

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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