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INFORMATIVE NOTE

TAX AND EMPLOYMENT AND LABOUR

Digital Nomads

Legal and tax framework

In the context of a growing transition to a digital economy, the possibility of working anywhere in the world as a remote worker is gaining more and more supporters, and this trend has been encouraged and promoted by many global companies.

The concept of digital nomadism focuses on a lifestyle and work that can be considered nomadic in the sense that it does not depend on a fixed location and allows freedom to move around for extended periods of time. Digital nomads are people who use technology to work remotely and their work depends exclusively on the use of the electronic means available to them.

The number of digital nomads has been growing as a result of the pandemic and the limitations on the movement of people due to the lockdown measures that have been put into place. As a result, this seems like the right moment to look at the implications the arrival in Portugal of digital nomads will have in many areas of the law.

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1. Employment law issues

Given the breadth of the concept of digital nomadism, it covers various models of employment relationships, each with its own specific characteristics.

In this newsletter, we will only consider the situation of employees who work remotely.

The place of work is a very significant issue in the employment relationship. Accordingly, there are legal restrictions on the possibility of the employer changing it definitively or temporarily when there is no provision for a change.

Of course, there are situations where, due to the nature of the employees' duties, they may have non-fixed or mobile workplaces. In any case, in these situations, it is the employer exercising their management power that determines the place(s) where the employee must perform the employment contract.

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In the case of digital nomads, due to the characteristics of the work they do, the place of work becomes irrelevant to the proper performance of the employment contract. Therefore, it is possible, with a greater or lesser degree of freedom, for the employee to choose where to work.

There is no specific legislation governing this type of employment relationship and therefore the general rules applicable to ordinary employment contracts apply.

Therefore, in the case of employment situations involving digital nomads, the rules to be observed in this relationship must be established in the employment contract, or in a subsequent agreement.

For example, the rules need to address whether or not the employee is totally free to choose the place where work is being performed, or whether this depends on an agreement with the employer. These rules also need to address whether the employee's margin of freedom to choose the place of work is limited to a certain territorial area (within the country, in certain countries, in the EU) and whether the employer's agreement is required to choose such place of work in a different country/city which was not previously defined.

For example, the rules may also regulate responsibility for payment of expenses incurred by the employee as a result of successive changes in place of work and of "residence".

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In the cases of digital nomads who are allowed to work from several countries, the determination of the applicable law may be significant in terms of employment law (and the same rule applies to other areas, such as the laws on foreigners, on tax and on social security law), as there is no standard employment law.

The fundamental question that arises is which law should apply to the employment contract?

As a rule, the applicable law is the one in force in the country where the contract is performed.

However, in the case of this type of employee, the contract will tend to be performed successively in multiple countries, each with its own employment regulations. These may vary markedly in many important areas of the employment relationship, such as working hours, holidays, public holidays, absences, pay, and termination of the employment contract. They may also have an impact on employment and even quasi-employment costs (e.g., charges for social protection systems).

It is therefore highly recommended that the parties expressly choose the national law applicable to the contract. This will enable them to stabilise the legal framework that will govern the contractual relationship. Moreover, as there are no supplementary legal rules on this specific type of employment relationship, they must use the contract itself to set out the terms and conditions under which the employee can change the country they work from and the mutual rights and duties arising from any such changes.

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2. Tax issues

2.1. Tax residence

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The concept of tax residence is essential to determining the extent to which individuals are liable to tax.

Generally, in order to qualify as a Portuguese resident taxpayer under the Portuguese domestic rules, a person would need to either:

- Exceed the 183 day test of physical presence in Portugal in any 12 month period commencing or ending in the year concerned, or
- If the 183 day test of physical presence is not exceeded, hold a dwelling that implies an intention of setting up a permanent residence in any 12 month period commencing or ending in the year concerned.

To calculate the period of 183 days, a day of presence in Portugal is considered to be any full or partial day that includes an overnight stay.

