COVID-19: When does working from home trigger tax and social security implications?

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Key takeaways

- **If the period of working from home only lasts a few months, or takes place regularly but on a very low scale, it does not usually have any impact for the employer from a tax or social security law perspective.**
- **If a material business activity is carried out regularly and permanently by an employee working from home, the employer may become liable for tax in that jurisdiction.**
- **There are numerous cases where it is not immediately clear whether the employer is liable for tax in the jurisdiction of the home office. In such cases, it is advisable to seek a ruling from the responsible tax authorities.**
- **In an international context within the EU/EFTA area, if an employee regularly works from home in his jurisdiction of residence for 25% or more of his working hours, the local social security system in that jurisdiction usually applies exclusively.**

Introduction

Technology such as the internet and IT often make flexibility in the workplace possible or even essential in order to enable employees to complete some or all of their work outside the office.

If an employee carries out tasks outside the office only occasionally and on a small scale by working from home, e.g., reading and responding to emails, finishing up jobs, preparing for meetings, etc., this does not usually trigger any tax consequences.

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Working from home regularly, on the other hand, sees the work place de facto relocated to the employee's home office. Such scenarios may create tax liability for both the employer and employee as well as liability for social security contributions.

When does working from home in Switzerland constitute a permanent establishment for the employer?

From a Swiss perspective, a permanent establishment is a fixed place of business through which the business of an enterprise is wholly or partly carried on. Under domestic Swiss tax law, the term ‘permanent establishment’ is more narrowly defined than in other countries, which do not, for example, always require a fixed place of business.

In order for an activity to meet the definition of a permanent establishment, it has to take place over a certain time period and be of a certain importance for the business activities. Working from home temporarily for a few weeks or months – e.g., for health reasons or as a result of a pandemic – does not in principle constitute a permanent establishment. This is true even if the work carried out from home for the company is of key importance. Working from home on a very small scale does not in principle constitute a permanent establishment, even if the activities are carried out regularly (e.g., responding to emails in the evenings or preparing for meetings).

However, if a significant portion of an employee’s work is carried out from home over a period of at least 6-12 months, the activity in the employee’s home office can lead to a permanent establishment. In such scenarios, the home office is a fixed establishment in which a portion of the company's business activity is regularly carried out. From a Swiss perspective, it is also decisive whether the establishment is a business establishment that can be allocated to the employer. This is deemed to be the case if the home office is at the employer's disposal. Disposal does not necessarily require that the employer or its corporate bodies have unrestricted access to the home office, nor that the employer owns or leases the home office. Rather, it is decisive whether the employer can instruct the employee to use his home office for business performance. This is in principle the case if the employer expressly instructs the employee to carry out certain business activities from home, or if provisions to that effect are included in the employment contract.

Another criterion that can be considered, although it is not decisive in Switzerland, is whether the employer bears the costs for the home office. In certain circumstances, it can be sufficient to create a permanent establishment at the place of the home office if the employer does not provide another suitable work place for the employee and the employee therefore has no alternative but to work from home.

This is not the case in situations where the employer provides a suitable permanent work place and working from home is merely tolerated or even takes place against the employer's instructions. In such situations, the home office – not being at the disposal of the employer – does not constitute a permanent establishment, regardless of the scale of activities carried out there.

The Swiss courts have not yet dealt with this subject extensively, however, meaning that there is uncertainty in many cases around what constitutes a permanent establishment as a result of

working from home.

If a home office in Switzerland constitutes a permanent establishment for the employer, this permanent establishment triggers a limited tax liability on the part of the employer. The allocation of profit to a home office permanent establishment is often associated with uncertainty, especially if no revenue is generated by the activity carried out from home. In practice, taxation in such scenarios is often based on a profit mark-up on the costs (especially personnel costs) allocable to such a permanent establishment (cost-plus approach).

Does the employer have to deduct tax at source from the employee's salary (withholding tax on earned income)?

In principle, an employee's salary in Switzerland is not subject to withholding tax; it is the sole responsibility of the employee to pay tax on earned income. However, employers are required to deduct tax at source from an employee's salary and transfer it to the tax authorities if the employee in question (and, if applicable, their spouse or registered partner) does not hold Swiss nationality and is not in possession of a Swiss permanent residence permit, or if the employee is resident abroad for tax purposes.

