LET'S TALK ABOUT NOMAD EMPLOYEES!

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S.M.E.

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INTRODUCTION

Employees working from overseas is hardly a new phenomenon. However, the COVID-19 pandemic created an unusual situation where many employees were required by force of circumstance to work from their homes in a different jurisdiction to the one where their corporate employer was located. Initially, many tax authorities opted to lenient treatment for the temporary foreign presence. In particular, cross-border workers were often granted waivers from applicable tax regimes for a certain period of time, to allow them to work from home full-time. As the pandemic receded, so too have many of the forbearance measures it created for remote working across borders.

Yet, while tax policies can be changed overnight, cultural changes generally cannot. Building on advances in information technology over the past thirty years, the COVID-19 pandemic has created widespread acceptance of remote and hybrid work in all areas of the econoour. This comes at a time when, recent layoffs in the IT sector aside, demand in many countries for skilled professionals in the IT sector and beyond far outstrips supply. Add to the mix the high rental costs and bad weather in many northern European cities, and it is understandable that companies and employees are interested in the idea of working from anywhere. It must be said that, although most of the media commentary around digital nomads has focused on stories of sun-soaked, cocktail drinking, and well-paid nomads, their employers also benefit from an expanded hiring pool and reduced relocation costs in this global war for talent.

Our colleague Monique van Herksen, tax partner in the Simmons & Simmons Amsterdam office, recently prepared a paper for the U.N. Tax Committee entitled "We Need to Talk about (the Taxation of) Nomad Employees." Her paper highlights that many countries are trying to attract digital nomads, with at least 49 offering Nomad visas that typically grant 12-month permits (which may be extended) that allow a visitor a right to stay in a country and work remotely via a computer or laptop for a foreign-based employer or business. Depending on the jurisdiction, the benefits can come with tax challenges for both employer companies and employees.

CORPORATE TAX

The first tax risk for companies is the unintended creation of a fiscal permanent establishment ("P.E.") in a foreign jurisdiction through the activities of nomad employees. The risk of nomad employees creating a P.E. depends on the nature of the role they perform, the duration for which they are working in the relevant jurisdiction and the number of employees working in the same jurisdiction. Staff performing back office or administrative functions are generally less likely to create P.E.'s as many jurisdictions and treaties consider activities that are merely preparatory or auxiliary to the business do not constitute P.E.'s. However frontline staff, sales staff, or staff performing the core profit-generating function of the business trigger considerably greater risk of creating a P.E.

The inadvertent creation of a P.E. can potentially lead to significant corporate tax exposure to companies due to unaccounted for tax liabilities that cause interest and penalties to accumulate. However, the main source of worry for many companies is their limited knowledge and experience of the tax law in the P.E. jurisdiction. For companies that lack the infrastructure required to meet the additional compliance obligations, the quantum of tax exposure is often a secondary concern to the administrative challenges it creates.

Small- and medium-sized enterprises ("S.M.E.'s") face a significant exposure where senior management decide to work remotely from abroad. Senior management exert significant influence over the profitability of S.M.E.'s, thus increasing the potential exposure. Additionally, if enough senior management relocate to the same jurisdiction, this could potentially impact the place of effective management and control of the company and hence its tax residence.

Therefore, it is important that companies that wish to employ digital nomads carefully consider the impact this might have on their compliance obligations and corporate tax exposure. Depending on the circumstances, the existence of a P.E. can lead to a determination that a fixed establishment exists for value added tax ("V.A.T.") purposes (discussed below).

VALUE ADDED TAX

The existence of a P.E. for corporate tax purposes may lead local tax authorities to consider or apply greater scrutiny to whether a fixed establishment also exists for V.A.T. purposes. However, the definition of a fixed establishment for V.A.T. purposes differs from that of a P.E. for corporate tax purposes in certain key respect. Therefore, not all P.E.'s create fixed establishments for V.A.T. purposes.

For V.A.T. purposes, a fixed establishment is usually defined as an establishment with a sufficient degree of permanence and an adequate structure in terms of human and technical resources such as an office, computer, office equipment. However, our colleague Monique van Herksen points out in her report to the U.N. Tax Committee, advances in technology mean that very little substance is often required to create the human and technical resource necessary to deliver a service, which can be done via a laptop or a mobile device. As such, the level of substance deemed necessary to create a fixed establishment for V.A.T. purposes is becoming increasingly harder to define. V.A.T. cases continue to be heard at the CJEU and in local courts, seeking to challenge or clarify the level of substance required to qualify as a fixed establishment.

Where the Nomad employee's activities result in the employer making supplies of goods or services in that jurisdiction, this could create unexpected V.A.T. liabilities for the employer. The consequences of inadvertently creating a V.A.T. fixed establishment can be quite severe, including V.A.T. costs, interest, penalties and fines. In some jurisdictions, failure to register for V.A.T. can even extend to criminal liability! The V.A.T. risk posed by the presence of Nomad employees in a foreign jurisdiction should therefore not be underestimated.