Therefore, anyone who meets one of the above conditions becomes resident from the first day of physical presence in Portugal, except when they have been resident there on any day of the previous year.

If they are considered resident in Portugal, they are taxed on all their income, including income obtained outside Portugal. Otherwise, they are only subject to taxation on income obtained in Portugal.

The pandemic has created cases in which the criteria for tax residence in countries have been met by people who were forced to stay in a particular country for more than 183 days and this has subjected these people to potential taxation in the country in question.

The Portuguese Tax Authorities have not yet taken a position on this matter. However, the OECD has already issued guidance on residence acquired by reason of physical presence in any given country due to the pandemic.

In these guidelines, the OECD recommends that, during the period when lockdown and pandemic containment measures are imposed by governments, the relevant authorities should assess whether to apply the domestic tax residence criteria to an individual in this situation. In any event, it is also argued that the residence tie-breaker criteria provided for in the applicable Convention for the Avoidance of Double Taxation (DTC) should render any positive residence conflict innocuous, as this analysis requires the consideration of other relevant factors to ascertain an individual's tax residence under normal circumstances. We note that, this does not apply to situations where individuals remain in their host countries after the end of the pandemic-induced restrictions.

2.2 Considerations concerning the existence of a permanent establishment

The rules applicable to permanent establishments also raise issues regarding digital nomadism.

Under Portuguese tax law, a permanent establishment is considered to be any fixed place of business through which a commercial, industrial or agricultural activity is carried on.

The Portuguese Courts and Tax Authorities consider that a "fixed place" permanent establishment is deemed to exist whenever the following conditions are fulfilled: (i) the company needs to have premises or equipment at its disposal in Portugal; (ii) the place of business must be at the company's disposal and should be "fixed" - with certain degree of permanence (both geographically and time wise); and (iii) the company's business has to be wholly or partly carried out through that fixed place.

Since 1 January 2021, Portuguese tax legislation has established that a permanent establishment is also deemed to exist whenever a person, other than an independent agent, acts in Portugal on behalf of a company, where the person:

- Has and habitually exercises powers of intermediation and conclusion of contracts binding the company, within the scope of the company's activities, including contracts:

  i) In the name of the company;

  ii) For the transfer of ownership or the granting of the right to use property belonging to that company or in respect of which that company holds the right of use; or

  iii) For the provision of services by that company;

- Usually plays a determinant role in the conclusion of contracts referred to in the previous sub-paragraph entered into by the company on an habitual basis and without substantial changes; or

- Keeps in Portugal a stock of goods or merchandise for delivery of those goods or merchandise on behalf of the company, even they do not habitually conclude contracts regarding those goods or merchandise and do not have any involvement in the conclusion of such contracts.

Finally, a permanent establishment should not be considered to exist when persons acting on behalf of a non-resident company qualify as independent agents. In other words, they act as commissionaire agents or any other agent who, acting in the normal course of their business, bears the company's business risk and are subject to detailed instructions or comprehensive control by the company.

Moreover, the State Budget Law for 2021, which came into force on 1 January 2021, introduced a new concept of permanent establishment. This concept of permanent establishment arises whenever a non-resident company provides services in Portugal, including consultancy services, through its own employees or other personnel hired by the company for this purpose. For these purposes, the activities in question must be carried out for more than 183 days in a 12-month period beginning or ending in the relevant tax year. However, DTCs entered into by Portugal do not usually provide for this concept of permanent establishment and the provisions of DTCs prevail over Portuguese domestic law provisions.

The assessment of the existence of a permanent establishment will therefore always depend on a case-by-case analysis.

In this regard, the OECD has also issued guidance to the effect that the pandemic is unlikely to create any changes to the assessment of the existence of a permanent establishment for the employer in a given country. Furthermore, the OECD has also determined that the temporary conclusion of remote working contracts (specifically, in home office situations) should not create a permanent establishment for companies.

