

Tax Autonomy and Tax Competition

A practitioners perspective

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DDLGN course

Berne, December 6, 2018

Conference of the Cantonal Ministers of Finance

- 26 cantonal ministers of finance
- 1 central secretariat

Ministers meet 3 - 4 times every year

Committee of 7 ministers meets 7 - 10 times every year

Federal minister of finance often participates in these meetings

- Main issues
 - Fiscal policy
 - Tax policy
 - Public budgeting and accounting
 - Intergovernmental fiscal relations

Homepage (only in German and French): www.fdk-cdf.ch

Outline

- General features of Swiss Fiscal Federalism
- Tax autonomy of Swiss cantons
- Tax competition
- Horizontal collaboration

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General features of Swiss Fiscal Federalism

- 8.3m inhabitants
- 4 national languages
- Fragmented territorial structure
- Differences between the cantons
 - **Area:** GR is 192 times larger than BS
 - **Population** ZH is 91 more populous than AI
 - **GDP per capita** is in BS 3.2 times higher than in UR
 - **Personal income tax** (CHF 100'000, married couple with two children) is 10 times higher in NE than in ZG

General features of Swiss Fiscal Federalism

- Total Government spending: 33% of GDP
- Aggregate surplus: 0.4% of GDP
- Aggregate public debt (IMF definition): 43% of GDP

2017	Public Expenditures	Public Revenues	Gross Debt (IMF definition)
Confederation	34%	36%	49%
Cantons	44%	42%	29%
Local Governments	22%	22%	23%
Total	100%	100%	100%

General features of Swiss Fiscal Federalism

- The fragmented structure provides beneficiary effects from decentralization
 - Heterogeneous preferences
 - Accountability
 - Laboratory federalism
- Is Switzerland too fragmented?
 - Economies of scale
 - Spillover effects
 - Fiscal disparities

Positive aspects prevail – difficulties can be resolved

General features of Swiss Fiscal Federalism

- Important constitutional principles
 - **Subsidiarity** : A task should be assigned to the lowest possible level of government
 - **Fiscal equivalence** : finances, benefits and decision-making should be located at the identical level of government
 - **Solidarity** : Mechanism of fiscal equalization
- Competitive federalism
 - Fiscal outcomes vary from one canton to the other
- Cooperative federalism
 - Practical solutions for efficient service provision
 - Horizontal and vertical co-operation

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Tax autonomy of Swiss cantons - Basics

