

6. Covid 19 - the Biggest Disrupting Factor on the Global Tax System

Dr. Markus Frank Huber, Biogen International, Zug



Who would have thought that a tiny virus may have a tremendous impact on the economy and will lead to a dramatic step forward in the digitalization of workflows. Undoubtedly, the lockdowns in various countries around the globe had adverse consequences on the economy. Most of the countries implemented stimulus packages. In April 2021, President Biden unveiled a more than \$2 trillion infrastructure and economic recovery package. The plan aims to revitalize U.S. transportation infrastructure, water systems, broadband and manufacturing, among other goals. Simultaneously, he also revealed how to finance the investments. An increase in the corporate tax rate to 28% and measures designed to prevent offshoring of profits should fund the spending, according to the White House. As taxes are the most relevant source to fund a State, it is inherent that there should be in the long term a close correlation between the spending of a State and the tax rates. Conversely tax measures may also be used to stimulate the economy. As soon as Covid 19 led to lockdowns, all the states around the Globe became active to introduce measures to relieve the taxpayers; most prominent ones, moratoria regarding tax payments, generous extensions of deadlines for filing of returns etc.

Most of the countries required that to the extent possible employees should work from home. While in the past a lot of the companies may have offered employees, whose activities allow to work remotely that they may occasionally work from home, this all of a sudden became the new standard for those employees. It became also transparent that work from home may have its advantages. Human resource departments worldwide realized that offering employees the possibility to work from home has become a very important tool to overcome shortage in hiring. But also, governments discovered that the digital nomads could be a source to create additional revenue. Greece was contemplating to offer to anyone immigrating from a foreign country in 2021, not to have to pay income tax on half of their salary for the next seven years, whether salaried or self-employed¹⁾. Anecdotally, last summer there were reports in the newspapers that Directors of Tax of some companies asked their employees to return to the place where those entities are incorporated. Apparently, the head of tax discovered that some of the employees enjoyed some form of “deluxe” working from home. The employees, instead of working from their small apartments somewhere in the big cities, rented vacation homes in the south of France enjoying the French way of life. Why were the Directors of Tax of those companies concerned?

When Could Work from Home Create Issues for Corporations?

Generally, corporations are subject to unlimited taxation at the place where they are incorporated. This is true to the extent that their management and control is also exercised there. In addition, companies may be subject to limited taxation at places where they create a permanent establishment (p.e.). If under a work from home model a company creates a p.e. at the Home Office (HO) of the employees, the company could be subject to taxation at HO locations too and would

have reporting requirements. In an extreme situation, if e.g., all the decision makers of a company were to live in the same jurisdiction outside the jurisdiction of incorporation and work on a HO basis, the respective jurisdiction could argue that management and control have been relocated. Accordingly, the company would therefore be subject to unlimited taxation in the other jurisdiction. In Switzerland, a similar situation could arise, if the company is incorporated in one canton, however, the decision makers working in HO live in another canton. This could have adverse tax consequences if the company is incorporated in a low taxing canton, but, the decision makers reside in a high taxing canton.

A p.e. is a fixed place of business in which the business activity of a company is carried out in whole or in part²⁾. Accordingly, the following elements need to be met cumulatively to lead to the conclusion that a p.e. exists:

- Fixed place of business such as a plant or an office. The latter is inherent if an employee is working in HO.
- Which is permanently, and not merely temporarily, at the disposal of the enterprise. In other words, the HO would not constitute a p.e. if the employees work there occasionally. This was generally the case in the past. But in the current situation, this may obviously have changed.
- Qualitatively and quantitatively essential activity performed at the p.e., i.e., the work performed contributes to the value generation of the enterprise which should regularly be the case, if a leadership function or e.g., sales activities are performed at the HO.
- The location where those activities are performed must be part of the business of the enterprise. Since HO is operated by an employee, this requirement seems always to be met.

So, we may now understand why some of the Directors of Tax had concerns, when they discovered that their employees were renting vacation homes somewhere at the beaches, when the company was incorporated in another jurisdiction. However, as so often in the tax law, the question whether a p.e. exists, is not a black or white decision, since it depends on the actual facts and circumstances³⁾. There seems to be consensus amongst the leading scholars, where HO is used on a continuous basis for carrying on essential business activities for an enterprise and it is clear from the facts and circumstances that the enterprise has required the individual to use that location to carry on the enterprise's business, the HO may be considered to constitute a p.e. of the enterprise. The latter may be the case where the nature of the employment clearly requires an office, or the HO is used on a frequent basis for e.g. meetings with clients. Likewise, if the HO is used on a permanent basis for essential functions and the employer tolerates the use of HO by the employee.