2.3. Benefits of becoming a Portuguese tax resident

Portuguese tax legislation provides for various relocation incentives for fostering the investment in Portugal by attracting digital nomads to become tax resident in Portugal, namely: (i) the non-habitual resident regime and (ii) the tax incentive for former Portuguese residents (*Programa Regressar*).

"Another issue to be taken into account by digital nomads is the existence in Portuguese tax legislation of incentives to relocate to Portugal and acquire tax residence here. In this context, the non-habitual resident regime and the tax incentive for former Portuguese residents are of particular note."

(i) Non-habitual resident regime

Employment income (less the amount of contributions paid by the employee to compulsory social security schemes, including Portuguese and foreign schemes) earned by tax residents in Portugal is generally subject to progressive rates of up to 48%, plus a solidarity surcharge (if applicable).

However, under the Non-Habitual Resident ("NHR") regime, employment income is subject to a more favourable treatment as follows:

- Employment income obtained in Portugal from high value added activities is taxed at a flat rate of 20%. If the income does not result from a high added value activity, it will be subject to the progressive rates mentioned above;

- Employment income obtained outside Portugal will be exempt in Portugal if: (i) the employee is actually taxed by the source State under the applicable DTC; or (ii) if no DTC is applicable, the income is actually taxed by the source state. If the income is not actually taxed in the source state, it can benefit from the flat rate of 20% if it meets the conditions mentioned above.

To benefit from the NHR regime, the employee has to meet two requirements: (i) qualification as tax resident in Portugal according to certain criteria; and (ii) not having been subject to taxation in Portugal during the five years prior to residing in Portugal.

NHR tax status applies for a period of 10 years. If, during the 10-year period, the employee is considered resident in another country, the employee will not benefit from the NHR status until he or she returns to Portugal. The 10 year period is not suspended during the absence of the employee from Portugal.

(ii) Programa Regressar / Tax incentive for former Portuguese residents

This programme is intended to support emigrants returning to Portugal. Eligible emigrants will benefit from an exclusion from taxation of the taxable base of 50% of their employment income. Taxable income will, however, be subject to the progressive rates mentioned above.

To benefit for the tax incentive for former Portuguese residents, Portuguese emigrants must meet all of the following requirements: (i) the employee must be considered as tax resident in Portugal in 2019 or 2020; (ii) the employee cannot have qualified as resident in Portugal in any of the previous three years; (iii) the employee must have qualified as tax resident in Portugal at any time before 31 December 2015; (iv) the employee must have his/her tax situation regularized; and (v) this regime is not cumulative with the NHR status.

This regime is applicable to the income earned in the first year in which the resident meets the requirements mentioned above and continues for the next four years. Accordingly, for any former resident who becomes resident in 2021, the regime will apply until 2025.

2.4. Considerations on the applicable social security rules

Under the Portuguese Social Security Contributions Code, income from employment is subject to social security contributions at an aggregate rate of 34.75%, of which 11% is payable by the employee and 23.75% by the employer.

Under the terms of Regulation (EC) 883/2004 of 29 April 2004, an individual who engages in an employed or self-employed activity in a Member State is subject to the legislation of that Member State.

In the case of an individual who normally works as an employed person in two or more Member States, that person will be subject to the legislation of the Member State of residence of the individual if he or she does a substantial part of their work in that Member State.

Conversely, if the employee does not do a substantial part of their work in their Member State of residence, the applicable legislation will be that of the Member State where the registered office or place of business of the employer is situated, if the employee is employed by two or more employers that have their registered office or place of business in two Member States, one of which is the Member State of residence. For these purposes, a "substantial part" of an employee's work means at least 25% of their working time and/or earnings.

If the Regulation (EC) 883/2004 is not applicable, it will be necessary to assess whether there are agreements governing the social security legislation applicable between the two countries concerned. These agreements will be particularly important for situations involving third countries and they will have to be examined on a case-by-case basis.

3. Regulatory issues

From a regulatory perspective, one of the issues that may concern digital nomads is the requirement for a work permit under Portuguese law. Whether such a requirement applies will depend on a set of factors to be assessed in the specific case.

