Switzerland/European Union

*Marcel R. Jung**

The Switzerland-EC Agreement on the Free Movement of Persons: Measures Equivalent to Those in the EC Treaty – A Swiss Income Tax Perspective

Contents

1. Introduction[1]

Switzerland is one of the most European of states. It has four national languages, is a federation of 26 separate cantons, with 27 different tax acts, and the foreign population represents approximately 20% of the total. Switzerland is integrated into Europe not only geographically and culturally, but also economically and legally. Around 400,000 Swiss nationals reside in the European Union. More than 900,000 EU/European Free Trade Association (EFTA) nationals live in Switzerland, around 680,000 of whom hold a permanent residence permit and approximately 170,000 a temporary residence permit. Roughly 180,000 EU/EFTA nationals are cross-border workers, most of whom are employed, with a few self-employed.[2]

Switzerland applied for membership of the European Union in 1992, but as a result of two negative public referenda (on the European Economic Agreement (EEA) in 1992 and the start of accession negotiations in 2001), the issue has fallen into abeyance.[3] Even though Switzerland is not a Member State, the question arises as to whether or not EC law has an effect on Swiss income tax law, in particular in respect of the freedom of persons and services. In the light of the Community principle of equal treatment, the question further arises as to whether or not EU/EFTA nationals must accept "ready-made" instead of "made-to-measure" Swiss income taxation? The purpose of this article is to analyse the scope of this

* **Dr. iur. et lic. oec., LL.M. (Tax), attorney-at-law and Swiss certified tax expert, Bär & Karrer, Zurich. The author can be contacted at m.jung@baerkarrer.ch.**

1. This article follows on from Marcel R. Jung, "Art. 15 of the Switzerland-EC Savings Tax Agreement: Measures Equivalent to Those in the EC Parent-Subsidiary and the Interest and Royalties Directives – A Swiss Perspective", 46 *European Taxation* 3 (2006), p. 112 et seq. and the conference "The EU and Third Countries: Direct Taxation", held in Vienna, Austria, from 12 to 14 October 2006, which considered the effect of EC law on third countries and tax issues arising in the relation to EEA Member States, candidate Member States, countries with a partnership or association agreement with the European Union and certain other countries. For the latter, see Pasquale Pistone, "The Impact of European Law on the Relations with Third Countries in the Field of Direct Taxation", 34 *Intertax* (2006), p. 234 et seq. and Rita Szudoczky, "Vienna Conference on 'The EU and Third States: Direct Taxation'", 47 *European Taxation* 2 (2007), p. 93 et seq.

2. As at 31 December 2004. See Federal Statistical Office at www.bfs.admin.ch.

3. In 2004, the Federal Parliament decided to maintain the application for membership. See Federal Government, Europe Report, Federal Journal, 2006, p. 6825.

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and illustrate how it arises.[4] First, the background of Switzerland's relations with the Community is outlined (see 2.). The relevant Swiss international tax law is then discussed (see 3.). The article continues with an analysis of the interpretation and application of the Agreement of 21 June 1999 on the Free Movement of Persons (AFMP) (see 4.). Finally, the effect on Swiss income tax law is considered (see 5.).

2. Switzerland and the Community

As an economic counterbalance to the EEC, the Convention on Establishing the European Free Trade Association was signed on 4 January 1960.[5] In the light of this, on 22 July 1972, Switzerland signed the Free Trade Agreement with the EEC.[6] Currently, the EFTA Member States are Iceland, Liechtenstein, Norway and Switzerland.

Switzerland obtained access to the "free movement of judgments" by virtue of the Lugano Convention of 16 September 1988 on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters.[7] This is a parallel convention to the Brussels Convention. The Brussels Convention of 27 September 1969 on the Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters was concluded on the basis of Art. 220 of the EEC Treaty (now Art. 293 of the EC Treaty) and entered into force on 1 February 1973 between the original six Member States.[8] It was superseded by Council Regulation (EC) No 44/2001 of 22 December 2000 on Jurisdiction and the Recognition and Enforcement of Judgments in Civil and Commercial Matters.

On 2 May 1992, Switzerland signed the EEA Agreement. On 6 December 1992, however, the ratification of the EEA Agreement was rejected in a referendum. The EEA Agreement was amended by the Agreement of 14 October 2003 on the accession to the EEA of the 10 new Member States which joined the European Union on 1 May 2004.[9] Currently, the EEA Agreement applies between the European Union, its 27 Member States and Iceland, Liechtenstein and Norway (the EEA/EFTA Member States).[10]

Since the rejection of the EEA Agreement in 1992, Switzerland aims to have access to the Single Market by virtue of bilateral agreements. On 21 June 1999, seven bilateral agreements were signed, inter alia regarding the free movement of persons.[11] By virtue of the Vaduz Agreement of 21 June 2001 in respect of the EFTA Convention, Switzerland concluded *measures equivalent* to the free movement of persons with Iceland, Liechtenstein and Norway.[12] On 26 October 2004, Switzerland signed the Protocol to the AFMP on the participation of the 10 new Member States.[13] Transitional periods comparable to those granted to the old 15 Member States were negotiated between the parties.[14] On 26 October 2004, nine further bilateral agreements were signed, inter alia in respect of the avoidance of the double taxation of retired EU officials resident in Switzerland.[15] Art. 15 of the Switzerland-EC Savings Tax Agreement also provides for *measures equivalent* to those in the EC Parent-Subsidiary and the Interest and Royalties Directives.[16]

4. See Pascal Hinny, "Die bilateralen Verträge und ihre Auswirkungen auf unser Steuerrecht", *Der Schweizer Treuhänder* (2000) p. 1147 et seq., "Impact on Swiss Tax Law of the Non-Discrimination Requirement in the EC-Swiss Bilateral Agreements", 41 *European Taxation* 11 (2001), p. 423 et seq., "Das Diskriminierungsverbot des Personenverkehrsabkommens im Schweizer Steuerrecht", *IFF Forum für Steuerrecht* (2004), p. 165 et seq., and "Personenverkehrsabkommen und Schweizer Quellensteuerordnung", *IFF Forum für Steuerrecht* (2004), p. 251 et seq.; Jean-Marc Rivier, "L'égalité devant l'impôt des traivailleurs Suisse et étrangers", 71 *Archiv für Schweizerisches Abgaberecht* (2002), p. 97 et seq.; Andreas Kolb, "Bilaterale Verträge I – Personenfreizügigkeit/Grenzgängerbesteuerung", *IFF Forum für Steuerrecht* (2004), p. 22 et seq.; René Schreiber and Roger Jaun, "EuGH-Urteil zur Wegzugsbesteuerung – eine Chance für die Schweiz?", *Der Schweizer Treuhänder* (2004), p. 769 et seq.; Roger M. Cadosch, "Switzerland: Taxation of Employment Income – Compliance of Swiss Tax Law with the EC Swiss Sectoral Agreement on Free Movement of Persons", 32 *Intertax* (2004), p. 586 et seq. and *The Influence on Swiss tax law of the Swiss-EC agreement on the free movements of persons* (Berne: Stämpfli, 2005); Yves Noel, "*Biehl, Schumacker* … et la Suisse: l'impôt à la source au scanner de la jurisprudence communautaire", in Peter Locher, Bernard Rolli and Peter Spori (eds.), *Internationales Steuerrecht der Schweiz – Festschrift zum 80. Geburtstag von Walther Ryser* (Berne: Stämpfli, 2005), p. 141 et seq.; and Wolfgang Kessler, Klaus Eicker and Ralph Obser, "Die Schweiz und das Europäische Steuerrecht", 14 *Internationales Steuerrecht* (2005), p. 658 et seq. See also Jon Elvar Gudmundsson, "European Tax Law in the Relations with EFTA Countries", 34 *Intertax* (2006), p. 58 et seq.

5. Convention of 4 January 1962 Establishing the European Free Trade Association (EFTA), as amended by the Vaduz Agreement of 21 June 2001, SR 0.632.31.

6. Free Trade Agreement of 22 July 1972 between Switzerland and the European Economic Community, Official Journal (EC), L 300, 31 December 1972, p. 189 = SR 0.632.401. The Commission has recently started a consultation procedure under Art. 27 of the Agreement and has raised the question of whether or not certain corporate tax regimes in some Swiss cantons qualify as State aid.

7. Lugano Convention of 16 September 1988 on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters, SR 0.275.11. The Contracting Parties are Switzerland, the old 15 Member States, Poland, Norway, Iceland and Gibraltar.

8. Council Regulation (EC) No 44/2001 of 22 December 2000 on Jurisdiction and the Recognition and Enforcement of Judgments in Civil and Commercial Matters, Official Journal (EC), L 12, 16 January 2001, p. 1.

9. Agreement of 2 May 1992 on the European Economic Area (EEA Agreement), Official Journal (EC), L 1, 3 January 1994, p. 3, as adjusted by the Protocol of 17 March 1993, Official Journal (EC), L 1, 3 January 1994, p. 572, by virtue of which the reference to the "Swiss Confederation" as a Contracting Party was deleted.

10. The EEA Enlargement Agreement on the accession of Bulgaria and Romania was signed on 25 July 2007 and provisionally applies from 1 August 2007.

11. Agreement of 21 June 1999 between the European Community and its Member States, of the one part, and the Swiss Confederation, of the other, on the Free Movement of Persons, Official Journal (EC), L 114, 30 April 2002, p. 6 = SR 0.142.112.681.

12. The Vaduz Agreement of 21 June 2001 to the EFTA Convention, AS 2003 2685, including the Protocol on the Free Movement of Persons between Switzerland and Liechtenstein. The AFMP and the Vaduz Agreement entered into force on 1 June 2002.

13. Protocol of 26 October 2004 to the Agreement between the European Community and its Member States, of the one part, and the Swiss Confederation, of the other, on the Free Movement of Persons, Official Journal (EC), L 89, 38 March 2006, p. 28 = AS 2006 995. The Protocol entered into force on 1 April 2006.

14. In relation to the old 15 Member States, Cyprus and Malta, and the EFTA Member States, the transitional periods in respect of residence permits for employed and self-employed persons expired with effect from 1 June 2007.

15. Agreement between the Swiss Council and the Commission of the European Communities with a view to avoiding the double taxation of retired officials of the institutions and agencies of the European Communities resident in Switzerland, SR 0.672.926.81. The Agreement entered into force on 31 May 2005.

16. The Agreement of 26 October 2004 between the Community and the Swiss Confederation providing for measures equivalent to those set out in Council Directive 2003/48/EC on taxation of savings income in the form of interest payments and the accompanying Memorandum of Understanding, Official Journal (EC), L 385, 29 December 2004, p. 30. See Jung, note 1. See also Alexandra Storckmeijer, *Cross-border payments between Switzerland and the EU – Analysis under Article 15 of the Swiss-EU Savings Agreement and Article 56 EC Treaty* (Geneva/Zurich/Basle: Schulthess, 2007). See again Peter Riedweg and Reto Heuberger, "Die Quellensteuerbefreiung von Dividenden, Zinsen und Lizenzgebühren nach Art. 15 Zinsbesteuerungsabkommen", *IFF Forum fur Steuerrecht* (2006), p. 29 et seq. and p. 110 et seq.; Stefan Oesterhelt

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On 1 January 2007, Bulgaria and Romania joined the European Union. The effect on Switzerland is that most bilateral agreements are automatically extended to these two Member States.[17] An additional Protocol is, however, required in respect of the AFMP.

3. Swiss Income Tax Law

3.1. Harmonized tax law

The Swiss income tax system has three levels of tax jurisdiction. Federal income tax is levied under the Federal Act of 14 December 1990 on the Federal Direct Tax (DBG).[18] Each of the 26 cantons levies separate income and net wealth taxes. The communes also charge additional income and net wealth taxes. To harmonize the Swiss income tax system, the Federal Parliament introduced the Federal Act of 14 December 1990 on the Harmonization of Income Taxes of Cantons und Communes (StHG).[19] The StHG is a framework law that provides for detailed rules on individual income and net wealth taxes, corporate income and capital taxes, procedural law, and criminal tax law. The tax acts of the cantons must comply with these federal guidelines.

3.2. Social security system

The question arises as to whether contributions to Swiss and foreign social security systems are tax deductible. The Swiss social security system is, therefore, briefly outlined. This rests on three pillars: (1) the old-age, survivors' (AHV) and invalidity insurance (IV), (2) the mandatory and facultative occupational benefit plan (BV) and (3) the voluntary individual retirement account and personal savings.

Individuals who have their domicile in Switzerland or exercise an employment activity in Switzerland are subject to the old-age, survivors' and invalidity insurance. The contributions for employment income are borne equally by Swiss employers and employees, each at a rate of 4.9%.[20] If the employees are not employed by a Swiss employer or a Swiss permanent establishment (PE, or ANOBAG),[21] they are subject to Swiss social security at the rate for self-employed individuals, i.e. at a rate of 9.2%.[22] There is no income cap. The result is an "income tax" for high-income earners. Non-employed individuals pay contributions based on their financial circumstances or, at least, a minimum.[23] Employment income starting from CHF 23,205 up to a maximum amount of CHF 79,560 (*koordinierter Lohn*) is subject to the occupational benefit plan.[24] The contributions are again borne equally by the Swiss employer and the employee, each at graduated, progressive rates of between 3.5% and 9% (depending on the employee's age).[25] If, however, individuals are not employed by a Swiss employer or a Swiss PE, they are not subject to the mandatory occupational benefit plan. Self-employed individuals are entitled to voluntary contributions to the occupational benefit plan. Finally, employed and self-employed individuals are entitled to deduct voluntary payments to individual retirement accounts from gross income. The maximum is CHF 6,365 for individuals who are insured with an occupational benefit plan and CHF 31,824 for individuals without an occupational benefit plan.[26]

3.3. Residence taxation

3.3.1. Unlimited tax liability

Individuals are subject to unlimited tax liability and, therefore, resident for Swiss domestic tax purposes, if they have their domicile or usual abode in Switzerland. Individuals have their domicile in Switzerland if they reside there with the intent of permanently staying. Alternatively, a usual abode in Switzerland is assumed if individuals stay there, notwithstanding temporary interruptions, for at least 30 days and engage in an employment activity or for at least 90 days without such an activity.

Resident Swiss nationals and resident foreign employees who hold a permanent residence permit are taxed by virtue of the ordinary taxation procedure. Taxpayers must file an annual tax return on the basis of which the cantonal tax administration assesses the taxable income and taxable net wealth (the "mixed" assessment proce-

and Maurus Winzap, "Quellensteuerbefreiung von Dividenden, Zinsen und Lizenzen durch Art.15 Zinsbesteuerungsabkommen", 74 *Archiv für Schweizerisches Abgaberecht* (2005), p. 449 et seq.; Robert Danon and Pierre-Marie Glauser, "Cross-border Dividends from the Perspective of Switzerland and the Source State – Selected Issues under Article 15 of the Swiss-EU Savings Agreement", 33 *Intertax* (2005), p. 498 et seq.; and Xavier Oberson, "Agreement between Switzerland and the European Union on the Taxation of Savings – A Balanced '*Compromis Helvétique*'", 59 *Bulletin for International Fiscal Documentation* 3 (2005), p. 108 et seq.

