Competition, Harmonization and Redistribution: Corporate Taxation in Switzerland

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1 Introduction

There is broad-based international agreement that corporate taxation requires supranational coordination. Profit sheltering in low- or zero-tax jurisdictions has been recognized at least since the launch of the OECD's Base Erosion and Profit Shifting (BEPS) initiative in 2013 as a harmful practice for all nations bar a few tax havens. That practice has been estimated to deprive corporate host-country governments of some 200 billion dollars in annual tax revenue (OECD, 2017). According to Tørsløv, Wier and Zucman (2022), eliminating purely tax-motivated profit shifting would increase the corporate tax base by up to 20% in the European Union, 10% in the United States and 5% in developing countries. In contrast, it would contract the corporate tax base by 55% in tax havens. Even if unchecked tax competition implies efficiency losses overall, coordination creates losers as well as winners and therefore implies challenging institutional and political tradeoffs.

Policy coordination in this area boils down to four essential dimensions: (1) harmonization of tax bases, (2) jurisdictional apportionment of tax bases, (3) harmonization of tax rates, and (4) redistribution of tax revenue. The OECD BEPS negotiations have so far involved dimensions (1) to (3). Proposals also exist for cross-country revenue sharing (dimension 4), e.g. among member states of the European Union (European Parliament, 2021).

As a federal country that had started out as a loose confederation of cantons and became integrated, gradually and democratically, Switzerland could be considered as something of a

model or test case for international coordination. Corporate taxation is a case in point. As this article will show, many of the issues that are currently being negotiated at the international level have been disputed within Switzerland as well, and most have been settled within stable and widely supported institutional structures.

This paper thus aims to provide an overview of corporate taxation in Switzerland, structured where possible around the four essential dimensions of policy coordination, and aiming to tease out parallels with current supranational negotiations. We describe and discuss current institutional arrangements and the scientific public-finance literature that exists on them. We moreover seek to trace the emergence of those arrangements and the political and economic forces that helped them into being.

2 Swiss Fiscal Federalism: Three Levels of Government

In this section, we will provide a concise overview of taxation (beyond but including corporate taxes) in the Swiss three-tier system consisting of municipalities, cantons and the federal government:

- Maps with cantons and municipalities
- Descriptive stats on revenue and expenditure shares
- Description of assignment of tax bases and expenditure items to government levels
- Description of fiscal autonomy/coordination across government levels
- Basics of corporate taxation

3 Corporate Tax Base

3.1 Definition: Taxable Profits and Capital

In this section, we will describe the evolution and the current state of the corporate tax base definition. We will focus on selective details, motivated by their relevance to current international discussions. This will include a discussion of deduction of tax payments from taxable profit and of implications for tax competition (firms in high tax locations do not bear the full burden of the local tax).

Important sources:

- Bundesgesetz über die Harmonisierung der direkten Steuern der Kantone und Gemeinden (StHG) vom 14. Dezember 1990.
- Kreisschreiben und Rundschreiben der Eidgenössischen Steuerverwaltung seit 1980, bzw. 2004.

3.2 The Geography of Taxable Profits

In this section, we will provide maps and summary statistics on the spatial distribution of taxable profits. We have collected data on gross profits (total and per capita) are at the canton level since 1950, and at the municipality level since 1970.[1]

By way of an example, Figure 1 presents the per capita gross profit in the Swiss cantons in 1950 and in 2015. A comparison of the two graphs shows that the distribution of per-capita profits across cantons has become more unequal over time, with a particularly pronounced concentration of taxable profits in the canton of Zug (ZG). For an illustration of how changes in per-capita corporate tax bases correlate with changes in canton-level corporate tax rates, see Figure 3 below.

3.3 How Did We Get Here?

In this section, we will provide historical background to the genesis of tax-base harmonization as enshrined in the landmark federal law of 1990 ("Steuerharmonisierungsgesetz"). The aim will be to draw out parallels and differences with respect to the ongoing international efforts at harmonizing corporate tax bases.

