

# Kluwer International Tax Blog

## Croatia: A New (Tax-Free) Promised Land for Digital Nomads? (Part I)

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The concept of “digital nomadism” has emerged in popular literature some 25 years ago, in a thought-provoking and prescient book co-authored by Tsugio Makimoto and David Manners.[1] Put simply, the notion has been that various technological advances will make it possible for large swathes of people to discard traditional norms of work and employment, becoming truly “location-independent” in an increasingly globalized job market. Fast forward to the present time, and we see a new “creative class” – mainly comprised of Millennials – who can perform skilled and reasonably paid labour while backpacking through South-Eastern Asia or enjoying the amenities of a Costa Rican beach resort.[2] As summed up by Hannonen, the term “digital nomad” describes a category of mobile professionals who perform their work remotely from anywhere in the world, taking advantage of digital technologies. In contrast, “digital nomadism” refers to the lifestyle these highly mobile location independent professionals develop.[3] The sensational rise of the digital nomad phenomenon – for example, in 2020, the number of US citizens describing themselves as [digital nomads surpassed 10 million](#) – is a consequence of both pervasive mobility and ever-improving connectivity. Indeed, the material and immaterial infrastructure for nomadic work and lifestyle – including, inter alia, internet speed and availability, accessibility of laptops and other work-related gadgets, low-cost air travel – has improved immensely in the last decade or so.[4] Indeed, as evidenced by the Google Ngram Viewer, the [usage of the term “digital nomad” in English corpora](#) has shot up dramatically since 2012.

While most digital nomads belong to a limited range of knowledge-oriented occupations such as computer programming and IT, web design, engineering, and marketing, one of the broad societal fallouts from the COVID-19 pandemic has been the mainstreaming of “[remote work](#)”, which lies at the heart of digital nomadism. From a regulatory perspective, including tax law, the lack of location-dependence of modern workers and self-employed professionals – i.e. the fact that the locations where they reside may be completely unaffected by the locations of their employers or clients – poses significant challenges.[5] This seems self-evident to tax lawyers, who are used to the complexities arising when one tries to apply tax rules founded on the idea of territoriality (e.g. definitions of fiscal residence, PE rules, etc.) to the complexities of cross-border economic activities. Digital nomads present an interesting problem, however, in that they challenge the traditional assumption of international tax theory that labour is relatively immobile across national borders. Accordingly, the phenomenon of “geoarbitrage”, commonly associated with digital nomads[6], may be likened to the well-documented practices of multinational companies that engage in “jurisdiction shopping” to minimize their overall tax burden.[7]

Unsurprisingly then, legislators in many states recognized the need to adapt their normative frameworks to attract the nomadic talent to their own localities, at least in the short term, and bring home some monetary and non-monetary benefits (e.g., an increase in the level of personal consumption, knowledge spillovers, etc.). Comparative experience shows that two areas of law are crucial: migration law and tax law. Indeed, from the perspective of a highly-skilled mobile individual, a country that offers an easy path to legalize her stay in its territory, accompanied with a generous tax incentive, may constitute an attractive destination. Estonia is deemed a pioneer of this new regulatory competition, with its “digital nomad visa” programme adopted in 2020. Among more than 30 countries that followed suit and adopted similar regimes specifically targeted at digital nomads is Croatia, with respective legislative amendments in force since 1 January 2021.

## 1. Moving Beyond the ‘Sun and the Sea’: Croatia Joins the Digital Nomad Market

It all started with a tweet. Or, to be more precise, with an open letter written by a Dutch entrepreneur – and a Croatian resident since 2006 – Jan De Jong, who in the summer of 2020 urged the Croatian government to introduce a special visa regime for digital nomads, based on the Estonian example. Forty-four days later, the official Twitter account of the Croatian Prime Minister, Mr Andrej Plenković, featured a photo from the meeting between him and Mr De Jong, announcing that relevant legislative changes will indeed be made. By the end of 2020, the Croatian Parliament adopted the new version of the Foreigners Act (*Zakon o strancima*), which introduced the definition of a “digital nomad” in the domestic legal system and laid out a specific migration law regime applicable to digital nomads. To clarify the tax treatment of income earned by digital nomads during their stay in Croatia, amendments to the Personal Income Tax Act (*Zakon o porezu na dohodak*) were also adopted. Analysed in more detail below, the new rules came into force on 1 January 2021.

