



Tax Insights
from International Tax
Services

Signing of Protocol to US-Croatia treaty suggests significant development on US treaty program

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In brief

What happened?

The United States and Croatia signed a protocol (the Protocol) amending the pending US-Croatia income tax treaty (the Treaty) on April 28, 2026. The delay in advancing the Croatian income tax treaty, signed in 2022, was due to needed discussions between the US Treasury Department and the Senate regarding an acceptable Double Tax Relief article. A key point of discussion was whether US tax treaties should obligate the United States to provide an indirect foreign tax credit consistent with Section 960. This issue is addressed in the Protocol.

Why is it relevant?

The Treaty was signed on December 7, 2022, but has not yet entered into force. The Protocol makes changes that Treasury believes will facilitate its transmission to the Senate for advice and consent to ratification. No treaties or protocols have advanced to the Senate ratification stage since the ratification of the US-Chile treaty on June 22, 2023. The resolution of coverage of the indirect tax credit could open the door to advance other pending agreements and further treaty negotiations. One long-awaited agreement is a new or revised treaty between the United States and Switzerland. Although it previously had been reported that the United States and Switzerland had reached agreement on the details of a new or revised treaty, there could be further discussions regarding the Double Tax Relief article in light of the revised approach reflected in the Protocol.

Actions to consider

Because the Treaty and Protocol reflect what has been indicated to be Treasury's current tax treaty policy, taxpayers that have investments or dealings with Croatia--and taxpayers that rely on US tax treaties in general--should monitor these developments.

In detail

Background

The US income tax treaty with Croatia that was signed in December 2022, but is not yet in force, is the first bilateral income tax treaty between the United States and Croatia. For a detailed discussion about the Treaty and its significance beyond taxpayers engaged in work, trade, and investment involving Croatia, please refer to our PwC Insight – Newly signed treaty with Croatia reflects a major shift in US income tax treaty terms.

The US Model Treaty, which is generally the starting point for US income tax treaty negotiations, was last updated in 2016, prior to the enactment of the Tax Cuts and Jobs Act (TCJA) in 2017. The 2016 US Model contains provisions shifting the historical focus on the treaty policy goal of encouraging cross-border investment by reducing incidences of double taxation, toward a heightened focus on preventing or limiting the use of income tax treaties to facilitate 'stateless income.' Among these provisions are significantly tighter limitation on benefits (LOB) requirements to access the benefits of a tax treaty. Because the Treaty with Croatia is the first US income tax treaty to be fully negotiated post-TCJA and on the basis of the 2016 US Model Treaty, it could signal trends for future treaties.

Observation: The 2016 US Model is 10 years old and was released prior to the TCJA. Further, in contrast to the 1996 and 2006 versions of the US Model Treaty, a technical explanation, which provides a basic explanation of US treaty policy, has not been released.

Summary of the Protocol

As announced by Treasury, the amendments to the Treaty incorporated by the Protocol are intended to bring the Treaty into conformity with aspects of current US law and to reflect discussions with the US Senate on the rules regarding relief from double taxation to be included in new tax treaties.

Observation: In its announcement, Treasury specifically highlights the Treaty's significance as reflecting post-TCJA US law and current income tax treaty policy.

Below is a summary of the Protocol's provisions.

Active conduct of a trade or business definition

Article I(3) adds a clause that defines the term "active conduct of a trade or business" within the LOB article.

Observation: The added language, which draws on the definition of 'trade or business' in regulations under Section 367(a), is consistent with language that is often included in Treasury's technical explanation of a treaty's active trade or business provisions. It is not clear what motivated this addition.

Relief from double taxation

Article II of the Protocol replaces paragraphs 2, 3, and 4 of the Relief from Double Taxation article (Article 23) of the Treaty.

Paragraph 2 of the Treaty deals with the obligation of the United States to provide a credit to US residents or citizens for taxes paid to Croatia, and to provide a dividends-received-deduction for 10% shareholders of a Croatian company. The Protocol amends this provision by adding that the United States will allow a credit to a US resident or citizen that is a US shareholder or a foreign controlled US shareholder of a Croatia-resident controlled foreign corporation (CFC) or foreign controlled foreign corporation (FCFC) for income tax paid or accrued to Croatia by the CFC or FCFC that is properly attributable to the profits giving rise to an income inclusion of that US resident or citizen.