In fact, the following factors may remove the risk of a permit being required: (i) the employee works under an employment contract (and not as a service provider), (ii) the employee does not work with clients or potential clients in Portugal, and (iii) the employee only works with remote infrastructure (i.e. the employee does not have the company's premises or equipment at his/her disposal). In these circumstances, the specific location of the employee is merely incidental to the work done and do not make it possible to determine a relevant connection with Portugal beyond the employee's residence. In any case, this is a situation that must be analysed taking into consideration the specific circumstances of each situation.

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Differently, questions also arise in relation to Portuguese employees who work remotely outside Portugal. In this scenario, the Portuguese employer must ensure that no permit requirements apply under the law of the state where the employee is located. Regarding supervision requirements, an employee working abroad is subject to the same control and supervision mechanisms they would be if working in Portugal, and this ensures neutrality. It may also be necessary or advisable to communicate this information to the supervisory authorities.

For this purpose, the Portuguese authorities should confirm that the existence of employees working from other countries does not imply the existence of a permanent establishment under the domestic rules of that country.

4. Immigration issues

Unlike what happens in some countries of the European Union or the Schengen Area, Portugal still has no specific visa or residence permit for digital nomads. However, there are several types of visa and residence permits available for nationals of third states and these can be adapted to the specific situation of each interested party.

As regards the types of visa available, it is important to distinguish between the possibility of applying for temporary stay visas or residence permits, depending on whether the duration of the stay in Portugal is less than or more than 1 year, respectively.

Generally, the types of visas/residence permits include the following variants: (i) to work as an employee (whether seasonal or not) or as a self-employed worker; (ii) scientific research activities; (iii) teaching at a higher education institution or working in a highly qualified activity; (iv) study programmes, (v) training (including transfers of nationals of states party to the WTO, between establishments of the same company or group of companies, for professional training, provided the applicant has been an employee for more than 1 year); (vi) unpaid professional traineeship or unpaid voluntary work for a non-profit cause; (vii) retired persons or persons living on their own income; (viii) entrepreneurs ("StartUp Visa") and investment activities ("Golden Visa").

In the case of residence permits, it is possible to apply for family reunification of the holders of the permits, provided certain requirements are met.

5. Personal data protection issues

When it involves the processing of personal data, remote working increases the risk of data breaches and, as a rule, provides less guarantees to data subjects that their data will be processed in accordance with the General Data Protection Regulation[1] ("GDPR"). As a result, hiring of remote workers – as employees or as service providers, in particular when they assume the position of subcontractors[2] – should be preceded by the imposition of rules, either from a cybersecurity perspective (e.g., obligation to only store data in the cloud of the employer or client) or from a personal data protection perspective (e.g., obligation to delete all data after the provision of the service or at the end of the project).

The fact these providers are individuals or that they are located outside the European Economic Area does not remove the need to comply with the provisions of the GDPR. For example, (i) employees must follow the instructions of the employer subject to the GDPR; (ii) subcontractors must act in accordance with the terms of their contract under Article 28, and, (iii) service providers acting as controllers must comply with the provisions of the instrument on which the international transfer is based, under the terms of Articles 45 and following of the GDPR.

Furthermore, and depending on the work in question (e.g., in cases of intermediation of online sales), the extraterritorial application of the GDPR may also be at issue (see article 3(2)(a) of the GDPR under which the GDPR applies to "*the processing of personal data of data subjects who are in the Union (...) where the processing activities are related to: (a) the offering of goods or services, irrespective of whether a payment of the data subject is required, to such data subjects in the Union*").

In short, there should be an increased concern, both on the part of digital nomads and on the part of those who use their services, for example, on an outsourcing basis, to ensure compliance with the GDPR – under the applicable terms – and a binding of the parties in terms that mitigate the risk of data breaches and allow data subjects to know how their data are processed, in the light of the transparency principle. ■

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1 Regulation (EU) 2016/679 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, and repealing Directive 95/46/EC.

2 See Article 28 of the GDPR.