## 2. Migration Law Aspects: Digital Nomad Visa Programme

Article 3(1)(43) Foreigners Act<sup>[8]</sup> provides a domestic law definition of a digital nomad, as “a third-country national who is employed or performs work through communication technology for a company or his own company that is not registered in the Republic of Croatia and does not perform work or provide services to employers in the Republic of Croatia”. This definition includes, essentially, three elements: (i) *nationality*: the Foreigners Act regulates the movement, migration and employment of third-country nationals, i.e., persons who do not hold nationality of an EU Member State, nor of any other country belonging to the European Economic Area (EEA), nor of Switzerland; since EU/EEA/Swiss nationals are guaranteed free movement and residence rights under EU law, they would have no benefit from the specifics of a digital nomad regime; accordingly, from the point of view of Croatian law *stricto sensu*, only third-country nationals are included in the digital nomad category; (ii) *type of work*: the explicit reference to communication technology makes it clear that digital nomads are individuals who rely on IT technology to render services to their employers or clients; (iii) *residence of employers/clients*: while it is quite obvious that an individual cannot be deemed a digital nomad if she is employed by a company resident in Croatia, it is interesting that the definition also excludes individuals who perform services to Croatian residents outside the ambit of an employment relationship.

Digital nomads may legalize their stay in Croatia by obtaining a permit for temporary stay, i.e., the

right to stay in the Croatian territory for a specific purpose and a period not exceeding one year. A third-country national can apply for a temporary stay [online](#) or in person. The documentation supporting the application includes: (i) copy of a valid travel document; (ii) proof of health insurance valid in Croatia; (iii) proof of type of work (see *supra*; e.g., an employment contract which makes clear that the person performs work through communication technology for a non-resident company); (iv) proof of means of subsistence during the person's stay in Croatia (according to specific government regulation, digital nomads are required to prove – e.g., by a bank statement or other proof of regular income – that their monthly income is at least 2.250 EUR); (v) proof that the person has not been convicted of criminal offences; (iv) proof of an address in Croatia where the person intends to stay, at least temporarily (e.g., confirmation of hotel booking).

If all these requirements are met, a temporary stay will be granted to a digital nomad for the requested period, which may not eventually exceed one year. Furthermore, according to Article 57(4) of the Foreigners Act, a digital nomad may submit a new application on the same basis but only six months after the expiry of the previously granted period of temporary stay. Other than this burdensome procedure, EU/EEA/Swiss nationals who stay in Croatia for a period exceeding three months – irrespective of their line of work – are obliged only to register their temporary stay with the competent Croatian authorities, with the possibility of extending their interim stay periods for up to five years in total.

### 3. Taxation of Digital Nomads' Income in Croatia

The introduction of the 'digital nomad visa' in the new Croatian Foreigners Act has been accompanied by a new provision into the Croatian Personal Income Tax Act (PITA).[9] Namely, under Article 9(1)(26) of the PITA, individuals who acquired a digital nomad status shall not be taxed on their income derived based on employment or self-employment activity conducted for an employer not registered in Croatia. The new tax exemption targeted at digital nomads – which came into force on 1 January 2021 – gave munition to the government and some professional associations to market Croatia as one of the most nomad-friendly jurisdictions in the world. However, to verify the validity of such an assumption, it is necessary to carefully break down the tax exemption in question and assess its legal effects.

A first observation is that the subjective scope of the tax exemption is linked with the definition of a digital nomad under Croatian migration law, as summarized above. In other words, the tax exemption in question relates only to individuals that acquired the status of a digital nomad under Croatian law, i.e., foreigners who have completed the procedure of obtaining a temporary stay permit on this basis. Importantly, it follows that Article 9(1)(26) of the PITA does not apply to EU/EEA/Swiss nationals working remotely while staying in Croatia. One may imagine two web developers sharing a co-working space while enjoying their stay in the city of Split. If one is an EU national, she cannot be deemed a digital nomad under Croatian law, hence also ineligible for the tax exemption in question!

