

## Research on Tax Administration of Construction Enterprises in European Union

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**Abstract:** The shift in the global economic landscape has opened up significant opportunities for domestic construction enterprises to expand their reach abroad through the implementation of the national "Belt and Road" initiative. This has led to a surge in overseas engineering projects, greatly accelerating the development of these enterprises. In recent years, China has undertaken a significant number of construction projects in Southeast Asia, Central Asia, Africa and other regions, thereby accumulating a substantial body of experience in the implementation process. However, there has been a paucity of projects in Europe, particularly in EU countries, which have been subject to analysis of the principal tax types involved in construction enterprises in the EU, with a view to identifying and comparing the differences. In light of the domestic tax and the experience gained from the construction of projects in Croatia, this paper puts forward suggestions regarding the tax administration of construction enterprises in the EU. The aim is to avoid tax risks, reduce the tax burden and improve the economic benefits of overseas construction projects through the implementation of tax planning strategies. The disparate tax system and rigorous implementation procedures present significant challenges for construction enterprises. In the context of tax management, it is crucial for these enterprises to identify strategies to mitigate the tax risks inherent in project implementation and to utilize tax planning techniques to minimize their tax burden.

**Keywords:** European Union, Tax Administration, Construction Enterprises,

### Tax Risk

#### 1. Introduction

The European Union (EU) is an international organisation comprising 28 member states. The EU does not levy taxes, which are instead the responsibility of individual member countries. Member countries are free to tailor tax laws to their national needs, while at the same time they must adhere to certain fundamental principles, such as the principle of non-discrimination and respect for the free movement of the internal market. In order to ensure fair and effective taxation of cross-border activities within the EU, the EU implements cooperation procedures and legal frameworks.

#### 2. The Main Taxes Involved in Construction Enterprises in the EU

##### 2.1 Value-Added Tax

###### 2.1.1 Target of tax increase

Value Added Tax [1] (VAT) is a tax levied on businesses for the sale of goods or services, the importation of goods, and the purchase of goods within the European Union (EU) Community. VAT [2] payers are defined as legal entities and individuals who are legally obligated to pay the VAT according to the tax law. This specifically refers to legal entities and individuals engaged in the sale or importation of goods or the provision of processing, repair, and taxable services within the territory.

###### 2.1.2 Scope of collection

Value Added Tax (VAT) is levied at the point of consumption and is applicable to the majority of goods and services sold within the European Union (EU). In accordance with the European VAT [3] system, the final consumer

is the sole entity responsible for bearing the burden of VAT on goods or services. In the majority of instances, businesses engaged in the supply chain are obliged to pay VAT when they sell to the subsequent customer in the chain, deducting the VAT paid on the purchase of materials and other goods or services in the process.

#### 2.1.3 Tax rate

In accordance with the regulations, the member states of the European Union are permitted to establish their own national standard value-added tax (VAT) rates, which are to be applied to the supply of goods and services. However, the standard rate is required to be no less than 15%. Based on the standard tax rate, the member states may set one or two lower tax rates, according to the circumstances, provided that the minimum rate does not exceed 5%.

Croatia has one of the relatively high standard VAT rates in the EU, at 25%. However, there are reduced rates available for certain types of goods and services. Importers and sellers of these items may apply a reduced rate of 13%, while providers of specific services may apply a further reduced rate of 5%.

#### 2.1.4 Tax calculation

VAT sales are defined as the total value of the goods and services provided, or to be provided, and any additional costs incurred. In the absence of other considerations, the VAT tax base is deemed to be the market value of the goods or services in question. The VAT tax [4] base for imported goods is determined by adding together the taxable price of the customs, along with any applicable customs duties, import duties, excise taxes and other customs clearance charges. The specific calculation method is as follows:

Output tax = Sales x tax rate

Tax payable = output tax - input tax

## 2.2 Profit Tax

### 2.2.1 Tax object and tax calculation

Enterprise income tax can be divided into income and capital income. With regard to the design of tax rates, some countries apply the same rate to both, while others apply different rates to them. Taxpayers of enterprise income tax are divided into two categories: resident enterprises and non-resident enterprises. The criteria for determining whether an enterprise is a resident enterprise vary from country to

country. They include the standards for registration and the actual location of the management organisation.

