Introduction
Transfer pricing provisions in Croatia were introduced through the Corporate Income Tax (CIT) Act on 1 January 2005, but only in recent years the Croatian tax authorities have recognised the importance of transfer pricing. The result is an educated transfer pricing team of the tax authorities with access to the Amadeus database, as well as an increased number of audits related specifically to transfer pricing.

Generally, Croatian transfer pricing regulations mostly rely on the arm’s-length principle and methods specified by the Organisation for Economic Co-operation and Development (OECD) Guidelines.

Statutory rules
Transfer pricing regulations application
The transfer pricing regulations are applied to all cross-border transactions between domestic entities and their related parties, as well as to transactions between resident related parties, where one party has:

- preferential tax status, i.e. pays profit tax at the decreased tax rate
- the right to utilise tax losses carried forward from the past periods.

Legislative framework
Transfer pricing rules are prescribed by the CIT Act and by the CIT Ordinance.

According to the transfer pricing provisions of the CIT Act and the related ordinance, the business relations between related entities will only be recognised if a taxpayer has and provides (at the request of the tax authority) the following information:

- Information about the group, the position of the taxpayer in the group and the analysis of related transactions, i.e. general information about the group and the specific information about the taxpayer.
- Identification of the method selected, a description of information reviewed, the methods and analyses used to determine the arm’s-length price and the rationale for selecting the specific method.
- Documentation about the assumptions and valuations made in the course of determining the arm’s-length price (which would underline benchmark analysis, functional analysis and risk analysis).
- Documentation about all calculations made in the course of the application of the selected method in relation to the taxpayer and any comparables used in the analysis.
- Updated documentation that relies on a prior-year analysis containing adjustments because of material changes in relevant facts and circumstances.
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According to the CIT Act, the following methods can be used to determine the arm’s-length price:

• The comparable uncontrolled price method.
• The resale price method.
• The cost-plus method.
• The profit split method.
• The net-profit method (which is equivalent to the transactional net margin method under the OECD Guidelines).

**Arm’s-length principle**

Prices between a Croatian entity and its foreign-related party or domestic-related party (under certain conditions) must be charged at arm’s length. The prices between related entities which are different from the market prices will not be recognised for tax purposes.

**Definition of related parties**

The General Tax Act defines related entities as legally independent companies which, in their mutual relations, satisfy the following:

• Two or more natural or legal persons which for carrying out the obligations under the tax-debt relationships constitute a single risk because one of them, directly or indirectly, holds control in the others or, directly or indirectly, has significant influence on others.
• Apart from control of significant influence, related entities will also be those where deterioration or improvement of the economic and financial condition of one person can cause the deterioration or improvement of the economic and financial condition of others, because there is a possibility of the transfer of losses, profits or payment capability.

**Deadline for submitting the TP documentation**

Although the tax regulations state that TP documentation should be available on the Tax Authority request, the recent Tax Authority’s initiative demonstrates that the documentation should be available at the time of CIT return submission, which is four months upon the financial year-end.

**Other regulations**

There are no other regulations, but the OECD Guidelines can be used as a general guide. Additionally, the tax authority has issued the Guidebook for the Surveillance of Transfer Pricing. It is not a binding regulation and its purpose is to serve as a guideline for the tax authority’s inspectors during the transfer pricing surveillance. However, it can also be used as a guideline for taxpayers.

**Legal cases**

There are no legal cases in Croatia related to transfer pricing.

**Burden of proof**

The burden of proof lies with the local taxpayer.
**Tax audit procedures**

In Croatia, in order to be fully recognised for tax purposes, all costs incurred between two companies must meet the following conditions:

- They should be proven as necessary and provided for the benefit of the local company.
- The description of the services on the invoice must correspond to the services actually provided.
- The invoice must be supported with documentation of services provided (e.g. in case of consulting or advisory activities, this may include various correspondence, emails, reports, projects, etc.).
- The value on the invoice should be an arm’s-length price.

Currently there is no special tax audit procedure specific to transfer pricing that differs from the regular tax audit procedure. However, the tax authority has published the Guidebook for Surveillance of Transfer Pricing, which is designed for internal use, but is also available to all taxpayers.

**Revised assessments and the appeals procedure**

The standard legal procedure is for the tax authority to issue a resolution at the conclusion of the tax audit (i.e. first instance).

Prior to the issuance of the resolution, the tax authority issues ‘tax audit minutes’. The taxpayer has an opportunity to object to the tax audit minutes and make written comments/remarks about the statements made in the minutes. Subsequently, the tax office issues the written resolution.

If, at the first-instance level, the tax office does not accept the taxpayer’s objection to the resolution, the taxpayer can appeal to the Central Tax Office (i.e. second instance). In the second instance, the Central Tax Office will issue a second-instance resolution. With this second-instance resolution, the Central Tax Office can resolve the conflict itself or prepare instructions for the first instance as to how to resolve the conflict.

In the event that the second-instance resolution is unfavourable and not acceptable to the taxpayer, the taxpayer may next appeal the second-instance resolution.

**Additional tax and penalties**

Current Croatian legislation does not proscribe additional tax and penalties in relation to transfer pricing. The general penalties contained in the law apply to these cases as well. However, if the prices between related entities are different from those between non-related resident and non-resident entities, any excess amounts will not be recognised for taxation purposes.

**Resources available to the tax authorities**

The Tax Authority has access to the Amadeus database. The Tax Authority is also known to use publicly available, relevant data from other companies that operate in the Croatian market.

**Use and availability of comparable information**

*See previous section.*
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Risk transactions or industries
Transfer pricing is an area of increasing interest for the Croatian Tax Authority. So far, they are not organised on an industry-specific basis, but special attention has been directed towards management fees and royalties charged between related parties, which may trigger an inspection.

Limitation of double taxation and competent authority proceedings
While mutual agreement provisions exist in Croatian tax treaties, there is currently little practical experience in this area. Croatia has signed 52 Double Tax Treaties (DTT).

Advance pricing agreements (APAs)
Croatia does not have an APA programme in place.

Anticipated developments in law and practice
We do not have information about potential law changes or practice developments in the near future. Croatia should join the European Union (EU) on 1 July 2013, but as the TP regulation is already in accordance with OECD Guidelines, no major changes should be introduced.

Liaison with customs authorities
Tax Authorities are related with the customs authorities and should they identify irregularities, they will notify customs authorities.

OECD issues
None. Croatia is not as yet a member of the OECD, but the transfer pricing provisions generally reflect the arm’s-length principle and methods provided by OECD Guidelines.

Joint investigations
We are not aware of joint investigations at this time.

Thin capitalisation
Thin capitalisation provisions were introduced on 1 January 2005. These provisions state that interest payments on loans from a shareholder of a company holding at least 25% of shares or voting power of the taxpayer will not be recognised for tax purposes if the amount of the loan exceeds four times the amount of the shareholder’s share in the capital or their voting power, except the interest payments on loans received from a financial organisation.

A third-party loan will be considered to be given by a shareholder if it is guaranteed by the shareholder.

Management services
These services consist of various consulting and business services, which are attracting the attention of the Tax Authority. The Tax Authority is very aggressive in challenging the deductibility of this type of expense. Therefore, in order to prove these services are tax-deductible, the taxpayers must satisfy the terms stated under the tax audit procedures section (i.e. have sufficient support or evidence for the provision of the services).