Global Tax Update

GERMANY

Court rules on taxation of income from German statutory pension after moving to Italy

After a long working life is over, some pensioners may decide to move their residence abroad, but which country has the right of taxation for the pension? The German Federal Fiscal Court recently decided this issue (again) in the case of a pensioner with German citizenship who moved his residence to Italy.

According to the relevant provision, in the Germany-Italy income tax treaty, pensions paid under the social security legislation of a contracting state 'by' that state will be taxable in that state only if the recipient is a national of that state without being a national of the other contracting state.

In a prior decision from 2011, Germany's Federal Fiscal Court interpreted this provision and the word 'by' to mean that Germany, as the source state, would not have a right of taxation because the pension derives from contributions of the employee and the employer. This led to the risk of double non-taxation because Italy was also denied an Italian right of taxation.

In 2022, the Federal Fiscal Court changed its position regarding the interpretation of the treaty provision so that a state entity does not need to be the economic bearer of the pension payment. The underlying cash state principle in the income tax treaty should be understood in a broader sense. This results in Germany having the right of taxation.

BDO Comment

The change in case law has implications for German pensioners living in Italy. They are subject to a limited tax liability in Germany and thus have tax declaration obligations and tax payments in Germany. Under certain conditions, the tax payments may be avoided by applying for treatment as a taxpayer with unlimited tax liability; however, that would involve considerable compliance efforts on the part of the German pensioner abroad.

INDIA

Delhi Tax Tribunal rules on applicability of withholding tax provision to reimbursement of salary cost in case of secondment

The movement of employees across countries is a common practice. Often, employees from one entity within a group are assigned to another entity in a host country. This can be for specific assignments, technical support, or to provide expertise in specific areas of operation. In most cases, a portion of the seconded employees' payroll remains in the home country to ensure the continuity of their social security benefits in their home country. The home company usually disburses the social security contributions, along with a portion of the employee's salary in the home country, which is later reimbursed by the host company to which the employee has been seconded, on a cost-to-cost basis.

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In the secondment model, seconded employees work under the host company's direction, supervision, and control. In such cases, the host company bears the entire salary and related costs, including social security contributions paid in the home country. The host company takes responsibility for the work done by the seconded employee during the period of secondment in India and usually retains the right to terminate the secondment.

Secondment has been a contentious issue in India, where the tax authorities argue that under the secondment arrangement, the home company provides services to its host company in India through the seconded employees. They claim that the reimbursement to the home company by the Indian host company, including social security contributions and salaries paid in the home country, qualifies as a "fee for technical services" (FTS) and is therefore taxable in India. As such, it is subject to withholding tax under Section 195 of the Income tax Act, 1961.

Various courts have examined similar matters, and two key principles have emerged: each case needs to be analysed based on the facts, and the substance-over-form doctrine needs to be taken into consideration in determining whether the agreement is a "contract for service" or a "contract of service".

The Delhi Tax Tribunal recently examined the applicability of the withholding tax provision on the reimbursement of salary costs in the case of a secondment.

Facts Of The Case

The taxpayer, a company incorporated in India, is a subsidiary of a UK-based company and operates as a captive service centre to provide IT services (research operations, business process outsourcing, and management consultancy support services) to group entities.

The taxpayer recruited three UK company employees to work exclusively for it on a full-time basis as regional CEO, CFO, and HR Officer. The employees were released by the UK company and subsequently entered separate employment contracts with the taxpayer, so that during the period of employment, the taxpayer was the sole and exclusive employer of the employees, having complete control, while the hired employees ceased to be employees of the UK company. Further, the taxpayer had an unconditional right to terminate these employees, while the UK company had no obligation to replace them.

The taxpayer entered a "salary reimbursement agreement" with the UK company whereby the UK company would pay 40% of the seconded employees' salary in foreign currency and claim reimbursement thereof from the taxpayer for administrative (and the employees') convenience. For this purpose, the taxpayer was supposed to inform the UK company of the amount of foreign currency payable as salary to the seconded employees, as determined by and supposed to be reimbursed by the taxpayer. According to the appointment letters and salary reimbursement agreement, the taxpayer was exclusively and solely liable to pay salaries, allowances, and requisites to the seconded employees.

However, the Indian tax authorities disallowed the expenditure relating to reimbursement on the grounds that the reimbursements of expenses for seconded employees is in the nature of fees for technical services and is liable to deducting tax at source (TDS). The taxpayer filed an appeal.

Delhi Tax Tribunal Ruling

The tribunal upheld the taxpayer's claim and disregarded the applicability of Section 195 of the IT Act. They also made the following observations.

The employees had an employee-employer relationship with the taxpayer only, and thus had no rights to act on behalf of the UK company or bind the UK company, which prompted the conclusion that the taxpayer was the legal and economic employer.