In general, the balance of taxable income less allowable deductions represents the taxable income. Allowable deductions include expenses or losses incurred by a taxpayer in business activities undertaken with the intention of obtaining income.

Tax payable = Taxable income x specified tax rate

Taxable income = Total income - Total expenses - Non-taxable income - tax-exempt income - Deductions - losses allowed to be made up for previous years

It is worth mentioning that the basic rate of corporate income tax in Croatia is 18%.

### 2.2.2 Withholding income tax

It is possible for EU countries to impose a withholding tax on foreign enterprises. To illustrate, when Croatian taxpayers remunerate foreign legal entities (i.e., non-resident enterprises) for intellectual property royalties, market research service fees, tax consulting service fees and audit service fees, they are required to withhold income tax at a rate of 15%. With regard to equity investment income, such as dividends and bonuses distributed to non-resident enterprises, the applicable withholding tax rate is 12%. Similarly, interest paid to non-resident enterprises may be subject to withholding income tax at a rate of 15%.

The conclusion of a bilateral tax treaty with Croatia will have an impact on the rate of withholding income tax. The following table presents the withholding income tax rates between Croatia and China, as well as those applicable to non-agreement countries (as shown in Table 1).

**Table 1. Withholding Tax Rates in Croatia and China.**

Income recipient country	Dividend	Interest	Royalty
China	5%	0/10%	10%
Non-agreement countries	12%	15%	15%

In the case of countries with a corporate tax rate of less than 12.5%, the withholding tax rate will be increased to 20%. It should be noted that this is not applicable to EU member states that have signed a bilateral tax agreement with Croatia. Furthermore, there will be no restrictions on companies moving profits abroad after they have fulfilled their tax

obligations.

### **2.3 Income Tax**

Individual income taxpayers are classified as either resident taxpayers or non-resident taxpayers. Countries that exercise resident jurisdiction typically impose taxes on the global income of individual residents, whereas countries that exercise territorial jurisdiction tax both resident and non-resident individuals who derive income from within their jurisdiction.

#### **2.3.1 Resident taxpayer**

In the European Union, in general, a resident taxpayer is one of the following:

The individual in question must either own real estate in the European Union or have the right to use or dispose of real estate for a period exceeding 183 days over the course of one or two natural years;

Stay for more than 183 days in one or two natural years.

In accordance with the established conditions for resident taxpayers, project managers and imported domestic workers are typically required to adhere to an 183-day detention period, contingent upon the prevailing labour legislation of the country in which the project is situated. This entails the necessity to enter into labour contracts within the local employment framework, to remunerate employees, and to discharge social security and personal income tax obligations in accordance with the prescribed legal proportions. The elevated cost of labour in the EU will inevitably place a greater financial burden on construction enterprises, which must therefore be planned in accordance with local policies.

#### **2.3.2 Tax calculation**

Individuals who are resident in a jurisdiction are liable to pay income tax on their worldwide income. In general, the individual income is reported as an annual summary tax return, and the taxable income is calculated as the tax payable at the progressive tax rate after deducting items and non-taxable income.

Tax payable on annual income = Taxable income x tax rate of the corresponding level - foreign tax credit

#### **2.3.3 Characteristics of individual income tax**

Overall, the social security and welfare system of EU countries is regarded as exemplary, while labour costs for enterprises are

considered to be high. In practice, local employees have indicated that the employment contract is typically understood to entail the payment of net wages, with social security and personal income tax obligations falling on the enterprise.

By way of illustration, an examination of the welfare and social security system in Croatia reveals that it remains distinct from the domestic personal income tax system [5].

### **2.4 Croatia**

#### **2.4.1 Croatian welfare system**

In Croatia, employment contracts between enterprises and employees stipulate net wages. Employment income, as defined by Croatian tax law, encompasses all income derived from the employment relationship, including wages, pensions, various types of benefits, benefits exceeding non-taxable levels, and bonuses. This concept is analogous to the "comprehensive income" delineated in the current individual income tax law of China [6-8].