4 Profit Apportionment

In this section, we will describe and discuss rules and practices for apportioning profits of multi-establishment firms across jurisdictions. This is a surprisingly non-contentious though only partially codified area of tax coordination in Switzerland. Much is governed by case law (mainly by the Federal Supreme Court) and coordinated by a semi-formal body consisting of cantonal finance ministers. Here too, our focus will be on establishing parallels with respect to current international discussions.

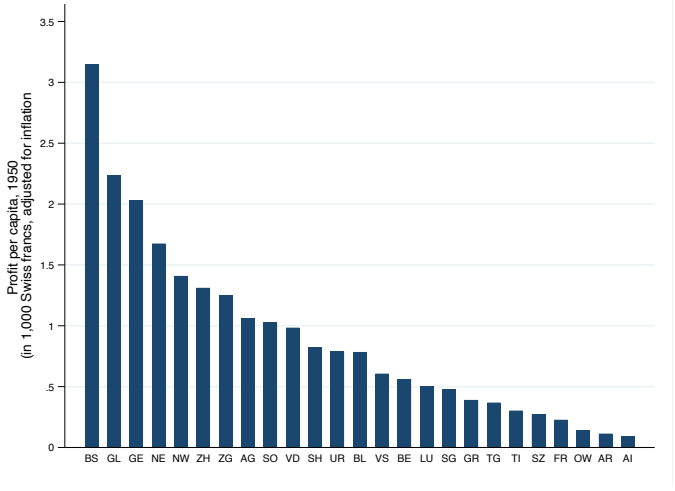
5 Tax Rates

5.1 Tax Burden: Statutory and Effective Rates

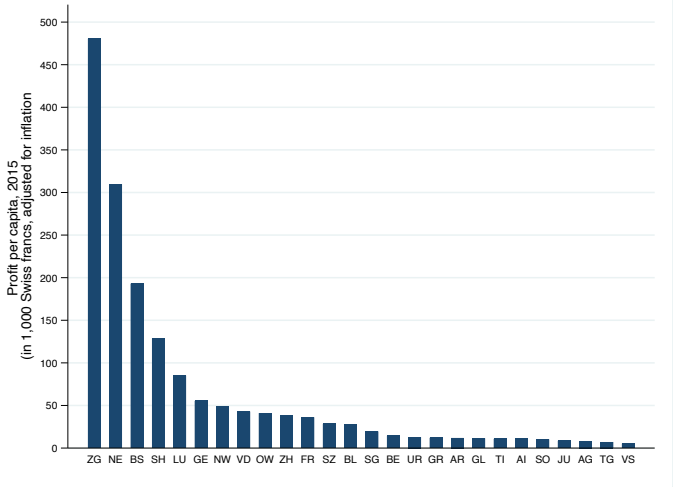
In this section, we will summarize current and past statutory tax rates schedules, covering also a recent reform necessitated by the OECD's objection to differential tax treatment of multinational and domestic firms. Effective tax burdens implied by both corporate income taxes and capital taxes will be presented.

To compute the corporate tax, we can draw on Krapf and Staubli (2020), who have collected tax rates from publicly available federal, cantonal, and municipal tax laws. Most cantons define tax schedules, while municipalities determine multipliers that they apply to their canton

[1] Source: `https://www.estv.admin.ch/estv/de/home/die-estv/steuerstatistiken-estv/allgemeine-steuerstatistiken/direkte-bundessteuer/dbst-jp-kanton-ab-1983.html` for cantonal-level data and `https://www.estv.admin.ch/estv/de/home/die-estv/steuerstatistiken-estv/allgemeine-steuerstatistiken/direkte-bundessteuer.html#-583074674` for municipality-level data.



