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Switzerland – Court Makes Landmark Decision on Inter-cantonal Taxation of Employment Income

by KPMG AG, Zurich (KPMG AG in Switzerland is a KPMG International member firm)

The Swiss Federal Supreme Court ruled[1] on 29 January 2014, that the current system of inter-cantonal allocation of income taxes of Swiss resident taxpayers who are subject to wage withholding taxes is in violation of the provisions of the free movement agreement with the European Union ("EU") and European Free Trade Association ("EFTA").

Why This Matters

This case exposes the unequal tax treatment under Swiss law of EU and EFTA nationals who move to different Swiss cantons. Generally, in certain cases, the EU or EFTA national moving between cantons could remain subject to tax in the original canton from which he moved, which is what happened in the case before the Federal Supreme Court. Given the system of inter-cantonal allocation of income taxation, with circumstances being equal, the EU/EFTA taxpayer moving between cantons could remain subject to higher taxation in the canton from which he moved, whereas his Swiss citizen counterpart could be subject to lower taxation in the canton to which he moved.

This decision means that all EU and EFTA national taxpayers moving between cantons in Switzerland will be treated equally.

Background

Switzerland levies income taxes based on the residency canton of the taxpayer. If a person who is not subject to wage withholding taxes on his or her employment income (e.g., Swiss citizens or non-Swiss citizens with a C permit) moves residency from canton A to canton B during the tax year, he or she is liable to the income tax rates of canton B for **the entire tax year**. However, Article 38 para. 4 of the Federal Law on Tax Harmonization (StHG) explicitly states that a person subject to wage withholding taxes on employment income (e.g., non-Swiss citizens with a B or L permit) who moves his or her residency from canton A to canton B during the tax year, will be subject to income tax **on a *pro-rata temporis* basis** in canton A and in canton B.

The Court Case

In the court case the plaintiff, a German national subject to wage withholding taxes, resided in the canton of St. Gallen ("high tax canton") at the beginning of the tax year and moved in November to the canton of Schwyz ("low tax canton"). Based on the applicable rules set by the StHG, the canton of Schwyz assessed the plaintiff's income and wealth on a *pro rata* basis, leaving most of the taxable income and wealth in the canton of St. Gallen for taxation purposes. This approach led to effectively higher taxation of the plaintiff's income and wealth in contrast to a hypothetical Swiss national who would have moved between those cantons in the same tax year.

The Federal Supreme Court ruled that the taxation on a *pro rata* basis for employment income under the StHG is a direct violation of the non-discriminatory rule of the free movement of persons treaty with the EU (and EFTA). And, therefore, the taxation of employment income of EU and EFTA nationals who are subject to wage withholding taxes is unlawful in cases where the taxation on a *pro-rata* basis would result in higher taxation compared to the taxation of a Swiss citizen.

KPMG Note

■ EU and EFTA nationals who are Swiss residents, subject to wage tax withholding and are moving from a canton with high tax rates to a canton with lower tax rates may wish to consider an appeal of any outstanding tax assessments issued based on a *pro rata temporis* allocation.

■ The KPMG International member firm in Switzerland can assist with the filing of appeals and the calculation of potential tax savings based on this court decision.

■ The system of wage tax withholdings for EU and EFTA nationals is currently undergoing a fundamental legislative review. A revised law is to be expected in the near future. KPMG will endeavor to keep readers informed of any further developments.

Footnote:

1 A yet unpublished decision (2C_490/2013),

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For more information or assistance, please contact your usual KPMG professional or one of the professionals noted below with the KPMG International member firm in Switzerland:

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