

BRIEFING FEBRUARY 2023

IMPACT OF TELEWORKING ON THE TAXATION OF ITALIAN FRONTIER WORKERS AND THEIR EMPLOYERS

The extraordinary regime agreed upon by Swiss and Italian competent authorities during the COVID-19 pandemic allowed to disregard tax effects of teleworking performed by Italian resident cross-border workers employed by Swiss resident employers.

However, the extraordinary regime is no longer in effect from 1 February 2023 and the impact of teleworking for Swiss employers of Italian-resident cross-border workers (especially in Grisons, Valais and Ticino) can be far reaching.

In particular, teleworking can lead to loss of frontier worker status, with the consequence of full Italian taxation on the income earned by Italian resident cross-border workers. At the same time, teleworking can create tax issues for the Swiss employer both in Italy (tax liability/permanent establishment) and in Switzerland (transfer pricing, salary source taxes), and the management of such risks can lead to employment law issues.

Finally, certain changes in the system of European social security coordination should be monitored, since in the (near) future teleworking could have an impact on the applicable social security legislation.

INTRODUCTION

While teleworking has existed since the 1970s, before the COVID-19 its spread has been rather limited and its impact from a tax (and social security) perspective has not been in the focus of public discussion in academia, jurisprudence and legislation.

Things have radically changed in the wake of the COVID-19 pandemic, as teleworking has become more and more widespread, not only in the exceptional pandemic situation, but also as an increasingly normal part of most office-related jobs.

According to official data, approximately 90'000 Italian residents cross the border to Switzerland regularly in order to work for Swiss employees. They too, and their employers, have been affected by the COVID-19 restrictions and have, in many cases, resorted to teleworking.

As emergency measures and international agreements fade out or are renewed, it is advisable for employers to understand the future impact of teleworking on the tax and social security situation, both as relates to them and their employees. In addition, recent sudden developments in effect from 1 February 2023 make it imperative for any Swiss employer employing Italian cross-border workers to re-assess its internal situation as regards teleworking.

This briefing aims at providing the basic tools to perform an initial assessment in this respect.

GENERAL INFO ON TAX TREATMENT OF ITALIAN RESIDENTS EMPLOYED BY SWISS COMPANIES

From a Swiss *domestic perspective*, non-resident workers employed by a Swiss employer are taxed at source (withholding done by the employer).

Pursuant to domestic legislation, only days of physical presence are taxable in Switzerland. In practice, a reduction of the taxable basis can be obtained for working days spent outside of Switzerland.

Example:

- Mr. A lives in Como (Italy), is employed by X. SA in Lugano and in January 2023 has been travelling abroad for one week (including two weekends);
- the 5 working days spent abroad can be deducted from the tax basis of the month January 2023 (i.e. only 15/20 of the salary of January will be subject to taxation, at the rate of the full salary). Non-working days are not considered.

As a general rule, Italy retains full taxing rights for workers with Italian tax residents that are employed by Swiss resident companies (pursuant to the Swiss-Italian double tax treaty of 1976, "**CH-I DTA**"). Double taxation is avoided, under the CH-I DTA, by Italy granting a tax credit to its resident cross-border workers. In other words, Italian residents that work in Switzerland may, under the CH-I DTA, credit the (source) wage taxes paid in Switzerland towards the income taxes to be paid in Italy.

In this context, it should be noted that Italian income taxation is typically much higher than wage taxes to be paid in Switzerland. By way of example, a married person earning CHF 80'000 yearly with two children and a non-working spouse would pay wage taxes of approximately 2% (Ticino), whereas the same person would (depending on applicable deductions) pay income taxes in excess of 30% in Italy.

**THE SPECIFIC CASE OF FRONTIER WORKERS
(LAVORATORI FRONTALIERI)**

Current situation

As an exception to the general rule, special rules apply in the case of Italian *frontier workers* employed in Switzerland pursuant to the applicable Swiss-Italian agreement of 1974 ("**FA 1974**").

