

# Sub-national tax competition in Switzerland

The institutional framework and a practitioners perspective on its effects

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Tax competition between sub-central governments

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## Outline

- General features of Swiss Fiscal Federalism
- Tax competition among cantons
- Institutional constraints to competition
- Final remarks

## General features of Swiss Fiscal Federalism

- Three levels of government
  - Federal government (Confederation)
  - Regional governments (26 cantons)
  - Local governments (2636 municipalities)



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## General features of Swiss Fiscal Federalism

- Asymmetric federalism: Marked differences among the cantons (max/min ratios)
  - Surface area: 192
  - Population: 85
  - Aggregate income per capita: 3.05
  - Tax burden on the payroll of CHF 100'000 for a married couple with two children: 3.3

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## Tax competition among cantons

- Competences with regard to taxation
  - In principle...  
Federal, cantonal and shared competences  
The competences of the Confederation are explicitly defined in the constitution
  - In practice...  
**Taxes on goods and services** are most important for the Confederation.  
**Direct taxes** are a shared competence of the three levels of government.  
→ *27 tax laws, significant autonomy and marked differences*

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## Tax competition among cantons

- Revenue structure of the three levels of government
  - Confederation (total CHF 59 bn)
    - Value added tax (33%), Federal direct tax (26%), withholding tax (7%), stamp duty (5%), mineral oil taxes (9%)
  - Cantons (total CHF 75 bn):
    - Taxes (46%), Fees and user charges (15%), revenue sharing (8%), grants (20%)
  - Municipalities (total CHF 49 bn):
    - Taxes (48%), Fees and user charges (28%), grants (15%)

***Cantons and municipalities strongly depend on their own revenues primarily from taxes on income and net wealth.***

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## Tax competition among cantons

- Mix of cantonal taxes (total tax revenues CHF 37 bn):
  - Personal income and net wealth taxes (68%)
  - Corporate income tax and tax on capital (19%)
  - Real estate taxes (1%)
  - Capital gains taxes (2%)
  - Capital transfer taxes (2%)
  - Inheritance and gift taxes (2%)
  - Others (5%)
- Tax base harmonization for the most important taxes
- Autonomy for everything else

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## Tax competition among cantons

- Empirical evidence indicates the existence of tax competition among the cantons (Feld 2009):
  - Mobility of the tax base:  
Individuals and enterprises select their place of residence (other things equal) in cantons with relatively low taxes
  - Strategic behavior by cantons:  
Cantons use tax policy strategically in order to attract mobile tax bases

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## Tax competition among cantons

- What kind of cantonal tax policies lead to competition?
  - Independent cantonal legislation: adjustment of the tax mix
    - Inheritance tax for direct descendants
    - Real estate transfer taxes for self occupancy
  - Within the constraint of a harmonized tax base:
    - Amount of deductions
    - Statutory tax rates
    - Progressivity of the tax rates
  - Tax holidays for regional policy purposes
  - Leeway in tax administration
    - Expenditure based individual taxation
    - Business taxation

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## Tax competition among cantons

- Lowering statutory tax rates of corporate income taxation – the case of the canton of Lucerne
  - The statutory tax rate on corporate income (net profit after taxes CHF 1m) and capital (taxable capital of CHF 10m) will be strongly reduced: by 25% in 2010 and another 50% until 2012 (8.5% federal corporate income tax is not included)
    - 2009: 14%
    - 2010: 10.5%
    - 2012: 5.25%
  - Other cantons have average tax rates in 2009 ranging from 6% in Obwalden to 23.48% in Geneva.
  - Active information by the government of the canton of Lucerne

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## Institutional constraints to tax competition

- Constitutional principles had a harmonizing effect on cantonal taxation – the case of the canton of Obwalden
  - General constitutional principles need to be respected by cantonal tax laws
    - Regularity principle
    - Ability to pay principle
  - The relatively poor and rural canton of Obwalden introduced regressive income tax rates (starting from revenues higher than CHF 300'000) in a referendum (86% approval)
  - The Federal Court ruled this tax scheme unconstitutional
  - Introduction of a flat rate income tax by affected cantons

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## Institutional constraints to tax competition

- Public opinion about tax competition – The case of popular initiatives at the federal level
  - Tax competition is an important issue in cantonal politics and in the public debate
  - Pending popular initiative “in favor of fair taxes” (ballot in fall 2010): Harmonization of cantonal/municipal marginal tax rates for high incomes
  - Co-operation is inevitable among cantons in different policy areas: There may be checks and balances between tax policy and other sectoral policies

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## Institutional constraints to tax competition

- Fiscal equalization
  - Grants are an important revenue source of the cantons
  - New Fiscal Equalization since 2008
  - Equalization transfers are linked to an aggregate tax base and an expenditure needs measure
    - Tax burden has been eliminated as a criteria for equalization transfers
    - Vertical and horizontal resources (or tax base) equalization
  - More tax competition due to the new equalization system?
    - Fiscal equalization is a tax on the tax cantonal base – problematic incentives for development
    - Cantonal tax cuts thanks to higher unconditional equalization transfers

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## Final remarks

- Fiscal federalism and sub-national autonomy require a certain tolerance of inequality with regard to taxation.
- Tax competition in Switzerland in its present form has beneficial effects.
  - Inter-cantonal competition may be fierce in some areas...
  - ...but it still has institutional and political constraints

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