17. See, for example, the Agreement of 26 October 2004 between the Community and the Swiss Confederation providing for measures equivalent to those set out in Council Directive 2003/48/EC on taxation of savings income in the form of interest payments and the accompanying Memorandum of Understanding, Official Journal (EC), L 385, 29 December 2004, p. 30.
18. Federal Act of 14 December 1990 on the Federal Direct Tax (DBG), SR 642.11.
19. Federal Act of 14 December 1990 on the Harmonization of the Direct Taxes of Cantons and Communes (StHG), SR 642.14.
20. Plus military service income replacement, each at a rate of 0.15% and up to a salary of CHF 106,800 unemployment insurance, each at a rate of 1%.
21. Arts. 6(1) and 12(1) of the Federal Act of 20 December 1946 on the Old-age and Survivors' Insurance (AHVG), SR 831.10. The Federal Tribunal noted on 9 April 1984 that administrative practice applies the term "permanent establishment" in Art. 12(1) of the AHVG in a more extensive way for the purposes of the Swiss old-age and survivors' insurance than the term "permanent establishment" for Swiss tax purposes. The Court left the question open as to whether or not this practice complies with Swiss law. See Federal Tribunal, 9 April 1984, *Lehmann gegen Ausgleichskasse des Kantons Zürich und AHV-Rekurskommission des Kantons Zürich*, BGE 110 V 72, Para. 5.b). See again Federal Social Office (*Bundesamt für Sozialversicherung*), *Guidelines on the Collection of the Contributions of the Old-age, Survivors' and Invalidity Insurance* (WBB) (Berne: 1 January 2007), Para. 1022.
22. Plus military service income replacement at a rate of 0.3%. Below a threshold of CHF 53,100, lower rates apply.
23. Old-age, survivors' and invalidity insurance contributions range from CHF 432 to CHF 9,800 and military service income replacement contributions from CHF 13 to CHF 300.
24. Art. 8(1) of the Federal Act of 25 June 1982 on the Occupational Benefit Plan (BVG), SR 831.40, as amended by the Federal Ordinance of 18 April 1984 on Occupational Old-age, Survivors' and Invalidity Insurance (BVV 2), SR 831.441.1, as amended on 22 September 2006, AS 2006 4159. Additional portions of salary may be insured on a facultative basis up to a maximum salary of CHF 795,600. Arts. 79(c) and 8(1) of the BVG, as amended on 22 September 2006.
25. At least 50% of both mandatory and facultative contributions must be borne by the Swiss employer.
26. Art. 7(1) of the Federal Ordinance of 13 November 1985 on the Tax Deductibility of Contributions to Recognized Forms of Individual Retirement Accounts (BVV 3), SR 831.461.3.

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dure). Professional allowances (employment and self-employment expenses), private allowances (administration of assets and real estate maintenance), and general allowances (private debt interest, maintenance payments, contributions to social security system, etc.) are deductible from gross income in determining net income (the principle of objective ability-to-pay). Personal and family allowances (*Sozialabzüge*), which take account of each child maintained by the taxpayer, are deductible from net income in determining taxable income (the principle of subjective ability-to-pay). The cantons may take account of further personal and family allowances.

The income of spouses who do not live separately, de facto or by virtue of law, are aggregated (joint tax return). A special tax bracket mitigates progression. If both spouses derive income from an employment or self-employment activity, special allowances are granted.

3.3.2. Prohibition of inter-cantonal double taxation

The Federal Constitution provides for the principle of the prohibition of inter-cantonal double taxation.[27] From this, the Federal Tribunal has derived the principle of non-discrimination (*Verbot der Schlechterstellung*). Under this rule, a canton may not treat taxpayers who are subject to tax on only part of their income or net wealth less favourably or worse than taxpayers who are subject to taxation on all their income or net wealth.[28]

The Federal Tribunal has established the following allocation rules:[29] (1) expenses that are connected with a particular income item are allocated to the canton that taxes the item, (2) interest expenses are deductible from investment income and, therefore, are apportioned between the cantons in proportion to the assets located in a canton and (3) allowances for personal and family circumstances are apportioned between the cantons in proportion to their taxable income quotas. Accordingly, taxpayers are entitled to pro rata allowances for personal and family circumstances in the source canton.[30]

3.3.3. Allowances for personal and family circumstances

Sec. 6(1) of the Income Tax Act of 8 June 1997 of the Canton of Zurich provides for an allocation rule according to which tax-free allowances (*steuerfreie Beträge*) must be apportioned between the Canton of Zurich and another canton or foreign state in proportion to their taxable income quotas. A similar rule for personal and family circumstances is provided for in Art. 35(3) of the DBG.[31]

The previous allocation rule was in Sec. 7(1) of the old Income Tax Act of 8 July 1951 of the Canton of Zurich. This was at issue in a case before the Commission of Appeal for Tax Matters I of the Canton of Zurich.[32] In this case, Y, an Italian national, became Swiss resident in 1988. He was subject to income tax in Switzerland on approximately 41% of his worldwide income and, in Italy, on around 59%. Y made maintenance payments to his former spouse, who was resident in Italy. The Commission held that tax-free allowances should be treated as personal and family allowances. It noted that the allocation rule follows the federal case law. Next, the Commission argued that maintenance payments should be treated as tax-free allowances. Finally, the Commission held that the allocation rule applied in the cross-border context. Accordingly, the maintenance payments were apportioned between Switzerland and Italy in proportion to their taxable income quotas.

3.3.4. Allowances for professional expenses

In 1984, the tax deductibility of contributions to a foreign social security system was at issue in a case before the Court of Appeal of the Canton of Aargau.[33] In the case, a Swiss national who was resident in Switzerland, but worked as an employee in Germany, paid contributions to the German social security system. The Court held that the non-deductibility of the contributions to the German social security system constituted discrimination. Taking into account the constitutional principle of equal treatment, the Court concluded that contributions to the German social security system were, in contrast to the previous text of the Tax Act of the Canton of Aargau, tax deductible similarly to contributions to the Swiss old-age, survivors' and invalidity insurance.

In another case, the Court of Appeal of the Canton of Aargau held, taking into account the non-discrimination clause in Art. XVIII of the old Switzerland–US tax treaty, that contributions paid to the US social security system by a US national who was resident and worked as an employee in Switzerland for five years were tax deductible, provided that the US social security system is equivalent to the Swiss occupational benefit plan.[34]

27. Art. 127(3) of the Federal Constitution of 18 December 1998, SR 101.
28. Federal Tribunal (*Bundesgericht*), 3 December 1937, *Züfle*, 40 *Zentralblatt für Staats- und Gemeindeverwaltung* (1939), p. 240.
29. Federal Tribunal, 5 July 1978, *X. v. Steuerverwaltungen der Kantone Zug und Zürich*, BGE 104 Ia 256, Para. 4.
30. Federal Tribunal, 2 April 1947, *Jost*, in Kurt Locher, *Die Praxis der Bundessteuern – Das interkantonale Doppelbesteuerungsrecht* (Therwil: Verlag für Gesellschaft und Recht, Cumulative Supplement No. 46, 2006, loose-leaf), § 9 III No. 2. See also Federal Tribunal, 20 May 1983, *Meier v. Steuerrekurskommission Zürich*, *Der Steuerentscheid* (1984) SO A 24.41.3 No. 1 regarding a taxpayer who was entitled to the full allowances for personal and family circumstances in his canton of residence, as he was subject to a separate real estate capital gains tax in the source canton.
31. In contrast to Art. 35(3) of the DBG, the previous allocation rule in Art. 24 of the old Federal Decree of 9 December 1940 on the Federal Income Tax (BdBSt) took professional expenses into account. The Federal Tribunal noted that the tax authorities did not apply that provision in cases in which the expenses are connected with a particular income item. Instead, the principles of the avoidance of inter-cantonal double taxation are applied. See Federal Tribunal, 9 December 1996, *R.W. und M.W. v. Camera di diritto tributario del Tribunale d'appello*, *Der Steuerentscheid* (1998) DBG B 22.3 No. 65, Para. 4.a).
32. Commission of Appeal for Tax Matters I (*Steuer-Rekurskommission I*) of the Canton of Zurich, 5 November 1992, *Y. v. Steuerkommission X Zürich*, *Der Steuerentscheid* (1994) ZH B 11.3 No. 7.
33. Court of Appeal (*Verwaltungsgericht*) of the Canton of Aargau, 21 December 1984, *X. v. Steueramt des Kantons Aargau*, *Der Steuerentscheid* (1985) AG B 27.1 No. 4.
34. Court of Appeal for Tax Matters (*Steuerrekursgericht*) of the Canton of Aargau, 30 December 1988, *X. v. Steueramt des Kantons Aargau*, *Der Steuerentscheid* (1989) AG B 27.1 No. 8, Para. 5.

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3.4. Source taxation

3.4.1. Resident foreign employees with no permanent residence permit

The employment income of foreign nationals who have their domicile or usual abode in Switzerland and are, therefore, resident for Swiss domestic tax purposes, but without a permanent residence permit, is subject to source taxation.[35] Resident foreign employees who receive employment income from an employer abroad and whose remuneration is not borne by a PE are taxed by way of the ordinary taxation procedure, as there is no source taxation procedure applicable.[36]

The source taxation procedure is a simplified and standardized taxation system,[37] which was introduced in the 1960s. In 1990, the federal and cantonal source taxation procedures were harmonized.[38] The harmonized tax law expressly refers to the term "foreign" employees ("*ausländische*" *Arbeitnehmer*), but is limited in scope to foreign employees who do not hold a permanent residence permit.[39] Accordingly, the source taxation procedure is linked directly to foreign nationality.

The Federal Tax Administration has published details of the calculations of the source tax rates.[40] Nevertheless, there is still a lack of transparency as to how the source tax rates are determined.[41] The source tax rate of a particular canton is an aggregation of the federal tax rate and the average of the cantonal and communal tax rates. The source tax rates only take account of lump-sum amounts for professional expenses, social security contributions (old-age, survivors' and invalidity insurance, and occupational benefit plan), insurance premiums (military service income replacement system, unemployment insurance, mandatory accidents insurance, and life and sickness insurance premiums), and personal and family allowances (allowances for each child maintained by the taxpayer).[42] In contrast, resident taxpayers who are taxed by way of the ordinary taxation procedure are entitled to deduct, in particular, actual professional expenses, voluntary contributions to recognized forms of individual retirement accounts, private debt interest and maintenance payments to a former spouse and/or for children.

If the employment income exceeds a threshold (for example, CHF 120,000 for Federal income tax purposes), a subsequent ordinary taxation procedure, i.e. the "mixed" assessment procedure, applies. The withheld tax is credited, without interest, against the ordinary income tax.[43] If the subsequent ordinary taxation procedure does not apply, a correction of the source tax rates applied may be granted by the tax administration on an individual request to take account of allowances not included in the source tax rates.[44]

It should also be noted that the Commission of Appeal for Tax Matters II of the Canton of Zurich held on 24 February 1993 that a taxpayer who has his usual abode in Switzerland and is, therefore, subject to unlimited tax liability and resident for Swiss domestic tax purposes, is entitled to the subsequent ordinary taxation procedure, even if resident abroad for Swiss treaty purposes.[45]

A new source taxation procedure for resident employees has recently been introduced by virtue of the Federal Act of 17 June 2005 on Measures against Illegal Employment.[46] Under this, if employment income does not exceed CHF 19,890, the employment income is subject to a flat-rate tax without taking into account other income, professional expenses or personal and family allowances.[47]

3.4.2. Non-resident individuals and legal entities

The following individuals who have neither their domicile nor usual abode in Switzerland and legal entities who have neither their place of incorporation nor place of effective management in Switzerland and are, therefore, not resident for Swiss domestic tax purposes, are taxed by way of the source taxation procedure if they receive Swiss-source income: (1) employees, (2) international transport employees, (3) artistes, sportsmen and lecturers, (4) members of boards of directors, (5) mortgage creditors, (6) recipients of pensions from an employer or a pension fund based on previous public service, and (7) recipients of payments from Swiss private pension funds.[48] Tax treaties may limit these taxing rights of Switzerland.[49] Particularly in respect of artistes

35. Other income is taxed by way of the ordinary taxation procedure.
36. Art. 6 of the of the Federal Ordinance of 19 October 1993 on Source Taxation of the Federal Income Tax (QStV), SR 642.118.2.
37. It appears that the first source taxation procedure for employment income was introduced in the Canton of Wallis by the Finance Act of 10 November 1903, which was discussed in the Federal Tribunal, 13 September 1912, *Mutti v. Valais*, BGE 38 I 381.
38. Art. 83 et seq. of the DBG and Art. 32 et seq. of the StHG.
39. Spouses who do not live separately, de facto or legally, are taxed by way of the ordinary income taxation procedure if one of the spouses is a Swiss national or holds a permanent residence permit.
40. Federal Tax Administration, Notices of 1 September 2005 and 22 August 2006 on Source Taxation.
41. Four tax brackets apply, i.e. bracket "A" for single taxpayers, bracket "B" for spouses, bracket "C" for spouses who both have employment or self-employment income and bracket "D" for taxpayers with spare-time employment income. See Art. 1(1) of the QStV.
42. Expatriates may claim further allowances for effective expenses. Federal Ordinance of 2 October 2000 on the Deductions for Special Professional Expenses Concerning the Federal Income Tax of Managing Employees and Specialists Temporarily Working in Switzerland (ExpaV), SR 642.118.3.
43. Art. 4(1) of the QStV.
44. Art. 2(e) of the QStV.
45. Commission of Appeal for Tax Matters II (*Steuer-Rekurskommission II*) of the Canton of Zurich, 24 February 1993, *Y. v. Steuerkommission X Zürich*, *Der Steuerentscheid* (1994) ZH B 81.6 No. 1, Para. 3.c). Peter Locher agrees with the entitlement to the subsequent ordinary taxation procedure. He, however, argues that a taxpayer who has his usual abode in Switzerland, but is resident abroad for Swiss treaty purposes, is subject to Swiss limited rather than Swiss unlimited tax liability. See Peter Locher, *Kommentar zum DBG, II. Teil* (Therwil/Basle: Verlag für Recht und Gesellschaft AG, 2004), Introduction to Art. 83 et seq. of the DBG, Para. 12.
46. Federal Journal 2005, p. 4193. The new law will enter into force on 1 January 2008.
47. Arts. 83(1) and 37a of the DBG and Arts. 32(1) and 11(4) of the StHG refer to the minimum annual threshold salary of CHF 19,890 in Art. 7 of the BVG, as amended on 22 September 2006.
48. Art. 91 et seq. of the DBG and Art. 35 et seq. of the StHG.
49. Arts. 15(2) and 15(3), 18 and 19(1) and (2) of the OECD Model. Switzerland has concluded agreements with France, Germany, Italy and Liechtenstein that provide for special taxing rights in respect of frontier workers. Switzerland has recently agreed to delete the frontier worker clause in Art. 15(4) of the Austria–Switzerland tax treaty by virtue of the amending protocol of 21

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and sportsmen, treaty law generally, however, assigns the taxing right to Switzerland if those persons exercise their activities there.[50]

The first two taxpayer categories are generally taxed under the same source taxation procedure as resident foreign employees without a permanent residence permit. The subsequent ordinary taxation procedure does not, however, apply. In particular, employees who stay only for a brief period in Switzerland (*für kurze Dauer*), frontier workers who work in Switzerland (*Grenzgänger*) and employees who work in Switzerland and return weekly (*Wochenaufenthalter*) are expressly subject to the source taxation procedure.[51] According to administrative practice, frontier workers and employees who return weekly are also subject to the source taxation procedure if they stay, notwithstanding temporary interruptions, for at least 30 days in Switzerland and, therefore, have their usual abode in Switzerland. In this case, however, they are, in principle, subject to Swiss unlimited tax liability, and, therefore, resident for Swiss domestic tax purposes.[52]

Artistes, sportsmen and lecturers are taxed by way of separate progressive tax brackets on gross income. A 20% lump-sum deduction or a deduction of actual professional expenses is granted.[53] No allowances for personal and family circumstances are granted. The source taxation procedure applies, regardless of whether or not the artiste, sportsman or lecturer is employed or self-employed and whether or not the remuneration is paid to another person who organizes the activity.

The final four categories of taxpayers are subject to a separate proportional tax rate. No allowances for professional expenses or personal and family circumstances are granted.

3.4.3. Joint liability

The person who owes the taxable income is required to withhold the source tax if the taxable income becomes due and to pay over the taxes periodically to the cantonal tax administration (*Zahlungssubstitution*). That person is also subject to joint liability (*Mithaftung*) in respect of the payment of the source tax.[54] As that person becomes party to the source taxation procedure (*Steuersubstitution*), that person must be subject to unlimited or limited tax liability in Switzerland.[55] Additionally, in respect of artistes, sportsmen and lectures, promoters charged with the presentation in Switzerland are jointly and severally liable (*solidarische Mithaftung*) for the source tax.[56] This joint liability appears not to be limited to persons having a tax affiliation with Switzerland.

