



Taxes in Hungary, Serbia, and Croatia: a brief overview

All three countries share similar tax environment and regulations: all have VAT and income tax and social contributions are withheld by the employer. However, tax rates differ, as well as the efficiency of the tax authorities. Labor and VAT tax rates are more favorable to business in Serbia, but its tax authorities are known to be slow, inefficient, and partial in dealings with tax payers. For a company that is labor intensive and exports outside of the region, labor tax and VAT rates are the most important ones to determine its most efficient investment location.

Tax regulations in Serbia, Hungary and Croatia follow international standards, so their main characteristics are similar: taxes are paid only on income derived from activities in Hungary, fiscal year is from January to December, tax residence is determined by the fact if the natural person has resided more than 183 days in the country within a year etc.

The tax environment can be estimated through total tax burden, as well as through the quality of tax administration. The Doing Business Report of the World Bank tries to qualify tax system to a certain extent through its Paying Taxes indicator. This indicator measure what are time, number of payments, total tax rate (calculated as total taxes paid in comparison to gained profits) necessary for a local medium size enterprise to pay all taxes and to comply with post filing process.

The constructed Quality Index is based on the total time needed to comply with the VAT refund procedure, time to obtain the VAT refund, time to comply with the corporate income tax audit and complete a corporate income tax audit.

Paying Taxes WB	OECD income	high	Hungary	Croatia	Serbia
Rank	-		93.	95.	82.
DTF score	83.1		71.5	79.0	73.6
No of payments	-		11	35	33
Time in hours	-		277	206	225.5
Total tax rate	-		46.5%	20.6%	39.7%
Post filing Index	83.5		63.9	62.2	91.1

DTF score = distance to frontier measured to the best performing economy;

However, since all companies have professional financial and accountant service, these regulations can be troubling but are not the most burdensome. For companies that would engage in production for exports, the most burdensome tax regulations would be those on VAT refund and the total time



necessary to receive those funds back. In this regard, Croatia outperforms by a high margin both Serbia and Hungary, that have almost identical results.

There is currently a delay in VAT refunds in Serbia, which is the consequence of the new and supposedly temporary policy of tax authorities to deeper audit VAT refunds in the country, due to allegations of many misconducts. There are data that many companies would close down in a couple of days after they received the VAT refunds, and that would open at a later date again, which raised red flags for some possible misconduct on a wider scale. This policy has extended the VAT refund from 8.2 in 2015/2016 to the current 14.7 in 2016/2017; however, there is a high probability that VAT refunds in the future would turn back to its previous level.

	Hungary	Croatia	Serbia
Time to receive VAT refunds – in weeks	15.2	6.2	14.7

From the point of labor costs, Serbia provides a more suitable destination for investments that are labor intensive. Not only are wages in Serbia significantly lower than those in Hungary and Croatia, but labor taxation (through both income tax and social security contributions) is less burdensome. For example, when calculated on an average salary, for every worker paid in Hungary or Croatia - almost two workers can be hired in Serbia.

	Hungary	Croatia	Serbia
Average net wage	657	800	396
Average gross wage	988	1093	546
Total labor costs	1220	1281	644

Net wage = money taken home by an employee; Gross wage = wage from the contract, including income tax and social security contributions paid by the employee; Total labor costs = gross wages plus social security contributions paid by the employer

When sales tax is taken into accounts, all three countries have a VAT tax system, although with different rates. VAT is applied to all goods and services, and afterwards it is refunded for VAT sources that were paid by suppliers on intermediate goods, or in full if the products are exported. Regular VAT rates in all countries are applied to the vast majority of products, while preferential rate(s) is applied to a limited number of products classified as necessities, such as basic foodstuffs, medicine or publishing. The EU VAT regulation has somewhat harmonized VAT rates across Europe, making an obligatory span for VAT rates, with the minimum of 5% and the maximum of 25%. Hungary, however, introduced the 27% VAT rate after the recession that followed the financial crisis in 2009 as temporary measure, but continues to apply it. Theoretically, Hungary should decrease the VAT rate below the upper EU threshold, but there is no information if and when this move could take place. VAT rates are also more favorable to entrepreneurial activities in Serbia, than in Croatia or Hungary.



