

## Croatia passes Law to implement Mandatory Disclosure Rules

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### Executive summary

The Croatian Parliament has approved the Croatian *Act on Administrative Cooperation in the Field of Taxation implementing the European Union (EU) Directive on the mandatory disclosure and exchange of cross-border tax arrangements* (referred to as DAC6 or the Directive).<sup>1</sup>

Following the approval of the Croatian Act (the primary legislation), the Croatian Minister of Finance executed the Bylaws (the secondary legislation) on the Automatic Exchange of Information in the Field of Taxation, which supplement the primary legislation and include the hallmarks as contained in Annex IV of the Directive.

The Act entered into force on 1 January 2020 and the Bylaws entered into force on 3 January 2020. Both the primary and secondary legislation will be effective from 1 July 2020.

The final Croatian Mandatory Disclosure Rules (MDR) legislation is broadly aligned to the requirements of the Directive. It is not yet known whether the Croatian Tax Authority plans to issue further guidance in respect of the interpretation or practical operation of the MDR rules.

## Detailed discussion

### Background

The Council of the European Union Directive 2018/822 of 25 May 2018 amending Directive 2011/16/EU regarding the mandatory automatic exchange of information in the field of taxation (the Directive or DAC6), entered into force on 25 June 2018.<sup>2</sup>

The Directive requires intermediaries (including EU-based tax consultants, banks and lawyers) and in some situations, taxpayers, to report certain cross-border arrangements (reportable arrangements) to the relevant EU member state tax authority. This disclosure regime applies to all taxes except value added tax (VAT), customs duties, excise duties and compulsory social security contributions.<sup>3</sup> Cross-border arrangements will be reportable if they contain certain features (known as hallmarks). The hallmarks cover a broad range of structures and transactions. For more background, see EY Global Tax Alert, [Council of the EU reaches an agreement on new mandatory transparency rules for intermediaries and taxpayers](#), dated 14 March 2018.

EU Member States were to adopt and publish national laws required to comply with the Directive by 31 December 2019.

The key differences between the final Croatian legislation and the Directive are summarized below.

### Scope of taxes covered

The scope of taxes covered under the Croatian final legislation is fully aligned with the Directive and applies to all taxes except VAT, customs duties, excise duties and compulsory social security contributions.

### Reportable arrangements

Under the Directive, an arrangement is reportable if:

- ▶ The arrangement meets the definition of a cross-border arrangement; and
- ▶ The arrangement meets at least one of the hallmarks A-E specified in Annex IV of the Directive.

Under DAC6, cross-border arrangements are defined as arrangements concerning more than one Member State or a Member State and a third country. The hallmarks can be distinguished as hallmarks which are subject to the main benefit test (MBT), and those which by themselves trigger a reporting obligation without being subject to the MBT.

The overall definition of “reportable arrangements” included in the final Croatian legislation aligns with the DAC6 definition. The definition of reportable arrangements does not include domestic arrangements and there are no additional hallmarks included in the final Croatian legislation in addition to hallmarks A-E of DAC6.

### Hallmarks A-E of the Directive

Most elements of the hallmarks included in DAC6 are not expressly defined. The final Croatian legislation also does not separately define most elements of the hallmarks.

### Main benefit test

In accordance with DAC6, under the final Croatian legislation, the MBT will be satisfied if it can be established that the main benefit or one of the main benefits which, having regard to all relevant facts and circumstances, a person may reasonably expect to derive from an arrangement, is the obtaining of a tax advantage. No further guidance is provided in the final Croatian legislation as to how the MBT test should be interpreted.

### Intermediaries

Under the Directive, intermediaries with EU nexus have the primary obligation to report arrangements to the tax authority. The Directive gives Member States the option to exempt intermediaries from the obligation to report where the reporting obligation would breach legal professional privilege (LPP). If there are no intermediaries which can report, the obligation will shift to the taxpayers.