Under the new Swiss-source taxation procedure, as introduced by the measures against illegal employment, the person who owes the taxable income is required to withhold the source tax if the taxable income becomes due and to pay over the taxes periodically to the cantonal social security administration. The new law does not also provide for joint liability.

3.4.4. Equal treatment and non-discrimination

3.4.4.1. Equal treatment under the Federal Constitution

In 1962, the Federal Tribunal held that the source taxation procedure of the Canton of St. Gallen violated the constitutional principle of equal treatment.[57] The Court stated that the procedure treated, without any objective reasons, foreign nationals who were resident but did not hold a permanent residence permit differently from both foreign nationals with a permanent residence permit and resident Swiss nationals. It was noted that the purpose of the source taxation procedure is the facilitation of taxation of individuals who stay only for a brief duration in the canton. The Court, however, held that such a purpose could not justify the different tax treatment. It was emphasized that difficulties could arise from the brief duration of presence in the Canton, but not from the lack of a residence permit. The Court argued that an objective reason for the application of a source taxation procedure could be lack of residence in the Canton. Finally, the Court concluded that resident foreign nationals without a permanent residence permit were in the same position as resident foreign nationals with a permanent residence permit and resident Swiss nationals.[58]

Three years later, the Federal Tribunal confirmed its previous ruling insofar as the source taxation procedure of the Canton of Aargau constituted unequal treatment.[59] The Court, however, reconsidered the justification argument. In this case, the Court held that the tax administration could not always clarify the question of residence of foreign employees. In 1964, approximately 720,900 frontier workers and foreign employees without a permanent residence permit worked in Switzerland. The Court noted that there was an increasing number of foreign employees who left Switzerland without paying taxes. It was concluded that the unequal treatment was

March 2006, Federal Journal 2006, p. 5167. The amending protocol entered into force on 2 February 2007 and, in general, applies with retroactive effect from 1 January 2006.

50. See Art. 17 of the OECD Model.

51. Art. 91 of the DBG requires that individuals have neither their domicile nor usual abode in Switzerland and that legal entities have neither their place of incorporation nor place of effective management in Switzerland, and refers not only to employees who stay only for a brief period in Switzerland (*für kurze Dauer*) but also to frontier workers who work in Switzerland (*Grenzgänger*) and employees who work in Switzerland and return weekly (*Wochenaufenthalter*).

52. See Felix Richner, Walter Frei, Stefan Kaufmann and Hans Ulrich Meuter, *Kommentar zum harmonisierten Steuergesetz*, 2nd edition (Zurich: Schulthess, 2006), § 3 Paras. 74 and 75, § 94 Para. 14. See again note 45.

53. Art. 92 of the DBG, Art. 35(1)(b) of the StHG and Art. 7(3) of the QStV.

54. Art. 88(1) and (3) and Art. 100(1) and (2) of the DBG, and Art. 37(1) of the StHG.

55. Ernst Blumenstein and Peter Locher, *System des schweizerischen Steuerrechts*, 6th edition (Zurich: Schulthess, 2002), p. 77.

56. Art. 92(4) of the DBG.

57. Federal Tribunal, 21 March 1962, *O.R/Arbeitgeber-Vereinigung Rheintal und E.K./Arbeitgeber-Verband Rorschach v. Regierungsrat des Kantons St. Gallen*, 32 *Archiv für Schweizerisches Abgaberecht* (1963/64), p. 199.

58. In the author's view, this argument is similar to the concept in Art. 24(1) of the OECD Model, according to which residents and non-residents are not in the same circumstances.

59. Federal Tribunal, 12 May 1965, *Minister v. Grosser Rat des Kantons Aargau*, BGE 91 I 81.

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justified, in particular, on the grounds of *the need to safeguard the collection of taxes*.

In 1970, the Federal Tribunal held that the source tax rates of the Canton of Zurich also constituted unequal treatment.[60] The Court held that such a procedure was, however, justified on grounds of objective reasons. Specifically, the Court referred to August Reimann, the then chairman of the Tax Administration of the Canton of Zurich, who noted that the ordinary taxation procedure is made-to-measure (*Massarbeit*) and the source taxation procedure is ready-made (*Konfektion*).[61] The Court concluded that the source taxation procedure could only be implemented by way of lump-sum tax rates.

Resident taxpayers who are taxed by way of the ordinary taxation procedure are entitled to deduct professional expenses from gross income, in particular necessary expenses for travel between home and work and necessary additional expenses for food when away from home. These allowances were at issue in a case decided by the Federal Tribunal in 1996.[62] In this case, R.W., a Swiss national, and his spouse M.W., an Italian national, were resident in Italy. R.W. worked as an employee in the Canton of Ticino and returned to his home in Italy once a week. Under the Italy–Switzerland tax treaty, he was subject to source taxation in Switzerland. The Court held that an employee who was resident abroad but worked in Switzerland and returned home once a week is also entitled to those allowances.

The Federal Tax Administration stated in Circular No. 1 of 30 January 1986 that the counterpart of the tax deductibility of contributions to occupational benefit plan is the taxation of the benefits.[63] According to Circular No. 2 of 31 January 1986, the tax deductibility of contributions paid to recognized forms of individual retirement accounts requires that the taxpayer is subject to both unlimited tax liability in Switzerland and Swiss old-age, survivors' and invalidity insurance.[64] In a case decided in 1992, the Federal Tribunal, however, rejected this requirement.[65] In this case, B was an Italian national and resident for Swiss treaty purposes in Italy, but worked as a computer engineer in the Canton of Ticino. He was subject both to Swiss old-age, survivors' and invalidity insurance and Swiss occupational benefit plan. B was taxed by way of the source taxation procedure, but was entitled to the subsequent ordinary taxation procedure, apparently because he had his usual abode in Switzerland.[66] The Court held that a frontier worker was entitled to deduct voluntary contributions paid to recognized forms of individual retirement accounts from his Swiss gross employment income.[67] It was also held that the deduction could not be rejected on grounds that the future benefits of the plan could not be taxed, as B was resident in Italy. In other words, the Court rejected the justification on grounds of the need for fiscal coherence.[68] The Federal Tribunal requested the Federal Tax Administration to amend Circular No. 2 and to inform the public that the relevant clause of that Circular was invalid. The Circular has, however, not yet been amended.

In this respect, it should be noted that Switzerland signed an amending protocol to the Switzerland–UK tax treaty on 26 June 2007.[69] The protocol contains measures relating to pensions, under which pension contributions paid to a scheme recognized for tax purposes in one state may, under certain conditions, be deductible in the other state.

3.4.4.2. Non-discrimination in tax treaties

All the tax treaties that Switzerland has concluded with the Member States, except for those with Cyprus and Malta, provide for a non-discrimination clause based on Art. 24(1) of the OECD Model Convention (hereinafter: the OECD Model).[70] Under Para. 4 of the Commentary on Art. 24(1) of the OECD Model, "the underlying question is whether two persons who are residents of the same State are being treated differently solely by reason of having different nationality". J.F. Avery Jones et al. have criticized this on the basis that there is considerable reluctance on the part of courts and tax administrations to accept that a national tax law provision is contrary to the non-discrimination article.[71] These authors emphasize that the wording of Art. 24(1) of the OECD Model, which refers to similar rather than identical circum-

60. Federal Tribunal, 28 January 1970, *Y. v. Kanton Zürich und Verwaltungsgericht des Kantons Zürich*, BGE 96 I 45.
61. August Reimann, "Die Quellensteuer für erwerbstätige Ausländer", 67 *Zentralblatt für Staats- und Gemeindeverwaltung* (1966), p. 102. Klaus Tappolet, however, raised the question of whether or not the residence permit is a suitable criterion to distinguish between taxpayers who cause difficulties in the collection of taxes from those who do not cause such difficulties. See Klaus Tappolet, "Verstösst die Quellenbesteuerung ausländischer Arbeitnehmer gegen staatsvertragliche Gleichbehandlungsklauseln?", in Markus Reich and Martin Zweifel (eds.), *Das Schweizerische Steuerrecht: Festschrift zum 70. Geburtstag von Ferdinand Zuppinger* (Berne: Stämpfli, 1989), p. 632.
62. Federal Tribunal, 9 December 1996, *R.W. und M.W. v. Camera di diritto tributario del Tribunale d'appello, Der Steuerentscheid* (1998) DBG B 22.3 No. 65.
63. Federal Tax Administration, Circular No. 1, 30 January 1986, Para. IV.
64. Federal Tax Administration, Circular No. 2, 31 January 1986, Para. 2.
65. Federal Tribunal, 21 June 1992, *B. v. Camera di diritto tributario del Tribunale di Appello*, *Der Steuerentscheid* (1992), BdBSt B 27.1 No. 14.
66. See 3.4.1.
67. In contrast, in another case, the Federal Tribunal noted by way of an obiter dictum that the tax deductibility of contributions paid to occupational benefit plan by an employee requires that the taxpayer is subject to *unlimited tax liability* in Switzerland. See Federal Tribunal, 19 February 2001, *X. v. Steueramt des Kantons Bern*, *Der Steuerentscheid* (2001) DBG B 27.1 No. 25, Para. 5.c)aa).
68. See 4.3.2. See also ECJ, 28 January 1992, Case C-204/90, *Hanns-Martin Bachmann v. Belgian State*, Para. 21 and ECJ, 11 August 1995, Case C-80/94, *G.H.E.J. Wielockx v. Inspecteur der Directe Belastingen*, Para. 25.
69. The amending protocol is still subject to parliamentary approval. At the time of writing, the text of the protocol has not yet been published.
70. Switzerland has concluded the Exchange of Letters of 30 March 1987 on the taxation of shipping and air transport with Malta. SR 0.672.954.55. There is no double tax treaty with Cyprus. Art. 15 of the Switzerland-EC Savings Tax Agreement, however, also applies in relation to those two Member States. The Agreement of 26 October 2004 between the Community and the Swiss Confederation providing for measures equivalent to those set out in Council Directive 2003/48/EC on taxation of savings income in the form of interest payments and the accompanying Memorandum of Understanding, Official Journal (EC), L 385, 29 December 2004, p. 30.
71. J.F. Avery Jones et al., "The Non-discrimination Article in Tax Treaties", 31 *European Taxation* 10 (1991), p. 345.

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stances, has enabled courts and tax administrations to argue that the provision does not apply in various cases, due to supposed differences in factual circumstances.[72]

In 1988, the question arose as to whether or not the source taxation procedure of the Canton of Zurich, insofar as it applies for federal income tax purposes, complied with the Federal Constitution.[73] The old Federal Decree of 9 December 1940 on the Federal Income Tax (BdBSt) did not expressly provide for a source taxation procedure. That source taxation procedure was also challenged under Art. 25(1) of the Germany–Switzerland tax treaty.

The Commission of Appeal for the Federal Income Tax quoted Ferdinand Zuppinger, who in turn referred to August Reimann.[74] Both took the view that the principle of non-discrimination in tax treaties must be interpreted in the same way as the constitutional principle of equal treatment.[75] As, however, different tax treatment on grounds of nationality constitutes a prohibited discrimination, the Commission concluded that there were serious doubts as to whether or not the source taxation procedure complied with the treaty law. The Commission also raised doubts as to whether or not the case law of the Federal Tribunal regarding source taxation procedures under the principle of equal treatment of the Federal Constitution could be upheld in a new case. The Commission, however, emphasized that the non-application of the source taxation procedure would mean that approximately 50,000 foreign employees would have to be taxed by way of the ordinary taxation procedure. On grounds of technical and administrative difficulties, the Commission concluded that the source taxation procedure had to apply, even if unconstitutionally.

In 1992, the source taxation procedure of the Canton of Zurich was again challenged under Art. 24(1) of the Japan–Switzerland tax treaty.[76] The Court of Appeal of the Canton of Zurich held that the principle of equal treatment (*Gleichbehandlung*) in Art. 24(1) of the Japan–Switzerland tax treaty only applies in the same circumstances and has no wider meaning than the constitutional principle of equal treatment. Accordingly, the Court concluded that the source taxation procedure complied with treaty law.

In the author's view, the Swiss-source taxation procedure for resident foreign employees who do not hold a residence permit cannot be justified on the grounds of administrative difficulties and/or the need to safeguard the collection of taxes.[77] The procedure does not comply with Swiss treaty law.[78] Art. 24(1) of the OECD Model contains a rule of non-discrimination rather than equal treatment. The German term "*Gleichbehandlung*" as a heading for Art. 24 of the OECD Model and the term "principle of equal treatment" that is used in the Commentary are too broad.[79] Any discrimination linked to foreign nationality constitutes a prohibited discrimination. Such discrimination cannot be justified. In contrast to the federal constitutional principal of equal treatment, Art. 24(1) of the OECD Model contains an absolute non-discrimination provision. In this respect, Art. 24(1) of the OECD Model is stricter than the Community principle of equal treatment.[80] In contrast to the EC law concept, Art. 24(1) of the OECD Model, however, only covers direct discrimination.[81] Art. 24(1) of the OECD Model establishes the principle that nationals of a Contracting State may not be less favourably treated in the other Contracting State than nationals of the latter State in the same circumstances.[82] The underlying question of this clause is "whether two persons who are residents of the same state are being treated differently solely by reason of having different nationality".[83] The object of this clause is to prevent discrimination in one state against the nationals of the other and, therefore, does not cover discrimination against own nationals (reverse discrimination).[84] Similarly, it appears that the EC law concept does also not cover reverse discrimination.[85]

In 2000, the Federal Tribunal decided a case under the Italy–Switzerland tax treaty regarding the source taxation procedure for non-resident employees.[86] Specifically, the source tax rates do not take account of mainte-

72. Id., p. 312. For example, with regard to the source taxation procedure for resident foreign nationals who do not hold a permanent residence permit, Danielle Yersin argues that "les contribuables sont dans une *situation différente* des assujettis suisse ou bénéficiant d'un permis d'établissement, ce qui justifie une simplification de leur imposition", in "L'égalité de traitement en droit fiscal", 111 *Zeitschrift des Bernischen Juristenvereins* (1992), p. 255. See in 3.4.4.2., however, the absolute nature of the non-discrimination principle in the treaty context.

73. Commission of Appeal for the Federal Income Tax (*Bundessteuer-Rekurskommission Zürich*) of the Canton of Zurich, 21 December 1998, *X. v. Abteilung Direkte Bundessteuer des Kantons Zürich*, *Der Steuerentscheid* (1989), BdBSt B 81.4 No. 1.

74. Ferdinand Zuppinger, "Einige grundsätzliche Überlegungen zur Zürcherischen Quellensteuer", 42 *SteuerRevue* (1967), p. 240 et seq. and Reimann, note 61.

75. Reimann, note 61, p. 100 and Zuppinger, note 74, p. 241.

76. Court of Appeal (*Verwaltungsgericht*) of the Canton of Zurich, 3 March 1992, *X. und Y. v. Rekurskommission III des Kantons Zürich*, *Zürcher Steuerpraxis* (1992), p. 135.

77. See Avery Jones et al., note 71 and Klaus Vogel and Moris Lehner, *Doppelbesteuerung der Bundesrepublik Deutschland auf dem Gebiet der Steuern vom Einkommen und Vermögen, Kommentar auf der Grundlage der Musterabkommen*, 4th edition (Munich: Beck, 2003), Paras. 4 and 14 to Art. 24. In contrast, with regard to the source taxation procedure for resident foreign nationals who do not hold a permanent residence permit, Yersin, note 72, argues that "les contribuables sont dans une situation différente des assujettis suisse ou bénéficiant d'un permis d'établissement, ce qui *justifie* une simplification de leur imposition." See in 3.4.4.2., however, the absolute nature of the non-discrimination principle in the treaty context.