(a) 1950



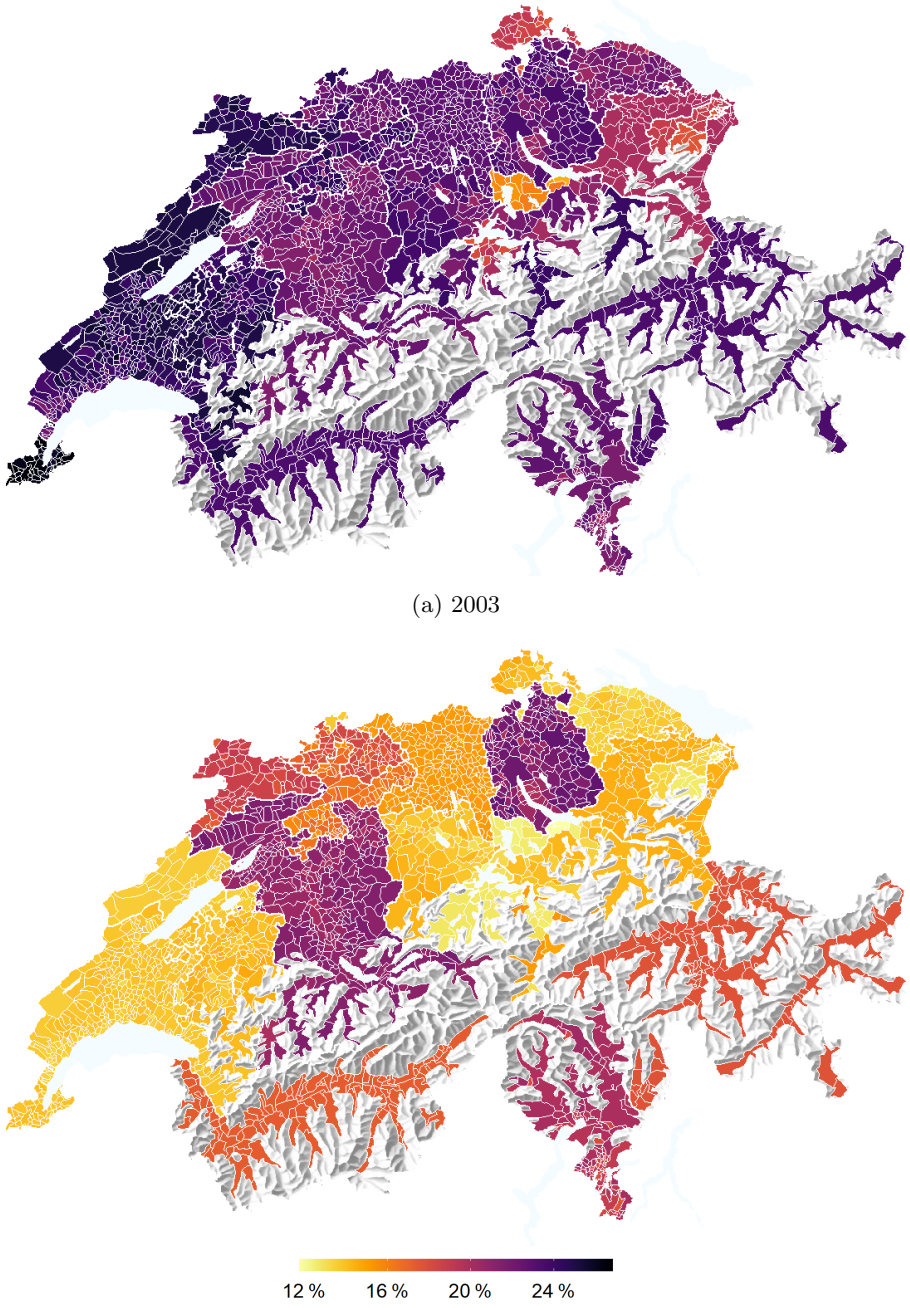
(b) 2015

Figure 1: Per capita gross profit in the Swiss cantons in 1950 and in 2015.