Second, Article 9(1)(26) of the PITA is utterly silent on the all-important issue of tax residence. It follows that the income tax exemption – within its objective scope – is provided to all individuals with the digital nomad status, irrespective of whether they may be considered as Croatian tax residents. It has to be noted here that, since a digital nomad may legally stay in Croatia for an

uninterrupted period of 12 months, she may meet the tax residence test enshrined in Article 3 of the PITA in conjunction with Article 43 of the General Tax Act. Put simply, if a digital nomad uses the same place of accommodation (e.g., a leased apartment) in Croatia for more than 183 days, she may satisfy the domestic law tax residence criteria. Leaving aside the enforcement issues – indeed it seems extremely difficult for Croatian tax authorities to administer the domestic residence test vis-à-vis digital nomads – one has to also pay attention to the so-called residence tiebreaker rules contained in double tax conventions, particularly those rules modelled on the basis of Article 4(2) of the OECD Model Tax Convention. Accordingly, in the case of a digital nomad who has tax resident status under the domestic law of a country with which Croatia has a tax treaty, it seems highly unlikely that the ties with Croatia will prevail under respective treaty tiebreaker rules, mainly because of the ‘centre of vital interest’, ‘permanent home’ and nationality tiebreakers. In other words, in a tax treaty setting – e.g., in the case of a national individual and resident of Russia – digital nomads will probably be considered Croatian non-residents for income tax purposes. It may be added here that other countries provide more certainty about the residence status of digital nomads. On the one hand, [Estonian tax authorities](#) have made it clear publicly that a digital nomad becomes a resident – at least under domestic tax law – after a 183-day stay in Estonian territory over 12 months. Conversely, [Spain](#) has in December 2021 announced the introduction of a special regime under which digital nomads are guaranteed a non-resident status for five years, with their income subject to a reduced tax rate applicable to non-residents.

Third, as far as the objective scope of Article 9(1)(26) of the PITA is concerned, only certain digital nomads’ income items qualify for tax exemption, namely those earned concerning the activities based on which the person acquired digital nomad status. Thus, the objective scope of the exemption is limited both in terms of ‘type-of-income’ and in terms of ‘geographic source of income’. The tax exemption covers only this type of employment or self-employment income earned by a digital nomad. Conversely, items such as rental income, dividends, interest and capital gains, which a digital nomad may earn during their stay in Croatia, are not covered. Notably, payments to digital nomads made by Croatian residents do not qualify, i.e., the tax break applies only to income paid out by non-residents.

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[1] T. Makimoto & D. Manners, *Digital nomad* (Wiley 1997).

[2] On the creative class concept, see R. Florida, *The Rise Of The Creative Class, Revisited* (Basic Books 2012), pp. 8-12.

[3] O. Hannonen, *In Search of a Digital nomad: Defining the Phenomenon*, *Information Technology & Tourism* 22, (2020), p. 336.

[4] See R.A. Woldoff & R. C. Litchfield, *Digital Nomads: In Search of Freedom, Community, and Meaningful Work in the New Economy* p. 7 (Oxford University Press 2021).

[5] See, e.g., Svetislav V. Kostić, *In Search of the Digital Nomad – Rethinking the Taxation of Employment Income under Tax Treaties*, 11 *World Tax Journal* 2, 2019, pp. 203-206.

[6] See C. Bonneau & J. Aroles, *Digital Nomads: A New Form of Leisure Class?*, in *Experiencing the New World of Work* p. 160 (Cambridge University Press 2021).

[7] See, e.g., T. Dagan, *International Tax Policy: Between Competition and Cooperation* p. 215

(Cambridge University Press 2018).

[8] Official Gazette of the Republic of Croatia, No. 133/2020.

[9] Official Gazette of the Republic of Croatia, Nos. 115/2016, 106/2018, 121/2019, 32/2020, 138/2020.

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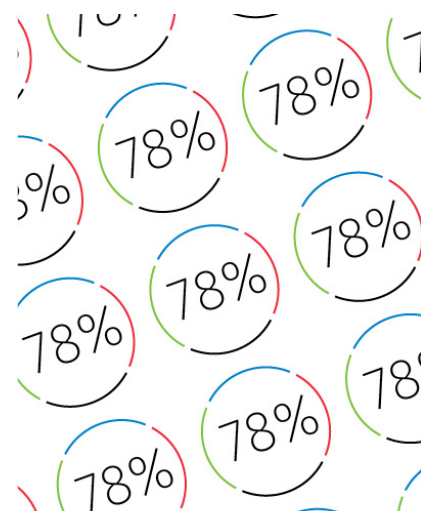
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