In contrast to the rules in various other countries, the duty to deduct tax at source from earned income only exists if the employer is tax resident in Switzerland or has a permanent establishment in Switzerland. If a home office constitutes a permanent establishment in Switzerland for a foreign employer, that employer may be required to pay withholding tax on the salary paid to the employee besides being liable for tax on the permanent establishment profits.

Who can deduct expenses for home office from their taxable income?

Under Swiss employment law, the employer is required in principle to provide employees with the infrastructure (devices and material) needed to carry out their work. If the employer also pays an employee compensation for the use of an office in his own home, or any other compensation for the use of the employee's private infrastructure, this compensation is generally considered taxable income from the perspective of the Swiss tax authorities. In some circumstances the associated costs can then be deducted in the individual tax return as professional expenses. However, the Swiss tax authorities often take a restrictive view in practice.

Costs borne by the employer can be deducted from corporate income tax provided that they constitute justified business expenses.

Does working from home affect social security contributions?

As a rule, Swiss social security contributions are payable on a salary earned by an individual who is resident in Switzerland or pursues gainful employment in Switzerland. This is in principle also the case when the employer is domiciled abroad, provided that (some of) the activity is performed in Switzerland for more than three subsequent months in a given calendar year.

In order to avoid a multiple social security burden, Switzerland has concluded agreements with various states that govern which social security system is applicable. The most significant in this context is the Agreement on the free movement of persons between Switzerland, the EU, and the EU and EFTA member states (AFMP). If a person has Swiss, EU or EFTA nationality, only one social security system of these contracting states applies. The applicable system is based on the requirements of the regulation (EC) 883/2004 and its applicable supplementary provisions in accordance with the AFMP.

As a general rule, the social security system of the member state where the employee is resident prevails, provided the employee performs a significant portion of the work activities there. A significant portion has consistently become established in practice as a volume of at least 25% of the total work activity (the 25% rule). If an employee has a foreign employer and that employee works in his jurisdiction of residence for less than 25% of the total work activity, the social security system in the country of his foreign employer primarily applies.

Performing gainful activities from home can thus have implications on the applicable social security system in two respects. On the one hand, a home office in Switzerland can, as set out above, result in the creation of a permanent establishment in Switzerland for the foreign employer. In this scenario, the social security authorities may take the stance that the Swiss permanent establishment is to be considered as the employer rather than the (foreign) headquarters. This is especially the case if the employer registers the permanent establishment in Switzerland as a branch.

On the other hand, the 25% rule generally dictates that a home office triggers application of the social security system in the jurisdiction of residence of the employee if that employee works from home (or elsewhere in the jurisdiction of residence) for more than 25% of his working hours. This is still the case if the employee works from home without the knowledge, or even against the instructions, of the employer. In such scenarios, the employer should include binding arrangements in the employment contract stating that the employee may not work from home for more than 25% of total working hours and requiring the employee to confirm the hours and place of work in a tracking calendar.

In exceptional situations, the employee may work from home for a significant portion of the working hours over a certain period even if this was not the plan when the parties entered into a working relationship. Reasons can be personal in nature (e.g., health-related mobility issues or quarantine) or triggered by the general environment (e.g., pandemic). In this context, the Federal Social Insurance Office recently confirmed that the applicable social security system – and in particular the ‘25% rule’ described above – would be determined based on the usual place of work. If an employee works significantly from home temporarily and over a relatively short period of time, this should not in principle affect which social security system is applicable. If cases of doubt, however, it is advisable to seek a ruling from the processing social security office.

Need for action?

If a company and/or its employees wish for a portion of work to be carried out from home regularly, the possible tax implications and impact on social security contributions should be examined in advance. If uncertainty remains, it is generally recommended to seek a ruling on the specific situation from the responsible authorities.

Ultimately, all aspects of regular work activity carried out from home should be expressly governed by the employment contract (maximum scope, compensation, right or obligation to work from home).

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No legal or tax advice

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