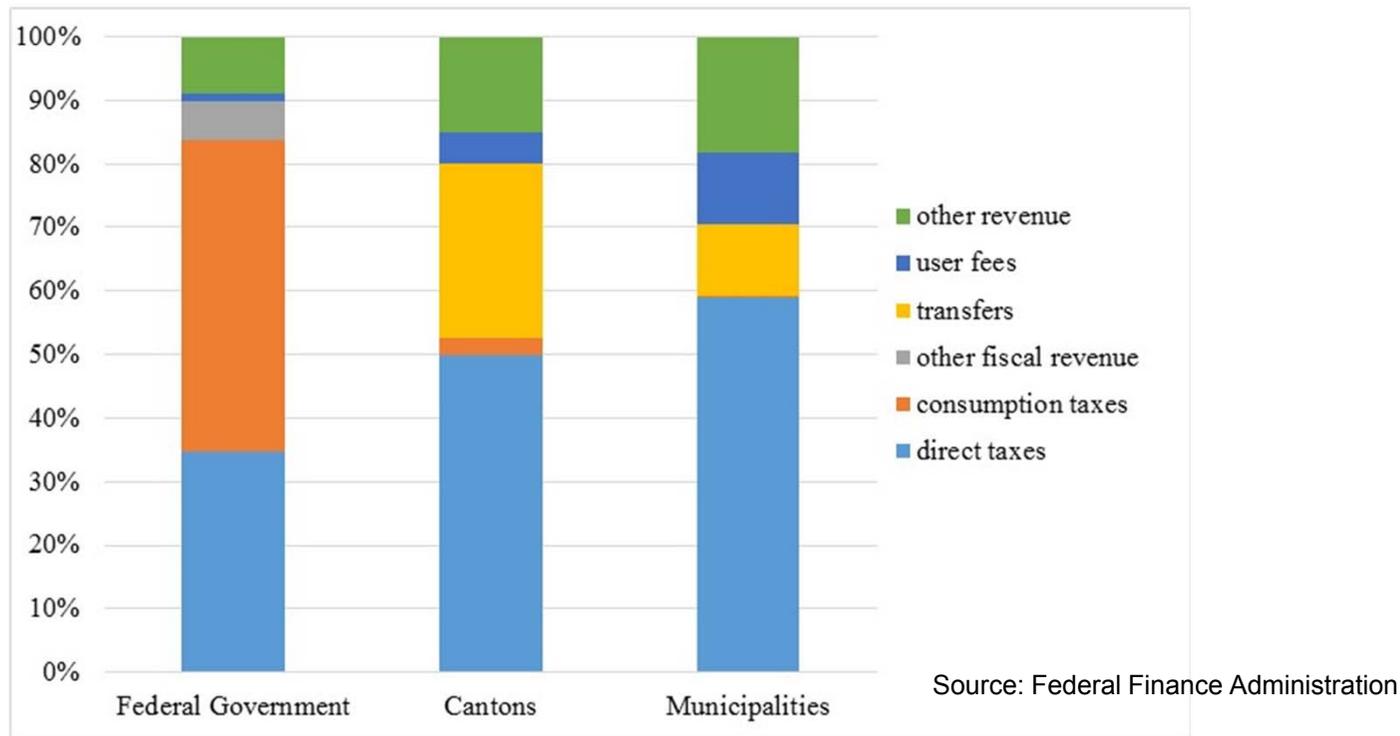
- Financial autonomy
 - Cantons are competent to provide public services and levy taxes unless explicitly excluded by the federal Constitution
- Organizational autonomy
 - Cantons can choose how they want to provide the services within their competence.
- Cantons implement federal law
 - Government agencies mostly at the cantonal / local level (e.g. federal highways)
- Relations with the local governments
 - Cantons define individually the relations to their local governments

Tax autonomy of Swiss cantons - Basics

- Taxes on goods and services are mainly a federal competence (VAT)
- Income Tax: shared federal-cantonal competence
- 27 different income tax laws
 - One federal and 26 cantonal
 - Federal tax harmonization law – Tax base harmonization
 - Complete autonomy for cantonal tax rates
- Tax administration mainly at the cantonal level
 - Cantons collect also federal direct taxes

Tax autonomy of Swiss cantons - Revenues

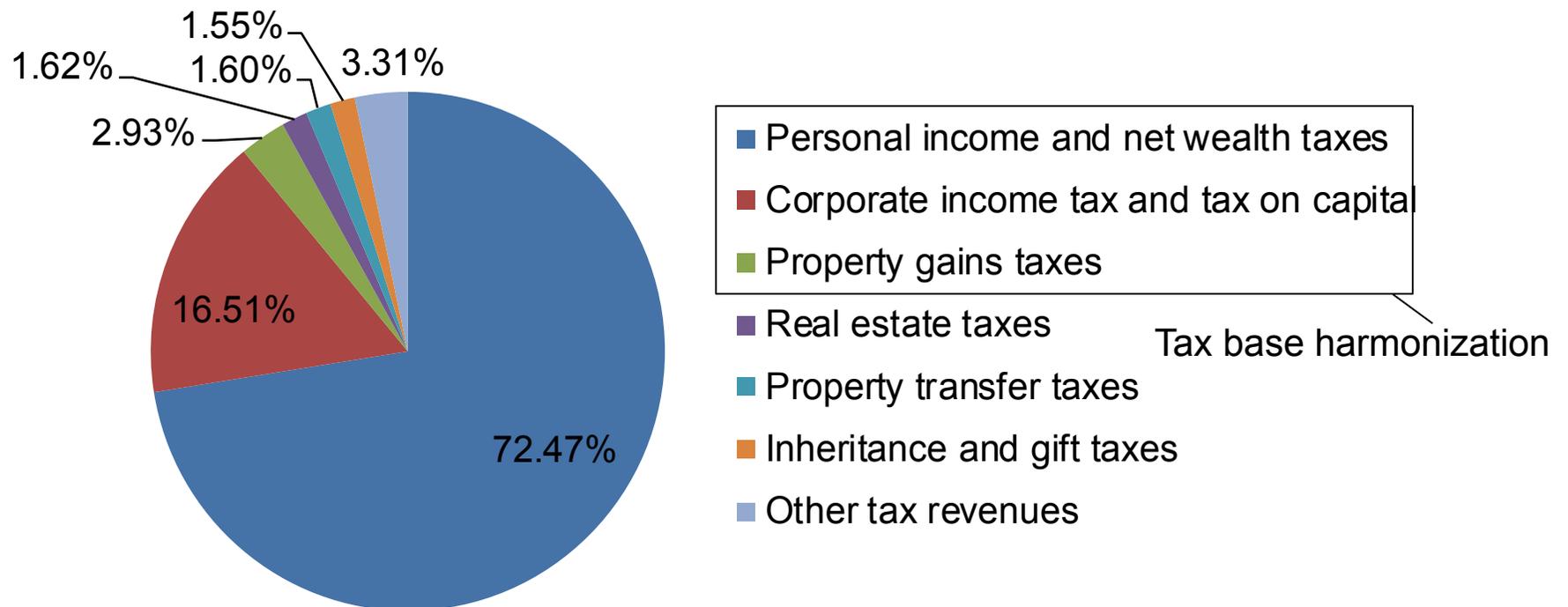
- Revenue structure of the three levels of government



