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flash Alert

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United Kingdom – New Treaty with Croatia to Replace 1981 Treaty

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Her Majesty's Revenue & Customs (HMRC) in the United Kingdom has confirmed that an agreement between the U.K. and Croatia was signed on 15 January 2015, which amends the existing double taxation treaty signed with Yugoslavia in 1981.¹ The amended agreement will come into force when both countries have completed their parliamentary procedures and exchanged diplomatic notes.

Why This Matters

The amended agreement makes a number of changes to articles relevant to U.K. individuals working in Croatia and Croatian individuals working in the United Kingdom that affect their residency status, potential double taxation and relief therefrom, permanent establishment, etc. This treaty, notably, does not contain a remittance basis clause. Employers with operations in the two countries should be aware of the changes and the fact that the way tax liabilities are computed in the host location will change once the new treaty is in force.

Treaty in Summary

The agreement, or treaty, is based on the current OECD model treaty and contains the standard OECD provisions relating to the exchange of information between the U.K. and Croatia.

This newsletter summarizes briefly the provisions that may concern international executives and their employers.

Interest and Dividends

The treaty allows the source country to tax interest or dividends arising in that country and paid to a resident of the other country. Dividends will be taxed at 5 percent where the individual has direct or indirect control of 25 percent of the company or at 15 percent where the dividends are paid out of income derived directly or indirectly from immoveable property and distributed from an investment vehicle. All other dividends will be taxed at 10 percent. In the current convention, the reference to investment vehicles does not exist and other dividends are taxed at 5 percent and 15 percent respectively.

Interest can now be taxed in the source country at a rate not exceeding 5 percent, whereas in the current convention the rate is 10 percent.

Remuneration and Director's Fees

Remuneration from employment derived by a resident of one country for services performed in the other country can be excluded from tax in that other country provided the remuneration is paid by an employer who is not a resident of the country where the services are performed and the employee is not present in that country for more than 183 days.

The treaty will require taxpayers to consider presence in the other country over any 183-day period starting or ending in the fiscal year in question, as opposed to current practice where only presence exceeding 183 days within the fiscal year would lead to a tax liability. This change is likely to reduce the availability of relief. The article continues to contain the standard provisions prohibiting relief where costs are borne or recharged to the other country from the source country.

Director's fees continue to have the potential to be taxed in both locations with the appropriate relief being given for double taxation.

Relief for Foreign Taxes

The treaty allows relief for taxes paid in the U.K. by a resident of Croatia to be given as a deduction from the taxes due in Croatia. The deduction given will be restricted to the lesser of the Croatian tax payable or the U.K. taxes paid on that same income.

The U.K. will give a credit against the overall U.K. tax liability for the Croatian taxes paid and due under the treaty. The credit will be restricted to the lesser of the U.K. tax payable or the Croatian taxes paid on that same income.

Pensions and Pension Contributions

Pensions paid to a resident of one of the contracting states will be taxable only in the state where the individual is resident. However, a lump sum paid will be taxed in the state in which the pension scheme is established.

The treaty now provides for relief in the host country for pension contributions made to a tax-recognized pension scheme in the home location for both income and corporation tax. The relief available is subject to the same conditions and limits as a scheme in the host country and that country must recognize the scheme as being broadly equivalent to a qualifying pension scheme in that location. To qualify for relief under the article, the employee must have been nonresident in the host state and a member of the pension scheme prior to starting work there.

Remittance Basis Clause

Many U.K. treaties limit relief when income is taxable only if remitted to the U.K. and that income is not remitted. This treaty does not contain such a remittance clause.

Next Steps

The new treaty will enter into force once it has received parliamentary approval and has been ratified by both countries.

Footnote:

1 The full text of the treaty can be found at:

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/394970/Croatia_and_UK_tax_treaty_-_not_in_force.pdf .

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The information contained in this newsletter was submitted by the KPMG International member firm in the United Kingdom. The information contained herein is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser.

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