

Tax Alert

Human Capital ALERTS

New developments on taxation at source in Geneva

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Executive Summary

Following the wide reaching decision of the Swiss Federal Court earlier this year, employees subject to withholding in the canton of Geneva can now take benefit of substantial tax deductions that have been previously disallowed. To take advantage of the new rules, eligible taxpayers need to disclose both Swiss and foreign sourced income and assets, and they must now file an annual tax return. Moreover, French resident cross-border workers employed in Geneva need to qualify as "virtual residents" for the additional deductions to apply.

Although foreign income would not constitute taxable income in Switzerland, it may however affect the Swiss tax rate and this could off-set potential tax savings. Particular attention needs therefore to be paid to the international allocation of taxable elements.

The new rules offer interesting tax planning opportunities for employees taxed at source in Geneva, and other cantons are likely to follow suit. Ernst & Young can help you to optimize your position, minimizing your tax liability and can guide you through the increasingly complex tax at source regularization process.

Geneva follows the Federal Court decision

Following the decision of the Swiss Federal Court, the Geneva tax authorities have recently adapted their position and clarified the options available to employees subject to withholding in the canton.

As a brief reminder, in a case issued on January 26, 2010, the Federal Court concluded that a cross-border worker resident in France, subject to withholding taxes on his employment income in Geneva, should be able to claim the same tax deductions as a Swiss resident filing annual tax returns. In the meantime, the cantonal authorities have confirmed that these new rules shall also apply to employees taxed at source in Switzerland as Swiss tax residents (e.g. B-permit holders). Prior to the decision, both categories of taxpayers were only been entitled to limited itemized deductions¹. For further details, please refer to our tax alert of March 2010.

Available deductions will now include items that were previously disallowed, e.g. actual travel costs from home to office, other business expenses, and also actual insurance premiums. These deductions will, however, only be taken into account for tax year 2009 if a claim has been lodged before the usual deadline, i.e. until March 31 of this year.

In addition, to apply for these additional deductions, the filing of a complete tax return will now be required. The return will include all Swiss, as well as any foreign, income and wealth. The determination of taxable income will be made by the authorities on the basis of Swiss domestic and double tax treaty law. The taxable income will be subject to ordinary Swiss tax rates on the federal, cantonal and communal level, meaning that tax at source rates shall no longer apply. Accordingly, foreign sourced income, e.g. foreign spousal income, rental value or deemed rental value of foreign properties, will not be taxed in Switzerland, but will be taken into account to determine the applicable tax rate.²

The filing deadline for the tax return has been fixed as August 31, 2010 but filing extensions can be requested. Should the return not be submitted within the requested deadline, fines and an arbitrary taxation ("taxation d'office") are likely to apply, and will most probably increase the final tax liability.

The virtual residence test for "Frontaliers"

Specific rules will apply to cross-border workers (the so-called "frontaliers") who have their domicile in France, and work in Geneva. Considered French tax residents, cross-border workers will now be entitled to the full range of tax deductions available to Swiss resident taxpayers, provided that they are considered as virtual residents in Switzerland ("quasi-résidents").

To qualify as a virtual resident, at least 90% of their income has to be earned in Switzerland. Foreign earned income includes, but is not limited to, foreign spousal (employment) income and also the rental value and/or deemed rental value of foreign properties, investment income and other items such as unemployment benefits and family allowances. To determine the portion of income earned in Switzerland, the authorities will use a separate form that they have started to distribute to all cross-border workers who have claimed the additional deductions.

If the taxpayer qualifies as a virtual resident, additional deductions and other income as described above will be considered when filing the tax return. If the virtual residence test is not met, the taxpayer is still allowed to claim the itemized deductions. Also, cross-border workers have the option to withdraw their claim for the additional deductions if previously requested. This may be worth considering in cases where the impact of foreign sourced income on the Swiss tax rate outweighs the potential benefit of the additional deductions, or if the top rate has been reached under taxation at source.

Taxpayers must inform the authorities if they wish to continue with their claim through an additional form distributed by the authorities, along with the virtual

1 According to the Geneva regulations, itemized deductions include third pillar contributions, repurchase of contribution gaps to pension funds, alimony, child support payments and childcare costs.

2 Please note that unlike cross-border commuters, Swiss tax residents (e.g. typically B-permit holders) are subject to taxation in Switzerland on their worldwide income and assets. Hence, investment income from Swiss and non Swiss investments shall be taxed in that country. Double taxation can be avoided by granting a tax credit in Switzerland.

residence test. It is not expected that the possibility to withdraw the initial claim will also be applicable for future tax years.

Other cantons may follow

The decision of the Swiss Federal Court has significantly improved the position and tax planning opportunities of employees subject to withholding in Switzerland. It is expected that other cantons will follow Geneva and adapt their cantonal regulations and procedures to reflect the latest developments in federal law.

At this stage, some cantons (e.g. Basel-Stadt and Basel-Land) that previously refused tax at source regulations, have recently indicated that they will follow this Federal Court decision for virtual residents. It is likely that Schwyz will also come to a similar conclusion.

In some other cantons of the German speaking part of Switzerland, like Zurich, Zug, Berne, Aargau and Schaffhausen it was already possible to apply for further tax deductions, in particular with respect to additional housing and commuting costs for international commuters. This was also available to non-Swiss tax residents who were not filing a complete tax return in Switzerland.

In the canton of Vaud, recognized cross-border workers are exempted from Swiss income tax and the Federal Court decision should therefore not impact them. However, the decision may affect weekly commuters who should now be allowed to file a tax return and claim actual deductions, provided that the virtual resident test is met. The Federal Court decision has, however, not yet formally been implemented by the Vaud authorities.

Finally, it appears that a few cantons (e.g. Ticino) are more reluctant to take any immediate action on this matter, and prefer to observe the evolution of the

process in the rest of Switzerland before coming to a decision.

It is generally expected that the recent decision will create more administrative costs for the tax authorities, as well as a dramatic reduction of revenue for the cantons because of the savings made by the taxpayers resulting from the deductions.

What can be done now?

Employees subject to tax at source now need to identify the best position for them that will take into account the savings from additional deductions, versus the reporting and international allocation of additional income and the subsequent impact on the effective tax rate in Switzerland. In addition, the application of ordinary tax rates may alter the outcome.

Also, taxpayers must be aware that claims for additional deductions are likely to delay the processing of their tax assessment and subsequent refund, hence affecting the taxpayer's cash flow.

To identify any individual tax savings and to find the best solution for you and your employees, it may therefore be advisable to carry out comparative tax estimates based on the available options. Your Human Capital team is at your disposal if you would like us to perform any tax optimizations for you, or if you need further guidance relating to any part of the tax at source regularization process.

We are also in continued discussions with the authorities to ensure that the federal decision is consistently applied throughout the cantons, and that transparency for the taxpayers can be improved.

Please do not hesitate to contact us if you would like to discuss any of the issues raised above in further details.

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