TAX ISSUES FOR REMOTE WORKERS AND THEIR SWISS EMPLOYERS

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INTRODUCTION

The COVID-19 pandemic and the health measures implemented by governments led to an unprecedented globalization of remote working. In some instances, work was done at home, in other instances, executives were stranded abroad. Either way, this new form of work is prevalent in border areas where employees living on one side of a border work at a facility on the other side of the border.

Remote work implies particular constraints in tax and social security matters, both for border workers and for their employers. For the employee, identifying the country that has primary right to levy tax and social security contributions on salaries is a major concern. For employers, besides concerns about obligations to withhold tax and social security contributions on salaries paid, permanent establishment and the place of effective management concerns arise.

Aware of such challenges, European governments and the O.E.C.D. focused on the need to adapt the traditional taxation system, which is mainly based on the territoriality principle. Switzerland, which is very attractive for skilled foreign labor, is particularly concerned by these issues and is obliged to deal with its neighboring countries. The Swiss cross-border workforce is growing each year. There were 380,821 border workers as of the fourth quarter of 2022,[1] consisting of 214,235 French residents, 89,378 Italian residents, 65,958 German residents, and 12,250 Austrian residents. That was twice the number of cross-border worker that existed in 2002. The number of cross-border workers is predicted to double again in the next 10 years.

This article discusses the implications of remote working practices in the Swiss context, looking at income tax and social security charges on mobile workers and the allocation of the company's taxable profits between Switzerland and its neighboring countries.

INCOME TAX AND SOCIAL SECURITY CHARGES

Under Swiss domestic law, persons who are not fiscally domiciled in Switzerland are subject to Swiss income tax if a jurisdictional nexus exists, such as employment in Switzerland.[2] Where a nonresident individual does not work full time in Switzerland, only compensation for days worked in Switzerland is taxed. This applies to cross-border workers who commute daily to a place of work in Switzerland. It applies also to weekly workers who remain in Switzerland during the week but

1 According to the F.S.O. – Statistics on cross-border workers 2023.

2 Article 5 al 1 let a F.D.T.A.

regularly return home on weekend, provided their center of vital interests is abroad. The physical and effective activity on Swiss territory is the link for tax liability in Switzerland.[3]

Wages paid to cross-border workers are subject to wage withholding tax that varies with the compensation amount and the personal situation of the employee, such as marital status and the number of dependent children, if any.[4]

If an individual is employed in Switzerland but maintains the center of his or her vital interests abroad, the relevant bilateral tax treaty between the country of residence and Switzerland specifies the circumstances in which tax is imposed in Switzerland or the country of residence. In principle, income tax treaties that are based on the O.E.C.D. Model Tax Convention provide that employment income is taxable in the state where the individual performs services for an employer, with a split between several states if the employee works in several states.

Most income tax treaties entered into by Switzerland include a provision under which the right to tax is retained by the country of residence of the employee where the following three conditions are met:

- The employee is present in Switzerland not more than 183 days in any 12-month period.
- The income is paid by an employer who does not reside in Switzerland.
- The remuneration is not borne by a permanent establishment in Switzerland.

The right to tax shifts to Switzerland if any of the three conditions is not met.

SWISS – FRENCH AGREEMENTS ON CROSS-BORDER WORKERS

Different rules apply to cross-border workers. Switzerland has in effect several agreements regarding taxing rights on cross-border workers. These agreements differ from one neighboring country to another and sometimes even from one canton to another.

Regarding France, which is home to most of the Swiss cross-border workers, the tax treatment of the cross-border workers' income varies according to the canton in which the employee regularly works.

Agreement of April 11, 1983 (Taxation of Cross-Border Workers)

This agreement between France and Switzerland applies to compensation income of cross-border workers in eight cantons, Basel Stadt, Basel Land, Bern, Jura, Neuchatel, Solothurn, Vaud, Valais/Wallis. In deviation from the France-Switzerland Income Tax Treaty, it provides that compensation of French resident cross-border workers in relation to each of the covered cantons is taxed exclusively in France. In turn, France pays 4.5% of the aggregate gross cross-border workers' salaries to the canton of employment. Under the agreement, the tax is levied directly on the

3 Federal Court decision from 25 March 2011 ATF 137 II 246.

4 Article 91 F.D.T.A.

employee, who makes payments in installments. The Swiss employer does not file any form or make any tax payment in France.