Observation: There is a significant change to the introductory language to the provisions of paragraph 2 of the Relief from Double Taxation article in the Treaty and the Protocol. Where the standard formulation in US income tax treaties currently in force provides “[i]n accordance with the provisions and subject to the limitations of the law of the United States (as it may be amended from time to time without changing the general principle hereof),” the language in the Treaty as modified by the Protocol is “[i]n accordance with the provisions of, and to the extent allowed under, the law of the United States (as it may be amended from time to time without changing the general principle hereof).” The inclusion of the phrase “to the extent allowed under” US law adds a restrictive reading of the introductory language in line with the decision in *Toulouse v. Commissioner*, 157 T.C. 49 (2021).

Observation: The reference to a credit for a US resident or citizen that is a US shareholder or a foreign controlled US shareholder of a Croatia-resident CFC or FCFC for income tax paid to Croatia that is properly attributable to the profits giving rise to an income inclusion of that US resident or citizen is a meaningful amendment and differs from the relief from double taxation provision in the 2010 income tax treaty with Chile, which did not include such a provision. See our PwC Insight – [US-Chile treaty enters into force](#). As discussed in the Insight, because the TCJA made changes to certain domestic law foreign tax credit rules, it was considered that certain Relief from Double Taxation provisions of the treaty with Chile, which had been signed prior to the TCJA, had to be amended to address those TCJA changes. This modification was done by replacing the indirect foreign tax credit language that had been in the treaty with a dividends-received-deduction provision. However, the Chilean treaty did not include an indirect credit commitment, which had been included in US income tax treaties entered into prior to the Chilean treaty. At the time, the Senate indicated that further work would be needed with respect to future treaties to fully evaluate the policy reflected in the Relief from Double Taxation article in view of the changes resulting from the TCJA.

Paragraph 3 of the Treaty provides that the Croatian taxes that are referred to in the Taxes Covered (Article 2) are considered income taxes for this purpose, and it provides a resourcing rule for income of a US resident or citizen that may be taxed in Croatia under the Treaty. This language remains largely unchanged as a result of the Protocol, although the portion pertaining to the taxes considered to be income taxes has been moved.

Paragraph 4 pertains to US citizens that are residents of Croatia and provides rules for how the United States and Croatia allocate taxing rights (often referred to as ‘the three-bite rule’). This provision remains largely unchanged as a result of the Protocol.

Non-discrimination

The Treaty’s Non-Discrimination article (Article 24) provides that nationals of a Contracting State will not be subjected in the other Contracting State to any taxation or related requirement that is more

burdensome than the taxation and related requirements to which nationals of that other Contracting State in the same circumstances are or may be subjected. The provision applies to persons that are not residents of one or both of the Contracting States, but it is noted that for the purposes of US taxation, US nationals that are subject to tax on a worldwide basis are not in the same circumstances as nationals of Croatia who are not residents of the United States. Article III of the Protocol deletes the first paragraph of the non-discrimination article and replaces it with language that is similar except that additional language is included providing that the United States is not obligated to grant to a national of Croatia certain benefits (e.g., personal allowances, reliefs, and reductions for tax purposes) unless certain information is provided.

Observation: This amendment coordinates with certain rules enacted as part of the One Big Beautiful Bill Act of 2025.

Protocol ratification and entry into force

Article IV of the Protocol pertains to certain procedural aspects related to ratification and entry into force of the Protocol, which will be on the date of entry into force of the Treaty.

Next steps and impact on other pending treaties

In its announcement of the Protocol, Treasury indicated that it will be transmitted as a package with the Treaty to the Senate for advice and consent. In recent decades, despite Treasury's ongoing negotiation of income tax treaties, there have been only isolated instances where the Senate has considered pending income tax treaties, most recently approving the treaty with Chile in 2023. In addition to the Croatia Treaty, there are currently pending treaties with Hungary (2010) (although the previous treaty with Hungary was terminated, so it is possible that the pending treaty will not advance), Poland (2013), and Vietnam (2015). Negotiations reportedly have been initiated with respect to treaties with other countries (e.g., Norway and Switzerland), although those treaties have not yet been signed.

Observation: Treasury's indication that the signing of the Protocol will allow the administration to transmit the Treaty and Protocol to the Senate for advice and consent could signal forthcoming movement on pending agreements, although procedural hurdles in the Senate could continue to impair the ratification process.

Let's talk

For a deeper discussion of how this treaty development might affect your business, please contact:

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