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Marco Cavallaro

Internationalization dynamics in the Swiss
Corporate Tax Reform III

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**Internationalization dynamics
in the Swiss Corporate Tax Reform III**

Marco CAVALLARO
Author

Dr. Francesco MAIANI
Supervisor

Dr. Andreas LADNER
Expert

in the

University of Lausanne
Faculty of Law, Criminal Justice and Public
Administration
Swiss Graduate School of Public Administration

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“ Events and developments are not global or national or local or some other scale, but an intersection of global and other spatial qualities. [...] A government may be sited at a country level, but it is a place where supranational, national and subnational spaces converge. Thus states are involved in transworld law and regional arrangements as well as national regulation and relations with provincial and local authorities. ”

John Aart Scholte (2005: 78)

UNIVERSITY OF LAUSANNE

Abstract

Faculty of Law, Criminal Justice and Public Administration
Swiss Graduate School of Public Administration

Master in Public Management and Policy

Internationalization dynamics in the Swiss Corporate Tax Reform III

by Marco CAVALLARO

Over the last years, in a context of international tax competition, international and regional institutions such as the G20, the OECD, and the European Union are redefining what is acceptable in terms of corporate fiscal policy. Certain Swiss preferential tax treatments are considered by the above-mentioned institutions as harmful tax practices. As a consequence, the Swiss government has planned a third corporate tax reform (CTR III). The objective of this reform is to ensure international acceptability of the corporate tax system without prejudicing local public finances and Swiss corporate tax attractiveness. Therefore, we can posit that the CTR III is an internationalized object influenced by both regulation trends and tax competition framework. The main purpose of this paper is to provide elements of answer on how the currently discussed CTR III is influenced by the international environment, by focusing on its content as well as the reactions and positions of local stakeholders. With the help of internationalization literature, two distinct internationalization processes have been identified through the propositions of compliance measures with internationally-defined standards and competitiveness-enhancing measures. With regard to the configuration of local actors, the degree of conflict seems to be rather high. The current content of the reform is supported by the business community and right-wing parties and rejected by the unions and the Socialist Party.

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Abbreviations

BEPS	B ase E rosion and P rofit S hifting
CDP	Swiss C hristian D emocratic P eople's P arty
CFC	C ontrolled F oreign C ompany
CFD	C onference of C antonal F inance D irectors
CGC	C antonal G overnments C onference
CTR III	C orporate T ax R eform I II
EC	E uropean C ommission
ECOFIN	E conomic and F inancial A ffairs C ouncil of the C ouncil of the E uropean U nion
EU	E uropean U nion
FDF	Swiss F ederal D epartment of F inance
FDP	Swiss F ree D emocratic P arty
FHTP	F orum on H armful T ax P ractices
FTA	Swiss F ederal T ax A dministration
G20	T he G roup of T wenty major economies
NID	N otional I nterest D eduction
OECD	O rganization for E conomic C ooperation and D evelopment
SAC	Swiss A ssociation of C ities
SACU	Swiss A rts and C rafts U nion
SFTU	Swiss F ederation of T rade U nions
SNB	Swiss N ational B ank
SP	Swiss S ocialist P arty
SPP	Swiss P eople's P arty
SPSTU	Swiss P ublic S ector T rade U nion
TFEU	T reaty on the F unctioning of the E uropean U nion
THA	T ax H armonization A ct

Chapter 1

Introduction

“Recently more and more enterprises organized abroad by American firms have arranged their corporate structures-aided by artificial arrangements between parent and subsidiary regarding intercompany pricing, the transfer of patent licensing rights, the shifting of management fees, and similar practices [...] in order to reduce sharply or eliminate completely their tax liabilities both at home and abroad.” These words were not spoken by recent U.S. Presidents Barack Obama or George W. Bush, but by John Fitzgerald Kennedy in an address to the U.S. Congress in 1963. As globalization developed, more and more nation states have reduced their corporate tax burden in order to attract foreign capital. This practice is said to have negative effects on governments, firms and citizens. Indeed, such policies are not only viewed as harmful for national budgets but also for the credibility of the national tax system since preferential tax regimes may be considered by citizens and media as unfair. A reduced tax burden on certain companies would lead to a distorted competition at the expense of other firms, in particular those active in the national market only. Finally, a large part of the population of countries in which firms are relocating for fiscal issues, are likely to compensate States’ fiscal losses by paying more taxes (OECD, 2013b: 8).

Even though, as shown by the quotation above, the corporate tax base erosion issue is not new, it has become a global problem only recently. The OECD’s BEPS Plan and the EU Code of Conduct on business taxation are among the most concrete projects seeking to alleviate the harmful effects of international tax competition. Through these projects, the OECD (with the influence of the G20) and the European Commission are

defining whether determined tax practices are acceptable or not at the international and European levels. Switzerland is one of the countries whose corporate tax system is affected by these initiatives. A lack of clarity on the future developments of the tax regime would lead to an increased uncertainty for businesses. To address these concerns, the Swiss government has launched a third corporate tax reform (CTR III), whose aim is to reach an internationally accepted corporate tax system without prejudice to local public finances and Swiss corporate tax competitiveness.

Embedded in the context of globalization, the currently discussed CTR III is an example of how a local policy may be influenced by events occurring outside national boundaries. Certain scholars refer this phenomenon as the *internationalization of public policy*. By applying the theory resulting from internationalization literature on this specific case, the purpose of this paper is to demonstrate how the CTR III is influenced by the international environment. Not only in terms of international acceptance, but also with regard to tax competition, and actors' configuration.

