AT A GLANCE

European Parliament

Tax challenges of cross-border teleworking

The pandemic led to unprecedented circumstances in the workplace, with millions of people having to work from their homes. With teleworking gradually becoming the new normal, the question is whether employees and employers are aware of and able to deal with potential tax consequences that can arise when employees occasionally work remotely from a country other than that in which their employer is based.

Division of taxing rights

The on-going digitalisation of the workplace, by means of fast online access and videoconferencing tools, has in some sectors allowed employees to work from home, a development that has been accelerated considerably by the pandemic. This new work environment can improve employees' work-life balance, but challenges can arise. For instance, there can be complications in the field of taxation, when employees are working remotely from a country other than that in which their employer is located. Such situations typically occur in border regions (when an employee's home and their usual place of employment are located on different sides of the border).[1]

When an employee teleworks from a country other than that in which their employer is based, the respective countries need to agree on the **division of taxing rights** on the employee's wage income. Countries set up such arrangements in bilateral tax agreements. While there is no global or EU standard[2] that countries are required to follow for these, many EU countries draw inspiration from the OECD's Model Tax Convention (MTC). In principle, according to the MTC, employment income is taxable in the place of activity, i.e. where the work is performed. Where employees occasionally telework in one country but also work in the usual place of employment in the other country, their income would generally be taxable on a **pro-rata** basis.

Throughout the pandemic, a large number of people were suddenly obliged to work full-time from home, with the taxing right therefore being switched entirely to the countries in which the employees were teleworking, i.e. their country of residence. To avoid this scenario, and upon the recommendation of the OECD, several Member States adopted specific temporary provisions in their bilateral tax agreements. For instance, Belgium agreed with neighbouring countries Luxembourg, the Netherlands, France and Germany that, until 30 June 2022, the days spent in the home office in one country due to COVID-19 restrictions would be deemed working days spent at the usual place of activity in the other country.

Example: an employer based in Germany and an employee resident in Belgium

- Before the COVID-19 crisis, a Belgian resident worked at an office in Germany for 5 days a week. According to the German-Belgian bilateral tax agreement, the Belgian resident's wage was taxable in Germany.[3]
- During the COVID-19 crisis, the Belgian resident was obliged to work from their home in Belgium for 5 days per week. Thanks to the dedicated COVID-19 agreement made between Belgium and Germany, the Belgian resident's telework days were deemed as days worked in Germany. The salary was therefore taxed exclusively in Germany.
- After 30 June 2022, the German employer decided to allow the Belgian resident to telework one day a week. Consequently, a pro-rata division is now made whereby 20 % of the salary income will be taxable in Belgium, while 80 % will be taxable in Germany.

With the application of telework expected to become normal, even in a post-COVID-19 scenario, with more and more employers also likely to offer such flexibility as part of their employment packages to attract employees, the number of cross-border teleworkers is likely to rise over the coming years. While the current bilateral tax agreements in place provide a framework for efficient taxation of income streams between

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countries, the reality is often more complicated: countries can disagree on the split of the taxable income, resulting in citizens being double-taxed and lengthy and costly court cases to resolve the problem. Both the cross-border teleworker and their employer are also likely to face additional **compliance costs**, with the employee filing two tax declarations and the employer possibly needing to set up dual payroll systems and deal with multiple national withholding tax obligations. If companies consider the administrative burden to be excessive, they may decide not to allow their employees to telework at all.

Moreover, in terms of overall fiscal policy, an increasing number of cross-border teleworkers, particularly those in 'fully remote' positions, would cause an observable **spillover of income tax revenue** from one country to another, with some academics noting that we may see the start of a 'race to the bottom' in personal income tax. Employees are also likely to see a (considerable) difference in their net-home pay, especially if there are stark differences in the tax rate on personal income between the country of telework/residence and the 'usual' work country.

Home address as permanent establishment

While less obvious, cross-border teleworking can also have an impact on the distribution of **corporate tax** revenue. A cross-border teleworking employee may inadvertently create a permanent establishment for its company, i.e. the employee's home office is considered a fixed place of business. Definitions of what constitutes a permanent establishment are laid down in bilateral tax agreements, and generally operate through a series of tests based on facts and circumstances. At the time of the pandemic, the OECD argued that the unique and temporary circumstances of the crisis should not lead to the creation of new permanent establishments, with many countries following that advice throughout the pandemic. It remains to be seen how the rise of telework in a post-COVID world will be perceived by national tax authorities in the long term. If a permanent establishment is considered to have been created, it would not only result in a series of tax reporting obligations, it would also mean accurately allocating a certain share of the business's income from the 'usual' office country to the teleworker's home office country. Again, employers judging that there may be a risk of accidentally creating a permanent establishment may decide to disallow teleworking.

EU action

Concerns regarding the taxation of cross-border workers are not new. In 2010, a Commission expert group published a report on 'ways to tackle inheritance cross-border tax obstacles facing individuals within the EU', highlighting the difficult situation employers and their cross-border working employees may face. That report focused on posted workers and frontier workers as opposed to teleworkers. The expert group recommended setting up an **EU-wide one-stop-shop**, offering a simple way for employers to report the number of days their employees worked in another country.

The pandemic led the topic to resurface. In June 2021, the Commission argued that the expert group report's suggestions for cross-border workers remained valid and had 'gained in relevance due to the effects of the pandemic', and it held discussions with Member States and stakeholders on the subject. In July 2022, the European Economic and Social Committee (EESC) adopted an opinion (Rapporteur: Krister Andersson, Employers – Group I, Sweden) encouraging the Commission to consider the expert group's one-stop-shop idea. One possibility, to adapt to the changing work environment, the EESC noted, would be for Member States to agree to tax an employee's income only if the number of working days in that country exceeded 96 days per calendar year (thereby allowing cross-border employees to enjoy roughly two days' teleworking per week without there being any tax repercussions).

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[1] Cross-border teleworking is however not limited to neighbouring countries. For instance, an employee may telework temporarily abroad for a number of weeks as part of a 'workcation', while others may even work remotely full-time (digital nomads) potentially from anywhere in the world.

[2] Bilateral tax agreements between countries can vary considerably, and some may have special provisions in place for frontier workers and posted workers. A non-exhaustive overview of specific provisions found in tax agreements between EU Member States can be found in a Commission paper.

[3] The wage income would still need to be declared to the Belgian tax authorities. While the wage income would be exempt from taxation in Belgium, it would be taken into account to calculate the marginal effective rate at which the non-exempt income of the Belgian was subject to tax.

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