It is not uncommon for companies to provide their employees with certain non-taxable benefits. These may include, for example, the provision of a company car or a company mobile phone. In the case of China, the Chinese yuan is pegged to the Croatian kuna at a rate of approximately 1:1:

An allowance for travel within the country (Croatia) is permitted, with a daily limit of 150 kuna. Additionally, transportation and accommodation costs are eligible for reimbursement;

The remuneration permitted for the utilisation of an employee's private vehicle for professional purposes is limited to a maximum of 2 kuna per kilometre;

The remuneration package includes a disability benefit (not exceeding 2,500 kunas per year), a death benefit for employees (not exceeding 7,500 kunas), and a death benefit for employees' close relatives (not exceeding 3,000 kunas);

In addition to the basic remuneration, occasional rewards (not exceeding 2,500 kuna per year) are paid at Christmas, Easter or during holidays.

In the event that the total value of the aforementioned benefits exceeds the prescribed limit, the excess will be deemed to constitute the employee's salary and will be

subject to personal income tax, additional tax and social insurance, the burden of which will fall on the employer and the employee in equal measure

#### 2.4.2 Croatian Social Security system

The Croatian social security system is distinct from the domestic system, which is divided into two parts. The first is the social security system, which encompasses pension, health and unemployment insurance. The pension insurance contribution ratio is 20%, comprising a 15% contribution to the first pillar pension insurance, a 5% contribution to the second pillar pension insurance and a payment base of the total salary. The second is the social insurance paid by the enterprise for the employees, with the base being the total salary (no limit is set). The distribution of contributions can be observed as follows: health insurance (15%), work-related injury insurance (0.5%), and unemployment insurance (1.7%).

#### 2.4.3 Croatian Social Security system

Croatia's personal income tax system is characterised by a progressive tax structure, whereby the basic pre-tax deduction of personal income tax is set at 4,000 kuna per month. Additionally, maintenance and other expenses incurred for dependants can be deducted, in a manner analogous to the special deductions permitted in the country. Thereafter, the taxable income is calculated through the submission of an annual summary tax return. The following individual income tax rate table is employed for the purpose of determining the amount of tax payable (as shown in Table 2).

**Table 2. Individual Income Tax Rate Table.**

Annual taxable income (unit: Kuna)		Tax rate
exceed	Not more than	
0	360,000	20%
360,000	-	30%

#### 2.4.4. Customs Duties

A tariff is defined as a tax levied by a customs office set up by a government with the objective of regulating the activities of exporters. The accession of Croatia to the EU Customs Union on 1 July 2013 resulted in the establishment of a unified customs trade policy and set of procedures. Following the completion of customs clearance procedures in any EU Member State, imported goods are permitted to move freely between EU member states without the necessity of additional customs procedures.

Tax payable = Customs value of imported goods (or customs composition assessable price) X applicable tariff rate

The following section presents the import duty rates applicable to the principal goods imported into Croatia (as shown in Table 3).

**Table 3. Individual Income Tax Rate Table**

Trade name	Tariff rate	Trade name	Tariff rate
Textiles and clothing	0-8%	Electronic products	0-14%
Agricultural products	0-26%	Bicycle, motorcycle	0-7%
Steel, metallurgical products	0-9%	Plastics and its products	0-15%
Ceramic glass products	0-11%	Tariff rate	0-6.5%

The tariff rate is subject to fluctuations as a consequence of international relations and trade policies. Consequently, it is advisable to consult the customs website in order to ascertain the specific tax rate applicable to the goods in question, which should be identified according to the HS code.

### 3. Suggestions on Tax Administration of Construction Enterprises in EU

#### 3.1 Familiar with EU Tax System

In order to effectively manage and plan taxes within the European Union, construction enterprises must first gain a comprehensive understanding of the EU's tax laws and regulations. Additionally, they must be aware of the specific implementation regulations and methods of the policies of the country where the project is located. Furthermore, they must formulate corresponding tax planning schemes through comparison and analysis. In this process, professional organizations can be engaged to provide assistance:

The engagement of a professional translator or translation agency is strongly advised. By accurately translating and analysing the tax laws and regulations of the country in which the project is located, it is possible to assist the financial staff of the construction enterprise in formulating effective countermeasures and providing a policy basis for the development of tax planning work.

