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Changes to withholding tax applied to income from gainful activity in Switzerland

The overhaul of withholding tax has established the necessary prerequisites for ending the differences between the treatment of taxpayers who are subject to withholding tax and those who are subject to ordinary taxation, as well as enabling Switzerland to comply with its international obligations. These changes came into force on 01 January 2021.



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Judgment of the Federal Supreme Court

A judgment of the Federal Supreme Court established that it was necessary to enact legislation to overhaul the rules governing the taxation at source of income from gainful activity. It held in 2010 for the first time that, in some cases, the Swiss law on withholding tax violated the Agreement on the Free Movement of Persons concluded with the European Union. According to the Federal Supreme Court, persons liable to withholding tax who do not have their tax domicile or place of residence in Switzerland are entitled to the same deductions as persons liable to ordinary taxation in Switzerland, provided that they earn more than 90 percent of their global income in Switzerland. As a result, so-called "quasi residents" were incorporated into Swiss tax law as an additional category of persons.

The old law until 31 December 2020

Swiss law on persons liable to withholding tax differentiates between "residents" and "non-residents".

Resident persons have their main place of residence or the centre of their vital interests in Switzerland, or are physically present in Switzerland for a specified minimum period of time. In addition, these persons do not hold a settlement permit issued by foreign immigration authorities. Any income from employment by this class of persons is taxed at source, with a different rate of withholding tax being applied depending upon their status (married, number of children, etc.). Under the old law, it was possible for persons liable to withholding tax to make additional deductions, such as, for example, for pillar 3a purchases or actual travel costs, by way of a subsequent rate correction procedure. Only residents with a gross annual income greater than CHF 120,000 were subsequently required to file an ordinary tax return and thus subjected to an ordinary tax assessment. No other residents were eligible for this "subsequent ordinary tax assessment". Taxation was thus only approximately based on the rates and the rate corrections, which often resulted in adverse outcomes for taxpayers.

Non-residents, i.e., persons who only carry on their employment in Switzerland, have until now been subject always and exclusively to withholding tax. There was no possibility for a subsequent rate correction.

New law as of 01 January 2021

The core feature of the new rules is the expansion of ordinary tax assessment, whilst maintaining the prior levy of withholding tax. This means that tax collection is still ensured, whilst on the other hand removing the unequal treatment.

It is now possible for residents with a gross annual income below CHF 120,000 to apply for subsequent ordinary tax assessment. The application must be submitted without exception by 31 March of the year after the relevant tax year. If no application is submitted by that date, the withholding tax applied to the income from gainful activity becomes definitive. This means that a subsequent rate correction is no longer possible under the new law.

Non-residents may also apply for an ordinary tax assessment by 31 March of the following year, provided that they qualify as "quasi residents". This prerequisite is met if the overwhelming proportion (generally, at least 90%) of worldwide income is earned and is thus liable to tax in Switzerland. This calculation must also take account of the spouse's income.

Conclusion

The new statutory rules establish similar rules and comparable treatment, as had been called for, between persons who are liable to withholding tax and those who are subject to an ordinary tax assessment. However, the reform did not fundamentally alter the system of withholding tax, but rather only made some necessary corrections. This issue is still highly complex, and therefore persons who are liable to withholding tax, and their employers, should continue to obtain professional support in future.

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