Notes: This figure shows the per capita gross profit across the 26 Swiss cantons (in 2015 Swiss francs) in 1950 and in 2015.

schedule. By way of an example, Figure 2 shows the distribution of corporate tax rates across municipalities. While there is variation within cantons, the regional clustering of tax rates in these maps shows that most of the variation emerges at the cantonal level. The intra-national variation in consolidated effective corporate tax rates, ranging from 12% to 25% in 2020, is considerable and thus makes Switzerland an interesting empirical laboratory.

Even longer series are available at the level of the 26 canton capital municipalities: starting in 1950, those recently compiled data offer new insights on long-term dynamics in sub-federal



(a) 2003

(b) 2020

Figure 2: Effective Average Corporate Income Tax across Swiss Municipalities

tax setting and tax base location decisions. Figure 3 shows the evolution of effective corporate tax rates between 1950 and 2015 with the size of the symbols proportional to the increase in the canton-level per-capita gross profit over the same time period. It emerges quite clearly that

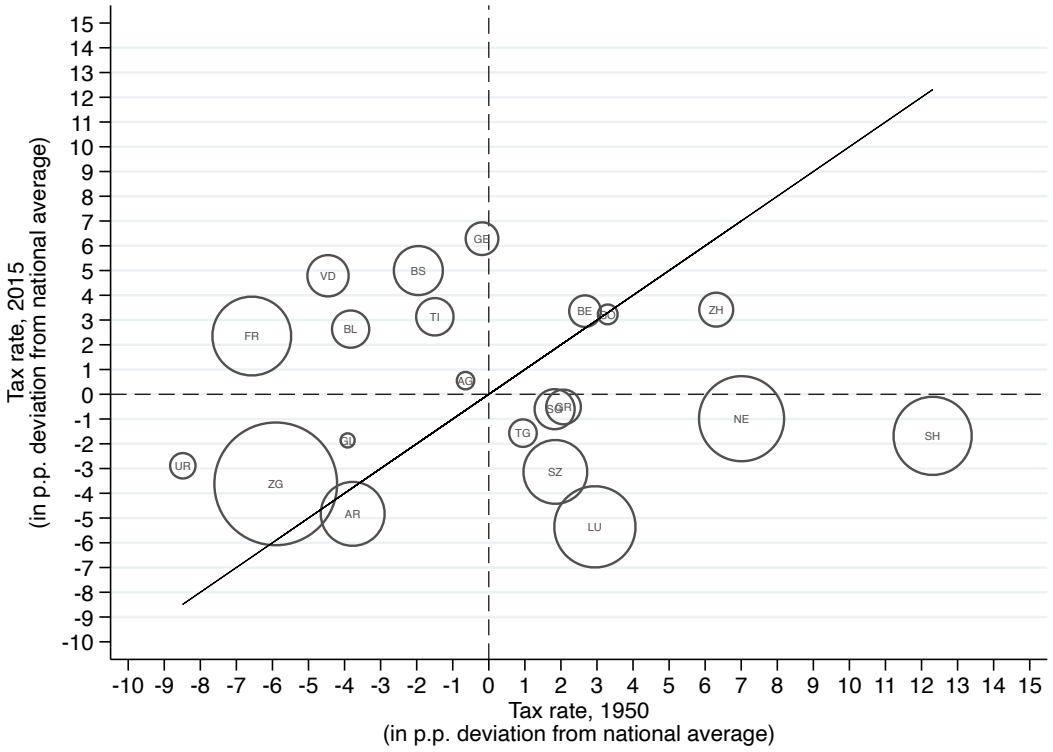


Figure 3: Effective Average Corporate Income Tax Rate across Swiss Cantons, 1950 and 2015.

