KPMG

GMS Flash Alert

2021-016 | January 12, 2021

Italy & Switzerland - New Cross-Border Commuter Agreement

On 23 December 2020, Italy and Switzerland signed a new agreement concerning the income taxation of cross-border commuters and a protocol amending the double taxation treaty ("DTT") in force between the two countries. The new deal will replace the previous agreement which dated from 1974 in respect of cross-border commuters employed in Switzerland in the Cantons of Ticino, Graubünden, and Valais, and provides for a "transitional regime" from 31 December 2018, until the date of entry into force of the new agreement (which is still to be determined).[1, 2, 3]

WHY THIS MATTERS

The previous agreement between Italy and Switzerland had become outdated and several areas were unclear. The new agreement clarifies matters around taxing authorities' jurisdiction and tax liability for affected cross-border commuters, taking into account developments since the last agreement was signed, and enables employers and their employees to better plan and enhance their compliance.

Background and New Requirements

Under the current agreement between Italy and Switzerland, dated 1974, cross-border workers working in Switzerland and residing in Italy in the 20 km area from the Swiss border, are subject to employment income taxation in Switzerland only. This regime will still be applicable to those individuals who worked in Switzerland during the transitional period (more on the transitional period/regime below), even in cases of interruption of the previous employment relationship with the Swiss employer, provided that they continue to work in Switzerland in the cross-border area for a tax-resident employer.

Moreover, until fiscal year 2033, the above-mentioned Swiss cantons will continue to pay 40 percent of their tax withholdings, applied on commuters' tax revenues, to the Italian municipalities where the impacted individuals reside.

As of 2034, those Swiss cantons will retain the whole of the tax withholdings applied, without having to pay over any amounts to the Italian municipalities.

In order to avoid any abuse of the regime, there is now a clearer definition of **cross-border worker**:

> An individual, tax resident in a municipality whose territory is located, totally or partially, in the area of 20 km from the border with the other Contracting State, that (i) carries out an employed activity in the border area of the other Contracting State for a resident employer, permanent establishment, or fixed base of that other State, and (ii) returns, in principle, on a daily basis to his principal place of residence in the municipality as stated at point (i).

It has been established that the Contracting State in which the employee's activity is carried out, will provide the state of residence annually in an electronic format (by 20 March of the year following the fiscal year of reference) the information relevant for the purposes of taxation of the cross-border worker (e.g., personal identification data, amount of gross remuneration received, and mandatory social security contribution paid, the amount of tax withholdings applied, etc.).

More Details

The 1974 agreement provided that Italian tax resident employees were taxable only in Switzerland on their employment income from exercising a cross border employment. In return, the Swiss Cantons (Ticino, Graubünden, Valais) where the employee worked, made a payment to the Italian authorities. As noted, the new agreement substantially changes and clarifies the position.

Transitional regime[4] – Italian cross-border employees who have been working in Switzerland for a Swiss employer either before or from 31 December 2018 until the entry into force of the new agreement are "grandfathered" by the new agreement and considered as "current cross-border workers," so they will continue to apply the previous agreement, thereby being subject to employment income taxation in Switzerland only. Their status does not change.

New regime – The new cross-border agreement that applies to commuters who will start working in Switzerland in the Cantons of Ticino, Graubünden, and Valais, after the agreement enters into force ("new cross-border workers"), allows concurrent taxation of the commuter's employment income as follows:

- tax withholding that cannot exceed 80 percent of the tax which would otherwise be payable in Switzerland (considered as the State of source) where the employment activity is performed;

- ordinary taxation in Italy (considered the State of tax residency of the individual) with the possibility to alleviate any double taxation by claiming the Swiss foreign tax credit and also benefiting from a tax-free allowance under Italian tax law.

Clear definition of cross-border area/worker and new administrative cooperation – Accurate definitions are provided of the cross-border area (including the Italian regions of Lombardy, Piedmont, Valle d'Aosta, and the Autonomous Province of Bolzano and the Swiss Cantons of Ticino, Graubünden, or Valais) and of "worker," together with new definitions of electronic information sharing and monitoring of the imposition of tax on the impacted commuter.

KPMG NOTE

Considering the high number of Italian residents who commute daily to Switzerland and who can be covered by the definition of cross-border worker, it is essential that they undertake actions as follows:

- Promptly engage in a working relationship with a Swiss employer (or other equivalent entity), should they need to apply the previous regime of tax exemption in Italy with respect to their employment income for employment activity carried out in the Swiss border area, before the end of the transitional period;

- Perform any financial and tax analyses concerning the application of the new agreement (considering the implications for temporary double imposition and additional tax compliance in terms of declaring and paying taxes in Italy on the Swiss cross-border-sourced income) – along with the application of the foreign tax credit mechanism or any other process that might help reduce the afore-mentioned double imposition.

Additionally, the Italian Ministry of Economy and Finance has anticipated the introduction of other measures, in terms of increasing to EUR 10,000.00 the "free-tax area," full deduction of the Swiss family allowances, and recognition of the voluntary pension contributions.

For the Swiss employer, it will be important to foster an accurate understanding of the new tax rules and potential consequences for employees, and explain any differences between the new and old regimes and how the transitional period works.

Moreover, we are still awaiting the formal implementation of the new agreement. In anticipation, employers should put in place systems and procedures to foster accurate tax compliance, to report Swiss-sourced income, and to alleviate any double imposition, while also bearing in mind the agreed enhanced interactions and information sharing that will occur between the Italian and Swiss tax administration.

FOOTNOTES:

1 *Accordo tra la Repubblica Italiana e la Confederazione svizzera relativo all'imposizione dei lavoratori frontalieri del 23 dicembre 2020;* Accordo.pdf (mef.gov.it) .

2 *Protocollo che Modifica la convenzione tra la Repubblica italiana e la Confederazione svizzera del 23 dicembre 2020.*

3 *Accordo tra la Svizzera e L'Italia 3 ottobre 1974*

See the Swiss Federal tax authorities' website (in German, French and Italian).

See "La Svizzera e l'Italia firmano un nuovo accordo sull'imposizione dei lavoratori frontalieri," at: https://www.admin.ch/gov/it/pagina-iniziale/documentazione/comunicati-stampa.msg-id-81813.html .

4 Transitional regime: those who work or have worked in the cantons of Graubünden, Ticino, or Valais in the period between 31 December 2018 and the date of entry into force of the new agreement fall under the transitional regime applicable to "current frontier workers." Current cross-border commuters will continue to be taxed exclusively in Switzerland. Until the end of 2033, Switzerland will pay financial compensation in favour of the Italian border municipalities equal to 40 percent of the withholding tax levied by Switzerland. After this date, Switzerland will retain all tax revenue.

Contact us

For additional information or assistance, please contact your local GMS or People Services professional* or one of the following professionals with the KPMG International member firms in Switzerland and in Italy:

Stefania Quaglia
KPMG-Italy
Tel. +39 02 67644944
squagliasquaglia@kpmg.it

Tatiana Pedretti
KPMG-Switzerland
Tel. +41 58 249 46 43
tpedretti@kpmg.com

** Please note the KPMG International member firm in the United States does not provide immigration or labour law services. However, KPMG Law LLP in Canada can assist clients with U.S. immigration matters.*

The information contained in this newsletter was submitted by the KPMG International member firms in Italy and in Switzerland.

www.kpmg.com

kpmg.com/socialmedia

Flash Alert is a GMS publication of KPMG LLP's Washington National Tax practice. To view this publication or recent prior issues online, please click here. To learn more about our GMS practice, please visit us on the Internet: click here or go to http://www.kpmg.com.