	Hungary	Croatia	Serbia
Preferential VAT rate	18% (and 5%)	13% (and 5%)	10%
Regular VAT rate	27%	25%	20%

Corporate tax rates in all three countries are very favorable when compared to OECD countries, but Hungary and Serbia beat Croatia in this measure. Croatia has, therefore, recently introduced changes in corporate tax regime, in order to align its tax rate more with its regional peers, lowering its tax rate for 2 percentage points and introducing a significantly lower tax bracket for small companies. But even after these changes, its corporate tax regime remains less attractive than those of Serbia and Hungary.

	Hungary	Croatia	Serbia
Corporate tax rate	9%	18%	10%
Special tax rate	-	12%	-

Other taxes and surcharges can also be numerous, but they are less generous than the above-mentioned VAT, corporate or income tax and social security contributions. These smaller taxes and surcharges strongly differ between countries, and divided between the central and local government. The most important ones for majority of businesses is the property tax, an important source of income for local government in all three countries, while the most important tax for new business ventures is the one-off transfer tax for purchase of land and real estate.

	Hungary	Croatia	Serbia
Transfer tax	4%	4%	2.5%
Property tax	3% for land; 3.6% for buildings	-	0.3 – 0.4%

The system of parafiscal surcharges in Serbia is still not well regulated – there are hundreds of small surcharges on the central government and local level. There is not even an official list of them, which decreases business predictability. However, the new Law on taxes and surcharges in Serbia is being written, supported by the IMF, and it is expected to eliminate the possibility of easy introduction of new local surcharges and make the system more predictable.

An important caveat regarding the uneven quality of tax authorities in different areas of the country should be taken into account, since the recent World Bank study (Doing Business in the European Union 2017: Bulgaria, Hungary and Romania) showed that there can be a high level of variation in the local administrative quality, although the study did not cover Paying Taxes section. In Serbia, tax authorities are divided between the central and local government – the central government tax authorities are under the Ministry of finance and it controls the most important taxes. The Ministry has dispersed taxed authority branch offices across the country, covering smaller administrative areas. Apart from that, local



government (municipalities and towns) have their own local tax authorities which are in charge of smaller local taxes. Therefore, it is possible that administrative capacities differ not only in the case of local tax authorities, but also between local branches of the central tax authorities.

Case study

A hypothetical example could do well to illustrate the potential attractiveness of tax regimes in Serbia, Hungary, and Croatia. The case study regards a processing company that employs 50 workers on an average salary, makes 25 million euros in exports with a 10% revenue margin. Wage and VAT expenses (calculated as monetary costs of the VAT payables, which are paid and afterwards refunded, with predominant bank interest rate on liquidity loans in the country: Hungary 3.22%, Croatia 3.62%, Serbia 2.92%) and corporate taxes are considered as the main expenses of the enterprise.

	Hungary	Croatia	Serbia
1 Revenue margin	2 500 000	2 500 000	2 500 000
2 VAT payable	6 750 000	6 250 000	5 000 000
3 VAT expenses (2*interest rate*duration)	63 000	28 000	39 400
4 Wages expenditures	732 000	768 600	386 400
5 Total expenses (3+4)	794 000	796 000	425 800
6 Gross earnings (1-5)	1 706 000	1 704 000	2 074 200
7 Corporate tax (6*tax rate)	153 540	306 720	207 420
8 Net earnings (6-7)	1 552 460	1 397 280	1 866 780
9 Net earnings as % of the margin	62.1%	55.9%	74.7%

The table illustrates that the biggest profits under the same circumstances can be achieved in Serbia, followed by Hungary and with Croatia at the end of the list. Serbia provides almost twice the profits that could be expected in Croatia, and more than a half of it expected in Hungary. Serbian business environment is more suitable for the enterprise from this case study due to: (1) lower wages expenses (because of the lower level of wages but also lower labor tax and social security contributions), (2) lower VAT expenses (because of the lower VAT rate), and (3) low corporate tax rate. In the case study above, the described company would have acquired more than 300 000 EMU or 20% more profit on an annual basis if operating in Serbia, than in Hungary. Numbers for Croatia are even less promising.