

# Kluwer International Tax Blog

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

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In the first part of this two-piece article titled “*Croatia: A New (Tax-Free) Promised Land for Digital Nomads? (Part I)*”, we provided an overview of the new Croatian normative framework applicable to digital nomads, i.e., a set of migration and tax law provisions adopted to facilitate digital nomads’ temporary stay in Croatia. These legislative developments on the domestic law level have been put in the broader context of a new kind of regulatory competition taking place globally, where many states try to attract highly skilled and mobile to their territories. This second part will address international tax aspects of the newly-introduced domestic income tax exemption for digital nomads and assess its legal effects.

### 4. International Tax Law Aspects

Any tax law rule providing a tax exemption – such as Article 9(1)(26) PITA – is implicitly based on the idea that the activities or transactions in question would be subject to tax in the absence of such a rule. This is where the jurisdictional tax boundaries set by the rules of international tax law come into scope. In light of the time-honoured legal concepts of “residence” and “source”, enshrined both on a domestic law level and in the tax treaty network, an exemption from income tax may have legal effects in respect of (i) income of resident taxpayers, irrespective of whether such income is domestic or foreign-sourced, and (ii) domestic-source income of non-resident taxpayers. On the contrary, tax exemption may have no substantive legal effects on “Monty Python taxation”, i.e., taxation of foreign-source income earned by non-resident taxpayers.

Taking another look at Article 9(1)(26) of the PITA, assuming that the residence of the digital nomad’s employer/client serves as a proxy for the geographic source of income, this provision affects primarily digital nomads considered to be Croatian tax residents. In the case of a non-resident digital nomad, on the other hand, the provision reads as an exemption from the tax most likely not due in the first place. This is because Croatian domestic law relies, at least implicitly, on the employer’s residence as the source criterion concerning employment income. Regarding the amounts paid by non-resident payers for professional services of a non-resident temporarily present in Croatia, there is a risk that tax authorities may attribute such payments to a non-resident’s fixed base or a permanent establishment existing in Croatian territory. However, this seems like a very burdensome and uncertain exercise from the tax authorities’ perspective, particularly if, in the

alternative, they could claim that the taxpayer in question meets the residence test.

As already noted above, the existence of a tax treaty between Croatia and the digital nomad's country of residence provides more certainty to the nomad regarding her status as a Croatian (non-) resident. Furthermore, the tax treaty has the effect of setting a clear threshold for imposition of source-based tax in Croatia regarding the non-resident nomad's self-employment income, taking the form of either a fixed base (Article 14 of the OECD MC) or a permanent establishment (Article 7 of the OECD MC).

## 5. Summary of the Legal Effects of Article 9(1)(26) PITA and Its Assessment

It follows from the above that the tax exemption introduced in Article 9(1)(26) PITA has minimal legal effects. Namely, by adopting this provision in its domestic law, Croatia surrendered only a tiny portion of its prospective tax base, mainly if a tax treaty covers a particular situation. In essence, it is relevant only for digital nomads that may be deemed Croatian tax residents due to the length of their stay in Croatian territory. For this category of individuals, Article 9(1)(26) of the PITA clarifies that their employment or self-employment income paid by non-residents will not be subject to tax in Croatia. Put differently, regardless of any potential ambiguities surrounding the determination of their residence status, digital nomads' core income flowing from foreign sources is fully tax-exempt in Croatia. Considering that the Croatian tax system is notorious for its high level of legal uncertainty, this clarification in domestic income tax law is welcome and may act as an incentive to attract digital nomads from non-EU/EEA countries.

Keeping in mind the design of the tax exemption for digital nomads, it may hardly be described as a generous tax expenditure programme. The new special regime is of a temporary nature due to the one-year limit on digital nomads' permitted stay in Croatia. Similarly to other governments that embarked on offering tax concessions targeted at digital nomads, Article 9(1)(26) of the PITA is underpinned by the untested prediction that the amount of foregone tax revenue dwarfs in comparison to other monetary and non-monetary benefits associated with the influx of highly-skilled mobile professionals to the country.

At this point, more than a year after new migration and tax law rules related to digital nomads came into force, it is difficult to assess their practical impact. However, according to the [official data issued by the Ministry of the Interior](#), between 1 January and 3 September 2021, there have been 227 applications for a digital nomad visa, with 86 permits granted. Interestingly, many registered digital nomads in Croatia come from countries with which Croatia does not have a tax treaty (e.g., Argentina, Australia, Brazil and the United States), with more than a third of the approved applications belonging to US nationals.

## 6. Concluding Remarks

This article provided an overview of the Croatian "digital nomad programme", putting it in the global context of countries adapting to the new environment of more mobile work styles, only exacerbated with the fallout of the COVID-19 pandemic. At the end of 2020, Croatian policymakers decided to follow the example of Estonia and adopted legislative amendments to attract non-EU/EEA/Swiss digital nomads. Relevant changes in the migration law framework

undoubtedly alleviated the administrative burden for legalising digital nomads' temporary stay in Croatia. The introduction of this "digital nomad visa" regime accompanied a new tax exemption provision in the Personal Income Tax Act. As shown above, however, the effects of this tax exemption are minimal, particularly in light of the fundamentals of international tax law. The most important benefits that the new special regime provides is that it gives legal certainty to registered digital nomads that their foreign-income activities will not be subject to tax in Croatia. Also worth mentioning, in the coming period, it is to be expected that a re-evaluation of the Croatian digital scheme and its practical effects will be made, particularly in comparison with other countries that opted for a similar policy solution (e.g., Estonia, Portugal and Spain).

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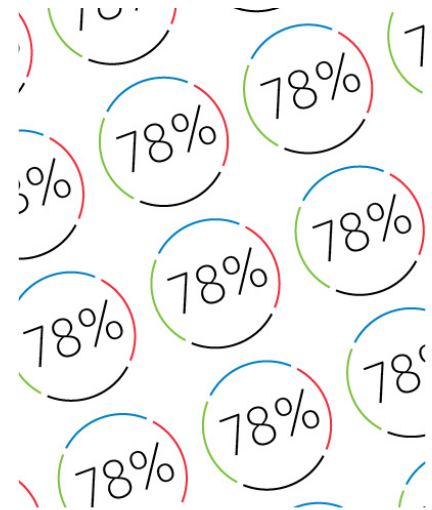
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