- ***Cantons and municipalities strongly depend on their own revenues primarily from direct taxes.***

Tax autonomy of Swiss cantons – Tax mix

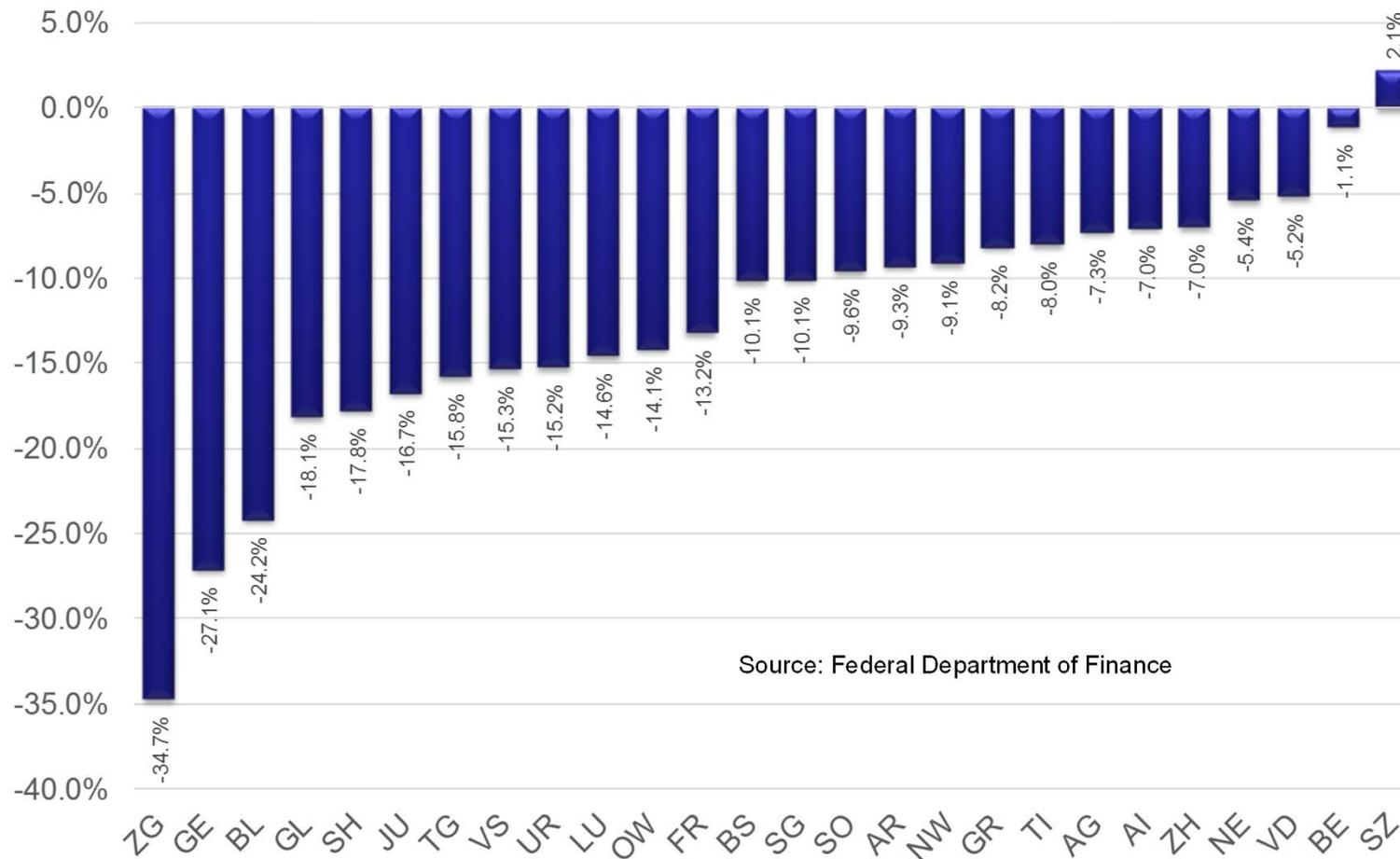
- Mix of cantonal and municipal tax revenue: CHF 74 bn (2016)



