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Swiss taxation of cross-border commuters working from home abroad

René Matteotti, Sarah Bühler and Peter Vogt of Tax Partner AG analyse Switzerland's bilateral cross-border commuter agreements, with a special focus on working from home, and discuss recent developments in this area.

Working from home is no longer to be considered from a purely pandemic-related perspective, but to be recognised as the new reality. Many employers allow their employees to work from home but, especially in cross-border situations, this leads to new challenges in several areas of law.

This article will focus on the issues relating to the taxation of employment income for commuters with employment in Switzerland but residency abroad. The permanent establishment risk, the place of effective management, and social security coordination are closely related topics that must also be considered, but are not covered in this article.

Domestic rules on the taxation of employment income

Under Swiss domestic law, employees who are not tax residents in Switzerland are subject to limited taxation when exercising an employment in Switzerland. A tax liability is created on the first Swiss working day. The Federal Supreme Court has confirmed several times that the taxing right is restricted to working days physically spent in Switzerland.

A separate rule applies to board fees paid by companies with domicile or permanent establishment in Switzerland: these are taxable in Switzerland regardless of the physical presence. Non-resident employees and board members are subject to Swiss taxation at source. As a result, the worldwide income has no impact on the determination of the applicable source tax rate, with the exception of employment income. While the source tax rates on employment income are progressive, a flat-rate tax applies on board fees.

Non-resident individuals may voluntarily file a Swiss tax return (for example, to claim a tax deduction for a pension fund buy-in) if they pass the quasi-resident test. Under certain circumstances, the authorities may also request non-resident individuals to mandatorily file a Swiss tax return

on an individual case basis. In the latter two situations, the applicable tax rate is determined based on the total worldwide income (for example, investment or rental income).

Allocation rules under double taxation agreements

The income tax rules in Swiss double taxation agreements (DTAs) largely follow the recommendations of the OECD Model Tax Convention on Income and on Capital (OECD-MC). Article 15 of the OECD-MC sets out the basis upon which employment income is taxed in cross-border situations.

As a main rule, the employee's state of residence may exclusively tax the employment income, unless the employment is exercised in another state. Based on the so-called place-of-work principle, the state in which the employment activity is physically carried out is allowed to tax the income from employment. The state of residence avoids a double taxation by applying either the exemption or the credit method.The 183-day rule, as a counter-exception to the place-of-work principle, does not apply to work-from-home cases if the work is performed in a state where the employer is neither resident nor has a permanent establishment. Under these tax allocation rules, working from home usually leads to a situation where the employment state is not entitled to tax income stemming from working days at home or in third countries.

For cross-border commuters, executive employees, board members, or employees in public service, special taxation rules may apply. Pursuant to Article 16 of the OECD-MC, remuneration received in the capacity as a member of the board of directors of a company with residence in Switzerland may be fully subject to tax in Switzerland, irrespective of where the duties are physically performed. The same principle applies to executives, but only in relation to Germany and when at least a fraction of the work is physically performed in Switzerland. The following section focuses on the tax rules for cross-border commuters.

Switzerland's bilateral cross-border commuter agreements

Switzerland has bilateral cross-border commuter agreements in place with Germany, the Principality of Liechtenstein, Italy, and France, but not with Austria.

To address the COVID pandemic, Switzerland concluded temporary mutual agreements with its neighbouring countries which also dealt with commuters. Since these agreements are no longer valid, they are not covered by this article. The cross-border workers provisions take precedence over the aforementioned taxation allocation rules regarding employment income.

Germany

In the case of a cross-border commuter with tax residency in Germany and employment in Switzerland, the employment income is fully taxable in Germany, whereby Switzerland is allowed to withhold a tax at source of a maximum of 4.5% on the total gross remuneration. To avoid double taxation, a tax credit is granted in Germany for the tax paid in Switzerland.

The Switzerland–Germany DTA defines a cross-border commuter as any person who has their residence in one state, has their place of work in the other state, and regularly returns from the place of work back to the place of residence.

The requirements of cross-border commuter status are fulfilled if a daily return generally takes place or is reasonable. If a daily return is reasonable (i.e., each way is a maximum of 100 kilometres by car or a maximum of 90 minutes by public transportation), the employee must commute to the place of work and back on at least one day per week or five days per month to qualify as a cross-border commuter. However, cross-border commuter status is lost if a total of 60 non-return days per calendar year is exceeded.

A harmful non-return day exists if a return to the place of residence is not reasonable or not possible due to work-related reasons. In 2022, the competent Swiss and German authorities declared that working days spent fully at the employee's place of residence do not count as harmful non-return days.

