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Frontier Workers and Remote Working: A Swiss-Italian Tax Perspective

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After more than 40 years, in December 2020, Italy and Switzerland signed a new agreement concerning cross-border workers. This update, part of a joint political commitment dated 2015, arrived precisely at the right time. Indeed, the pre-existent, and still in force, 1974 Swiss-Italian Agreement showed all its inconsistencies during 2020 when inappropriate rules had to face a profound change of ordinary habits due to the COVID-19 pandemic.

Commuters represent a crucial category of workers, often underestimated. Based on official statistics, Switzerland can count more than 85.000 Italian residents crossing the border every day to work in a neighbouring Canton among Graubünden, Valais, and Ticino. The most are concentrated in this latter, where commuters represent the higher share of total dependent employment.

Almost two years ago, when the COVID-19 pandemic hit and Italy first announced the closing of its borders, uncertainties and worries spread in the South of Switzerland. Commuting is key to many Swiss strategic sectors, including health and social care.[1] The closing of the external borders with Italy, therefore, represented an emergency for Switzerland's health system, with risky consequences for the Swiss economy and employment. An immediate response was highly required by Swiss authorities, especially from cantonal instances. Therefore, the Italian Interior Minister provided a specific regime to ensure the mobility of specific categories of commuters, derogating to general rules. This exception was the only official clarification for cross-border workers until June 2020, when a mutual agreement was signed.

Extraordinary circumstances require extraordinary measures. Anyway, the pandemic represented – and still means – only a booster in accepting the detachment of work-office-physical presence. This trend was already enforced in several fields but ignored by international taxation, where rules are still strongly related to physical presence – a nexus now clearly obsolete.

Against this background, this article will illustrate how Article 15(4) of the Switzerland-Italy tax treaty (CH-I DTC) and the 1974 Swiss-Italian Agreement, which is explicitly referred to in Article 15(4) of the CH-I DTC, does (not) address the taxation of cross-border workers in the age of remote working.

The Swiss-Italian 1974 Agreement on Cross-Border Workers

The relationship between Switzerland and Italy has always been standoffish for several reasons.

Historically, these two jurisdictions could overcome their different views only through political or strategic compromises. One key point was the fiscal treatment of commuters, concerning some Italian regions of the North and the three mentioned neighbouring Swiss Cantons, especially Ticino.

In 1974, after a lengthy exchange of letters, the governments of Switzerland and Italy signed the Agreement, still enforced, on frontier workers.

As an exception to general tax rules, the 1974 Swiss-Italian Agreement grants exclusive taxing rights on income from dependent employment to Switzerland as source jurisdiction. To that effect, Swiss employers apply a withholding tax on Italian commuters' salaries.

At the end of the fiscal year, Canton Ticino (with Canton Graubünden and Canton Valais) must pay a compensation fee (38.8% of the gross amount of taxes collected)[2] to the Italian municipalities located within 20 kilometres of the Swiss border.[3]

Only later, in 1976, the CH-I DTC was signed. Article 15(4) of the CH-I DTC recalls the 1974 Swiss-Italian Agreement, effectively incorporating the 1974 Agreement into the tax treaty.[4]

Definition of Frontier Worker: Daily Back-Home Requirement

The 1974 Swiss-Italian Agreement comprises only a few articles, missing a series of crucial issues.

The 1974 Agreement's inconsistencies reached their peak during the pandemic. Unlike agreements with other neighbouring countries, such as France, Germany, Liechtenstein, and Austria, the 1974 Swiss-Italian Agreement includes neither a definition of 'cross-border worker' nor a time period while cross-border workers can derogate to the daily-back home requirement.

Only from Italian parliamentary reports,[5] it is possible to identify the concept of frontier worker, applicable under the 1974 Agreement, as '*the worker who works in Switzerland, but which, at the end of the workday, comes back to his/her home in Italy*'.[6]

It is worth noting that, in 1999, Switzerland signed the Agreement on the free movement of persons with the European Union (EU). Article 28 of the Swiss-EU Agreement defines a commuter worker as one who works in a country different from the residence state and daily, or at least once a week, comes back home. The Agreement on frontier workers signed by Switzerland with Austria, for instance, was amended to follow this principle. Despite this, since Article 21(1) of the Swiss-EU Agreement states that its provisions do not affect pre-existing tax treaties,[7] it had no impact on the 1974 Swiss-Italian Agreement and Article 15(4) of the CH-I DTC.

Therefore, to apply the 1974 Agreement as a frontier worker, two *criteria* must cumulatively be satisfied: *(i)* the commuter must reside in an Italian municipality within 20 kilometres of the Swiss border; and *(ii)* the commuter must return home on a daily basis.