The employees' salary is paid partly by the taxpayer and the remaining through the UK company at the taxpayer's request, only for administrative purposes, and is reimbursed by the taxpayer on a cost-to-cost basis. This salary was chargeable to tax as salary in the hands of the employees, and not as FTS because there was no agreement/document to prove that the UK company provided any technical services. Accordingly, TDS under section 192 of the IT Act is withheld by the taxpayer before making payment to the employees.

Emphasis can be placed on CBDT Circular 720, dated 30 August, 1995 (PB-703), to observe that payment will be liable for TDS, only under one section, Section 192 of the IT Act in this case.

Accordingly, the salary reimbursement to the UK parent company need not be subjected to withholding tax because tax has already been deducted on salary paid to the employees where the taxpayer is found to be the legal and economic employer.

BDO Comment

The issue with respect to whether tax needs to be deducted from a reimbursement of salary cost because of a secondment arrangement has been a matter of debate before the Indian courts and tax tribunals.

It is a settled practice position that the mere reimbursement by an Indian entity to an overseas entity of the salary of seconded employees cannot be regarded as FTS, and the Indian entity therefore, is under no obligation to withhold on the reimbursement. It is irrelevant whether any profit element is included in the income or not.

The Delhi Tax Tribunal in the present case also held that the reimbursement by an Indian company of salary and other costs of the seconded employees working in India to a foreign entity does not constitute FTS, but it is only the reimbursement of salary by an Indian entity to a foreign entity. Hence, the taxpayer was not required to deduct TDS under Section 195 of the IT Act.

The terms and conditions of the secondment agreement between the home company and the Indian host company need to be carefully drafted and factually substantiated to take a position on the non-applicability of the TDS provision to the salary cost charge of seconded employees.

Cross Border Working - Recent Developments

Germany And Luxembourg Agree To Extension Of De Minimis Rule For Employees

Cross-border work is increasingly becoming the norm in the global labour market. Double taxation agreements regulate who has the right of taxation, generally depending on the scope of the activity in the other country.

In principle, employees who are resident in Germany and work in Luxembourg for a Luxembourg employer are taxed in Luxembourg exclusively if the activity is carried out exclusively in Luxembourg. However, if the employee also carries out an activity in Germany, the country of residence, the salary for the workdays in Germany is taxed there on a pro rata basis.

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Until now, the following de minimis rule applied: If the activity in the country of residence (Germany) lasted a maximum of 19 days per year, this was disregarded, and taxation still took place exclusively in Luxembourg. Conversely, if the activity in Germany lasted 20 days or more, taxation had to be split between the two countries from the first day of activity, according to the provisions of the Germany-Luxembourg income tax treaty.

Due to increasing international cooperation and the expansion of home offices because of the COVID-19 crisis, the 19-days per year threshold was often insufficient, which led to complicated consequences under tax law. The finance ministers of Germany and Luxembourg have acknowledged the situation, and the de minimis regulation has been extended to 34 days starting from 2024.

This change is intended not only to make cross-border work and the handling of home offices more flexible, but also to reduce bureaucracy and simplify taxation. Luxembourg is also implementing a regulation with Germany that it had previously negotiated to a similar extent with Belgium and France. Thus, conditions for the taxation of workers in neighbouring countries are beginning to be standardised.

Switzerland And France Sign Agreement On Taxation Of Cross-Border Teleworkers

In June 2023, Switzerland and France entered into an agreement that provides new and permanent taxation rules for income from home office work.

The supplementary agreement to the bilateral double taxation agreement between Switzerland and France allows cross-border home office working up to 40% of the working time per year - especially for cross-border commuters. It is part of the mutual agreement on home offices concluded on 22 December, 2022, which entered into force on 1 January, 2023.

What Is It The Agreement About?

The supplementary agreement offers Swiss employers and employees the option of arranging to work from their cross-border home office for up to 40% of the annual working time. Within this limit, the supplementary agreement provides that salary payments in connection with home office will be taxed in the contracting state in which the employer is located. The supplementary agreement also introduces an innovation: an automatic exchange of information on salary data for persons who are residents of a contracting state and work for an employer in the other contracting state.

Daily Cross-Border Commuters

Employees who fall under the special regulation for cross-border commuters (according to the special agreement of 11 April 1983, for the cantons of Berne, Solothurn, Basel-Stadt, Basel-Land, Vaud, Valais, Neuchâtel and Jura, to which reference is made in Article 17 paragraph 4 of the France-Switzerland double taxation agreement) may, without calling into question their cross-border commuter status, carry out their activity for a Swiss employer at home in France for up to 40% of the annual working time without Switzerland losing the full right of taxation of the corresponding salary.

