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Tax considerations for digital nomads

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The term “digital nomad” was first used in the late 1990s to refer to someone who works either remotely or from home to conduct their business and earn a living through the internet.

Digital nomads can work from foreign countries, from internet cafes, vehicles, open spaces or anywhere there is an internet connection using laptops, tablets or smartphones to conduct their businesses. Digital nomads may be entrepreneurs or employees.

People can be digital nomads for a variety of reasons including location preferences or for financial independence. This lifestyle however comes with a number of challenges including complying with local laws, obtaining work permits or visas and complying with international tax obligations.

In this article, we will look at some of the international tax considerations for the modern digital nomad.

Covid-19 may have caused a number of digital nomads to:

- Return to their home countries temporarily to work remotely, or
- To remain working remotely overseas on a permanent basis

Whilst employers may want to accommodate these requests for employees, the tax implications both in the UK and overseas should not be forgotten. Here are the main points to consider:

Tax residence

An individual's UK residence position determines their tax position and whether an individual is resident or not for a given tax year is based on the Statutory Residence Test.

Individuals who travel extensively need to keep in mind their UK tax residency position for the tax year. It is important to note, if the individual is a UK tax resident and is UK "domiciled", they are subject to tax on their worldwide income, but may be able to claim a Foreign Tax Credit for overseas income which is also taxed in another jurisdiction.

Individuals who are non-UK domiciled, but are UK tax resident for the tax year, could elect to be taxed each year either on the arising or the remittance basis in their UK self-assessment tax return. If they elect to be taxed on the remittance basis, any overseas income will not be taxable in the UK unless it is remitted to the UK. The notions of "domicile" and "remittance" are complex and it is important to take UK tax advice.

It is also possible for an individual to be dual resident in the UK and the overseas country, in which case the relevant Double Taxation Agreement should be considered to determine where they are treaty resident.

The employee may need to report their departure to HMRC on a P85 "Leaving the UK" form or a UK tax return.

PAYE

Whilst an employee overseas can continue to be paid from the UK payroll, PAYE adjustments may need to be made to ensure the correct tax treatment, for example, so that no tax is withheld (NT code), tax is withheld on a percentage of earnings (s690 agreement) or to claim a foreign tax credit via the payroll for taxes being withheld overseas (Net of Foreign Tax Credit Relief scheme). The correct steps will depend on the residence position.

Social Security

The social security position does not necessarily follow the tax position, so should be considered carefully on a case-by-case basis. If the employee is only temporarily overseas, they may be able to remain in UK NIC, however if they are moving permanently, the position will depend on whether they move to an EU/EEA country, or to a country with a social security agreement. If the employee is going to be working in several countries on an ongoing basis, there are further considerations. In any scenario, it is likely an application or change to the payroll NIC code will be required.

Permanent Establishment

Another important question is whether the employee has created a "permanent establishment" (PE) in the foreign territory. If so, tax advice should be taken in that country, but typically the rules for an overseas company creating a UK PE are the same for a UK PE creating an overseas PE, as they are governed by OECD conventions. Broadly, these are that the profit generated by the overseas permanent establishment is taxed in the jurisdiction in which the profit is generated.

Overseas compliance

It is important not to forget employer and employee obligations in the overseas location. Points to resolve may include:

- Will the employee become tax resident overseas? If so, when?
- Is a tax return required in the overseas territory?
- Is there a requirement for the employer to register locally and/or operate a payroll to withhold tax and social security?

The answers to these questions vary from country to country, so it is important to take local advice.

The same issues arise for entrepreneurs as well as for employees. Local tax laws in the overseas territory still have to be complied with and tax residence including the possibility of dual residence must also be understood. This is so that the resulting tax conventions as to what tax is paid, where it is paid, and which country has primary taxing rights, can be determined.

In addition, there may well be planning opportunities around the timing of when to become resident or non-resident. Such planning must be considered before a change of residence.

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