The Croatian final legislation exempts lawyers and tax advisors from the reporting obligation due to LPP. Croatian auditors, accountants and all other intermediaries that are not registered lawyers or registered tax advisors do not fall within the scope of the LPP exemption as defined in the Croatian legislation implementing DAC6.

Intermediaries who are exempt from the reporting obligation owing to LPP are required to notify, within three days, other intermediaries or, if there is no other intermediary, the relevant taxpayer, of the reporting obligation.

DAC6 defines two categories of intermediaries: promoters and service providers. The Croatian legislation defines intermediaries by reference to the same two categories. Only intermediaries that have nexus in Croatia have a reporting obligation in Croatia.

The final Croatian legislation does not provide clarity on whether employees of an entity can themselves be regarded as intermediaries. The final Croatian legislation also does not provide any clarity on whether an "in house" tax team could be regarded as an intermediary.

### Reporting deadlines

Under DAC6, for intermediaries (and relevant taxpayers), the trigger events for reporting under the Directive (from 1 July 2020) are when the reportable arrangement is "made available for implementation"; or when the reportable arrangement is "ready for implementation"; or when "the first step of implementation has been made." The Croatian final legislation includes the same trigger events.

Under the Directive, reporting starts from 1 July 2020 and exchanges between jurisdictions from 31 October 2020. However, reports will retroactively cover arrangements where the first step is implemented between 25 June 2018 and 1 July 2020. The Croatian reporting deadlines fully align with DAC6.

In accordance with Article 8ab, Paragraph 11 of the Directive, the final Croatian legislation imposes an annual filing obligation on relevant taxpayers about their use of reportable cross-border arrangements. The relevant taxpayers in respect of reportable cross-border arrangements are obliged to annually notify the Croatian tax authorities: (i) for every year in which the relevant taxpayer executes the transaction which is or forms part of a reportable cross-border arrangement; and (ii) for every year in which the relevant taxpayer utilizes or attempts to utilize tax benefits arising from a reportable cross-border arrangement. The relevant taxpayer shall notify the Croatian tax authorities within three months following the end of year in which the notifiable event occurs.

### Penalties

Penalties for non-compliance amounting to HRK2,000 to HRK200,000 (approx. €270 to €27,000) for the legal entity (taxpayer or intermediary), and HRK2,000 to HRK20,000 (approx. €270 to €2,700) for its authorized representative (e.g., members of the board of directors of the entity) may apply in respect of the following:

- (i) Failure to submit a complete statutory report or failure to submit the statutory report by the deadline
- (ii) Failure by an intermediary to submit a complete statutory quarterly report for marketable arrangements with up to date information by the deadline
- (iii) Failure by a relevant taxpayer to submit a complete statutory report (annual reporting) on information regarding the relevant taxpayer's use of the cross-border arrangement by the deadline
- (iv) Failure by an intermediary to inform other intermediaries or the relevant taxpayer of the reporting obligations where the LPP exemption applies

If the taxpayer or the intermediary is a natural person (and not a legal entity), the penalties for non-compliance will range from HRK1,000 to HRK100,000 (approx. €135 to €13,500).

### Next steps

Determining if there is a reportable cross-border arrangement raises complex technical and procedural issues for taxpayers and intermediaries. Due to the scale and significance of the regime enacted in the final legislation, taxpayers and intermediaries who have operations in Croatia should review their policies and strategies for logging and reporting tax arrangements so that they are fully prepared for meeting their obligations and specific deadlines.

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### Endnotes

1. The Act was approved on 29 November 2019.
2. For background on MDR, see EY Global Tax Alert, [EU publishes Directive on new mandatory transparency rules for intermediaries and taxpayers](#), dated 5 June 2018.
3. DAC6 sets out a minimum standard. Member States can take further measures; for example, (i) introduce reporting obligations for purely domestic arrangements; (ii) extend the scope of taxes covered; (iii) bring forward the start date for reporting.

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