Cross-border workers are defined as (i) any person resident in one state, (ii) who pursues an activity as an employed person in the other state, (iii) with an employer established in that other state, and (iv) who returns, as a general rule, daily to a place of residence in the first state.

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France-Switzerland Agreement of 1973

This agreement only relates to cross-border workers living in the French departments of Ain or Haute-Savoie and employed in the canton of Geneva. It provides that Geneva pays the neighboring departments of Ain and Haute-Savoie a special compensation of 3.5% of the gross salaries paid to all cross-border workers living there and working in Geneva. The allocation of taxing rights as such is provided by the France-Switzerland Income Tax Treaty, which determines that the income of the cross-border worker is taxable solely where employment services are performed, *i.e.* in Geneva for the cross-border workers covered by this agreement. France also imposes tax on its residents, but allows a credit equal to the amount of French tax due on the Swiss employment income.

France-Switzerland Income Tax Treaty (Applicable to the Cantons that are not Part of the 1983 Agreement on Taxation of Cross-Border Workers)

French cross-border workers are generally taxed in Switzerland, except that French tax is imposed on compensation for each day worked in France, generally at home. This results in excessive administrative and tax burdens for both employees and the employers. A Swiss employer is obliged to collect French tax from compensation payments, deposit the tax in France, and file the necessary forms. A Swiss employer with no permanent establishment in France must engage a tax representative in France to complete the paperwork and make payments. At that point, the compensation taxed in Switzerland is reduced.

COVID-19 Agreement

During the COVID-19 period, Switzerland concluded agreements with several other countries. Regarding France, an agreement was concluded as of May 13, 2020, and renewed several times until December 31, 2022 in order to address the tax effect of remote working during the period covered. Under these agreements, remote workers residing in France and working at home for a Swiss employer were exclusively taxed in Switzerland. The income was exempt from French tax even though France was the place where services were performed.

Post COVID-19 Agreement

In the post-COVID-19 period, remote working will likely continue. Considering the challenges it represents for cross-border workers and their employers, France and Switzerland have agreed to facilitate remote working on a permanent basis. The agreement which was reached on December 22, 2022, is not yet published and supposed to be signed and ratified before June 30, 2023, but is provisionally applied since January 1, 2023, and introduces a tolerance threshold if a not more than 40% of the workweek is performed remotely in France. The agreement will take the form of an amendment protocol to the France-Switzerland Income Tax Treaty.

Two situations must now be distinguished:

Workers Subject to the Cross-Border Regime in the Covered Cantons

Those who work in one of the eight signing cantons of the 1983 agreement on taxation of cross-border workers retain the status as cross-border workers. Their salary is taxed exclusively in France and France will continue to remit a subsidy to the covered cantons as long as the percentage of total days worked in France does not exceed 40% of the total days worked for the Swiss employer in the covered cantons.

Other Cross-Border Workers

Other workers are generally covered by the existing France-Switzerland Income Tax Treaty as modified by the Post COVID-19 Agreement. Regarding cross-border workers, days remotely worked from France remain taxed in the state of an employer in Switzerland on condition that the total number of remote workdays in France does not exceed 40% of total days worked. In consideration of maintaining the right to tax such income in Switzerland, adequate compensation (yet to be defined) will be paid to France, where the cross-border worker's place of residence is located.

Where the number of days worked in France exceeds 40% of the total number of days worked, compensation for days worked in France will be taxed in France. In addition, cross-border workers will lose their special status as quasi-residents who may benefit from certain tax deductions in Switzerland.

Several points await clarification for other cross-border workers taxable in France on French source compensation. Switzerland and France have not agreed to a tax collection assistance procedure. Consequently, a Swiss employer is still required to deduct tax at source in France. Special authorization must be obtained in order to collect and pay the tax of a foreign jurisdiction without violating Swiss law.