What is With Home Offices During Covid 19?

As mentioned above, the states have come up with special rules mitigating amongst others the tax consequences of the lockdown caused by COVID 19. The Organization for Economic Development (“OECD”) has published guidelines regarding what the states should do regarding employees

being stranded in a HO due to Covid 19⁴). Switzerland is a member of the OECD and generally follows the recommendations issued by the OECD. According to the guideline, the exceptional and temporary change of an employee's place of employment should not lead to a creation of a p.e. based on the following rationale:

- The enterprise lacks the power of disposal over the employee's premises (HO).
- Lack of durability of HO.

The guideline is clear, so our Director of Tax should not be concerned. Unfortunately, the guideline issued by the OECD is soft law, i.e., rather a recommendation than binding law. The states have the option to follow the guideline but there is no guarantee that they will do so. The guideline also addresses what is generally referred to as mind and management of a company. In other words, if chief executives and other senior executives perform their activities in their HO and sign contracts, this should not lead to the consequence that the enterprise becomes resident at the place where those activities are performed. In addition, Switzerland has concluded bi-lateral agreements with Germany, Italy and France to address some of the mentioned issues.

Should a director of tax also be concerned, in pure domestic pattern? One may assume that the company is registered in a low taxing canton, however, a substantial part of the employees resides in a high taxing canton. It seems that there is the general understanding that if employees as a result of the lockdown are prevented from commuting, this should not lead to the assumption of a p.e. at HO. Likewise, if contracts are signed in the HO, this should not lead to an agency p.e.

What in the Period of After Covid 19?

But what happens after the lockdown? What is for sure is that the above-mentioned recommendations issued by the OECD will no longer be applicable. Likewise, the agreements concluded among the different states will expire. Are we then back to the situation pre-Covid 19? This may be more than doubtful, as the states have accumulated substantial deficits and hence will desperately be searching for additional sources of revenue.

What is for sure too is that the Covid period has a tremendous impact on the future model where employees will work. New forms of where to work will be on high demand. Undoubtedly, there will be companies maintaining the traditional form of working. However, the majority of employers will change their model that may reach from hybrid models, say half of the days HO, the rest at the company, to always HO and even to work from anywhere. To what extent companies may be in a position to offer and have a preference for one of the models depends obviously on the activities performed. The HR department may be a strong supporter of flexible models, as this may make the company more attractive in the war for talents.

So, what should our Director of Tax do? First of all, get an understanding where the employees reside, and assess based on this information potential tax risks. Secondly, if not already done, categorize the employees into different groups.

- One group (A) that comprises the top management and those employees that are essential to support the most important functions of the entity (such as e.g. DEMPE⁵ function)
- One group (B) that comprises those employees that support the above cohort and may be needed to be close by or need to be permanently on campus (e.g., manufacturing, quality control etc.)
- One group (C) that comprises the rest of employees.

For the above groups different rules may apply. Whereas it may be essential that group A performs their functions in the country/canton where those functions need to be located, the most flexible regime may be applicable to group C. Obviously, based on the actual facts and circumstances our Director of Tax will assess potential tax risks entailed by the preferred work model. However, it may be more than doubtful, whether such analysis may lead the Tax Director to consent that the later cohort may enjoy home office deluxe style, in other words work from anywhere.

- 1) Greece to offer 50% income tax cut to lure remote workers during pandemic | Business | Economy and finance news from a German perspective | DW | 25.11.2020
- 2) Art. 52 para. 2 Federal Direct Tax Law and Art. 5 para. 1 OECD-MC
- 3) IOECD-MC 2017, Art. 5 ref. # 18
- 4) OECD Secretariat of 3 April 2020 (updated guidance of January 21, 2021) with an analysis of the consequences of COVID 19 on the taxation rights of contracting states in connection with
- 5) OECD (2015), Aligning Transfer Pricing Outcome with Value Creation, Actions 8-10 – 2015 Final Reports, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing Paris. "Development, Enhancement, Maintenance, Protection and Exploitation"

About the author:

Dr. Markus Frank Huber, PhD (law) is Head of European Tax of Biogen International GmbH in Zug and Partner Tax at Meyerlustenberger Lachenal AG in Zurich. He is a member of the Tax Chapter Board of the Swiss-American Chamber of Commerce.

This article reflects the personal view of the author.