78. See Tappolet, note 61, p. 633; Marco Duss, "Verfassungs- und DBA-widrige Quellen-Bundessteuer", 44 *SteuerRevue* (1989), p. 305 et seq.; Walter H. Boss, "Switzerland – National Report", in International Fiscal Association, "Non-discrimination rules in international taxation", *Cahiers de Droit Fiscal International*, Volume LXXVIIIb (The Hague, Kluwer, 1993), p. 674 et seq.; and Vogel and Lehner, note 77, Para. 58 to Art. 24. In contrast, Marco Möhr takes the view that the source taxation procedure for resident foreign employees is not directly linked to the foreign nationality and, therefore, does not violate the non-discrimination clause in tax treaties, *Die Bedeutung der Staatsangehörigkeit der natürlichen Person im schweizerischen Steuerrecht* (St. Gallen: Digitalis, 2002), p. 155 et seq.

79. Vogel and Lehner, note 77, Para. 3 to Art. 24.

80. See. 4.3.1.

81. Vogel and Lehner, note 77, Paras. 5 and 16 to Art. 24.

82. See Para. 9 of the Commentary on Art. 24 of the OECD Model.

83. See id., Para. 4.

84. See id., Para. 9.

85. See 4.3.2. and note 157.

86. Federal Tribunal, 31 January 2000, *A. v. Kanton Ticino*, 55 *SteuerRevue* (2000), p. 438 et seq.

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nance payments to a former spouse and/or for children. The Court held that personal and family circumstances, in particular maintenance payments that are not directly connected with the income taxed at source, must be taken into account in the state of residence.[87] It was also held that this is not a prohibited discrimination under Art. 25(1) of the Italy–Switzerland tax treaty.

In the light of the interpretation and application of the principle of equal treatment in the AFMP, the question arises as to whether or not Swiss treaty law should adopt an interpretation of Art. 24(1) of the OECD Model that takes account of the AFMP.[88] The principle of equal treatment in the AFMP prevails over the non-discrimination clauses in Swiss tax treaties (lex posterior derogat legi priori).[89] There are, however, significant differences between the treaty concept and EC law.[90] The Community interpretation rules can generally not be applied to Art. 24(1) of the OECD Model.[91] Nevertheless, the treaty principle may be interpreted based on EC law, but only insofar as it is necessary to implement the provisions of the AFMP.

3.5. Exit taxation

Swiss resident individuals who hold shares in Swiss or non-Swiss companies as part of their private assets realize a tax-free capital gain on the sale of the shares.[92] In contrast, Swiss resident individuals or non-Swiss resident individuals who hold the shares as part of a trade or business or Swiss PE are subject to Swiss income tax on realized capital gains.[93] The transfer of business assets to a PE in another canton is tax-neutral and, therefore, taxed on a realization basis.[94] The transfer of business assets to a PE abroad is, however, treated as a deemed sale (*steuerliche Entstrickung*).[95] Similarly, the transfer of residence abroad by Swiss resident individuals who hold business assets (sole proprietorship and partnerships) gives rise to a deemed sale, unless the business assets can be attributed to a Swiss PE immediately after the transfer. The taxpayer is liable to tax simply by reason of the transfer of business assets or his residence abroad and, therefore, taxed on an accrual basis. In the light of the European Court of Justice (ECJ) cases of *Lasteyrie du Saillant*[96] and "*N*",[97] the question arises as to whether or not this immediate exit taxation based on an accrual basis constitutes a restriction prohibited by the freedom of establishment for self-employed persons in the AFMP.[98]

4. Interpretation and Application of the AFMP

4.1. Legal nature and structure

4.1.1. Public international law

The AFMP was concluded between Switzerland and the European Union and its Member States. It is a "mixed agreement" under EC law.[99] From the Swiss perspective, the AFMP is an integral part of Swiss law. According to monistic theory, international law and national law are together part of one legal order.[100] The Vienna Convention on the Law of Treaties (hereinafter: the Vienna Convention) applies to the AFMP mutatis mutandis.[101] The Federal Tribunal has ruled that the provisions on the free movement of persons are sufficiently precise and clear and, therefore, self-executing.[102]

4.1.2. Freedom of persons and services

The AFMP contains a preamble, 25 articles, three annexes, several protocols and the Final Act.[103] The purpose of the agreement is to (1) grant a right of entry, residence, access to work as employed persons, the establishment of self-employed persons and the right to stay in the territory of the Contracting Parties after the end of the economic activity (Arts. 3, 4 and 7(c) AFMP), (2) facilitate the provision of services in the territory of the Contracting Parties, in particular to liberalize the provision of services of a brief duration (Art. 5 AFMP), (3) grant a right of entry into, and residence in, the territory of the Contracting Parties to persons without an economic activity in the host state (Art. 6 AFMP) and (4) grant the same living, employment and working conditions as those for nationals (Art. 7(a) AFMP).

In other words, EU and Swiss nationals may access the benefits of the Agreement if they are (1) employed individuals, (2) self-employed individuals, (3) individuals or

87. See Para. 38 et seq. of the Commentary on Art. 23A and 23B of the OECD Model.
88. See 4.3.1. Robert Waldburger, "Rechtsprechung im Jahr 2000", *IFF Forum für Steuerrecht* (2001), p. 163 et seq.
89. Art. 30(2) of the Vienna Convention.
90. See 4.3.
91. Vogel and Lehner, note 77, Para. 17 to Art. 24.
92. Art. 16(3) of the DBG and Art. 7(4)(b) of the StHG. It should be noted that capital gains may be re-characterized as dividend income. See, for example, Art. 20a(1)(a) and (b) of the DBG and Art. 7a(1)(a) and (b) of the StHG.
93. Art. 18(2) of the DBG and Art. 8(1) of the StHG.
94. Art. 18(2) e contrario of the DBG and Art. 8(1) e contrario of the StHG. See also Federal Tribunal, 27 April 1990, *X. AG v. Kantonales Steuergericht Solothurn*, BGE 116 Ia 81 regarding the previous exit taxes that applied to inter-cantonal transfers.
95. Arts. 18(2) and 4(1)(b) of the DBG and Arts. 8(1) and 4(1) of the StHG. See Marcel R. Jung, *Steuerneutrale Unternehmens-Umstrukturierungen im harmonisierten Steuerrecht* (Basle/Geneva/Munich: Helbing & Lichtenhahn, 2004), p. 273 et seq.
96. ECJ, 11 March 2004, Case C-9/02, *Hughes de Lasteyrie du Saillant v. Ministère de l'Économie, des Finances et de l'Industrie*.
97. ECJ, 7 September 2006, Case C-470/04, *N v. Inspecteur van de Belastingdienst Oost/kantoor Almelo*.
98. Schreiber and Jaun, note 4, p. 774.
99. See ECJ, Advocate General Colomer's Opinion, 6 June 2006, Case C-339/05, *Zentralbetriebsrat der Landeskrankenhäuser Tirols v. Land Tirol*, Para. 8; Nanette A. Neuwahl, "Joint Participation in International Treaties and the Exercise of Power by the EEC and its Member States: Mixed Agreements", 28 *Common Market Law Review* (1991), p. 717 et seq.; and Stephan Breitenmoser, "Sectoral Agreements between the EC and Switzerland: Contents and Context", 40 *Common Market Law Review* (2003), p. 1151 et seq.
100. Breitenmoser, note 99, p. 1145 et seq.
101. Vienna Convention on the Law of Treaties, signed by Switzerland on 23 May 1969 and entered into force on 6 June 1990, SR 0.111. See Astrid Epiney, "Zur Bedeutung der Rechtsprechung des EuGH für Anwendung und Auslegung der Personenfreizügigkeitsabkommens", 141 *Zeitschrift des Bernischen Juristenvereins* (2005), p. 8, footnote 13, and Thomas Cottier and Erik Evtimov, "Die sektoriellen Abkommen der Schweiz mit der EG: Anwendung und Rechtsschutz", 139 *Zeitschrift des Bernischen Juristenvereins* (2003), p. 106 et seq.
102. Federal Tribunal, 17 January 2003, *A.X. v. Regierungsrat und Verwaltungsgericht des Kantons Zürich*, BGE 129 II 249, Para. 3.3.
103. Annex I addresses the freedom of persons and services, Annex II the coordination of social security, and Annex III the mutual recognition of professional qualifications.

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companies that provide or receive services, in particular of a brief duration or (4) individuals who do not pursue an economic activity.[104] The right of establishment of companies in Arts. 43 and 48 and the free movement of capital in Art. 56 of the EC Treaty are not taken into account.[105] As noted in 2., Art. 15 of the Switzerland-EC Savings Tax Agreement, however, provides for *measures equivalent* to those in the EC Parent-Subsidiary and Interest and Royalties Directives.[106]

The Treaty of Maastricht on the European Union introduced in Arts. 8 and 8a of the EEC Treaty (now Arts. 17 and 18 of the EC Treaty) EU citizenship and the right to move and reside freely within the territory of the Member States subject to limitations and conditions set out in the EC Treaty and by the measures adopted to give it effect.[107] The AFMP also takes account of the right of entry and residence of persons without an economic activity. EC law requires that persons not pursuing an economic activity have sufficient means of existence and comprehensive sickness insurance. These requirements are set out in Art. 24(1) of Annex I of the AFMP.

The right to reside permanently in Switzerland is still governed by Swiss domestic law and international conventions on establishment.[108] Under supplementary agreements to international conventions on establishment and administrative practice, nationals of the old 15 Member States and the three EFTA Member States residing in Switzerland generally receive a permanent residence permit after five years. In contrast, nationals of the other 12 new Member States generally receive a permit after 10 years.[109]

4.1.3. Accompanying measures on social security

Under Art. 8 of the AFMP and Art. 2 of Annex II of the AFMP, the Contracting Parties agreed to apply the Community acts to which reference is made, as in force at the date of signature of the Agreement and as amended by Section A of Annex II, or rules equivalent to these acts. In particular, reference is made to Council Regulations (EEC) No. 1408/71 and No. 574/72.[110] This means that gainfully employed persons are, in general, subordinated to the social security system of one state, even if they work in more than one state.[111] As a rule, EU and Swiss nationals who are gainfully employed in only one state must contribute to the social security system in that state, even if they are resident in another state. If they work in more than one state and reside in one of those states they must contribute to the social security system of their country of residence.[112] A non-Swiss employer who employs an individual in Switzerland is, in general, subject to Swiss social security contributions, even though the non-Swiss employer has no place of business in Switzerland.[113] These rules cover, in particular, old-age, survivors' and invalidity insurance, the occupational benefit plan, unemployment insurance, accidents insurance, and sickness insurance.

From 1 June 2002, the liability to contribution to the Swiss old-age, survivors' and invalidity insurance is extended to income derived from an enterprise or PE in a Contracting State.[114] For example, a Swiss national who is resident in Switzerland and carries on his business in a

104. Art. 5(3) of the AFMP and Art. 23 of Annex I of the AFMP state that nationals of a Member State or Switzerland entering the territory of a Contracting Party solely to receive services have the right of entry and residence. Prima facie, it appears that the freedom to receive services is granted to individuals only. In the author's view, in the light of the objective of the AFMP, it is, however, doubtful whether or not the scope of the freedom of services in respect of companies is limited to the provision of services only.

105. The Federal Tribunal held in a case regarding the question of beneficial ownership under the Denmark–Switzerland tax treaty by way of an obiter dictum that the AFMP does not take account of the freedom of establishment of companies. See Federal Tribunal, 29 November 2005, *A. Holding ApS v. Eidg. Steuerverwaltung*, 2A.239/2005, Para. 3.5.2. In contrast, Art. 23 et seq. of the EFTA Convention provides for the freedom of establishment of companies and Art. 28 for the free movement of capital.

106. See note 16 and Storckmeijer (also note 16) who points out that Art. 15 of the Switzerland-EC Savings Tax Agreement is required to be interpreted and applied in conformity with the free movement of capital and the protection of the free movement of capital conferred by Art. 56 of the EC Treaty, note 16, p. 106.

107. The Treaty on the European Union, signed on 7 February 1992 in Maastricht, entered into force on 1 November 1993, Office for Official Publication of the European Communities, Luxembourg, 1992. See also Directive 2004/38/EC of the European Parliament and of the Council of 29 April 2004 on the right of citizens of the Union and their family members to move and reside freely within the territory of the Member States amending Regulation (EEC) No 1612/68 and repealing Directives 64/221/EEC, 68/360/EEC, 72/194/EEC, 73/148/EEC, 75/34/EEC, 75/35/EEC, 90/364/EEC, 90/365/EEC and 93/96/EEC, Official Journal (EC), L 158, 30 April 2004, p. 77.

108. Federal Tribunal, 6 January 2004, *X. v. Eidg. Justiz- und Polizeidepartement*, BGE 130 II 49, Para. 4.2.

109. The Federal Government considers whether the five-year period should be extended in relation to the new Member States.

110. Council Regulation (EEC) No. 1408/71 of 14 June 1971 on the application of social security schemes to employed persons, to self-employed persons and to the members of their families moving within the Community, Official Journal (EC), L 149, 5 July 1971, p. 2 = SR 0.831.109.268.1 and Council Regulation (EEC) No. 574/72 of 21 March 1972 fixing the procedure for implementing Regulation (EEC) No. 1408/71 on the application of social security schemes to employed persons and their families moving within the Community, Official Journal (EC), L 074, 27 March 1972, p. 1 = SR 0.831.109.268.11.

111. Annex VII of the Council Regulation (EEC) No. 1408/71 lists the circumstances in which a person is simultaneously subject to the legislation of two Member States. By virtue of the last but one paragraph p) of Sec. A(1) of Annex II of the AFMP, Switzerland added the circumstance in which an individual pursues a self-employment activity in Switzerland and an employment activity in another Contracting State.

112. If they reside in none of the states in which they work, they must contribute to the system of the state in which they carry on their principal work or in which their employer's head office is located. Special rules apply to persons who are sent to another state on a short secondment. EU and Swiss nationals who are sent to Switzerland on a short secondment by a firm whose head office is in a Member State remain insured with the system of the Member State in which their employer's head office is located. This only applies, however, when the secondment is for not longer than 12 months. In case of a longer secondment, an application can be made in order to continue with the same social security system.

113. Federal Social Office (*Bundesamt für Sozialversicherung*), *Guidelines on the Compulsory Coverage of the Basic Pension and Invalidity Insurance* (WVP) (Berne: 1 January 2007), Para. 2023. Art. 8 of the AFMP states that the Contracting Parties will make provision, in accordance with Annex II, for the coordination of social security systems with the aim, in particular, of fostering mutual administrative assistance and cooperation between authorities and institutions. An employer who has no place of business in Switzerland in whose territory the employee is employed may arrange for that worker to act on his behalf regarding the payment of contributions. In this case the employee is subject to Swiss social security at the rate for self-employed individuals (ANOBAG). See Art. 109 of the Council Regulation (EEC) No. 574/72 of 21 March 1972 fixing the procedure for implementing Regulation (EEC) No. 1408/71 on the application of social security schemes to employed persons and their families moving within the Community, Official Journal (EC), L 323, 13 December 1996, p. 38 = SR 0.831.109.268.11.

114. Art. 6ter(a) of the Federal Ordinance of 31 October 1947 on the Old-age and Survivors' Insurance (AHVV), SR 831.101, as amended on 18 October 2000, AS 2002 1351.

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Member State through a PE is liable to Swiss old-age, survivors' and invalidity insurance in respect of both Swiss and foreign- source income. The contributions are deductible from gross income on a pro rata basis in Switzerland and in the Member State.[115] Those not gainfully employed are not covered by the AFMP, unless they are family members or surviving dependants of persons who are or were gainfully employed, whatever their nationality.[116]

4.2. Reference to EC law and ECJ case law

The Preamble of the AFMP states that the Contracting Parties intend to introduce the free movement of persons "on the basis of the rules applying in the EC". Art. 16(1) of the AFMP states that the Contracting Parties will take all measures necessary to ensure that rights and obligations "*equivalent to those contained in the legal acts of the EC*" to which reference is made in the Agreement (*acquis communautaire*). Under Art. 16(2) of the AFMP, insofar as the application of the Agreement involves "concepts of Community law", account is taken of the relevant case law of the ECJ "prior" to the date of its signature.[117] Specifically, Art. 16(2) of the AFMP states that case law after date of signature will be brought to Switzerland's attention. At the request of either Contracting Party, a Joint Committee determines the implications of this case law.

