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Swiss Tax Law Changes: New Withholding Tax Rules

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Key Points

- Under Swiss law, Swiss employers must levy an employment withholding tax on the salary received by foreign nationals who do not hold a permanent residence permit.
- Only taxpayers whose salary exceeds a certain amount can file a subsequent ordinary tax return and therefore claim tax deductions through a subsequent tax return as do Swiss tax residents.
- Under certain circumstances, the current Swiss withholding tax regime violates the Bilateral Agreement on the Free Movement of Persons between Switzerland and the European Union.
- The new withholding tax rules aim to reduce possible inequities between foreigners subject to withholding tax and Swiss citizens or permanent residence permit holders who are not subject to the same tax regime.
- The new rules will enter into force on 1 January 2021.

Introduction

As a general rule, Swiss residents and temporary residents performing a gainful activity in Switzerland are subject to unlimited (worldwide) tax liability. Limited tax liability applies to non-resident individuals with a specific economic link with Switzerland. In that case, tax is levied only on specific income from a Swiss source (e.g., real estate).

Tax returns have to be filed in the canton where the taxpayer is resident at the end of the year.

Switzerland has 26 cantons, and the tax rates vary from canton to canton but are progressive and depend on individual personal circumstances (e.g., marital status, religion and number of children). Swiss employers must levy an employment withholding tax (*impôt à la source*) on the salary received by foreign nationals with a residence permit (L and B permit) but not on those who hold a permanent residence

permit (C permit). The withholding tax includes all ordinary taxes (federal, cantonal and communal taxes). In principle, the employer levies the withholding tax on a monthly basis. The rates are lower than the rates of the assessed income taxes because they apply to the gross income. Deductions are standardised and directly included in the rates.

Taxpayers whose salary exceeds a certain amount (gross annual salary of CHF 120,000 at the federal level, CHF 500,000 in Geneva) have to file a subsequent ordinary tax return for their worldwide income and assets. In that case, the withholding tax is considered as a prepayment of the individual's Swiss tax liability. Foreign employees residing in Switzerland with a gross salary of less than CHF 120,000 per year (CHF 500,000 in Geneva) with additional sources of income or additional assets (e.g., real estate) are also obliged to file a tax return.

Finally, an ordinary tax return is possible if the taxpayer marries a person with a permanent residence permit (C permit) or Swiss citizenship.

Except in the limited cases mentioned above, foreign nationals without a permanent residence permit with a gross salary of less than CHF 120,000 per year (CHF 500,000 in Geneva) could not file a subsequent tax return. In addition, persons who are domiciled abroad and are only employed in Switzerland were always subject to withholding tax and also could not file a subsequent tax return.

A subsequent tax return can in some circumstances reduce the tax burden and may lead to a partial tax refund. The possible additional deductions include purchases of contribution years in a pension fund (2nd pillar), contributions to a restricted private savings scheme (3a pillar), additional professional costs, interest on debts, costs of continuing professional education, expenses for child care, payments made to people unable to work and requiring support and maintenance paid to the former spouse or children.

In the past, the Swiss Federal Supreme Court has considered the taxation of foreign nationals subject to withholding tax to be objectively justifiable and in accordance with the principle of equality of rights.

The Background of the Swiss Tax Reform

In a judgment dated 26 January 2010, the Swiss Federal Court decided that under certain circumstances, the Swiss withholding tax regime violates the Bilateral Agreement on the Free Movement of Persons between Switzerland and the European Union. In addition, in accordance with the established jurisprudence of the European Court of Justice, the Swiss Federal Court declared that the situation of residents and non-residents is similar if non-residents earn at least 90 percent of their income in Switzerland. Quasi-residents should therefore have the same right to claim tax deductions through a tax return as do Swiss tax residents.

On 16 December 2016, the Swiss Federal Parliament agreed to amend the withholding tax rules in order to reduce some inequalities between foreigners subject to withholding tax and Swiss citizens or permanent residence permit holders.

On 11 April 2018, the Swiss Federal Council decided that the new withholding tax rules will enter into force on 1 January 2021.

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Key Points of the New Rules

The purpose of the new regime is to reduce inequalities between foreigners subject to withholding tax and Swiss citizens or foreign nationals with a permanent residence permit.

- As now, anyone subject to withholding tax who is a resident will have to file a tax return if their income exceeds CHF 120,000 at the federal level. However, anyone with a lower income will now be entitled to file voluntarily a subsequent ordinary tax return. Taxpayers will have the same opportunity to claim tax deductions for allowable expenses as ordinarily taxed individuals. The tax return must be submitted by 31 March of the year following the tax year.
- Quasi-residents subject to Swiss withholding tax will also have the opportunity to file a subsequent ordinary tax return to claim the allowable deductions. The quasi-resident status (i.e., non-residents earning at least 90 percent of their income in Switzerland) will therefore be included in Swiss law.

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