According to longstanding practice and to an unpublished agreement between the Italian and Swiss competent authorities of 1985, the definition of an (Italian) frontier worker requires the following elements:

- a) they are individuals and Italian residents;
- b) they reside within 20 Km of the border to Switzerland;
- c) they work in the Cantons of Grisons, Ticino or Valais;
- d) the work is performed as employee of a Swiss company or permanent establishment;
- e) the individuals in question cross the border and return home on a daily basis.

In the case of *frontier workers* that meet the above-mentioned definitions, the FA 1974 provides for exclusive Swiss taxing rights. In other words, no concurring Italian taxation is admissible for frontier workers under the FA 1974. In exchange, the Cantons of Grisons, Ticino and Valais annually forward 38.8% of Swiss wage taxes paid by Italian frontier workers to the Italian State.

Impending changes

The FA 1974 will be replaced in the near future (most likely on 1 January 2024) by a new agreement, signed on 23 December 2020 and in course of ratification by the Italian Parliament (the "**FA 2020**").

As regards the definition of frontier worker, the FA 2020 confirms all elements of the previous definition. Nevertheless, according to the additional protocol to the FA 2020, the status of frontier worker is not lost if the person in question is unable, due to professional reasons, to return to their home for a maximum of 45 days p.a. No similar exception is foreseen, however, for days in which the employee does not cross the border (i.e. works from home). The FA 2020 states, in a non-committal way, that the competent authorities shall consult each other to find solutions regarding teleworking.

Under the FA 2020, frontier workers will be subject to concurring Italian and Swiss taxation, whereas Swiss taxation will be limited to 80% of taxation under domestic legislation, with no reimbursement or forwarding of taxes from the Cantons to the Italian State.

Nevertheless, a grandfathering clause provides for the continuation of the current system (i.e. exclusive Swiss taxing rights) for all Italian residents already employed in the frontier region (i.e. Grisons, Ticino or Valais) at any moment starting from 31 December 2018.

The FA 2020 thus effectively establishes a two-track system, distinguishing between "old frontier workers" (taxed exclusively in Switzerland) and "new frontier workers" (taxed concurrently in Italy and Switzerland).

**IMPACT OF TELEWORKING ON THE TAX TREATMENT OF
(ITALIAN) CROSS-BORDER WORKERS AND THEIR SWISS
EMPLOYERS**

Pandemic period

On 18/19 June 2020, the Italian and Swiss competent authorities have entered into an agreement ("**CH-I COVID-19 Agreement**"), with effect from 24 February 2020. According to this agreement, taking into account the governmental emergency measures (lockdowns, etc.) issued in the COVID-19 pandemic, the competent authorities established that days spent working from home by employees that usually worked across the border would be disregarded and considered to have been performed in the country of the workplace (i.e. Italian residents employed by a Swiss company and usually working in Switzerland would be considered as having worked in Switzerland even on days spent working from home).

The period of validity of the CH-I COVID-19 Agreement has been extended, even after all the governmental measures related to the COVID-19 pandemic had been revoked. However, on 22 December 2022, the Italian and Swiss competent authorities announced that the agreement would cease its effects as of 1 February 2023.

It should be noted that, on the same day in which the termination of the CH-I COVID-19 Agreement was announced, the Swiss competent authority informed that it had reached a solution with France. According to the agreement with the French competent authority, in force

from 1 January 2023, up to 40% teleworking can be disregarded.

In summary, teleworking days by Italian residents employed by Swiss resident employers should have no consequences for both personal income taxes of the Italian resident employees and for the corporate taxes of their employers from 24 February 2020 to 31 January 2023.

It should be noted, however, that domestic legislation does not allow to tax days where non-resident employees were not physically present in Switzerland. Generally speaking, according to the jurisprudence of the Swiss federal supreme court, the lack of legal basis for taxation cannot be replaced by an international agreement. It is therefore at least questionable that, for Swiss salary source taxation purposes, the days spent teleworking should be included in the taxable basis.