Pandemic Troubles

What happened then when the Coronavirus emergency hit and many Swiss businesses suddenly required their Italian workers to stay in Ticino until the emergency ended, providing them board and lodging? And what happened to Italian workers who, instead, had to choose alternative working arrangements, such as home office work?

As explained above, differently from other tax treaty agreements, the 1974 Swiss-Italian Agreement does not contain any measure derogating the daily back-home requirement, nor does that Agreement includes any guidance for *force majeure* situations, such as the COVID-19.

The main concerns regarding the 1974 Swiss-Italian Agreement related to the possibility of considering cross-border workers for the Italy-Switzerland agreement all Italian workers who remained in Switzerland or worked from their home in Italy.

Since the daily home return is an essential requirement to the definition of a cross-border worker under the 1974 Swiss-Italian Agreement, arguably, frontier workers that must remain in either the source or residence state because of the pandemic could no longer qualify as cross-border workers. Thus, the special provisions of the 1974 Swiss-Italian Agreement addressing this issue (and the related Article 15(4) of the CH-I DTC) would not have been applicable.

The general rules for the taxation of income from employment, encompassed by Article of 15 OECD Model (art. 15(1) of the CH-I DTC), would instead apply. Under this provision, the residence state exclusively taxes employment income unless the activity is carried on (i.e., ‘*employment is exercised*’) in another state (the source state). The Commentary on Article 15 explains that this means the place where the employee is ‘physically present when performing the activities for which the employment income is paid’. As known, there are conditions attached to the place of exercise test: the source state may exercise a taxing right only if the employee is there for more than 183 days or the employer is a resident of the source state, or the employer has in the source state a permanent establishment that bears the remuneration.

In light of the above, Switzerland as the source state should have claimed taxing rights for Italians who remained in the Swiss territory to perform their employment. This would have applied despite the COVID-19 situation. For Italians forced to telework from their home in Italy, general rules seemed to grant Italy, as a residence state, the exclusive taxing right over private employment income. Because of the 1974 Swiss-Italian Agreement tax structure, this would have represented a problem for both employees and employers.

Following the OECD guidelines published in April 2020, as similarly negotiated with other neighbouring countries, in June 2020, Switzerland finally signed a mutual agreement with Italy stipulating that, as long as the emergency persists, no changes in pre-existent tax rules will be made. All days spent in the residence state through remote working due to COVID-19, must be considered time spent in the source state. This practically means that Switzerland keeps its exclusive taxing rights on income from dependent employment of Italian cross-border workers.

This agreement has been tacitly renewed and will remain in force at least as the emergency status is declared, i.e., until 31 March 2022.

The 2020 New Swiss-Italian Agreement

In December 2020, somewhat unexpectedly, Switzerland and Italy signed a new treaty on cross-border workers, repealing the old 1974 Agreement.[8]

Following the 2015 Roadmap,[9] this new set of rules introduces profound changes in the tax treatment of cross-border workers between the two countries. Such changes were required by the evolving framework both at the juridical and the economic level. First of all, the mentioned Agreement on the free movement of persons, in force since 2002, extended the commuter concept. Secondly, the number of cross-border workers, especially in Ticino, increased appreciably: they passed from 33'000 to more than 70'000 units in 2003-2020. Such a growth finds its main *ratio* on the combo Swiss higher wages- low tax pressure and cheap cost of life, staying in Italy.[10]

Under the new rules, the source state – in most circumstances, Switzerland – keeps limited taxing rights on income from private employment. This share cannot exceed 80% of the applicable withholding tax. As (usually) the residence country, Italy has full right to tax its resident frontier workers but must grant a double tax credit. *Viceversa*, Switzerland exempts 4/5 of the income from employment earned by its residents in Italy.[11]

The tax regime for the so-called 'new commuters', i.e., workers who satisfy the requirements starting from the enforcement of the 2020 New Swiss-Italian Agreement, is expected to enter into force on 1 January 2023.

The 'old commuters', i.e., individuals who work or have worked in the Cantons of Graubünden, Ticino, or Valais between 31 December 2018 and the date of entry into force of the new agreement, will continue to be subject to the 1974 Agreement's tax regime. Italian border municipalities will receive the compensation fee but only until 2033.[12] Despite this, Switzerland will maintain its exclusive taxing rights over the old commuters' employment income.

Aside from sharing taxing powers, the 2020 New Swiss-Italian Agreement introduces two novelties. First of all, the definition of cross-border worker. The concept is the same as described above, with spatial and temporal criteria, but it is expressed by the law this time.[13] Secondly, an exemption threshold. Switzerland and Italy agreed on a 45-days period during which the cross-border worker may derogate to the daily return requirement, although for 'work reasons only'. Personal reasons are therefore excluded. This clause is inspired by agreements signed with France[14] and Liechtenstein.[15] It is worth noting that there is no expressed fence of 'working reasons', but the provision allows the worker to remain in the source State only (and, eventually, in a third country).[16] The stay in the residence State is not covered by the threshold. This wording clearly emphasises the underestimation of the remote (home) working phenomenon.