Source: Federal Finance Administration

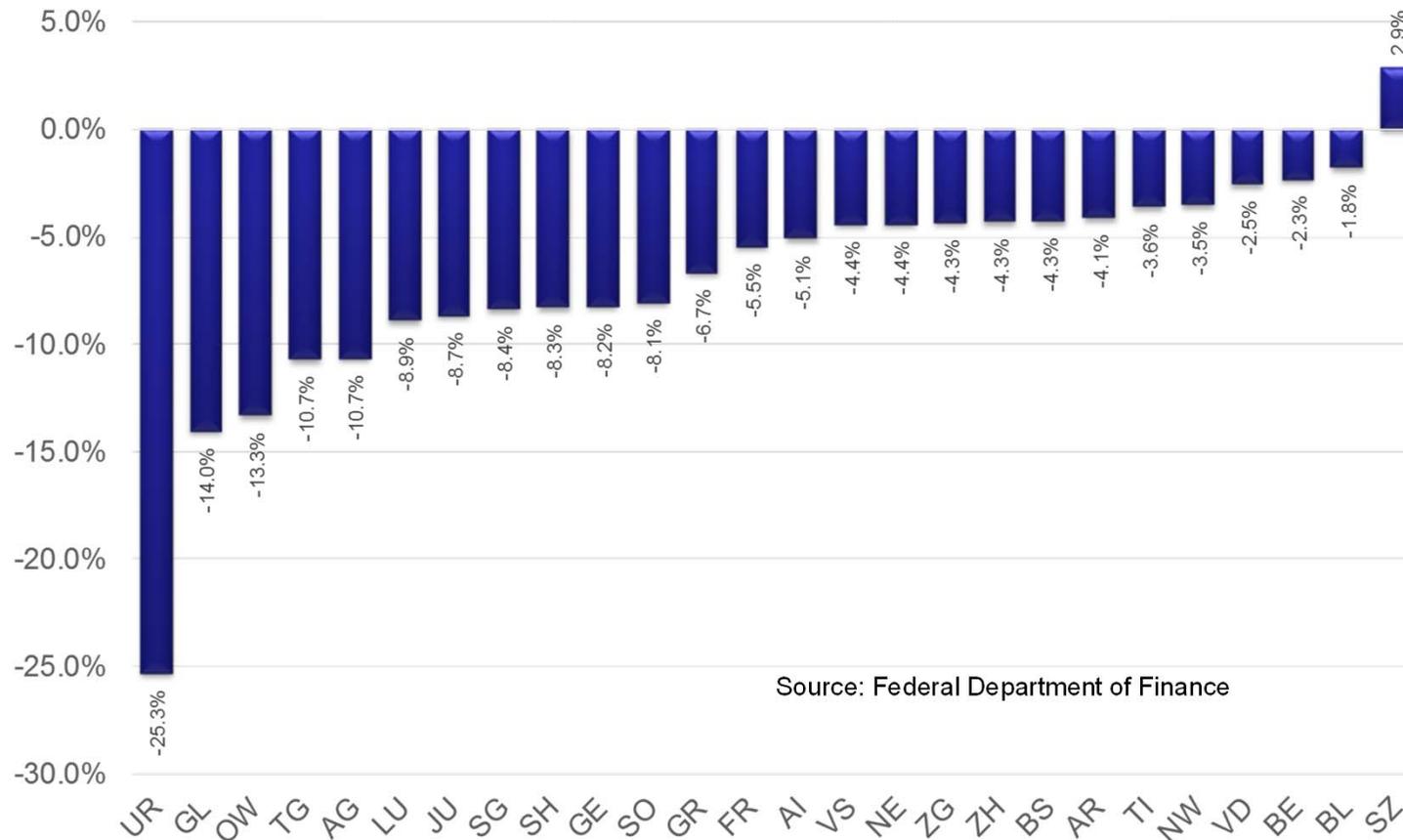
Tax autonomy of Swiss cantons – Tax burden