EMPLOYMENT TAX

Allowing employees to work from abroad may create additional employment tax obligations for employers. Employment tax obligations may arise under the domestic employment rules of the country in which the Nomad employee is physically present and working. Under Article 15 of the O.E.C.D. and U.N. Model Conventions, salaries and wages may be taxed in the country where the employment is exercised or in the country of the employer. Taxing rights are largely determined by the amount of working time the employee spends in each country, and whether or not the wage and salary costs are borne by a domestic employer or a P.E. in the overseas jurisdiction.

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As our colleague Monique van Herksen explains in her report to the U.N. Tax Committee, the greatest compliance burden triggered by an accidental P.E. is the administration of wage/payroll withholding tax obligations in the P.E. jurisdiction. Companies that become liable to wage/payroll withholding in another country generally end up seeking the services of payroll service providers. Payroll service providers usually process employee payroll, calculate and handle income and social security taxes and employer social security contributions, keep employment and payroll records on file, and prepare the necessary quarterly and year-end payroll reports. This reduces the compliance burden on the employer, but creates an additional cost.

Employers may also be responsible for making contributions to the social security system of the P.E. jurisdiction. However, exemptions may be available under bilateral social security totalization agreements. Social security totalization agreements work much like double taxation agreements by eliminating dual social security coverage and taxation, and ensures that employees do not lose benefit rights because they have divided their careers between two countries. Exemptions require that such totalization agreements are available between the countries in question, which may not always be the case. Therefore, this issue needs to be considered on a country by country and case by case basis.

PERSONAL INCOME TAX

Individual employee tax residence may be an overlooked issue in the Nomad employee discussion, and there may be many compliance obligations for Nomad employees such as foreign bank account reporting requirements. The digitalized and globalized econoour increasingly presents challenges for the residency concept, given the ease of mobility and the ability to work remotely.

In general, it is the employee who indicates where the place of tax residence, and they will have to comply with the respective reporting requirements. Tax residency can subsequently be verified based on facts and circumstances, and resolved in a treaty context under the tiebreaker rule in case of dual residence where a treaty applies.

COMMENTARY

Many countries have strategies in place to attract Nomad employees by providing specific visa regimes that attract remote workers. As our colleague Monique van Herksen points out in her paper, these Nomad employees can contribute to the local econoour by paying income taxes on their wages and being consumers of local products and services. Their children may go to local schools and they themselves may become part of the fabric that makes up the local community. Their social and professional networks may help attract further business to the country, either by way of competing employers setting up business in the country or by enticing foreign employers to set up a local presence. Often, Nomad employees have particular technical skills that are in demand. They may serve to inspire or train local talent to develop similar careers, or help deter such local talent from migrating to other jurisdictions.

As such, taking a welcoming approach towards Nomad employees and their corporate employers may contribute to the attractiveness of a country for business, or at least favor the country over other countries that take strict and unaccommodating positions. For developing countries, this has the potential to mitigate or even reverse the brain drain they have experienced for decades, where their most educated workers leave the country to work for overseas employers and end up remaining overseas. Encouraging skilled workers to remain *in situ*, and even attracting skilled employees from overseas, could allow developing countries to eventually grow new industries and move up the value chain. However, the mobility of highly skilled workers may also lead to tax competition, putting downward pressures on personal tax rates.

However, as our colleague Monique van Herksen points out in her paper, companies still have significant worries about remote work and Nomad employees. When surveyed to rank the order of identified tax challenges, being able to identify and meet mandatory compliance obligations came out as a strong number one, with resolving the P.E. exposure as a direct number two, and as a close number three, certainty on being able to administer wage withholding taxes correctly. Transfer pricing concerns ranked as number four, and V.A.T. concerns as number five. Company policies to address Nomad employees fall at the crossroads between the tax and H.R. functions in many companies, thus creating coordination problems. Given the resource constraints on their existing tax and H.R. department, most companies opt for rather restrictive policies such as allowing employees to work abroad for periods of less than 30-60 days.

Countries that want to attract Nomad employees should therefore provide clear rules and administrative mechanisms to

- minimize the compliance burden on corporate employers,
- provide certainty as to the tax exposure, and
- provide a variety of options to pay tax.

The above could include relatively easy steps such as providing clear and accessible guidance on matters such as tax compliance and filing obligations, P.E. and fixed establishment creation, and employee/wage withholding obligations. Of equal importance is the actual administrative burden and cost imposed on companies in attempting to achieve tax certainty and meet their compliance obligations. For example, companies would generally rather to pay wage/payroll withholding taxes directly to local tax authorities over dealing with payroll providers. Also worth noting is that advance transfer pricing agreements are often too time consuming and burdensome for companies to use in practice, particularly where employees are based abroad for relatively limited periods of time.

CONCLUSION

The COVID-19 pandemic demonstrates that countries can accommodate the business challenges presented by Nomad employees without compromising their tax revenue. However, as the pandemic recedes, many countries are returning to their pre-pandemic restrictive approach while others are making conscious efforts to attract and retain Nomad employees. From the perspective of companies that want to hire and attract Nomad employees, the biggest issue is the compliance cost. Countries seeking to attract Nomad employees would do well to focus on providing tax certainty and minimizing the administrative burden they create. Given the global war for talent, this is likely to be a live issue for some time. And as countries begin to wake up to the possibility of brain drain and the loss of tax revenue, it is likely that the issue of Nomad employees will be as pertinent to the 2020's as B.E.P.S. was to the 2010's.