There are an increasing number of cases decided by the Federal Tribunal regarding the right of residence and the coordination of social security systems.[118] The Federal Tribunal concluded that the interpretation of the AFMP must take into account ECJ case law in respect of the equivalent provisions of EC law prior to the signature of the AFMP. ECJ case law after this date is not binding,[119] but may be taken into account, unless objective arguments as set out in the AFMP are against it.[120] In the author's view, ECJ case law after the date of signature that deals with the "concepts of Community law" that were already established prior to the date of signature must be taken into account.[121] Under Art. 31(1) of the Vienna Convention, a treaty should also be interpreted in good faith and in the light of its object and purpose. Accordingly, ECJ case law after the date of signature is taken into account, insofar as it is required for an interpretation in good faith and the objective of the AFMP.[122]

Even though the articles on the principle of equal treatment as set out in the AFMP are not always identical to Arts. 39, 43 and 49 of the EC Treaty, in the author's view, an interpretation in good faith and in the light of the object and purpose of the AFMP means that the Agreement generally provides for *measures equivale*nt to those in the EC Treaty in respect of the free movement of workers, the right of establishment and the freedom of services. The right of establishment is, however, limited to individuals and the freedom to provide services appears to be limited to brief periods not exceeding 90 days of work in a calendar year. As noted in 4.1.2., the AFMP also takes account of the right of entry and residence of persons without an economic activity similar to Art. 18 of the EC Treaty that is not linked to an economic factor.

In a recent Austrian case decided by the Independent Finance Court, a worker, who was resident in Austria but employed by a Swiss company, was denied an exemption for third country income on the grounds that the he was employed by a Swiss rather than an Austrian company.[123] Specifically, the Court held that Arts. 39, 43 and 49 of the EC Treaty apply to Swiss territory by virtue of the AFMP.

ECJ case law on the freedom of establishment of companies does not apply under the AFMP. Accordingly, it appears that neither *Marks & Spencer*[124] nor *Cadbury Schweppes*,[125] which were decided on the legal basis of Arts. 43 and 48 of the EC Treaty, have an effect in the Switzerland-EC cross-border context. There is, however, a further case in which the ECJ considers the question of the effect of the free movement of capital in Art. 56 of the EC Treaty in relation to third countries.[126] In particular, the question arises as to whether or not discrimina-

115. Schweizerische Steuerkonferenz, *Vorsorge und Steuern* (Muri/Berne: Cosmos Verlag, Cumulative Supplement, Spring 2006), loose-leaf, Case A.3.4.4.

116. Sickness insurance is an exception to this rule. Federal Social Office and the State Secretariat for Economic Affairs (*Bundesamt für Sozialversicherung und Staatssekretariat für Wirtschaft*)/Information Centre of the Basic Pension and Invalidity Insurance (*Informationsstelle AHV/IV*), *Social Security in Switzerland, information for Swiss and citizens of an EC Member State living in Switzerland* (Berne: 2002), p. 9 and 12.

117. See Art. 31(4) of the Vienna Convention.

118. There is no published Swiss tax case within the context of the AFMP.

119. Federal Tribunal, 17 January 2003, *A.X. v. Regierungsrat und Verwaltungsgericht des Kantons Zürich*, BGE 129 II 249, Para. 4.2; Federal Tribunal, 28 March 2003, *X. v. Migrationsamt sowie Rekursgericht im Ausländerrecht des Kantons Aargau*, BGE 129 II 215, Para. 5.2; Federal Tribunal, 27 November 2003, *Verband Schweizerischer Assistenz- und Oberärzte, Sektion Zürich, und X. v. Regierungsrat des Kantons Zürich*, BGE 130 I 26, Para. 3.2.2; and Federal Tribunal, 7 April 2004, *X. v. Regierungsrat sowie Verwaltungsgericht des Kantons Zürich*, BGE 130 II 176, Para. 2.1.

120. Federal Tribunal, 4 November 2003, *A. und B. v. Departement für Justiz und Sicherheit sowie Verwaltungsgericht des Kantons Aargau*, BGE 130 II 1, Para. 3.6.1 and Federal Tribunal, 7 April 2004, *X. v. Regierungsrat sowie Verwaltungsgericht des Kantons Zürich*, BGE 130 II 176, Para. 2.1.

121. Epiney, note 101, p. 15 et seq.

122. Cottier and Evtimov, note 101, p. 109 et seq. and Epiney, note 101, p. 7 et seq.

123. Independent Finance Court (*Unabhängiger Finanzsenat*), 22 June 2006, *Y v. Tax Administration X*, UFSW, GZ RV/1007.

124. ECJ, 13 December 2005, Case C-446/03, *Marks & Spencer plc v. David Halsey (Her Majesty's Inspector of Taxes)*.

125. ECJ, 12 September 2006, Case C-196/04, *Cadbury Schweppes plc, Cadbury Schweppes Overseas Ltd v. Commissioners of Inland Revenue*.

126. ECJ, 24 May 2007, Case C-157/05, *Winfrid L. Holböck v. FA Salzburg-Land*. For the EC context, see ECJ, 15 July 2004, Case C-315/02, *Anneliese Lenz v. Finanzlandesdirektion für Tirol*; ECJ, Advocate General Bot's Opinion, 11 September 2007, Case C-101/05, *Skatteverket v. A* (Art. 56 of the EC Treaty regarding exemption of dividends in the form of shares in a Swiss subsidiary); and ECJ, Order, 10 May 2007, Case C-492/04, *Lasertec Gesellschaft für Stanzformen mbH v. Finanzamt Emmendingen*. See also ECJ, 12 December 2002, Case C-324/00, *Lankhorst-Hohorst GmbH v. Finanzamt Steinfurt*. See also ECJ, 23 February 2006, Case C-513/03, *Heirs of M.E.A. van Hilten-van der Heijden v. Inspecteur van de Belastingdienst/Particulieren/Ondernemingen buitenland te Heerlen* and ECJ, 3 October 2006, Case C-452/04, *Fidium Finanz AG v. Bundesanstalt für Finanzdienstleistungsaufsicht*. See again Tom O'Shea, "New Analysis: Third Country Denied Freedom of Establishment Rights in *Lasertec*", 46 *Tax Notes International* (2007), p. 990 et seq. and "*Holböck*: Austrian Dividend Tax Rules Found Compatible with the EC Treaty", 46 *Tax Notes International* (2007), p. 1131 et seq. See finally Axel Cordewener, Georg W. Kofler and Clemens Philipp Schindler, "Free Movement of Capital and Third Countries: Exploring the Outer Boundaries with *Lasertec*, *A and B* and *Holböck*" 47 *European Taxation* 8-9 (2007), p. 371 et seq.

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tions and restrictions may be justified on grounds that would not be accepted in the pure Community context.

4.3. Principle of equal treatment

4.3.1. Discrimination and restriction

Art. 2 of the AFMP provides for the principle of equal treatment, under which any nationals of one Contracting State who are lawfully resident in the territory of another Contracting State are not subject to any discrimination on the ground of nationality. This clause is self-executing.[127] The Federal Tribunal held that Art. 2 of the AFMP is construed in accordance with Art. 12 of the EC Treaty.[128] Art. 7(a) (economic activity and living, employment and working conditions) of the AFMP, Art. 9 (employed persons), Art. 15 (self-employed persons), Art. 19 (provision of services) and Art. 25 (purchase of immovable property) of Annex I and Art. 8(a) (coordination of social security systems) of the AFMP contain specific principles of equal treatment as leges speciales to Art. 2.[129] In particular, Art. 9(2) of Annex 1 of the AFMP states that an employed individual and the family members enjoy the same tax concession and welfare benefits as national employed persons and members of their family. Under Art. 15(2) of Annex 1 to the AFMP, this also applies to self-employed persons. Art. 9(2) of Annex 1 of the AFMP is construed in accordance with Art. 7(2) of Regulation (EEC) No. 1612/68.[130]

It appears that the ECJ uses the term "principle of equal treatment" as generic term and from this derives that the rules regarding equal treatment forbid not only "overt discrimination", but also "covert discrimination".[131] Taking account of this case law, the Federal Tribunal held that the principle of equal treatment of the AFMP prohibits not only overt discrimination on grounds of nationality, but also covert discrimination that, by the application of other criteria of differentiation, has the same result.[132] In respect of income taxation, the ECJ argued that there is a risk that the criterion of residence works, in particular, against taxpayers who are nationals of other Member States.[133] In the author's view, it is immaterial that the term "restriction" is expressly referred to only in Art. 17(a) of Annex I of the AFMP in connection with the freedom of services, as the EC law concept of restriction has already been established in *Bosman* decided on 15 December 1995 and, therefore, before the date of signature of the AFMP. Specifically, in the Austrian case noted in 4.2., the Independent Finance Court referred to *Bosman* and held that the free movement of workers as enshrined in the AFMP also forbids "restrictions".[134]

The question arises as to whether or not Art. 2 of the AFMP requires a specific economic quality, in particular as to whether or not individuals who do not pursue an economic activity have access to the principle of equal treatment. In the light of recent ECJ case law on EU citizenship and the freedom to reside, it appears that individuals without a cross-border economic activity may also have access to Art. 12 of the EC Treaty.[135] In *Pusa*, the ECJ held that situations falling within the scope of Community law include those involving the exercise of the fundamental freedoms guaranteed by the EC Treaty, in particular those involving the freedom to move and reside within the territory of the Member States, as conferred by Art. 18.[136] The ECJ also held that an EU national must be granted in all Member States the same treatment in law as that accorded to the nationals of those Member States who find themselves in the same situation. As the Federal Tribunal held that Art. 2 of the AFMP is construed in accordance with Art. 12 of the EC Treaty, persons without an economic activity in the host Member State, such as students and pensioners emigrating from a Member State to Switzerland, have, in general, access to the principle of equal treatment in Art. 2 of the AFMP.[137,138]

127. Breitenmoser, note 99, p. 1148.
128. Federal Tribunal, 27 November 2003, *Verband Schweizerischer Assistenz- und Oberärzte, Sektion Zürich, und X. v. Regierungsrat des Kantons Zürich*, BGE 130 I 26, Para. 3.2.2.
129. The interpretation of Art. 9(1) of Annex I of the AFMP was at issue in the reference to the ECJ by the *Landesgericht Innsbruck* regarding a labour law case. The case was, however, not decided. See ECJ, Order, 4 August 2006, Case C-339/05, *Zentralbetriebsrat der Landeskrankenhäuser Tirols v. Land Tirol*.
130. Regulation (EEC) No. 1612/68 of 15 October 1968 of the Council on freedom of movement for workers within the Community, Official Journal (EC), L 257, 19 October 1968, p. 2. The Federal Tribunal held that Art. 3 of Annex 1 of the AFMP concerning members of the family is construed in accordance with EC law and, in particular, referred to Regulation (EEC) No. 1612/68 of 15 October 1968. See Federal Tribunal, 17 January 2003, *A.X. v. Regierungsrat und Verwaltungsgericht des Kantons Zürich*, BGE 129 II 249, Para. 4.2 and Federal Tribunal, 4 November 2003, *A. und B. v. Departement für Justiz und Sicherheit sowie Verwaltungsgericht des Kantons Aargau*, BGE 130 II 1, Para. 3.3.
131. See ECJ, 8 May 1990, Case C-175/88, *Klaus Biehl v. Administration des Contributions du Grand-Duché de Luxembourg*, Paras. 12 and 13 and ECJ, 14 February 1995, Case C-279/93, *Finanzamt Köln-Altstadt v. Roland Schumacker*, Para. 26. Cordewener takes the view that the four freedoms are leges speciales to the general principle of non-discrimination and that the latter is derived from the general principle of equal treatment of EC law. See Axel Cordewener, *Europäische Grundfreiheiten und nationales Steuerrecht* (Cologne: Schmidt, 2002), p. 247, footnote 277.
132. Federal Tribunal, 27 November 2003, *Verband Schweizerischer Assistenz- und Oberärzte, Sektion Zürich, und X. v. Regierungsrat des Kantons Zürich*, BGE 130 I 26, Para. 3.2.2 and Federal Tribunal, 6 June 2005, *Bundesamt für Sozialversicherung v. M. und Versicherungsgericht des Kantons Aargau*, BGE 131 V 209, Para. 6.2.
133. ECJ, 28 January 1992, Case C-204/90, *Hanns-Martin Bachmann v. Belgian State*, Para. 14.
134. See Independent Finance Court, 22 June 2006, *Y v. Tax Administration X*, UFSW, GZ RV/1007. See also ECJ, 15 December 1995, Case C-415/93, *Union royale belge des sociétés de football association ASBL v. Jean-Marc Bosman, Royal club liégeois SA v. Jean-Marc Bosman and others and Union des associations européennes de football (UEFA) v. Jean-Marc Bosman*. See also 4.2.
135. Ben J.M. Terra and Peter J. Wattel, *European Tax Law*, 4th edition (The Hague: Kluwer Law International, 2005), p. 29 et seq.
136. ECJ, 29 April 2004, Case C-224/02, *Heikki Antero Pusa v. Osuuspankkien Keskinäinen Vakuutusyhtiö*, Paras. 17, 18 and 19.
137. In particular, persons without an economic activity have no right to social assistance benefits. See Art. 24(1)(a) of Annex I of the AFMP. See again Epiney, note 101, p. 15. See also Dieter W. Grossen and Claire de Palézieux, "Abkommen über die Freizügigkeit", in Daniel Tührer, Rolf Weber and Roger Zäch (eds.), *Bilaterale Verträge Schweiz – EG – Ein Handbuch* (Zurich: Schulthess, 2002), p. 109. In contrast, Pascal Hinny takes the view that individuals who do not pursue an economic activity have no access to the principle of equal treatment set out in Art. 2 in the AFMP. See Hinny, "Das Diskriminierungsverbot des Personenverkehrsabkommens im Schweizer Steuerrecht", note 4, p. 169. Furthermore, Hinny takes the view that the AFMP takes account of "reverse discrimination". See id., p. 175. Accordingly, Hinny argues that Art. 14 of the DBG and Art. 6 of the StHG do not discriminate against retired Swiss nationals who emigrate from a Member State to Switzerland even though they are entitled to the expense-based tax regime under Art. 14 of the DBG and Art. 6 of the StHG only until the end of the current tax period, but non-Swiss nationals are or may be entitled to an unlimited period of

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4.3.2. Justification

According to ECJ case law, a direct discriminatory measure can only be justified by EC Treaty provisions, for example public policy, public security and public health as listed in Art. 39(3) (the EC Treaty test). In addition to these grounds, an indirect discriminatory or restrictive measure can be justified on the grounds of imperative reasons of public interest (the rule of reason test).[139] Under the rule of reason test, justifications accepted by the ECJ in tax matters include the need to ensure coherence of the tax system,[140] the need to ensure effective fiscal supervision,[141] the need to prevent tax evasion or tax avoidance,[142] the need to ensure the balance in the allocation of taxing rights between different Member States[143] and the right of Member States to tax activities occurring on their national territory under the territoriality principle.[144] Justifications rejected by the ECJ include administrative difficulties,[145] loss of tax revenue,[146] advantages outweighing disadvantages,[147] residents and non-residents being in a different situation and, therefore, can be treated differently[148] and that the restriction is only trivial or minor in nature.[149] It is also required that the justified, discriminatory or restrictive measure is proportional, i.e. appropriate to ensuring attaining the objective and must not go beyond what is necessary to attain this (the principle of proportionality test).[150]

The ECJ has rejected a justification based on grounds of the need for fiscal supervision, as a Member State may invoke the Council Directive on the Mutual Assistance for the Exchange of Information.[151] With regard to *the need for safeguarding the collection of taxes*, the ECJ argues that the Member States may invoke the Council Directive on the Mutual Assistance for the Recovery of Claims.[152] Similarly to the EEA/EFTA Member States within the context of the EEA Agreement, both Directives do not apply to Switzerland.[153,154]

time. A key requirement of the expense-based tax regime is that the taxpayer does not engage in any gainful activity in Switzerland. See Hinny "Die bilateralen Verträge und ihre Auswirkungen auf unser Steuerrecht", note 4, p. 1153. In the light of the recent ECJ case law, in the author's view, the lack of an economic nexus is, however, no longer relevant. It also appears that Art. 2 of the AFMP, similarly to the EC Treaty, does not cover reverse discrimination (see 3.4.4.2. and 4.3.2.). Accordingly, Art. 14 of the DBG and Art. 6 of the StHG comply with the AFMP.