OTHER AGREEMENTS ON CROSS-BORDER WORKERS

Italy-Switzerland Agreement

In 2020, Switzerland and Italy entered into an agreement on cross-border workers, approved by the Italian Senate in February 2023. Under the terms of the Agreement, compensation received by cross-border workers residing in Italy who work as an employee in the border area in Switzerland for a resident employer there remain taxable only in Switzerland. This rule is effective for periods beginning after December 31, 2018. However, each of the cantons of Graubünden, Ticino and Valais must make compensating payments to Italian border municipalities through December 31, 2033. The compensatory payments equal 40% of the Swiss federal, cantonal, and municipal taxes on compensation collected from cross-border workers resident in Italy. The compensation is made in Swiss francs through a single payment during the first six months of the year following that to which the financial compensation refers.

Germany-Switzerland Income Tax Treaty

The Germany-Switzerland Income Tax Treaty addresses cross-border workers in Article 15a, which is a carveout from the general rules applicable to employment that appear in Article 15. Article 15a provides for taxation in the State of residence. Nonetheless, the State in which employment is carried out by a cross-border worker may also tax the activity performed, but at a rate that is capped at 4.5%. To benefit from the capped rate, an official certificate issued by the tax authorities in the country of residence must be provided. The definition of a cross-border worker in this treaty is similar to the definition in the 1983 agreement between France and Switzerland discussed above, except that a 60-day cap is placed on the number of days for which the cross-border worker does not return home at the end of the day. If the 60-day cap is exceeded, Article 15a is no longer applicable.

MEMBERS OF THE BOARD OF LEGAL ENTITIES

Remuneration paid to a nonresident taxpayer in his or her capacity as a member of the board of a legal entity having its seat in Switzerland is taxable in Switzerland. Income tax treaties concluded with neighboring states allocate the exclusive right to tax those payments to the jurisdiction in which the corporate seat is located.

SOCIAL SECURITY ASPECTS: LIABILITY OF THE SALARY TO SOCIAL SECURITY CONTRIBUTIONS

In Swiss-E.U. relations, social security matters are governed by the European coordination regulations, which have applied to Switzerland from April 1, 2012.[5] The general principle found in those regulations is that employees can participate in only one social security system and pay social security contributions to only system even when their compensation is earned in several countries. Consequently, if an employee resides in one Member State and works exclusively in another Member State, the employee participates only in the social security system of the Member State where his or her employer is located. In comparison, if an employee carries out substantial activity in his or her state of residence, the social security legislation of that Member State would apply. For this purpose, substantial activity occurs if the employee works more than 25% of the time in his or her Member State of residence.

In principle, a tolerance threshold of 25% can produce unique results. Likely, it does not mean that the employee can work remotely for one full workday and one-quarter of a workday each week without entailing any change in the applicable social security system. In reality, the threshold likely cannot be measured in terms of portions of the day. Rather, it likely is limited to one day each week for three weeks, and two days during the fourth week or one week out of every four weeks, adjusted for holidays. Whichever measurement applies, the Swiss employer must deduct and pay French social security contributions on the entire salary once the 25% standard is exceeded, which will not be known until the latter part of the year in most instances.

During the COVID-19 pandemic, Switzerland concluded derogation agreements with neighboring states to freeze the situation as if the days spent in the country of residence did not exist. In the case of France, the agreement continues to apply until June 30, 2023, and provides that the 25% threshold does not exist. Consequently,

5 Regulation (E.C.) No. 883/2004 of the European Parliament and of the Council of 29 April 2004 on the coordination of social security systems; Amended by: Regulation (E.C.) No 988/2009 of the European Parliament and of the Council of 16 September 2009.

a French resident employee of a Swiss employer participates only in the Swiss social security system through June 30, 2023. Thereafter, coverage will depend on whether the agreement with France is renewed. If not, E.U. coordination regulations will apply.

The social security rules apply equally to compensation paid to a director of a Swiss company. Such compensation is subject to Swiss social security payments.