Subject to compliance with this 40% limit, these employees remain liable to tax in their country of residence, France. The same applies in principle in the reverse case. In concrete terms, this means that France has the full right of taxation on the salary if an employee resident in Switzerland with a French employer works in a Swiss home office up to a maximum of 40%.

Other Cross-Border Workers

For other employees who do not meet the requirements for the application of the cross-border commuter status, and who fall under the regulations of the France-Switzerland double taxation agreement, the new mutual agreement basically provides for the same, namely that the salary remunerations which the French employee earns in the home office for his activity for the Swiss employer continue to be fully taxed in Switzerland, provided that they do not exceed 40% of the working time per calendar year. Again, the same applies in the reverse case.

What Does This Mean For Swiss Employers With French Employees?

For Swiss employers, this means that withholding taxes continue to be deducted as if the home office work performed in France, the employee's country of residence, had been performed on the employer's premises in Switzerland. However, if the activity in the French home office exceeds the 40% threshold, the part of the remuneration corresponding to the French home office activity is taxable in France starting from the first day of home office activity. This means that French home office activities over the 40% threshold are subject to the general provisions of the income tax treaty between Switzerland and France from the first day of teleworking.

In other words, the portion of the cross-border worker's salary that the employee performs at a place of residence in France and not at the usual place of work in Switzerland is taxable in France, not in Switzerland. Thus, for example, if an employer allows the employee to work from home three days per week (60% for a full-time equivalent), 60% of the employee's remuneration would be taxable in France.

When Does The Supplementary Agreement Enter Into Force?

The supplementary agreement must still be approved by the parliaments of both states before it can enter into force. Since the purpose and content of the new agreement are essentially the same as those of the provisions in the already concluded mutual agreement of 22 December, 2022, the signing of the supplementary agreement on 27 June, 2023, has immediate effect. The Memorandum of Understanding is valid until 31 December, 2024, but domestic ratification by the respective parliaments is expected by then.

Creation Of Domestic Legal Basis

Until now, Swiss tax law provided for withholding taxation on the earned income of employees' resident abroad only if the work was physically performed in Switzerland. The supplementary agreement now grants the employer's state of residence the right of taxation, even if employees work from their home office in the state of residence for up to 40%. To create a domestic legal basis for this, the Federal Council sent an amendment to the national tax law into consultation at its meeting on 9 June, 2023.

Risk Of Permanent Establishment

If an employee works from home in France for a Swiss employer, under certain conditions, this may pose a potential risk for the Swiss employer of establishing a permanent establishment in France. An analysis of this risk is always recommended in specific cases.

FAQs

Is the part of the salary related to the activity performed by the cross-border worker in France taxable in France?

As of 2023, if French home office activity exceeds the 40% threshold, the entire amount (not just the portion in excess of 40%) is taxable in France, starting from the first day of work in France. If the teleworking for a Swiss employer from a home office in France is below the 40% threshold, there is no allocation of the taxation right to France. In the reverse case, with a French employer and a Swiss teleworking employee, the situation would be the same.

What are the consequences if a Swiss employer employs French workers who work from home for more than 40% of their employment?

As of 2023, the Swiss employer must reduce the income subject to Swiss withholding taxes by the portion relating to the home office activity in France as part of payroll accounting. It is the employer's responsibility to keep a record of these days, or to delegate this duty to the employee concerned to attest to the corresponding days of presence. It is also necessary to contact the French tax authorities to clarify the conditions for taxation of the portion of the remuneration related to French home office activity, as Swiss employers may be subject to certain payroll tax obligations in France.

Does The Agreement Apply To Part-Time Employees?

Yes, a corresponding reduction is made in relation to the workload. For example, an employee with a 50% workload can perform home office activities up to one day per week (40% of the 50% workload).

Does the agreement apply if one performs home office activities from a second residence?

Yes, providing the secondary residence is in the country of residence.

How can an employer prove that the French employee's 40% home office activity threshold has not been exceeded?

The percentage of home office work an employee is allowed must be evidenced by the submission of a contractual document. This may include, for example, a provision of the employment contract binding the employee to his employer, or a home office agreement signed between the employer and his employee.

Is there a weekly limit that cannot be exceeded for determining the 40% threshold?

There is no weekly limit. Employers and employees will retain the flexibility to organise the work week as they wish throughout the year. The 40% mark cannot be exceeded within a calendar year. Thus, depending on how work is organised, it will be possible to work more than 40% from home for one part of the year, provided the 40% threshold is not exceeded for the full year.

BDO Comment

As cross-border working and working from home is now the 'new normal', established taxing practices will come under further scrutiny as tax and social security authorities seek to address how to efficiently and effectively tax individuals and their employers. We expect to see formal and practical working agreements put in place in the months and years to come. Do check with your local adviser as to latest developments.

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