From 1 February 2023

As mentioned, the CH-I COVID-19 Agreement is no longer in effect. Starting from 1 February 2023, therefore, the following impacts should be expected in case of teleworking of Italian resident workers employed by Swiss resident employers:

- cross-border workers that telework cannot be considered as frontier workers within the meaning of the FA 1974 (or under the grandfathering rules of the FA 2020). Therefore, they will be subject to concurring Italian and Swiss taxation for the days spent in Switzerland and exclusive Italian taxation for the days spent teleworking (double taxation is avoided via a tax credit mechanism). It should be noted that the Italian tax administration has confirmed such interpretation in a public ruling letter dated 26 January 2023 implying that even one single day spent teleworking could lead to loss of *frontier worker* status;
- as regards the Swiss resident employers, theoretically there should be no salary source tax withheld for days spent teleworking. Nevertheless, the exact procedure to manage teleworking from a salary source tax perspective should be discussed with the competent tax authority. The Ticino source salary tax authority, for example, has recommended that 100% of salary be continued to be object of salary source tax and that reimbursements be requested to the authority by the employees. Such a request must be addressed no later than 31 March of the subsequent year and, according to the Ticino tax authority, must be supported by evidence of full taxation in Italy;
- for the Swiss resident employers, teleworking made by Italian resident employees, can bear the risk of a corporate tax liability in Italy (permanent establishment) and subsequent disagreements on profits attribution/transfer pricing between Switzerland and Italy. According to OECD guidance on double tax treaties, the risk should only exist where teleworking is required by the employer, but the interpretation and practice of the Italian authorities appears to be unclear at present.

The question arises how to react to the serious impacts teleworking has in relation to Italian resident cross-border workers.

According to the most recent news, the Swiss competent authority has confirmed it will endeavor to reach an agreement with its Italian counterpart to find a more permanent solution that would allow to disregard teleworking up to a certain extent. Whether or not this will be the case is, of course, impossible to foretell. It is also possible that the Italian government will issue unilateral mitigating measures. The unfolding of the situation should therefore be carefully monitored.

As of now, the safest course of action to deal with the risks described above would be to restrict or even forbid access to teleworking for Italian resident frontier workers, if compatible with their employment agreement and with great caution to be given to further employment aspects (such as prohibition of discrimination based on the EU-Swiss agreement on the free movement of persons). In any case, each instance of teleworking by Italian resident workers should be carefully reviewed.

SOCIAL SECURITY ASPECTS

EU legislation on the coordination of social security systems applies also to Switzerland (both in relation to EU and to EFTA countries).

The main principle of the coordination rules is that the social security legislation of only one country shall apply to each (employed and/or self-employed) worker.

In the case of cross-border (employed) workers, the current regulation provides that the social security legislation of the country of employment is applicable, as long as the employee in question performs less than 25% of its work in their country of residence. If the 25% threshold is reached, the social security legislation of the country of residence applies.

Since June 2020, however, the competent authority has adopted temporary guidelines, targeted at dealing with the extraordinary COVID-19 situation, to disregard teleworking performed by cross-border workers. In other words, pursuant to the temporary guidelines, the social security system of the country of work shall continue to apply even if the employee performs work in his country of residence due to teleworking that meets or exceeds the 25%.

The temporary guidelines have been extended on several occasions and are currently set to expire on 30 June 2023. Therefore, no immediate action should be required in relation to teleworking as regards social security, other than ascertaining that the employer has the contractual rights to (unilaterally) limit teleworking if and when needed.

Discussions at the European level are ongoing in order to reach a more permanent solution allowing to disregard a certain portion of teleworking, with 40% being discussed as the most likely new threshold, but no decisions have been released yet.

The contents of this publication are for reference purposes only and reflect the situation at the beginning of February 2023. They do not constitute legal advice and should not be relied upon as such. Specific legal advice about your specific circumstances should always be sought separately before taking any action based on this publication.

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