RISKS OF REMOTE WORKING FOR THE EMPLOYER IN RELATION TO THE ALLOCATION OF TAXABLE PROFITS

As a general rule, legal entities in Switzerland are subject to unlimited taxation when their seat or effective management is found to be in Switzerland.[6] Where a permanent establishment exists, part of the company's profit can be allocated between the State or residence and the State where the permanent establishment is located, based on the separate activity of each.

Swiss tax law defines a permanent establishment as any fixed installation in which all or part of the company's activity is carried out. This definition is in line with the definition of a permanent establishment in the O.E.C.D. Model Tax Treaty, which also served as the basis for the France-Switzerland Income Tax Treaty, for example. The O.E.C.D. Model defines a permanent establishment as a fixed place of business through which an enterprise carries on all or part of its business.

Risk of Hybrid Work Arrangement

In practice, remote working could give rise to a permanent establishment at the place of residence of an employee having sufficient power to conclude contracts on behalf of the company. As an example, assume that a cross-border employee living in France works as a project manager for a Swiss company active in the field of IT. The employer grants the employee one day of telework per week, which does not meet the 25% threshold for application of French social security payment. The employee has no signing authority, but his function is to improve customer relations. To that end, he contributes indirectly to increasing the company's turnover and building customer loyalty. In this fact pattern, the Swiss company should have no responsibility for collecting French income tax or making French social security contributions with regards to the employee. Nonetheless, when the employee carries out his activity from his domicile in France, a French tax examiner may ask whether his added value could allow the French tax administration to tax part of the Swiss employer's profit by considering that the activity of the employee creates a permanent establishment in France.

During the COVID-19 pandemic, the O.E.C.D. guidance was that the home of the foreign remote worker did not constitute a P.E.[7] In the post-COVID-19 period, the conclusion might be different where the remote worker takes the lead role in negotiating contracts and does so from his or her home office. The risk is real as France has a very broad interpretation of the concept of permanent establishment. In a recent decision, the French Conseil d'Etat held that an agent may constitute a

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6 Article 50 F.D.T.A.

7 Publication April 2020.

permanent establishment if he or she habitually plays the lead role in the conclusion of contracts and participates in their negotiation. It does not matter that final approval of the contracts are signed abroad by personnel at the head office.[8]

In sum, there is no certainty that a cross-border worker who continues to work up to 25% of the time from a home office in France will not be viewed by the French tax authorities as either a fixed place of business permanent establishment or a dependent agent permanent establishment. This would shift tax exposure to France with a potentially concomitant reduction in Swiss tax.

On the other hand, it is one thing to assert that a permanent establishment exists in France, it is another thing to measure the arm's length profits that are attributable to the permanent establishment. The key is to measure the relative materiality of one day of working in France in comparison to four days of working in Switzerland along with Swiss residents assigned to negotiating the transaction. Clearly, proportionality will be important in determining the profit share taxed in France, if a permanent establishment were to exist there.

Other points to keep in mind are that (i) the failure to declare a permanent establishment in France may result in a penalty of 80% of additional tax assessment and (ii) Switzerland and France may have different views of the profits attributable to a one-day-each-week office.

Risk of Directors Who are Cross-Border Commuters

Beyond the questions of qualification of a permanent establishment, the situation of Swiss company directors who take strategic decisions from their home in France could raise questions relating to the tax residence of the Swiss employer, if effective management of the company in France could be construed. The same risk exists for a small businessman, whose operational and strategic management is in the hands of a single person resident in France. In this case, the place of effective management could be located at the place where the person remotely works. Such enterprise would thus not be taxed at its official seat, but at the domicile of the self-employed person. These risks have not yet materialized. Other risky fact patterns are sure to be identified. However, at some point the risks become more and more far-fetched as the meaning of the word "permanent" in the term "permanent establishment" becomes more and more nebulous.

CONCLUSION

Swiss companies wishing to allow their cross-border workers to work from home on a permanent basis should carefully analyze the consequences of that decision. In principle, exposure exists for the worker and the employer as to wage taxes and social security charges being imposed unexpectedly and exposure exists for the business as to the creation of a permanent establishment and a possible shifting of the place of effective management.

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