This means that an employee who resides within a reasonable distance from their place of work in the other state (100 kilometres/90 minutes) can work from home for four days a week and still qualify as a cross-border commuter. This is also true for executives commuting from Germany to Switzerland. They are also captured by the specific cross-border commuter provisions, which means that Switzerland could not claim its exclusive taxing right as stipulated in the Switzerland–Germany DTA for income derived by executives who are resident in Germany and employed by a Swiss resident employer, since the provisions for cross-border commuters take precedence over the specific allocation rule for income derived by executives. By contrast, board member fees are not in scope of the specific commuter provisions, which means that they would be fully taxable in Switzerland.

If the cross-border commuter status requirements are not met, the source tax on the employment income in Switzerland would not be limited to 4.5% and Germany would need to exclude the employment income taxed in Switzerland from its income tax. This is also true for the income derived by executives.

Liechtenstein

The situation is somewhat different with regard to Liechtenstein: as in relation to Germany, the employment income earned by a cross-border commuter may only be taxed in the employee's state of residence. But unlike the solution in the Switzerland–Germany DTA, Switzerland is not allowed to levy an income tax for cross-border commuters with residence in Liechtenstein.

According to the wording of the Switzerland–Liechtenstein DTA, a cross-border commuter is any employed person who has their residence in one state, has their place of work in the other state, and usually commutes between these places on a daily basis.

According to a decision of the Federal Supreme Court in 2009, a broad definition of a cross-border commuter is to be assumed. In the case assessed by the court, the employee worked from home in Liechtenstein for 40% of his workload. The Federal Supreme Court took the view that a daily commute to the place of work in Switzerland and back during the remaining 60% is sufficient to qualify as a cross-border commuter within the meaning of the Switzerland-Liechtenstein DTA. There is no requirement to cross the border on every working day.

The cross-border commuter status ceases to apply if a total of 45 work-related non-return days per calendar year is exceeded. Already in 2016, Switzerland and Liechtenstein declared in a mutual agreement that days on which the work is carried out from home in the employee's place of residence do not count as harmful non-return days. As a result, and as with the application of the commuter provision of the Switzerland–Germany DTA, working from home has no negative impact on the calculation of harmful non-return days.

The question of whether, in the case of full-time employment, three or even more days of working from home are allowed under the specific commuter provision is not answered by the wording of the agreement and was also left open by the Federal Supreme Court. If cross-border commuter status does not apply, Switzerland may at least tax the income attributable to the working days physically performed in Switzerland. Liechtenstein would need to credit the Swiss tax against its tax.

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Italy

The current cross-border commuter agreement with Italy from 1974 follows the place-of-work principle. If an employer is located in the Swiss cantons of Grisons, Ticino, or Valais and the employee resides in Italy, the Swiss working days are exclusively subject to tax in Switzerland, whereas Italian and third-country working days may be taxed in Italy. In other words, days spent working from home in Italy are not taxable in Switzerland, but in Italy.

In 2020, Switzerland and Italy signed a new cross-border commuter agreement that shall replace the existing one. It will be applicable as of January 1, 2024, provided that Italy concludes the ratification process in 2023.

For employees who qualify as cross-border commuters under the new agreement, the state of employment is allowed to levy a tax at source on employment income of up to 80% of the ordinary withholding. On the other hand, the employment income will newly be fully subject to ordinary taxation in the employee's state of residence. Italy will avoid double taxation for Italian residents by switching from the currently applicable exemption method to the foreign tax credit method.

Under the new agreement, a cross-border commuter is defined as an employee who resides within 20 kilometres of the border in one state and is employed by an employer located in the border area of the other state. The border area covers the cantons of Grisons, Ticino, and Valais, as well as the regions Lombardy, Piedmont, and Valle d'Aosta, and the province Bolzano.

In principle, a daily commute between the employee's place of residence to the place of work in the other state and back is required, whereby a maximum of 45 work-related non-return days per calendar year are permitted. It has not yet been confirmed whether working days spent at home count as harmful non-return days. It might be arguable whether the previously mentioned landmark decision

relating to Liechtenstein, which allows working from home for up to 40% per week without triggering the loss of commuter status, can be applied in relation to Italy: firstly, because of the uncertain definition of harmful non-return days and, secondly, because of the different situation with regard to the taxing rights.

It is therefore not yet clear what the tax implications of working from home will be under the new treaty. However, the new agreement includes an explicit provision that stipulates regular consultations between the contracting states on the tax issues relating to work from home. It would be welcome if the two contracting states provide further guidance on the impact of working from home on the commuter status.