Change of tax burden in % of a married couple with no children in the capital city, revenue CHF 100'000 (2005-2016)



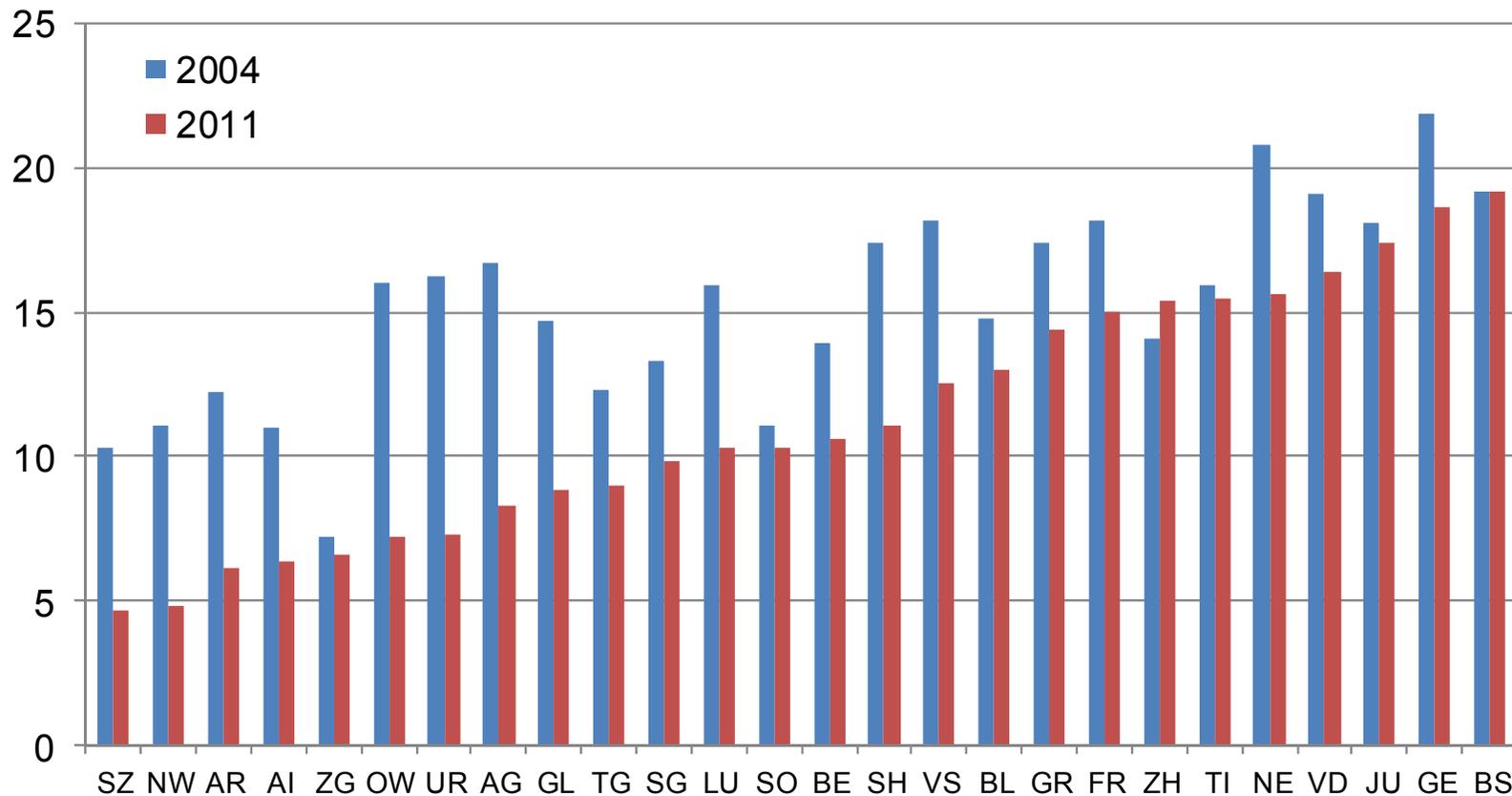
Tax autonomy of Swiss cantons – Tax burden