138. For Swiss income and net wealth tax purposes, Swiss and foreign partnerships are, in general, not treated as separate taxpayers. The partners are taxed on their fraction in the partnership's income and capital. Non-resident partners of foreign partnerships that maintain a PE in Switzerland are subject to Swiss limited income and net wealth tax liability. According to Art. 11 of the DBG (see also Art. 49(3) of the DBG and Art. 20(2) of the StHG), foreign partnerships and other foreign entities without juridical personality that are subject to Swiss limited tax liability, however, pay income and capital taxes under the provisions applicable to legal entities. Accordingly, the fraction in the foreign partnership's income and capital that is attributed to the non-resident partners is taxed by corporate income tax rates. In contrast, according to prevailing opinion, the fraction of the Swiss resident partners is taxed by individual income tax rates that are significantly higher than corporate income tax rates. It is argued that the constitutional principle of equal treatment requires that Swiss resident partners are taxed in same way, regardless of whether or not they are partners of a Swiss or a foreign partnership. See Michael Lang, Markus Reich and Christian Schmidt, "Personengesellschaften im Verhältnis Deutschland-Österreich-Schweiz", 16 *Internationales Steuerrecht* (2007) p. 3. If, however, a non-resident partner who is an EU national moves to Switzerland the question arises as to whether or not the application of individual income tax rates results in a prohibited restriction under the AFMP. If the partner stayed abroad, he would be taxed by lower corporate income tax rates. The partner is taxed at higher individual income tax rates simply by reason of the transfer of his residence from abroad to Switzerland. Consequently, the question arises as to whether or not the application of the individual income tax rates constitutes a restriction prohibited by the freedom of establishment for self-employed persons in the AFMP.

139. The ECJ summarized the common four criteria of its rule of reason test in ECJ, 30 November 1995, Case C-55/94, *Reinhard Gebhard v. Consiglio dell'Ordine degli Avvocati e Procuratori di Milano*, Para. 37.

140. ECJ, 28 January 1992, Case C-204/90, *Hanns-Martin Bachmann v. Belgian State*, Para. 28.

141. ECJ, 15 May 1997, Case C-250/95, *Futura Participations SA and Singer v. Administration des contributions*, Para. 31; ECJ, 14 September 2006, Case C-386/04, *Centro di Musicologia Walter Stauffer v. Finanzamt München für Körperschaften*, Para. 32; and ECJ, 7 September 2006, Case C-470/04, *N v. Inspecteur van de Belastingdienst Oost/kantoor Almelo*, Para. 52.

142. ECJ, 17 July 1997, Case C-28/95, *A. Leur-Bloem v. Inspecteur der Belastingdienst/Ondernemingen Amsterdam 2*, Para. 40.

143. ECJ, 13 December 2005, Case C-446/03, *Marks & Spencer plc v. David Halsey (Her Majesty's Inspector of Taxes)*, Para. 43.

144. ECJ, 7 September 2006, Case C-470/04, *N v. Inspecteur van de Belastingdienst Oost/kantoor Almelo*, Para. 41.

145. ECJ, 14 February 1995, Case C-279/93, *Finanzamt Köln-Altstadt v. Roland Schumacker*, Para. 43.

146. ECJ, 12 December 2002, Case C-385/00, *F.W L. de Groot v. Staatssecretaris van Financiën*, Para. 103.

147. Id., Para. 97.

148. ECJ, 14 February 1995, Case C-279/93, *Finanzamt Köln-Altstadt v. Roland Schumacker*, Para. 38.

149. ECJ, 11 March 2004, Case C-9/02, *Hughes de Lasteyrie du Saillant v. Ministère de l'Économie, des Finances et de l'Industrie*, Para. 43.

150. ECJ, 30 November 1995, Case C-55/94, *Reinhard Gebhard v. Consiglio dell'Ordine degli Avvocati e Procuratori di Milano*, Para. 37.

151. See ECJ, 28 January 1992, Case C-204/90, *Hanns-Martin Bachmann v. Belgian State*, Para. 18 and Council Directive 77/799/EEC of 19 December 1977 concerning mutual assistance by the competent authorities of the Member States in the field of direct taxation, certain excise duties and taxation of insurance premiums, Official Journal (EC), L 336, 27 December 1977, p. 15, as amended by Council Directive 2004/106/EC of 16 November 2004 amending Directives 77/799/EEC concerning mutual assistance by the competent authorities of the Member States in the field of direct taxation, certain excise duties and taxation of insurance premiums and Council Directive 92/12/EEC on the general arrangements for products subject to excise duty and on the holding, movement and monitoring of such products, Official Journal (EC), L 359, 4 December 2004, p. 30.

152. See ECJ, 7 September 2006, Case C-470/04, *N v. Inspecteur van de Belastingdienst Oost/kantoor Almelo*, Para. 53. See also ECJ, 16 May 2000, Case C-87/99, *Patrick Zurstrassen v. Administration des Contributions Directes*, Para. 25 and Council Directive 76/308/EEC of 15 March 1976 on mutual assistance for the recovery of claims resulting from operations forming part of the system of financing the European Agricultural Guidance and Guarantee Fund, and of the agricultural levies and customs duties, Official Journal (EC), L 73, 19 March 1976, p. 18, as amended by Council Directive 2001/44/EC of 15 June 2001 amending Directive 76/308/EEC on mutual assistance for the recovery of claims resulting from operations forming part of the system of financing the European Agricultural Guidance and Guarantee Fund, and of agricultural levies and customs duties and in respect of value added tax and certain excise duties, Official Journal (EC), L 175, 28 June 2001, p. 17.

153. Under the Memorandum of Understanding accompanying the Switzerland-EC Savings Tax Agreement of 26 October 2004, Official Journal (EC), L 385, 29 December 2004, p. 30, Switzerland agreed to enter into bilateral negotiations with each Member State with a view to including in the relevant tax treaty an exchange of information clause regarding "tax fraud" or "the like" for income not subject to the Switzerland-EC Savings Tax Agreement. This Swiss obligation complies with the new Swiss treaty policy as set out in Para. 24 of the OECD Commentary on Art. 26, as it has read since 15 July 2005. Switzerland has recently concluded such provisions (with Austria, Finland, Germany, Norway and the United Kingdom) and will also agree such provisions with the other EU/EFTA Member States.

154. Switzerland has recently agreed to include a limited measure on the assistance in the collection of taxes regarding employment income by virtue of the amending protocol of 21 March 2006 to the Austria–Switzerland tax treaty, Federal Journal 2006, p. 5167. The amending protocol entered into force on 2 February 2007 and, in general, applies with retroactive effect from 1 January 2006. See also Art. 24 of the Cooperation Agreement of 26 October 2004 between the European Community and the Member States, of the one part, and the Swiss Confederation, of the other part, to Combat Fraud and any other Illegal Activity to the Detriment of their Financial Interests, SR 0.351.926.81 (not yet into force). See again Art. 8 of the AFMP, according to which the Contracting Parties will make provision, in accordance with Annex

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Under Art. 5 of Annex 1 of the AFMP, the freedom of persons and services may be restricted only by means of measures that are justified on grounds of public order, public security or public health. In addition, under Art. 21(3) of the AFMP, no provision of the Agreement may prevent the Contracting Parties from adopting or applying measures to ensure the imposition, payment and effective recovery of taxes or to forestall tax evasion under their national tax legislation or tax treaties between Switzerland and the Member States or any other arrangement. In the author's view, within the context of the AFMP, the Federal Tribunal has also adopted the rule of reason test as established by the ECJ. In particular, the Federal Tribunal has referred in a social security case to the ECJ case of *Borawitz* and has held that a discriminatory measure can only be justified on grounds of objective reasons and that its application must be appropriate to ensuring the attainment of the objective.[155]

In contrast to the principal of non-discrimination in Art. 24(1) of the OECD Model, the Community principle of equal treatment is not of an absolute nature. In this respect, Art. 24(1) of the OECD Model is stricter than the EC law concept.[156] Conversely, the EC law concept also covers indirect discrimination. Similar to the principal of non-discrimination in Art. 24(1) of the OECD Model, it appears that the EC law concept does not cover reverse discrimination.[157]

4.3.3. Comparability

Art. 21(2) of the AFMP states that no provision of the Agreement may be interpreted in such a way as to prevent the Contracting Parties from distinguishing, when applying the relevant provisions of their fiscal legislation, between taxpayers whose "situations are not comparable", especially as regards their place of residence. Even though it is doubtful as to whether or not the Technical Explanations of 23 June 1999 of the Federal Government to the Sectoral Agreements between Switzerland and the European Union qualify as supplementary means of interpretation under Art. 32 of the Vienna Convention, they, at least, reflect the view of the Federal Government.[158] The Federal Government took the view that Art. 21(2) of the AFMP enshrines the principle of equal treatment (*Gleichbehandlungsgrundsatz*) in respect of income taxation that prohibits treating taxpayers differently if they are in "comparable circumstances".[159] It concluded that the prohibition of discrimination of Art. 21(2) of the AFMP is stricter than the non-discrimination clause provided for in tax treaties.[160] Finally, the Federal Government noted that it is difficult to assess the practical implications of that extension of the principle of equal treatment and assumes that it will not have far-reaching consequences.

In the author's view, Art. 21(2) of the AFMP does not enshrine a specific principle of equal treatment as leges speciales to Art. 2. Instead, it refers to the comparability test found in EC law.[161] Art. 21(2) of the AFMP is only a clarification in the field of direct taxation, under which there is no unequal treatment in cases where the taxpayers' "situations are not comparable".

4.4. Reference to tax treaties

For the purpose of the AFMP, Arts. 7(1) and 13(1) of Annex I provide a definition of the term "frontier worker", under which such a worker is a person who returns to the place of residence as a rule every day or at least once a week. As the term "frontier worker" has a different meaning in treaty law, for the sake of clarification, Art. 21(1) of the AFMP states that the provisions of tax treaties between Switzerland and the Member States are unaffected, in particular, the treaty definition of "frontier workers".[162]

4.5. EC tax law concepts

4.5.1. Allowances for personal and family circumstances

4.5.1.1. Virtual residence

In this respect, *Schumacker*[163] is relevant. Schumacker, a Belgian national, was employed in Germany, but lived with his wife and their children in Belgium. He was subject to a simplified tax procedure in Germany. Schumacker was taxed at the general tariff regardless of his family circumstances. Consequently, he did not benefit from the splitting tariff for married employed persons.

II, for the coordination of social security systems with the aim, in particular, of fostering mutual administrative assistance and cooperation between authorities and institutions.

155. Federal Tribunal, 6 June 2005, *Bundesamt für Sozialversicherung gegen M. und Versicherungsgericht des Kantons Aargau*, BGE 131 V 209, Para. 6.3 and ECJ, 21 September 2000, Case C-124/99, *Carl Borawitz v. Landesversicherungsanstalt Westfalen*, Para. 26 et seq. In Swiss constitutional law, the principle of proportionality is a long-standing juridical doctrine that has been codified in Art. 36(3) of the Federal Constitution of 18 December 1998, SR 101.

156. See 3.4.4.2.

157. See Terra and Wattel, note 135, p. 33 according to whom only discrimination against own nationals is not addressed by the EC Treaty. See again Peter J. Wattel, "EC Treaty freedoms, tax treaties and national courts", in Guglielmo Maisto (ed.), *Courts and Tax Treaty Law*, EC and International Tax Law Series No. 3 (Amsterdam: IBFD, 2007), p. 138, who argues that the only foot-holding grounds for the judgment in *Van Hilten* appears to be the argument that EC law does not oppose reverse discrimination. In contrast, Pascal Hinny takes the view that the AFMP also takes account of "reverse discrimination". See Hinny, "Das Diskriminierungsverbot des Personenverkehrsabkommens im Schweizer Steuerrecht", note 4, p. 175. See also Marjaana Helminen, "Non-discrimination and the Nordic Multilateral Double Taxation Convention", 61 *Bulletin for International Taxation* 3 (2007), p. 104, who notes under the heading "Discrimination against own nationals" that the tax treatment of a Member State may not, for example, restrict the right of its nationals to move to another Member State to work there.

158. Federal Government, Technical Explanations of 23 June 1999 to the Sectoral Agreements between Switzerland and the EC, Federal Journal 1999, p. 6128.

159. Id., Para. 274.32.

160. In contrast, Kolb, note 4, p. 30, takes the view that the principle of equal treatment in Art. 21(2) of the AFMP is equivalent to that of Art. 24(1) of the OECD Model and, therefore, denies the necessity to amend the Swiss-source taxation procedure. This view, however, follows the erroneous interpretation of the treaty non-discrimination principle by Zuppinger and Reimann. See 3.4.4.2.

161. See 4.3.3.

162. Switzerland has concluded agreements with France, Germany, Italy and Liechtenstein that provide for special taxing rights in respect of frontier workers.

163. ECJ, 14 February 1995, Case C-279/93, *Finanzamt Köln-Altstadt v. Roland Schumacker*.

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He was excluded from both the annual wages tax adjustment made by the employer and the annual income tax assessment made by the administration. Schumacker was also not entitled to deduct social expenses (old-age, sickness or invalidity insurance premiums).

The ECJ held that the rules of equal treatment[164] forbid not only overt (direct) discrimination by reason of nationality, but also all covert (indirect) discrimination, which, by the application of other criteria of differentiation, lead to the same result.[165] National rules under which a distinction is drawn on the basis of residence are liable to operate mainly to the detriment of nationals of the other Member States. Tax benefits granted only to residents of a Member State may constitute indirect discrimination by reason of nationality. The ECJ stated that the situations of residents and of non-residents are not, generally, comparable.[166] In the case of a non-resident who receives the major part of income and almost all family income in a Member State other than that of residence, discrimination, however, arises from the fact that personal and family circumstances are taken into account neither in the Member State of residence nor that of employment.[167] The ECJ rejected the justification based on grounds of the need for cohesion of the tax system and administrative difficulties.[168] In a *Schumacker* type case, a virtual resident taxpayer is, therefore, entitled to the full amount of allowances for personal and family circumstances in the host Member State.[169]

Following the legislative amendments required to adapt the income tax system for non-residents to the law as held in *Schumacker*, under Sec. 1(3) of the Income Tax Law (EStG), individuals who have neither their usual abode nor domicile in Germany may request to be subject to unlimited taxation if they derive German-source income that is subject to limited tax liability. At least 90% of their income in the calendar year must be subject to German income tax or the income that is not subject to German income tax must not exceed EUR 6,136 in the calendar year. Under Sec. 1a(1) of the EStG, in respect of nationals of one of the EU/EEA Member States, maintenance payments for divorced taxpayers or married taxpayers who are permanently separated are also granted if the recipient is resident in one of the EU/EEA Member States. The option for joint tax return for married taxpayers is also granted if one spouse is resident in one of the EU/EEA Member States. The 90% threshold in Sec. 1(3) of the EStG was tested in *Gschwind* and the ECJ held that it complies with Art. 48 (now Art. 39) of the EC Treaty.[170]

The German rules do not yet take account of Switzerland. In the author's view, due to the entry into force of the AFMP on 1 June 2002, the scope of the German rules should be extended in relation to Switzerland to comply with the principle of equal treatment set out in the AFMP.