What about Remote Working?

The 2020 New Swiss-Italian Agreement is silent on the tax treatment of frontier workers who work from their home office.

However, the Annex to the 2020 New Swiss-Italian Agreement contains a clause, stipulating that Switzerland and Italy would frequently monitor the remote working evolution and, if it were the case, an amendment to the agreement would be discussed. In any case (encompassing exceptional circumstances), the two countries may opt to sign a mutual agreement under Article 26 of the CH-I DTC.

This clause cannot be considered sufficient to address the present challenges. What will happen when (hopefully) both the emergency status and the mutual agreement end? As explained before, ordinary tax treaty provisions apply in the absence of specific derogating rules. The risk of double taxation, mainly due to changes in the individual's tax residence, is not inconceivable.

In its updated guidance on tax treaties released in January 2021, the OECD admits that it is possible that a change of place where commuters exercise their employment may also affect the application of the special provisions dealing with cross-border workers. Under the OECD guidance, '*[t]hese provisions apply special treatment to the employment income […] of cross-border workers and may often contain limits on the number of days that a worker may work outside the jurisdiction they regularly work before triggering a change in their status*'.

The problem is that such statement, based on which teleworking days are considered working days within the work jurisdiction, was contained in the emergency mutual agreement of June 2020, but it lacks both in the 1974 and 2020 Swiss-Italian Agreements. In the 1974 Agreement, no exemption threshold is provided. The 2020 Agreement contains the explained exemption threshold but for working reasons only and allowing the stay mainly in the source state, which does not necessarily correspond to the home-office regime.

The COVID-19 pandemic has undoubtedly been a booster for remote working, and it is no longer possible to ignore such a phenomenon. Cross-border workers are a peculiar category of workers, based on requirements that are *per se* far from the new virtual way to work. Staying still, monitoring the evolution of the home office, and waiting does not appear a smart strategy.

History teaches us that misunderstandings in such situations may result in troubles for taxpayers and tax administrations alike. In the absence of new specific rules, the risk is that inadequate old rules apply, affecting the determination of the tax residence and causing tax uncertainty.

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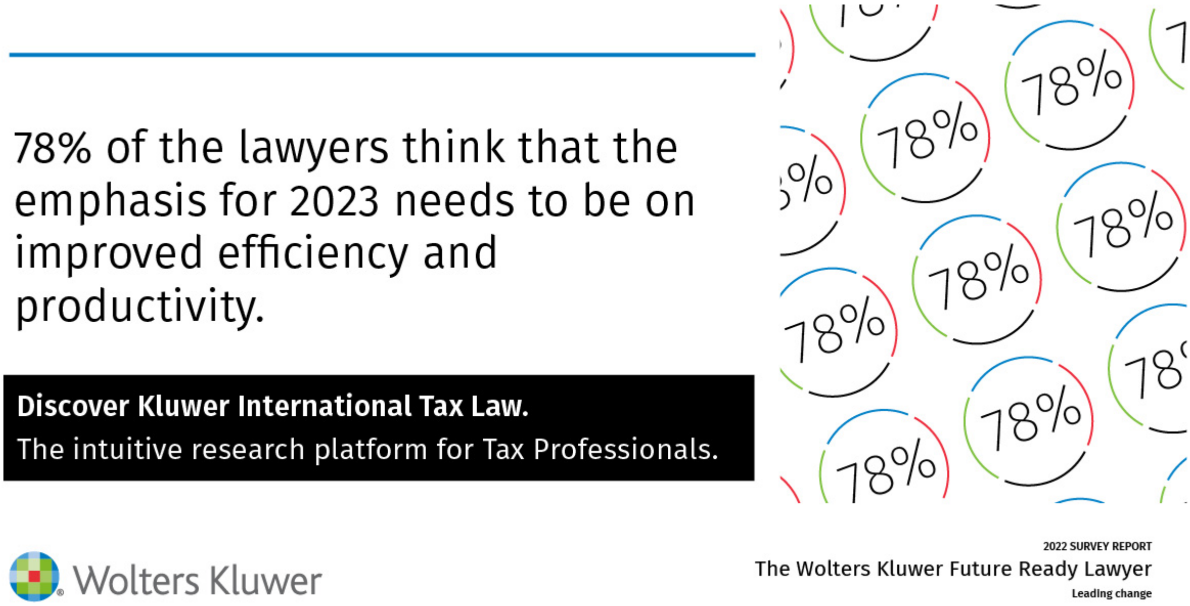

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