

Tax Alert

Human Capital ALERTS

Cross-border workers in the canton of Geneva – the Federal Court accepts an appeal to expand deductible expenses for cross-border workers

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Executive Summary

The Swiss Federal Court has made a wide reaching ruling that will impact the taxation of cross-border workers and more generally taxpayers currently subject to source withholding on their employment income.

An appeal had been lodged by a Swiss national being subject to withholding whilst living in France and working in the Geneva region (a cross-border worker). In accordance with the legislation concerning cross-border workers, the taxpayer had been unable to deduct any professional expenses from his taxable income, notably travel expenses incurred in the daily trip to and from his home.

On the basis of principles of inequality and discrimination the Federal Court has now decided in his favour. The Federal Court has concluded that cross-border workers should be subject to the same rules relating to deductible expenses as tax residents of Switzerland. The case will be reheard in the Geneva higher court which will reissue its verdict on the case and clarify the issues raised by this ruling such as what deductions can be claimed and exactly who will be eligible to claim them.

In the meantime, this decision seems to offer cross-border taxpayers the possibility to benefit from the deductions that were previously disallowed. Such deductions should be claimed by 31 March of the year following the tax year in question, in the form of a written claim to amend the tax assessment. Ernst & Young can assist you with this where required. Whilst we welcome this decision from the Federal Court, we fear that the increase in requests for amendments may result in the administration delaying the processing of regular deductions, and subsequently refunds due to taxpayers.

We are currently in discussions with the authorities regarding the practical application of this decision and to ensure the taxpayer's rights are preserved.

Withholding for cross-border workers

Employees who are domiciled in France and work in Geneva are subject to mandatory withholding on their employment income. Withholding is calculated using the standard tax rates applicable according to their level of income and their family situation, and is paid over to the authorities directly by their employer.

The tax brackets are used for Cantonal, Communal and Federal tax. The guidelines specify that these brackets already consider the ordinary rates and deductions applicable under both Geneva and Federal tax law. As such, standard professional expenses have already been factored into the tax tables, as well as social security costs and a set deduction for insurance premiums.

Possible itemized deductions

The taxpayer is still able to issue a written claim to amend the tax assessment before the 31 March following the tax year in question to take into account certain additional deductions against his/her taxable income, subject to certain limitations. These are limited to:

- ▶ repurchase of contribution gaps in second pillar pension funds
- ▶ contributions to recognized institutions relating to private pension funds (third pillar)
- ▶ alimony, child support payments and childcare costs as permitted according to Cantonal law

Any further deductions are disallowed.

Taxpayers in Geneva who are subject to self-assessment, must submit a tax return where tax is imposed on net income, calculated by reducing the total income by general standard deductions and other expenses allowed by the tax law (e.g. travel expenses and additional meal expenses). Unlike taxpayers subject to self-assessment, the cross-border worker, and any other taxpayer subject to tax at source, is unable to claim a deduction for actual professional expenses or deductions for insurance costs, the argument being that these costs are already taken into account through the tax brackets.

The decision of the Federal Court

On 26 January 2010, the Federal Court decided in the favour of a French domiciled Swiss national, working in Geneva. Since his move to France in 2001 and becoming a cross-border worker, his income was subject to mandatory withholding and he was no longer able to benefit from the deductions available to him when he was resident in Switzerland.

The taxpayer had lodged several complaints with the Geneva tax authorities on receipt of his tax assessments, claiming that he should be allowed to claim deductions such as travel and meal expenses, second and third pillar pension contributions, health insurance premiums, charitable donations, life insurance premiums and medical expenses. The Geneva tax authorities partly rejected these claims, allowing only deductions for the second pillar purchase and the third pillar contributions.

The Federal Court ruled that in general, residents and nonresidents of a state cannot be treated in the same way for income tax purposes. However, the Federal Court conceded that exceptions to this rule can be made when the nonresident is not in receipt of significant income in the State where he/she is resident and most of the income is generated in the State of employment. Such was the case for this taxpayer where more than 90% of his income was earned as salaries in Switzerland.

The taxpayer in question had not been able to benefit from the deductions available to Swiss residents, notably, the travel expenses incurred in the journey from his home to his workplace. These facts led the court to rule that this was a direct violation of the antidiscrimination clause of the Free Movement of Persons Act.

The Court concluded that consequently, the cross-border taxpayer should be allowed to claim the same deductions against taxable income available to Swiss resident taxpayers subject to self-assessment.

The consequences for taxpayers subject to withholding in the Geneva region

The judgement of the Federal court is in complete contrast to all other decisions made to date which refused in a systematic manner all additional tax deductions for taxpayers subject to withholding.

The case will be reheard in the Geneva higher courts which will in turn issue a ruling in light of the Federal Court's decision. We hope that this will clarify the situation for other taxpayers, such as which deductions will be applicable: Transport costs, medical insurance premiums, mortgage interest etc. and to whom they will be available: E.g. cross-border workers only, or all taxpayers subject to withholding, such as those in possession of a B permit.

Furthermore, Federal and Cantonal law will have to be rectified in light of this decision. However, this will be a long and drawn out process involving producing draft legislation which will be subject to referendum.

What can be done now?

Whilst this process is ongoing, taxpayers wishing to take advantage of the possibility to deduct previously disallowed expenses will still have to write to the Geneva tax authorities, formally requesting that they amend their tax assessments. For tax year 2009 this claim

must be filed by 31 March 2010 and Ernst & Young can assist you with this.

These taxpayers must be aware that any appeals made against their assessment will probably delay the processing of their tax assessment and corresponding refund. In light of the potential financial impact for the authorities and legal uncertainty, they may continue to challenge these deductions to cross-border workers. Furthermore, they may increasingly audit these claims, giving rise to further delays. Whilst the assessment is under audit, no refund will be issued until the review is closed, even where claims for standard deductions are being made. It may therefore be the case that any potential refunds will be delayed at least several months, and in some cases it may be years before they are paid out, hence affecting the taxpayer's cash flow.

Furthermore, this ruling raises questions regarding the future of the withholding tax system for cross-border workers and the possibility for this population to file tax returns.

We are currently in discussions with the authorities regarding the practical application of this decision and to ensure the taxpayer's rights are preserved.

Your Human Capital team is at your disposal if you would like to discuss any of the issues raised above in further detail.

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