4.5.1.2. No virtual residence

Here, *de Groot*[171] is relevant. De Groot was a resident of the Netherlands. He was employed in the Netherlands and in other Member States by companies established in the Netherlands, France, Germany and the United Kingdom. De Groot had to make maintenance payments. He benefited from the allowances for personal and family circumstances only in proportion to the income that he had received in the Netherlands. Accordingly, as a consequence of his exercising his right to freedom of movement, he forfeited part of the tax allowances to which he was entitled as a resident of the Netherlands, as he also received income in another Member State that was taxed in that Member State without his personal and family circumstances being taken into account. The ECJ held that such a rule constituted an obstacle to the free movement of workers that was prohibited by Art. 48 (now Art. 39) of the EC Treaty.

The ruling was criticized by commentators on grounds that the principle of equal treatment requires the host Member State to grant the non-resident taxpayer personal benefits on a *pro rata parte* basis.[172] Specifically, Kees van Raad has proposed a concept of fractional taxation.[173] Under this concept, a Member State from which a non-resident individual derives income treats this individual *pro rata parte* in respect of the taxable income and related deductible expenses, personal deductions and the tax rate on the same basis as a resident taxpayer. Swiss tax law provides for fractional taxation in respect of allowances for personal and family circumstances.[174] As outlined in 4.2., the Swiss-source tax rates also take account of certain allowances for personal and family circumstances.

4.5.2. Allowances for professional expenses

In *Schumacker*, non-residents were deprived of the possibility of relying on certain items forming part of the

164. Art. 48 of the EEC Treaty (now Art. 39 of the EC Treaty) and Art. 7(2) of Regulation (EEC) No. 1612/68.
165. ECJ, 14 February 1995, Case C-279/93, *Finanzamt Köln-Altstadt v. Roland Schumacker*, Para. 26. See also ECJ, 8 May 1990, Case C-175/88, *Klaus Biehl v. Administration des Contributions du Grand-Duché de Luxembourg*, Para. 12; ECJ, 16 May 2000, Case C-87/99, *Patrick Zurstrassen v. Administration des Contributions Directes*, Para. 18; and ECJ, 12 December 2002, Case C 385/00, *F.W.L. de Groot v. Staatssecretaris van Financiën*, Para. 76.
166. Id., Para. 31.
167. Id., Para. 38. See also Commission Recommendation of 21 December 1993 on the taxation of certain items of income received by non-residents in a Member State other than that in which they are resident (94/79/EC), Official Journal (EC), L 039, 10 February 1994, p. 22.
168. Id., Para. 39 et seq.
169. It appears that the term "virtual resident" was introduced by Peter J. Wattel, "The EC Court's Attempts to Reconcile the Treaty Freedoms with International Tax Law", 33 *Common Market Law Review* (1996), p. 226. Schumacker was resident in an exemption state. Avery Jones takes the view that *Schumacker* does not apply within a tax credit state context. In this respect, see J.F. Avery Jones, "What is the Difference between *Schumacker* and *Gilly*", 39 *European Taxation* 1 (1999), p. 2 et seq.
170. ECJ, 14 September 1999, Case C-391/97, *Frans Gschwind v. Finanzamt Aachen-Außenstadt*, Para. 32.
171. ECJ, 12 December 2002, Case C-385/00, *F.W.L. de Groot v. Staatssecretaris van Financiën*.
172. Terra and Wattel, note 135, p. 96 et seq.
173. Kees van Raad, "Fractional Taxation of Multi-State Income of EU Resident Individuals – A Proposal", in Krister Andersson, Peter Melz and Christer Silfverberg (eds.), *Liber Amicorum Sven-Olof Lodin*, Series on International Taxation No. 27 (The Hague: Kluwer Law International, 2001), p. 220 et seq.
174. See 3.3.3.

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basis of assessment in the host Member State, for example occupational expenses and special expenditures. There was a procedure under which non-resident taxpayers could ask the tax administration to supply them with a tax certificate indicating certain reliefs to which they were entitled and which the tax administration had to retrospectively apportion equally over the calendar year. The ECJ, however, emphasized that this was not binding, as there was no provision imposing an obligation on the tax administration to remedy in all cases the discriminatory consequences.[175] The Court, therefore, held that Art. 48 of the EEC Treaty (now Art. 39 of the EC Treaty) required "equal treatment" at procedural level for non-resident and resident EU nationals.[176] Accordingly, the refusal by the host Member State to grant non-resident EU nationals the benefit of procedure, such as the annual adjustment of deductions at source that were available to resident EU nationals, constituted unjustified discrimination.

In *Gerritse*,[177] the ECJ confirmed *Schumacker* within the context of the freedom of services under Arts. 59 and 60 (now Arts. 49 and 50) of the EC Treaty. Specifically, Gerritse, a Netherlands national resident in the Netherlands, received income for performing as a drummer at a radio station in Berlin. He was subject to limited taxation in Germany and was, therefore, taxed on his employment income from artistic activities at a rate of 25% on gross amount. No deduction for business expenses was, in principle, granted. The ECJ held that Arts. 59 and 60 (now Arts. 49 and 50) of the EC Treaty precluded a national provision that, in general, took into account gross income when taxing non-residents without deducting business expenses, whereas residents were taxed on their net income, after deducting these expenses.[178]

4.5.3. Exit taxation

In this respect, *Lasteyrie du Saillant*[179] applies. Lasteyrie du Saillant left France and settled in Belgium. At that date, he held or had held at some time during the five years preceding his departure from France, securities conferring entitlement to more than 25% of the profits of a company subject to corporation tax and established in France. Lasteyrie du Saillant was taxed on an accrual basis in respect of the increase in value of the securities. The ECJ held that a taxpayer wishing to transfer his tax residence outside France territory, in exercising the freedom of establishment guaranteed by Art. 52 (now Art. 43) of the EC Treaty, is subject to disadvantageous treatment compared to a person who maintains his residence in France. The requirement as to the establishing guarantees also constituted a restrictive effect. In particular, the ECJ rejected a justification based on grounds of the requirement to prevent tax avoidance or fiscal erosion.[180] The ruling in *Lasteyrie du Saillant* was confirmed in the recently decided "*N*" case. The ECJ noted that the taxpayer became liable simply by reason of the transfer of his residence from the Netherlands to the United Kingdom, whereas, if he had remained in the Netherlands, increases in value would have become taxable only based on a realization basis.[181] The ECJ, however, held that the allocation of the power to tax between the Member States was based on the territoriality principle.[182] This means that the Member State of emigration has the taxing right in respect of the increased value at the time of emigration. The ECJ also noted that the Member States may invoke Council Directives on the Mutual Assistance for the Exchange of Information and on the Mutual Assistance for the Recovery of Claims.[183]

In the light of *Lasteyrie du Saillant* and the infringement proceedings undertaken by the Commission, Germany has recently adopted amendments to the exit taxation regime as set out in Sec. 6 of the Foreign Tax Law (AStG).[184] At the same time, Germany extended its exit taxation in respect of shareholdings in foreign companies. The tax is assessed then, but deferred interest free until realization or an equivalent event. The deferral only applies if EU/EFTA nationals emigrate to another Member State. The deferral also requires that the exchange of information and the assistance in the collection of taxes between Germany and the other Member State is ensured. This requirement is fulfilled between the EU Member States by the two Council Directives.

Again, the German draft does not take account of Switzerland. In the author's view, because of the entry into force of the AFMP, the scope of this German draft should be extended to Switzerland. Also in the author's view, the question that arises at the level of justification is whether or not the need to safeguard the collection of taxes, rather than the requirement to ensure effective fiscal supervision or prevent tax evasion or tax avoidance. As noted in 4.3.2., the Council Directive does not apply to Switzerland. Accordingly, it appears that the requirement to safeguard the collection of taxes may justify the immediate exit taxation to Switzerland on the basis of

175. ECJ, 14 February 1995, Case C-279/93, *Finanzamt Köln-Altstadt v. Roland Schumacker*, Para. 54. See also ECJ, 26 October 1995, Case C-151/94, *Commission of the European Communities v. Grand Duchy of Luxembourg* (*Biehl II*), Para. 17.
176. Id., Para. 58.
177. ECJ, 12 June 2003, Case C-234/01, *Arnoud Gerritse v. Finanzamt Neuköllln-Nord*.
178. Id., Para. 55.
179. ECJ, 11 March 2004, Case C-9/02, *Hughes de Lasteyrie du Saillant v. Ministère de l'Économie, des Finances et de l'Industrie*. See also Laurent Olléon, "Exit lexit tax", *Revue de Jurisprudence Fiscale* (2004), p. 347 et seq. and Guillaume Goulard, "Que reste-t-il de l'*exit tax*?", 28 *Revue de Droit Fiscal* (2005), p. 26 et seq. This judgment was confirmed and developed in ECJ, 7 September 2006, Case C-470/04, *N v. Inspecteur van de Belastingdienst Oost/kantoor Almelo*. In addition, see the Communication from the Commission to the Council, the European Parliament and the European Economic and Social Committee – Exit taxation and the need for coordination of Member States' tax policy, 19 December 2006, COM(2006) 825 final.
180. Id., Para. 50.
181. ECJ, 7 September 2006, Case C-470/04, *N v. Inspecteur van de Belastingdienst Oost/kantoor Almelo*, Para. 35.
182. Id., Para. 41.
183. Id., Para. 52 et seq.
184. Letter of Ministry of Finance of 8 June 2005, BStBl I p. 714. Sec. 6(5) of the AstG, as amended by the Act of 7 December 2006 on Accompanying Tax Measures for the Introduction of the Societas Europea and the Amendment of Further Tax Provisions, BGBl I p. 2787. See Jan Frederik Bron, "Das *van Hilten*-Urteil des EuGH und die (Un-) Anwendbarkeit der Wegzugsbesteuerung im Verhältnis zu Drittstaaten", *Internationales Steuerrecht* (2006), p. 296 et seq.

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accrual taxation. The German draft may be justified on the grounds of Art. 21(3) of the AFMP, under which no provision of the Agreement prevents the Contracting Parties from adopting or applying measures to ensure the imposition, payment and the effective recovery of taxes. In *Leur-Bloem*, the ECJ, however, held that a general rule automatically excluding certain categories of operations from the tax advantage, whether or not there is actually tax evasion or tax avoidance, goes further than that necessary to prevent tax evasion or tax avoidance.[185] In the Austrian case previously referred to, the Independent Finance Court held that the measure in question constituted a prohibited restriction of the free movement of workers set out in Arts. 1 and 2 of the AFMP and Art. 2 of Annex I of the AFMP.[186] The Court also argued that it was not appropriate to ensuring the attainment of the justification based on fiscal supervision and that the setting of a general rule was not proportional.[187] The Court argued that the tax authorities may require the taxpayer to provide such proof as they may consider necessary to determine whether or not the taxpayer is entitled to the exemption from third state income. Accordingly, the German draft that excludes certain categories of transfers from exercising the free movement of establishment, whether or not there is actually a need of safeguarding the collection of taxes, goes further than that necessary to safeguard the collection of taxes under Art. 21(3) of the AFMP.

The German draft is similar to Austrian exit taxation in Sec. 31 of the Income Tax Act, as amended in 2004. A tax deferral applies if an individual emigrates to another Member State, provided that the exchange of information and the assistance in the collection of taxes between Austria and the other Member State is ensured.[188] There is no reference to Switzerland. In fact, the Austrian Ministry of Finance has taken the view that the transfer of residence from Austria to Switzerland gives rise to Austrian exit taxation regardless of Art. 13(4) of the Austria–Switzerland tax treaty, under which Austria may tax capital gains derived from the sale of securities in Austrian companies for five years after the transfer.[189] Under the new Art. 13(4) of the Austria–Switzerland tax treaty, as amended by the protocol of 21 March 2006, the state of emigration may tax increases in the value of securities in companies until emigration in accordance with its domestic law if the securities are sold or measures are taken by the individual that result in the loss of the taxing right.[190] Taxation solely on grounds of the transfer of seat is prohibited. The tax may be assessed at the time of emigration.[191] In the author's view, in contrast to the German draft, these Austrian treaty rules comply with the principles of territoriality and proportionality as held by the ECJ in the "*N*" case and, therefore, with the principle of equal treatment in the AFMP.

4.5.4. Source taxation and joint liability

The German source taxation procedure for non-resident artistes and sportsmen was at issue in *Scorpio*.[192] Scorpio was a company which organized concerts with a registered office in Germany. It concluded a contract with an individual trading under the name of Europop, who made a music group available to it. Europop was resident in the Netherlands and neither subject to unlimited nor limited tax liability in Germany. The German tax authorities called on Scorpio's liability and demanded payment of the tax that Scorpio should have retained at source from the payment made to Europop, i.e. 15% of the gross amount of that payment. According to the German rules, the payment debtor must retain tax at source on account of the artiste and sportsman (the tax debtor) who is subject to limited tax liability in Germany under Sec. 46 of the EStG. The payment debtor is responsible for retaining and paying the tax.

The ECJ held that the obligation on the recipient of services to make a retention at source of the tax on the payment made to a provider of services residing in another Member State and the fact that that recipient may in certain cases incur liability are liable to deter companies such as Scorpio from using providers of services residing in other Member States. The Court concluded that legislation such as that at issue constitutes an obstacle to the freedom of services, prohibited in principle by Arts. 59 and 60 of the EEC Treaty (now Arts. 49 and 50 of the EC Treaty).[193]

The question then arose as to whether or not such legislation is nevertheless justified by the need to ensure the effective collection of income taxes. The ECJ held that the procedure of retention at source and the liability rules supporting it constitute a legitimate and appropriate means of ensuring the taxation of the income of a non-resident person. The Court recalled that at the material time, in 1993, no Community directive or any other instrument referred to in the case file governed mutual administrative assistance concerning the recov-

185. ECJ, 17 July 1997, Case C-28/95, *A. Leur-Bloem v. Inspecteur der Belastingdienst/Ondernemingen Amsterdam 2*, Para. 44.
186. See 4.2.
187. See Independent Finance Court, 22 June 2006, *Y v. Tax Administration X*, UFSW, GZ RV/1007.
188. See *Abgabeänderungsgesetz* 2004, BGBl. I No. 180/2004.
189. Ministry of Finance, EAS (*Express Antwort Service*) No. 1595 of 7 Februry 2000, No. 1845 of 6 July 2001, No. 2657 of 28 October 2005. See Reinhold Beiser, "Die österreichische Wegzugsbesteuerung beim Wegzug in die Schweiz", in Michael Lang and Heinz Jirousek (eds.), *Praxis des Internationalen Steuerrechts – Festschrift für Helmut Loukota zum 65. Geburtstag* (Vienna: Linde, 2005), p. 15 et seq. and Reinhold Beiser, "Die österreichische Wegzugsbesteuerung beim Wegzug in die Schweiz", *Österreichische Steuerzeitung* (2005), p. 262 et seq.
190. Amending Protocol of 21 March 2006 to the Double Tax Treaty of 30 January 1974 with Austria, Federal Journal 2006, p. 5167. The amending protocol entered into force on 2 February 2007 and, in general, applies with retroactive effect from 1 January 2006. The revised Art. 13(4) of the Austria–Switzerland tax treaty applies with retroactive effect from 1 January 2004. See Art. IX of the amending protocol of 21 March 2006. See also Heinz, Jirousek, "Revision des Doppelbesteuerungsabkommens Österreich-Schweiz", *Österreichische Steuerzeitung* (2005), p. 262 et seq.
191. Ministry of Finance, Technical Explanations of 6 July 2005 to the Amending Protocol of 21 March 2006 to the Double Tax Treaty with Switzerland of 30 January 1974, GZ. BMF-010221/0461-IV/4/2005.
192. ECJ, 3 October 2006, Case C-290/04, *FKP Scorpio Konzertproduktionen GmbH v. Finanzamt Hamburg-Eimsbüttel*. See also ECJ, 9 November 2006, Case C-433/04, *Commission of the European Communities v. Kingdom of Belgium* and ECJ, 11 May 2006, Case C-384/04, *Commissioners of Customs & Excise, Attorney General v. Federation of Technological Industries and Others*.
193. Id., Para. 34.

