Tax policies for a new generation

Young people joining today’s labour market are entering a new work environment, with ever-more flexibility for employees given the continued digitalisation of the workplace. Such changes however also come with new tax policy challenges. Meanwhile, the European Commission is seeking to promote tax policy education.

A new work environment and the rise of ‘digital nomads’

The ongoing digitalisation of the workplace, with high-speed internet access and videoconferencing tools, has allowed employees to work remotely, from the comfort of their own homes, a development heavily accelerated by the COVID-19 pandemic. Combined with the many cheap modes of international travel (and the EU’s freedom of movement), young people are now entering a global labour market with the potential for more (geographical) flexibility and more digital opportunities, compared with the previous generation of workers.

In this context, one particular new phenomenon is the rise of ‘digital nomads’: people who consistently telework from a country other than that in which their source of income, i.e. their employer (and its offices), is located. Anecdotal evidence suggests multinationals have already started opening vacancies for fully remote positions. These digital nomad jobs are usually found in white-collar, digitally driven professions (IT, social media, accounting), and seem primarily to attract the younger generations.1 They allow workers to combine earning an income with traveling the world, and to choose their place of residence in terms of societal or cultural benefits (such as an agreeable climate or high quality of healthcare), while also offering a better work-life balance.

To respond to these behavioural shifts in the workplace, six Member States (Croatia, Estonia, Greece, Hungary, Latvia and Malta) and twenty non-EU countries have already begun issuing dedicated digital nomad visas, allowing foreigners to work in their country for an extended period. Destinations that rely heavily on tourism see digital nomads as a (more stable) source of tax revenue and skills, thereby countering the uncertainty of the tourism sector (and the potential return of lockdowns) in a post-pandemic world.

Digital nomads may however pose taxation challenges. When it comes to allocating taxing rights on wages between the ‘residence country’ (where the employee resides) and the ‘work country’ (where employment is physically carried out), countries have bilateral tax agreements in place, often based on the OECD Model Tax Convention (MTC). In short, the MTC says the residence country has the taxing right on employment income, but the work country may also tax either if the employee carries out activities for more than 183 days in the work country, or if the salary is paid by a company, or by the local branch of a company, resident in the work country. If one of those conditions is fulfilled, the two jurisdictions tax the income attributable to the days worked in each state on a pro-rata basis. This arrangement, focused on physical presence, was set up with traditional frontier workers in mind (i.e. people working in one country, but returning every day to their home in another country) and cross-border workers (e.g. posted workers, or workers residing temporarily in another country because of a training course or for business). This system already showed its limitations during the COVID-19 pandemic, during which employees could be absent from their usual place of employment for months, requiring countries to issue dedicated measures for (international) teleworking citizens or workers stranded in a foreign jurisdiction owing to travel restrictions. However, this system is now being challenged by digital nomads who may hardly ever or never work physically in their employer’s country, thereby reducing or even displacing the taxing right of the employer’s country altogether.

In this context, digital nomads, when choosing a country of residence, may be motivated to choose those destinations that have the lowest tax rates on income. Some countries already offer special tax cuts or exemptions for newly arrived digital nomads. Concerns have been raised that this may be the global start of a race to the bottom in personal taxation, potentially undermining the stability of countries’ tax systems.
Personal income tax is usually a significant revenue raiser (four times greater than corporate tax on average in the EU), and the cross-border movement of (often highly skilled and well-paid) individuals, could affect a country’s revenue-raising capabilities and lead to ‘significant spillovers’ in other taxes.

**Tax wedge**

The concept of a tax wedge – the difference between an employer’s total labour costs for an employee and that employee’s net pay – is commonly used in economic literature to measure incentives both to work and to hire people. As this cannot be measured in terms of age group, the graph below shows the tax wedge using data for low-wage earners who are not married and have no children (on the assumption that these categories are most relevant to young people).

In 2021, the EU *tax wedge for this category was 39.2% of labour costs*, with the highest figures recorded in Belgium and Germany. This is considerably higher than in the US (24.7%) and Japan (31.2%). A high tax wedge may not only weaken young people’s incentives to look for work, but may also discourage businesses from hiring additional staff due to the high labour cost. An IMF study, taking data from 21 EU Member States, found that a 1 percentage point increase in the tax wedge led to a 0.3-1.3 percentage point increase in youth unemployment.

![Figure 1 – Tax wedge on labour costs, low-wage earners – Single people with no children, 2021](image)

Source: Eurostat; low-wage earners: wages at two-thirds of national average income.

**TAXEU**

In 2017, the European Commission launched the TAXEDU platform. TAXEDU has been designed to educate young EU citizens in accessible language about tax policy and how it affects individuals and society. The platform has dedicated tools for several age groups, ranging from children (including school material for teachers) to young adults. The latter group can find more in-depth information about taxes per EU Member State and can follow free online courses on the tax consequences of studying abroad, earning your first income or setting up your own business (and the corporate tax and VAT implications). Along with quizzes and tutorials, another feature of TAXEDU is the online game 'Taxlandia', which makes players prime minister for a day and puts them in charge of the fictional country 'Taxlandia' and its budget and tax administration. The game will challenge players to make smart and sustainable tax decisions and respond to public and business demands. Unexpected events, such as environmental disasters, will require higher tax revenue to invest in carbon-mitigating projects, while an excessive tax burden may lead companies to leave Taxlandia and citizens to demand your resignation.

1. While more research is needed into the demographics of digital nomads, their tendency to be younger may reflect greater digital literacy. In addition, being child- or partner-free may make it easier to move to other countries. Some digital nomads may live abroad for years, while others adopt the nomad lifestyle as part of a shorter sabbatical or 'workcation'.

2. In reality, tax administrations tend to have relatively older workers as staff. In 2020, just 15% of total full-time staff in the tax administrations of the Member States were under 35, while 31% were 55 or older (source: OECD Tax administration series).