Change of tax burden in % of a married couple with no children in the capital city, revenue CHF 400'000 (2005-2016)



Tax autonomy of Swiss cantons – Tax burdens

Corporate income tax burdens in %



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Tax competition

- 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
- Cantonal inheritance tax – alleged tax competition? (Brühlhart & Parchet 2014)

Tax competition

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

Tax competition – institutional constraints

- 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

Tax competition – institutional constraints

- Fiscal equalization
 - Grants are an important revenue source of the cantons
 - Important reform in 2008, adjustment in 2020
 - Equalization transfers are linked to an aggregate tax base measure
 - Tax competition despite the equalization system
 - Fiscal equalization is a tax/subsidy on the cantonal base
 - Problematic incentives for development (marginal rates of more than 100% for the poorest cantons) – progressive redistribution formula
 - Cantons cut taxes thanks to higher unconditional equalization transfers despite problematic incentive effects

Tax competition – institutional constraints

- Public opinion about tax competition is relevant
 - Tax competition is an important issue in cantonal politics and in the public debate
 - Popular initiatives and referenda about tax harmonization
 - Difficult financial situation of the cantons in combination with fiscal rules / fiscally conservative voters
 - Co-operation is inevitable among cantons in different policy areas: Informal links between tax policy and other sectoral policies

Tax competition – institutional constraints

- Corporate tax reform
 - Cantonal tax regimes will be abolished
 - New federal tax legislation to maintain the mobile tax base (patent box, etc.), stable federal tax rates at 8.5%
 - More revenue-sharing Confederation-cantons.
- A new wave of inter-cantonal corporate tax rate competition?
 - One time adoption
 - Converging tax rates expected
 - Institutional constraints should be effective

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Horizontal collaboration

- Vertical fiscal coordination (Confederation – cantons)
 - Autonomy vs. Solidarity
 - Increasing number of federal guidelines in fields of cantonal service provision
 - Creeping centralization
- Horizontal fiscal coordination (among cantons)
 - Efficiency of public service provision – Regional Spillover-effects (e.g. specialized medicine)
 - Regional equity concerns (fiscal equalization)

Horizontal collaboration

- Particular areas of collaboration
 - execution of criminal penalties and measures;
 - education;
 - cantonal institutions of higher education;
 - cultural institutions of supra-regional importance;
 - waste management;
 - waste water treatment;
 - urban transport;
 - advanced medical science and specialist clinics;
 - institutions for the rehabilitation and care of invalids.

Horizontal collaboration

- Pragmatic approach towards “inter-cantonal cooperation with mechanisms of compensation”
 - Practical solutions on a regional basis
 - Necessary cooperation for public service provision
 - Different policy areas
 - Limited practical use of the constitutional instruments

Final remarks

- Fiscal federalism and sub-national autonomy require a certain tolerance for inequality with regard to taxation.
- Fiscal competition is a central element of Swiss fiscal federalism.
- Cooperation is inevitable and well established
- Tax competition has institutional and political constraints
 - Tax base harmonization for the most important taxes
 - Constitutional principles of taxation
 - Fiscal equalization
 - Cantonal fiscal rules – fiscal preferences
 - Political restrictions