Notes: This figure shows the effective corporate income tax rate in the cantonal capital cities for 1950 and 2015. Tax rates are reported in percentage points deviation from the national average of each year. The size of symbols is proportional to the increase in canton-level per capita gross profit between 1950 and 2015.

cantons with below-average corporate tax rates in 2015 had seen disproportionate increases in taxable profits. This regularity, however, is far from universal – with some low-tax cantons seeing small increases in the tax base and vice-versa. We will investigate this in further depth.

5.2 Institutional Setting Governing Tax Rates

With the creation of the Swiss Confederation in 1848, cantons waived customs duties in favor of the Federal state. To compensate for tax revenue loss, cantons developed early versions of a fiscal system based on a wealth tax complemented by a tax on earnings. The increase in financing needs, in part due to the two World Wars, changed this *status quo*. Starting in 1915, the Confederation started levying a war tax on wealth and earnings of natural persons and on capital of legal entities. This tax was transformed into a federal income tax in 1934. At the cantonal level, the main shift was away from taxing wealth towards taxing personal and corporate income.

The federal income tax was originally supposed to last for four years only (1934-37). When World War II began and the economy did not improve, these temporary laws were repeatedly extended or replaced with laws that similarly allowed for direct taxation in 1938 and 1941. Since

1941, there has been a "direct federal tax" (direkte Bundessteuer), which until 1983 was refereed to as "defense tax" (Wehrsteuer).

In 1998, the federal government abolished its tax on corporate asset capital, which had been part of the direct federal tax. Most cantons still tax corporate capital. Following the lead of the federal government, most cantons have, however, moved towards proportional tariffs on corporate income as documented in Portmann and Staubli (2020).

Cantons differ not only in their effective tax rates, but also in the rules determining minimum and maximum tax rates, and in the autonomy they grant to their municipalities. We will provide canton-level information for the period 1950-2020 on the following variables:

- Minimum and maximum tax rate (in any);
- Progressivity of cantonal schedule vs flat rate;
- Are municipalities allowed to levy a corporate tax?
- Restrictions to municipality-level corporate tax rates.

6 Revenue and Equalization

6.1 Tax Revenue

In this section, we will provide a concise description of corporate tax revenues at the three jurisdictional levels (municipal, cantonal, federal), drawing mainly on the following sources:

- Municipal, cantonal and federal corporate tax revenue 1990-2019.

→ Maps with spatial distribution, line graphs with time series, etc.

- Federal tax revenue across cantons 1983-2018.

→ Maps with spatial distribution, line graphs with time series, etc.

6.2 Tax Equalization

In this section, we will describe and critically appraise fiscal equalization systems applied in Switzerland. Two levels can be distinguished: (a) the federal-level equalization system that redistributes tax revenues between the federal and cantonal governments as well as among cantons, and (b) canton-level equlization systems that redistribute tax revenues between cantonal and municipal authorities as well as among municipalities.

In general, we will analyze the redistributive effects and incentive effects of the fiscal equalization system. Both are particularly important in a system of tax competition. From a redistributive perspective, the fiscal equalization system might be interpreted as a barrier to tax competition within Switzerland (as it tends to redistribute fiscal resources from potential winners in tax competition to losers) and as a means for Swiss cantons and municipalities that do

not participate in international tax competition to participate in the fiscal resources of those Swiss jurisdictions that compete internationally. We will also review empirical evidence on incentive effects of fiscal equalization. The Swiss system is based on the notion of fiscal capacity equalization, both at the federal level and at the cantonal level. Previous literature has shown that this system strengthens taxing incentives and, thereby, increases corporate tax rates, for instance. As such, it counteracts incentives to lower corporate taxes in tax competition.

To assess these effects, we will summarize the main features of the institutional design, provide basic statistics on redistributive flows, and summarize the available research on incentive effects from variations in equalization rates. Particular attention will be devoted to the magnitude of statutory equalization rates and the weighting of the corporate tax base in computing aggregate tax capacity measures.

7 Conclusions

In this section, we will gather the main insights from the Swiss experience that speak to current debates on corporate tax coordination at the supranational level.

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