The optimal solution is to engage the services of a professional tax consulting firm. Given the complex nature of tax planning, it is essential



that relevant personnel possess a comprehensive understanding of tax, accounting, finance, and other professional knowledge. This enables them to design effective tax plans and make well-informed decisions. Through detailed consultation on the specific business involved in the construction process, feasible schemes are determined to guide the business compliance and legal development and avoid risks caused by incorrect policies and process operations.

### **3.2 Pay Attention to External Accounts Accounting**

The accounting of EU countries also implements international accounting standards, external accounting as the basic work, and the verification of various taxes is based on this. For example, the enterprise income tax calculation involves the deduction of expenses, and the depreciation life and method of fixed assets should be adopted on the premise of meeting the local accounting standards. Furthermore, accounting estimation policies favourable to construction enterprises should be adopted.

It is worth noting that labor costs in EU countries are extremely high, and the identification of labor costs is very different from that in China. In Croatia, the expenses of the construction enterprise staff canteen, personnel relocation expenses, daily necessities and other expenses are identified as non-monetary expenses of the staff welfare when the external accounting is considered as net wages, which not only bears the cost of 25% value-added tax, but also needs to pay social insurance and personal income tax, thus increasing the cost of the construction enterprise.

### **3.3 Emphasis is Placed on the Procurement of Equipment and Materials from Third Countries**

The following factors warrant close attention: market type, price, commercial invoice, and so on. Due to negligence or arbitrary actions by business personnel, discrepancies often arise between the agreed currency, amount, and commercial invoice and the actual payment of these items. These discrepancies are related to customs clearance documents, resulting in confusion regarding claims and debts in the accounting process. This significantly impacts

the accounting process.

The issue of whether the supplier is registered in a country with a low tax rate, colloquially known as a "tax haven", is a significant one. In order to prevent price dumping and protect local markets, EU countries often have penalties in place for companies that are registered in such countries. In Croatia's 2017 tax regime, which includes approximately 50 countries, the acquisition of equipment, materials or services from companies registered in countries with a low tax rate will be subject to an additional corporate income tax [9,10].

Follow the principle of comprehensive cost optimization. EU countries have higher standards for materials and equipment, materials and equipment purchased from the domestic need to be CE certified, in the case of homogeneity, for the purchase unit price, in addition to the comparison of CIF price or FOB price, but also consider the tariff and customs clearance costs incurred in the country, compare the comprehensive cost, in order to cost the best principle, decide whether to purchase in a third country or the EU.

### **3.4 Fully Enjoy the Preferential Tax Policies of the Host Country**

Construction enterprises that choose to "go out" must ensure that they are "rooted" in the host country. In addition, they should pay attention to the local preferential tax policies and engage in effective tax planning. To illustrate, in order to alleviate the tax burden on enterprises and stimulate economic growth during the novel coronavirus epidemic, Croatia introduced policies to reduce import value-added tax. Construction enterprises can proactively plan to arrange the purchase of materials and equipment during the tax preferential period, thereby avoiding payment of import value-added tax and reducing capital occupation and expenditure.

### **4. Conclusion**

In comparison to domestic markets, the economic, policy and legal environments in EU countries are markedly disparate. The discrepancies in financial regulations, in particular, have a profound impact on the operations of domestic construction enterprises. In light of the implementation of the "Belt and Road" initiative, it is imperative for

construction enterprises in the EU to pursue long-term and stable development, as well as to attain economic benefits. To this end, it is crucial for them to enhance their understanding of the tax policies prevailing in the countries where they are situated, to establish and refine their tax planning and management systems, to effectively mitigate the risks associated with the enterprise's business and management operations, and to minimise the tax risks confronting the enterprise.

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