts.

The organisation of the chart of accounts is not prescribed, but the forms of the balance sheet and the profit and loss account are. The chart of accounts is prescribed for banks, i.e. the first 6 digits of an account. This rule may be liberalised soon, or this obligation for the banks may be abolished.

Period for keeping the account records
The accounting records are kept for the financial year, which, regularly, corresponds to a calendar year. The ledger and the journal should be preserved for at least ten years and auxiliary records for five years.

5.3. Basic financial statements
Basic financial statements consist of:
- balance sheet;
- profit and loss account;
- statement of changes in financial position;
- notes to the financial statements.

Basic financial statements must give a true, reliable and unprejudiced view of the assets, liabilities, capital, cash flows and profit or loss, and they have to be signed by the authorised representative of the institution.

Requirement to prepare financial statements
Basic financial statements shall be prepared for the financial year. Financial statements shall be written in Croatian and expressed in Croatian Kunas with the auditors’ report enclosed.

Small entrepreneurs are not obliged to prepare the statement of changes in financial position.

Additional requirements for large entrepreneurs
Large entrepreneurs are required to prepare an annual report which, in addition to the financial statements, includes information for:
- all significant business events in the financial year;
- business development;
- research and development activities;
- acquisition of own shares.
Audit requirements
Financial statements of all large entrepreneurs, and of all medium-sized entrepreneurs organised as joint stock companies, are subject to audit once a year.
Small entrepreneurs organised as joint stock companies are subject to abridged audit (i.e. insight into operations) every third year.

Other medium-sized or small entrepreneurs are subject to audit as provided by their rules or by-laws.

Submission of financial statements and annual reports to shareholders
Large entrepreneurs are required to submit their financial statements and annual reports to their shareholders not later than six months following the year-end.

Medium-sized and small entrepreneurs are required to submit their financial statements and annual reports to their shareholders/owners not later than four months following the year-end.

Group, which consolidates the accounts, is required to submit its financial statements and annual reports not later than nine months following the year-end.

5.4. Audit firms
Audit firm is a legal entity registered for performing an audit. Audit firms are also entitled to deliver services in the field of accounting, tax advising, financial analysis and control.

The audit can be carried out either by an audit firm registered in Croatia or as a joint audit of a Croatian and a foreign audit firm. In any case, it has to be performed in the manner and according to International Auditing Standards.

Auditors' rights to access the information
The auditor has a statutory right of access to the accounting records and the information and explanations he considers necessary for the purposes of the audit. If the entrepreneur limits the scope of investigations or prevents the implementation of certain audit procedures, the auditor has to state that fact in his report.

Contents of the auditors' report
The auditors' report contains:
- the opinion;
- financial statements prepared by the management which were subject of the audit together with notes.

The report has to be signed by the authorised auditor and laid before all lawful representatives of the entrepreneur.

5.5. Consolidated financial information
Consolidation of financial statements shall be performed by holding companies in respect to subsidiaries, and the consolidated financial statements presented as group accounts.

Consolidation is performed for the purpose of determination of the state of assets, liabilities, capital, expenses, income and business result of all the participants in the consolidation as if they were a single whole.

VI. Investment opportunities by sectors

6.1. Sector overview

6.1.1. Tourism
The country offers diverse forms of tourism, including hunting and fishing, health tourism with 19 continental and sea resorts, nautical tourism with 44 marinas and about 15,000 berths, diving, religious tourism, cruising, etc. UNESCO protects numerous cultural monuments, e.g. Dubrovnik and National Parks such as Plitvice Lakes. Croatia has 1,185 islands that stretch from Dubrovnik to Istria. The Croatian coast remains attractive due to its mild climate throughout the entire year. Substantial investment is needed to improve the quality of service and capacity of the sector.

6.1.2. Agribusiness
Agriculture plays a major role in the economy, generating between 7.0 and 8.2% of GDP (1996-1998). Farming covers domestic needs for cereals and sugar, as well as industrial crops to a large extent. Fishing and fish processing have traditionally been the most important activities along the coastal part of Croatia and on the islands. There are currently 18 factories for fish processing in Croatia.

Food, beverages and tobacco
The Croatian food industry includes some of the most successful Croatian companies: 12 out of the 50 Croatian companies with the highest revenues in 1998 produce food, beverages and tobacco. The major export products of these industries are: Vegeta (food seasoning), biscuits and wafers, chocolate, canned fish, meat and cheese products, soups, olive oil, cigarettes, wine, beer and other alcoholic beverages.

Best investment opportunities exist in marine aquaculture, milk production, fish canning, wine production, meat and meat products, and early vegetables.
6.1.3. Manufacturing
The major industrial sectors are textiles and clothing, food processing, chemicals (incl. pharmaceuticals) and oil processing, metal processing, shipbuilding, timber and industrial machinery, and power generating equipment. In terms of employment and exports the textile and clothing industries lead the way followed by the manufacture of ships, metal and electrical industries, as well as wood industry.

6.2. Infrastructure
6.2.1. Transport
Croatia has 29,000 km of roads, out of which 20,000 are asphalted; 2,762 km of railways (983 km electrified). The main ports, Rijeka, Split and Ploce are well connected with the inland. Airports are located in the following coastal cities: Pula, Rijeka (Krk), Zadar, Split, Dubrovnik; on the island of Brac; and in the inland cities of Zagreb and Osijek. There are plans to build airports on the islands of Korcula, Hvar and Vis in near future.

The government welcomes the participation of western companies in the development of major infrastructure projects. Pan-European Transport Corridors No. V and X cross the country. Priority is given to the following three routes: Gorican-Zagreb-Rijeka (linking Central Europe with the Adriatic), Macelj-Zagreb-Belgrade (linking Western Europe with the Balkans), Zagreb-Dubrovnik (via Zadar-Sibenik-Split) (important for the development of tourist inflows).

6.2.2. Telecommunications
Croatian Telecom Inc. (HT) is the leading telecommunications services operator in Croatia, established on 1 January 1999 after the separation of the former monopolist Croatian Post and Telecommunications. HT is a joint stock company where 65% is owned by the state and 35% by Deutsche Telekom AG.

Croatia has more than 2 million installed fixed telephone lines. The goal of HT is the digitalisation of the complete switching and transmission infrastructure (74% digitalisation in the beginning of 1998). HT has introduced 3 mobile telephone networks - an analogous (NMT) network MOBITEL, a digital (GSM) network CRONET, and a BIP - HT paging system, based on ERMES standard.

6.2.3. Energy
Hrvatska Elektroprivreda (HEP) is a state-owned company, which carries out the activities of generation, transmission and distribution of electricity in the entire territory of Croatia, and operates the national power system. HEP supplies about 95% of the total electricity requirements in the country. The remaining 5% is produced in industrial co-generation plants, mainly for consumers' own needs, and in small private HPPs. HEP produces and distributes heat through district heating systems in Zagreb, Osijek and Sisak, and distributes gas in Osijek.

The Law on Electrical Utilities paves the way for the privatisation of the company. In the next 10 years Croatia will require an additional 1,500 MW of installed capacity (1,100 MW to be provided by TPP, and the rest by HPPs). Total investment required in the sector is estimated to USD 4.4 billion (46% will go for generating capacities, 16% for transmission, and 38% for distribution). The foreign share in these investments is expected to be 60%, mainly in the new HPPs, which will be built under the independent-power-producer (IPP) and single buyer schemes.