Tax Re-evaluation...Digital Nomads & Remote Work Residency Risks

The world and its workplace have changed and with it, so too have global tax residency risks.

The workplace revolution has continued in the post-pandemic society with the growth of remote and hybrid working truly replacing the traditional 9-5 office-based work model. Along with this workplace transformation, the rise in social media influencers and vloggers has led to a new style of worker...the digital nomad.

Whilst this revolution is attractive on the face of it, with the possibilities it can offer in terms of work-life balance, freedom and business benefits, there are tax challenges to be faced. The significant number of employees working in a hybrid fashion and the ease of operating and managing businesses remotely raises the concern that companies may neglect to manage corporate and employee tax residence.

This shift towards hybrid and remote working, as well as the digital nomad lifestyle, is increasing the risk for both companies and individuals to be deemed as being tax resident in multiple jurisdictions, which has led to tax authorities adjusting their approach to residency taxation.

Subsequently, there is a need to address these potential risks and Tax Insurance is offering a solution to help.

> "*We have seen an increase in clients looking to mitigate concerns surrounding tax residence risks including permanent establishment, place of effective management, and substance*"
> **Camila de Carvalho, Associate Director at UIB.**

Tax residence is usually regulated by the domestic laws of each jurisdiction. However, an individual or an entity may be considered a tax resident under the rules of more than one jurisdiction, which can result in double taxation or alternatively, a higher tax burden.

Tax authorities in many jurisdictions also consider the place of effective management of a company as being where the highest level of decision-making takes place, in addition to its place of incorporation when determining its corporate tax residence. This is especially important for Private Equity houses who may have Directors on the Boards of Portfolio Companies across multiple jurisdictions and may not be able to attend each meeting in person.

In such cases of dual resident conflicts, double taxation treaties can apply as a test, which look to the place of effective management to determine which country has the right to claim exclusive tax residence over the company.

As always, these assessments can be subject to interpretation by the relevant authority surrounding their correctness, and to address these potential risks, we expect to see an increase in the demand for specific Tax Insurance which provides protection against tax authorities challenging the historic and future residence position.

"Tax Insurance can provide a neat and prompt solution to remove concerns arising from residency risks. Insurers are able to work with clients and their brokers to understand the factual position and provide tailored and innovative solutions to remove risk" **Dawn Bhoma, Managing Principal of Icen Risk**

Benefits of Tax Insurance

- Reduces the likelihood of M&A deals being aborted by helping to overcome negotiation impasses and mitigating identified tax risks;
- Helps corporates manage potential risks identified on an ongoing standalone and look forward basis. (e.g. group reorganisations, permanent establishment risks, cash repatriation, delay or non-availability of advance ruling, etc.); and
- Allows sellers a cleaner exit by excluding or replacing specific indemnities and/or escrows in the SPA and speeding up the distribution of sales proceeds.

Tax Insurance – Key Points

- Transfers an identified, quantifiable but uncertain tax liability from the target balance sheet to an insurer
- Available pre or post M&A transaction or an ongoing standalone basis
- Duration of the policy: up to 10 years
- Premium: c.1.5% - 4%

Case Study

Scenario:
A private equity fund was acquiring a portfolio of hotels located in various jurisdictions. Both the vendor due diligence and buy side tax analysis raised concerns over residence risk, with a potential exposure of €35m.

Risk:
The Target was Jersey domiciled, however over the last 5 years, its majority shareholder had dialled in to board meetings from multiple countries, leading to a risk that the Target could be deemed to be tax resident in one of more countries.

Policy:
An insurance policy in the name of the Target was issued, with a limit of €35m, with the buyer named as a loss payee under the policy. The insurance allowed for a claim to be made should the tax authority in one of the countries raise a challenge around residency risks linked to place of effective management of the Target. Insurance helped provide certainty for the Buyer, and allowed negotiations to continue with a major pitfall having been mitigated.

With the revolutionised workplace in the post pandemic society, Tax Insurance can be a valuable solution to navigate and mitigate the potential consequences surrounding residency, resulting from the growth of remote and hybrid working, and the digital nomad revolution.

If you would like to discuss any of the points mentioned in this article or any other matters related to Transactional Risks, do not hesitate to contact one of our specialists at UIB.

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