If a taxpayer loses cross-border commuter status, the source tax on employment income would no longer be limited to 80% of the ordinary tax withholding. Italy, on the other hand, would need to credit the full Swiss tax against its tax. The new agreement foresees the automatic exchange of information relating to employment income data to ensure correct taxation.

France

To assess the situation in relation to France, a distinction must be made between the cross-border commuter agreement from 1983 and the Switzerland–France DTA from 1966.

The cross-border commuter agreement applies to commuters between France and the cantons of Berne, Solothurn, Basel City, Basel Country, Vaud, Valais, Neuchâtel, and Jura. All other cantons, such as Geneva or Zurich, are not covered by the agreement. If the cross-border commuter agreement does not apply due to the geographical scope or a lack of cross-border commuter status, the Switzerland–France DTA provisions take effect.

In contrast to the cross-border commuter agreement, the scope of the Switzerland–France DTA covers all of Switzerland (i.e., all cantons). A separate commuter agreement is in place for Geneva, but it only concerns the compensation payments between the states. Income taxation in connection with Geneva therefore follows the Switzerland–France DTA rules.

Cross-border commuter agreement

Under the cross-border commuter agreement, the employee's state of residence has an exclusive taxing right on employment income and needs to make a compensation payment of 4.5% on the gross income from employment to the other state.

Therefore, employers based in one of the eight cantons have no obligation to withhold Swiss tax at source on the employment income of French resident employees if they qualify as cross-border commuters. A cross-border commuter is defined as a person who is resident in one state and employed by an employer in the other state. In addition, the definition requires a usually daily commute between the place of residence and the place of work. A daily return is deemed to exist if a total of 45 non-return days per calendar year is not exceeded.

In December 2022, Switzerland and France signed a permanent mutual agreement regarding telework, effective from January 1, 2023. The agreement allows cross-border workers to exercise their employment from their residence state for up to 40% of the total working time without jeopardising their cross-border commuter status. If the work-from-home limit of 40% is exceeded, the conditions for cross-border worker status are not fulfilled and the provisions of the Switzerland–France DTA, which are outlined in the following, apply.

Switzerland–France DTA

Switzerland and France have, in addition, separately agreed to amend their DTA to better account for the tax implications of teleworking in general. A temporary mutual agreement was signed to bridge the time until the ratification process is completed. The provisions of the mutual agreement are applicable as of January 1, 2023 and are valid until December

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31, 2024, provided that the amendment to the Switzerland–France DTA is signed before June 30, 2023. Otherwise, the agreement will cease to be in force as of July 1, 2023.

Under the temporary mutual agreement, and the proposed amendment to the Switzerland–France DTA, activities performed by teleworking in the employee's state of residence for an employer located in the other state shall be deemed to be performed in that other state up to a limit of 40% of the working time per calendar year. However, under domestic law, the legal basis in Switzerland does not allow the taxation of working days outside Switzerland (except in the case of board fees). This means that Switzerland could only tax the income deriving from labour activities physically conducted in Switzerland in spite of the broader taxing right under the treaty.

As long as Switzerland cannot exercise its taxing right based on current domestic law, the employment income can still be taxed in France. It remains to be seen how this affects the existing French withholding tax obligations for Swiss employers which Switzerland wanted to remove because the compliance with these obligations would conflict with Swiss criminal law.

It is expected that the amendment of the Switzerland–France DTA and possible future teleworking agreements with other countries will be linked to the introduction of automatic exchange of information with regard to employment income data (for example, wage data or travel calendar data), similar to what has been agreed with Italy.

Outlook

Switzerland has regulated the taxation of cross-border commuters with its neighbouring countries in very different ways. With regard to working from home, some legal uncertainties have been eliminated in recent years, at least in relation to Germany, Liechtenstein and France. The teleworking agreement with France shows the latest efforts to facilitate working from home.

However, all the agreements only address the taxation of employment income and do not tackle issues such as permanent establishment risk and social security. For social security purposes in relation to the EU, actions are taking place to establish a framework agreement for cross-border telework from July 1, 2023, when the existing 'no-impact' position ends. In terms of the permanent establishment risk, however, there are no indications of efforts to provide more legal certainty. A coherent generous framework of the home office for personal income tax, corporate income tax and social security should be put in place. If working from home up to 40% does not trigger any redistribution of the taxing right on employment income, it should not create a permanent establishment in the state where the employee is resident either.

Clearly, there is a lot of momentum on working from home in general and further developments, including from the OECD, are to be expected on this topic. The case of Switzerland and its contracting partners demonstrates, though, how challenging it will be to find a uniform approach.

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