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NEWSLETTER

INTERNATIONAL TAX IMPLICATIONS OF THE COVID-19 PANDEMIC

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SUMMARY

The challenges brought forth by the Covid-19 pandemic have given rise to new issues facing international tax rules and conventions. The restrictions on the mobility of individuals may force a new perspective in terms of tax residency criteria, and the development of professional activities from a distance, through the use of digital means, should also be reflected upon with regards to what constitutes a permanent establishment. If addressed soon, these questions could help prevent future litigation and aid in the post-pandemic period of economic recovery.



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INTRODUCTION

In recent years, the international tax community has been faced with several challenges derived from the digitalization of the economy and the ability to work from a distance, using modern technology.

The current Covid-19 global pandemic has only raised more questions regarding these issues, as working from home became much more prominent due to public health concerns.

Although the current global lockdown is expected to only be temporary, the widespread reaction to the Covid-19 pandemic has caused a ripple effect, testing the established rules, which were designed for a scenario in which people are free to move across borders and to choose where to work and make a living.

As such, it is worth reflecting if rules aimed at a pre-pandemic world can continue to be interpreted and applied in the same way as they were before.

TAX RESIDENCY OF INDIVIDUALS

Even though Portugal has imposed strict border controls, namely regarding the tourist flow in and out of the

country, the return of Portuguese nationals and the departure of foreign residents is not likely to be restricted, as per the Government's recent pandemic-related decrees.

Despite this, some workers who are tax residents in other countries may find themselves unable to leave Portugal due to limited transportation options, or even due to harsher restrictions imposed by the destination country. For example, before the pandemic began, a Portuguese national who lived and worked abroad may have decided to come to Portugal for personal reasons and, after spending a few months in the country, is now caught by the lockdown ordered by the Portuguese government.

The lockdown started at the beginning of March and is set to last until the beginning of May or even further. In addition, due to the aforementioned restrictions, a Portuguese citizen who is a foreign tax resident may be forced to stay in Portugal for much longer than originally planned. As such, questions could arise regarding the possibility of this person being considered as a Portuguese resident, for tax purposes, in 2020, even though his or her stay in the

country has been dictated by *force majeure*.

Traditional tax residency rules seem to give no relevance to the underlying reasons of factual situations.

However, the interpretation of these rules should be seen in a new light due to the extraordinary circumstances the international tax community is currently faced with and the rationale behind each decision-making should be taken into account regarding tax residency (not just circumstances).

EMPLOYMENT INCOME

Portuguese nationals who are tax residents in a foreign country and are still under the employment of a foreign company during their stay in Portugal, could still receive their salary, partially or in full, given that they continue to work from home. This income could qualify as Portuguese-sourced employment income, and therefore be subject to personal income taxation in Portugal.

This should be the case if a person remains in Portugal for a period of at least 183 days, in accordance with the applicable tax legislation.

However, since this person's stay in Portugal is not a result of his or her own

will, it could be argued that this period should be seen as a forced holiday period, during which the employee can still work, but should not be considered for the purposes of determining that person's tax residency.

PERMANENT ESTABLISHMENT

Another relevant issue arises in case the activity performed in Portugal is seen as a permanent establishment of the foreign employer in Portugal.

In recent years, it has been highly debated if the growing trend of working from home, frequently across borders, could give rise to permanent establishments in the country in which the employee is located. However, in this pandemic scenario, the intention of the employers should perhaps be taken into account, as it was likely not their intention to establish a presence in that country.

This issue could trigger significant consequences because in case a permanent establishment is identified, the 183-day rule mentioned above would no longer apply and the employee could indeed be subject to personal income taxation in Portugal.

For instance, an employee could be a top manager of the foreign company and his prolonged working presence in Portugal could lead the Portuguese tax authorities to consider that the employer's place of management is located herein. In this case, and similarly to the tax residency rules for individuals, the established rules should be applied with the adequate flexibility considering current global events.

Furthermore, the foreign tax resident who is unable to travel from Portugal could be the employee of a multinational group and have been seconded from his country of residency to another European Union country before or during his stay in Portugal, in order to give adequate substance to the structure situated therein. As such, his or her forced working presence in Portugal could, in the eyes of the Portuguese tax authorities, devoid the permanent establishment of the other EU country of any economic substance.

CONCLUSIONS

The Covid-19 pandemic has given rise to a multitude of challenges to the current international tax rules and conventions, which may cause a rise in

tax litigation in the future if not addressed soon.

While the economic sustainability of families and companies is (and should be) the current priority of governments all around the world, as successive decrees are issued to face the restraints brought forth by the pandemic, a reflection on its possible long-term effects is also desirable, as it could play a pivotal role in the world's much-needed economic recovery once the Coronavirus is defeated.

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