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ery of tax debts between the Netherlands and Germany.[194] The use of retention at source also represented a proportionate means of ensuring the recovery of the tax debts of the State of taxation.[195] The ECJ also held that the same is true of the potential liability of the recipient of services who is required to make such a retention, as that enables the absence of retention at source to be penalized if necessary.[196]

5. Effect on Swiss Income Tax Law

5.1. Source taxation

5.1.1. Wrong approach: "nationalization" of domestic tax law

One way to bring Swiss income tax law into line with the AFMP could, prima facie, be to extend the Swiss-source taxation procedure for employment income to all resident and non-resident Swiss and foreign nationals.[197] The case law of the ECJ has influenced the Member State to "to nationalize" their income tax law. For example, some Member States have extended their thin capitalization and transfer pricing rules to domestic transaction.[198] The "nationalization" of domestic tax law is, however, an approach that may go beyond that which is necessary to comply with the EC Treaty. In particular, it disregards the principles of EC tax law, such as virtual residence, as established by the ECJ. Furthermore, this does not eliminate the discriminatory measures of the Swiss-source taxation procedure for non-employment income.

5.1.2. Resident foreign employees with no permanent residence permit

As only foreign nationals are subject to the Swiss-source taxation procedure for resident foreign employees without a permanent residence permit, the Federal Government recognizes that that procedure falls within the scope of Art. 21(2) of the AFMP.[199] The Federal Government, however, emphasizes that either a subsequent ordinary taxation procedure applies if the threshold is reached or a correction of the source tax rates may be granted. It has, therefore, concluded that the source taxation procedure complies overall (*im Grossen und Ganzen*) with the principle of equal treatment in the AFMP.[200]

In the author's view, that source taxation procedure is a direct discriminatory measure in respect of the exercise of the free movement of workers prohibited, in principle, by Art. 9 (employed persons) of Annex I of the AFMP.[201] The source tax rates take account of only lump sums, but not all kinds of objective tax and personal tax benefits. The threshold of CHF 120,000 (for Federal income tax purposes) is arbitrary. The withheld source tax is credited without interest against the ordinary income tax. It also results in a cash flow disadvantage compared to the ordinary income taxation procedure. In addition, the correction of the source tax rates is not binding.

This direct discrimination cannot be justified on the grounds of public order, public security or public health as listed in Art. 5 of Annex I of the AFMP. It may, however, be justified on the grounds of the need to safeguard the collection of taxes in Art. 21(3) of the AFMP. Discriminatory measures must, however, comply with the principle of proportionality. All nationals of the old 15 Member States are generally taxed by virtue of the source taxation procedure for a period of five years and all nationals of the other 12 new Member States for a period of ten years.[202] A source taxation procedure that excludes all categories of resident foreign employees without a permanent residence permit from the ordinary income taxation procedure and applies for such a long period, goes further than that necessary to safeguard the collection of taxes.

Even though the source taxation procedure would be qualified as an indirect discriminatory measure, arguments not capable of justifying a prohibited discrimination or restriction include administrative difficulties, loss of tax revenue, the other advantages outweighing the disadvantage, residents and non-residents being in a different situation and, therefore, can be treated differently, and the restriction being only trivial or minor in nature.[203] Again, the indirect discrimination of the source taxation procedure may be justified by virtue of Art. 21(3) of the AFMP. The discriminatory measures do not, however, comply with the principle of proportionality.

It should be noted that, depending on the facts, the source taxation procedure may also result in a lower tax burden than the application of the ordinary income taxation procedure. This potential outcome cannot, however, justify the discriminatory measure of the Swiss-source taxation procedure in a particular case.

Consequently, the source taxation procedure for resident foreign employees without a permanent residence permit should be eliminated. All resident employees should be taxed by way of the ordinary taxation procedure. Foreign employees are entitled to the ordinary taxation procedure only if they fulfil the requirements of usual abode or domicile in Switzerland. This amendment is necessary to comply with both treaty law and the

194. Id., Para. 36.
195. Id., Para. 37.
196. Id., Para. 38.
197. Such a "downwards harmonization" proposal is delivered by Cadosch, *The Influence on Swiss tax law of the Swiss-EC agreement on the free movements of persons*, note 4, pp. 72 and 77.
198. See, for example, the effect of *Lankhorst-Hohorst* in Germany and the United Kingdom.
199. Federal Government, Technical Explanations of 23 June 1999 to the Sectoral Agreements between Switzerland and the EC, Federal Journal 1999, Para. 274.32.
200. Similarly, Yersin, note 72 argues that, in the double tax treaty context, "celui-ci [l'impôt à la source] n'impose pas, *globalement*, une charge fiscale plus lourde aux étrangers …". See in 3.4.4.2., however, the absolute nature of the non-discrimination principle in the treaty context.
201. See also Hinny, "Personenverkehrsabkommen und Schweizer Quellensteuerordnung", note 4, p. 265. See also Vogel and Lehner, note 77, Para. 58 to Art. 24.
202. See 4.1.2.
203. See 4.3.2.

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AFMP. Such an amendment may be limited to nationals of treaty states and of EU/EFTA Member States.

Under the new Swiss-source taxation procedure as introduced by the measures against illegal employment, resident employees are subject to a flat-rate tax on their employment income without taking into account other income, professional expenses or personal and family allowances if the employment income does not exceed CHF 19,890. It appears that the new source taxation procedure is an indirect discriminatory measure in respect of the exercise of the free movement of workers prohibited in principle by Art. 9 (employed persons) of Annex I of the AFMP, as there is a risk that the criterion of a low income threshold works, in particular, against taxpayers who are nationals of Member States who are exercising the free movement of workers. The indirect discrimination may be justified by virtue of Art. 21(3) of the AFMP. The discriminatory measures do not, however, comply with the principle of proportionality. The new source taxation procedure excludes all categories of resident employees from the ordinary income taxation procedure and, therefore, goes further than that necessary to safeguard the collection of taxes. It is also doubtful as to whether or not the new source taxation procedure complies with the principle of ability-to-pay as enshrined in Art. 127(2) of the Federal Constitution, as it does not take account of other income, professional expenses or personal and family allowances.[204]

5.1.3. Virtual resident employees

The Federal Government takes the view that the Swiss-source taxation procedure for non-resident individuals and legal entities complies with the principle of equal treatment of the AFMP.[205] In the author's view, for a virtual resident individual, that source taxation procedure constitutes an indirect discriminatory measure prohibited, in principle, by Art. 9 (employed persons), Art. 15 (self-employed persons) or Art. 19 (provision of services) of Annex I of the AFMP. Employees and employees in international transport who are virtual resident in Switzerland are generally taxed under the same source taxation procedure as resident foreign employees without a permanent residence permit, but without the subsequent ordinary taxation procedure. Accordingly, they are discriminated against in the same way. Artistes, sportsmen, and lecturers are not entitled to allowances for personal and family circumstances. No allowances for professional allowances or personal and family circumstances are granted to members of board of directors.

Consequently, the term "residence" should be amended similarly to the German tax law adjustment to take account of the concept of virtual residence as established in *Schumacker* if a non-resident receives the major part of income or almost all family income in a Member State other than that of residence. The amendment may be limited to EU/EFTA nationals. In principle, virtual resident employees must be subject to the ordinary taxation procedure (the "mixed" assessment procedure). In the author's view, under Art. 21(3) of the AFMP, Switzerland may introduce proportionate measures within the context of virtual residence, particularly in respect of the need to safeguard the collection of taxes. For example, a provisional source taxation procedure with a subsequent ordinary taxation procedure, i.e. the "mixed" assessment procedure, according to which the withheld tax is credited with interest against the ordinary income tax should comply with the principle of equal treatment under the AFMP, regardless of the cash flow disadvantage of such a source taxation procedure compared to the ordinary taxation procedure.[206] The cash flow disadvantage should be proportionate with regard to the need to safeguard the collection of taxes.

5.1.4. Non-resident individuals and legal entities

Source taxation is an established concept of international tax law. According to ECJ case law, the situations of residents and non-residents are not, in general, comparable. The Swiss-source taxation procedure for individuals and legal entities who are not resident for Swiss domestic tax purposes generally complies with treaty law and the AFMP.[207] In the author's view, at the level of the objective tax benefits, the Swiss-source taxation procedure for non-resident individuals and legal entities, however, constitutes an indirect discriminatory measure prohibited, in principle, by Art. 9 (employed persons), Art. 15 (self-employed persons) or Art. 19 (provision of services) of Annex I of the AFMP. With regard to allowances for professional expenses, employees and employees in international transport are generally taxed under the same source taxation procedure as resident foreign employees without a permanent residence permit, but without the subsequent ordinary taxation procedure. Accordingly, they are discriminated against in the same way. The members of boards of directors are also discriminated against, as they are not entitled professional allowances. In contrast, the source taxation procedure for artistes, sportsmen and lecturers should comply with the principle of equal treatment in the AFMP, as it grants the deduction of effective professional expenses. The ECJ held in *Asscher*[208] and *Gerritse*[209] that non-residents and residents are in a comparable situation with regard to the progressivity rule. Accordingly, the application of a higher rate of tax to the income of certain non-residents than that that applies to those who are resident or treated constitutes indirect discrimination prohibited by EC law.

204. Federal Constitution of 18 December 1998, SR 101.
205. Federal Government, Technical Explanations of 23 June 1999 to the Sectoral Agreements between Switzerland and the EC, Federal Journal 1999, Para. 274.32.
206. See also Hinny, "Personenverkehrsabkommen und Schweizer Quellensteuerordnung", note 4, p. 268.
207. As an alternative to the extension of the source taxation procedure to all resident and non-resident employees, Rivier, note 4, p. 123 proposes that only non-resident employees may be subject to the source taxation procedure.
208. ECJ, 27 June 1996, Case C-107/94, *P.H. Asscher v. Staatssecretaris van Financiën*, Para. 49.
209. ECJ, 12 June 2003, Case C-234/01, *Arnoud Gerritse v. Finanzamt Neukölln-Nord*, Para. 53.

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In particular, the source taxation procedure for non-resident employees is expressly linked to frontier workers (*Grenzgänger*) and employees who return weekly (*Wochenaufenthalter*). According to administrative practice, frontier workers and employees who return weekly are also subject to the source taxation procedure if they have their usual abode in Switzerland, for example because they stay, notwithstanding temporary interruptions, for at least 30 days in Switzerland. In this case, however, they are in principle subject to unlimited tax liability and, therefore, resident for Swiss domestic tax purposes and, because of this, subject to the ordinary taxation procedure.[210] It is doubtful if this administrative practice complies with Swiss income tax law. Furthermore, those taxpayers typically receive the major part of income or almost all family income in Switzerland and, therefore, fall under the concept of virtual residence. Accordingly, taxpayers who have their domicile abroad and are resident abroad for Swiss treaty purposes, but receive the major part of income or almost all family income in Switzerland (regardless of whether or not they have their usual abode in Switzerland) should be included in the term "virtual residence" discussed in 5.1.3. and taxed by virtue of the provisional source taxation procedure with a subsequent ordinary taxation procedure.

5.1.5. Source taxation and joint liability

In the author's view, the Swiss-source taxation procedure for non-resident artistes, sportsmen and lectures constitutes an obstacle to the freedom to provide and to receive services, prohibited, in principle, by Art. 2 of the AFMP and Art. 19 (provision of services) of Annex I of the AFMP.[211] In the light of the *Scorpio* case, the source taxation procedure and the joint liability provision may be justified on the grounds of the need to safeguard the collection of taxes in Art. 21(3) of the AFMP. The ECJ held that the use of retention at source represents a proportionate means of ensuring the recovery of the tax debts of the State of taxation. The same is true of the potential liability of the recipient of services who is required to make such a retention.

The joint and several liability (*solidarische Mithaftung*) of the promoters charged with the presentation in Switzerland, however, appears to go beyond what is necessary to safeguard the collection of Swiss taxes and, therefore, might not comply with the principle of proportionality under the AFMP.

5.2. Exit taxation

EU and Swiss nationals who are self-employed persons are entitled to the freedom of establishment as enshrined in the AFMP. In the light of the *Lasteyrie du Saillant* and "*N*" cases, the immediate exit taxation constitutes a prohibited restriction. In the author's view, under Art. 21(3) of the AFMP, Switzerland may introduce proportionate measures, particularly in respect of the need to safeguard the collection of taxes. It appears that a guarantee is a proportionate measure, even though it constitutes a restrictive effect.[212] As there is no mutual assistance for the recovery of taxes between Switzerland and the Member States, the guarantee should be proportionate in respect of its disadvantage.

5.3. Allowances for personal and family circumstances

With regard to allowances for personal and family circumstances, Swiss tax law is based on fractional taxation.[213] Those allocation rules that were derived by the Federal Tribunal from the principle of prohibition of inter-cantonal double taxation, in general, comply with the principle of equal treatment of the AFMP. In *de Groot*, Switzerland as the residence state would, however, have to grant the full allowances for personal and family circumstances. In other words, the ruling of the Commission of Appeal for Tax Matters I of the Canton of Zurich of 5 November 1992 would now have a different outcome.[214]

5.4. Allowances for professional expenses

As allowances for professional expenses are connected to a particular income item, Swiss tax law allocates those allowances to the canton or state that taxes the income. This allocation rule complies with the principle of equal treatment in the AFMP.

Circulars No. 1 of 30 January 1986 on the tax deductibility of contributions to occupational benefit plan (BVG) and No. 2 of 31 January 1986 on the tax deductibility of contributions to recognized forms of individual retirement accounts should, however, be amended.[215] Both resident and non-residents who are subject to Swiss income taxation are entitled to deduct these contributions rather than only taxpayers who are subject to unlimited tax liability in Switzerland. The application of residence works, in particular, against taxpayers who are nationals of Member States and, therefore, constitutes an indirect discrimination.

6. Conclusions

In summary, the ordinary Swiss-source taxation rules and the new Swiss-source taxation procedure as introduced by the measures against illegal employment are primarily influenced by the rule of Swiss international tax law, under which Switzerland has not concluded treaty provisions on mutual assistance for the enforcement of tax debts due to another state.[216] In contrast, the Member States have departed from this rule, i.e. what in the

210. See 3.4.1. and note 45.
211. See note 104.
212. ECJ, 11 March 2004, Case C-9/02, *Hughes de Lasteyrie du Saillant v. Ministère de l'Économie, des Finances et de l'Industrie*, Para. 47 and ECJ, 5 July 2005, Case C-376/03, *D. v. Inspecteur van de Belastingdienst/Particulieren/Ondernemingen buitenland te Heerlen*, Para. 51.
213. See 3.3.2.
214. See 3.3.3.
215. Id.
216. Philip Baker, "Changing the Norm on Cross-border Enforcement of Tax Debts", 30 *Intertax* (2002), p. 216 et seq.

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United States is referred to as "the Revenue Rule",[217] by virtue of the Council Directive on the Mutual Assistance for the Recovery of Claims. This Directive has had and will have a significant effect on present and future EC tax law. Finally, in relation to EU/EFTA Member States under the AFMP, Switzerland and the Member States may, however, invoke the Revenue Rule as a justification of unequal treatment only subject to the strict Community proportionality test, which has the effect of a minor indirect departure from the Revenue Rule in Swiss international tax law. Consequently, although income taxation falls within their competence, Switzerland and the Member States must nonetheless exercise that competence consistently with the free movement of persons and services as set out in the EC Treaty.

217. *Jamiesen v. Commissioner for Internal Revenue*, 9 *International Tax Law Reports* (2007), p. 954 et seq.

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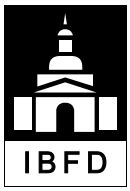

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