The paper is structured as follows: After having addressed methodological issues in Chapter 2, scholar findings in the field of policy internationalization and global tax competition will be introduced in the third chapter. In Chapter 4, the context of the reform will be explained through brief presentations of the Swiss corporate tax system and the OECD and EU projects against corporate tax base erosion. The fifth chapter will present the broad lines of the CTR III. The bulk of the analysis will be elaborated in Chapter 6, which characterizes the influence of the international context on the content of the reform as well as on the configuration of local actors.

Chapter 2

Methodology

The methodology used in this paper consists mainly in the so-called *desk research*. Indeed, this paper is based mostly on publications of the Swiss government, international institutions, and other stakeholders but also on existing research and press articles.

Theoretical insights are provided by existing research in the fields of globalization and internationalization studies. Literature in these fields has coined several concepts that often describe the same process¹. Concerning the possible content of the CTR III, the FTA consultation report (2014b), addressed to the stakeholders participating in the consultation phase, is at the time of this writing the most recent and complete Swiss official document on this matter and it will therefore be used as reference when it comes to depict Swiss Confederation's policy proposals. OECD and EU official documentation will constitute the main references concerning the identification of external pressures on Swiss corporate tax legislation. Positions of local actors will be detailed on the basis of consultation documents, press releases and press articles.

The main difficulty with regard to the drafting of this paper resides on the dynamic character of the subject. Particular attention on current events was necessary to report significant developments on this matter. Furthermore, it is not even sure whether this reform will be implemented since it could be subject to referendum. However, the CTR III, implemented or not, remains an obvious example of the extent to which local authorities can be influenced by the international environment.

¹For instance, the process of implementation of a policy based on foreign experience is referred to as *policy transfer*, *policy band-wagoning*, *lesson-drawing* among others.

Chapter 3

Theoretical framework

In the Theoretical framework section, notions such as *Internationalization* and *Tax Competition* will be developed. Defining these concepts and exposing their current episteme can be useful for the upcoming analysis, since this reform is directly concerned by external constraint and interstate competition. Subsequently, we will also provide theoretical insights on the impact of internationalization on the local stakeholders' configuration.

3.1 Defining Internationalization

Due to the developments over the last decades, we can assert that more and more public policies should be analyzed in a larger context than national boundaries. The term *Internationalization* - usually defined as an expression of “the growing weight of the international dimension in the conduct of national policies” (Fournier, 1996: 15) - becomes particularly relevant as the recent developments of world economy and the growing interdependence between nations enhance state governments to consider an international dimension in most of their policies. As Wayne Parsons stated: “Public policy now takes place in a world system as well as in national political systems.” (Parsons, 1996: 234) The expression *globalization*, which is more common than internationalization, differs with the latter in terms of units of analysis. Indeed, contrary to the notion of internationalization in which state governments are considered as the main unit of analysis, the term *globalization* implies that world social relations can also be described with other modes of organization, governance, and identity equally important such as regionalism,

cosmopolitanism, and other ideologies that transcend national boundaries (Scholte, 2005: 56). The term *internationalization* is used in this paper in a context in which a country legislation is influenced by a logic of justice and coherence between nations' corporate tax policies.

In order to better assess the complexity of such mechanisms, it appears necessary to acknowledge that internationalization does not occur in a homogeneous way. As Dolowitz and Marsh (2000) claimed, what they call *policy transfer* can result from a desire to implement successful policies that have been adopted abroad as well as from an imposition coming from a globally or regionally recognized supranational institution. During the 1990s, several labels were used by scholars in order to describe voluntary decision to adopt foreign-implemented policies: *Lesson-drawing* (Rose, 1993), *policy band-wagoning* (Ikenberry, 1990), *policy borrowing* (Cox, 1999) or *policy shopping* (Freeman, 1999). To describe a clear compulsion to conform originated by external entities, scholars used the terms *external inducement* (Ikenberry, 1990), *penetration* (Bennett, 1991) or *direct coercive transfers* (Dolowitz & Marsh, 1996: 347). However, internationalization often results from a mixture of both extremes. Local policies can for instance result from the existence of international competition or a willingness to align a determined legislation with regional or international legal framework.

In spite of the growing amount of papers discussing the issues of globalization and internationalization, there is no agreed consensus concerning their impact on nation states (Hay, 2004: 316). Owing to the increasing importance of international integration for domestic policy and the relativization of boundaries in a globalization era, some economists argued that nations have lost significance. In this direction, in the late 1960's, the economic historian Charles Kindleberger asserted that "the nation state is just about through as an economic unit" (Kindleberger, 1969). Pulitzer Prize winner Thomas Friedman stated that countries should wear what he has termed as the *golden straightjacket* by decentralizing government, privatizing industries, and abolishing tariffs as well as other obstacles to foreign investment. In sum, the nation state should sacrifice part of its economic sovereignty to capital markets and multinational corporations. Has the nation state really lost this much significance? Although it seems obvious that the overall weight of international dimension on domestic legislation has increased, nation states are far from having entirely lost their sovereignty. In the large majority of the cases, internationalization is rather flexible than rigid. Such flexibility allows governments to better adapt

local policies with a given level of external influence within their own context. As Jan Aart Scholte (2005: 78) asserted: “Events and developments are not global or national or local or some other scale, but an intersection of global and other spatial qualities. [...] A government may be sited at a country level, but it is a place where supranational, national and subnational spaces converge. Thus states are involved in transworld law and regional arrangements as well as national regulation and relations with provincial and local authorities.” Hence, for this paper, nation states will be regarded as spaces of interconnexion between various scales of governance. Processes of globalization and internationalization should therefore not be merely considered as constraints on declining nation states. The reality of globalization may be less significant as it is often emphasized. On this matter, Colin Hay, by using the example of international tax competition, mentions the hypothesis according to which ideas about globalization affect political outcomes in a more significant way than globalization itself (Hay, 2004: 343). Indeed, any political actor believing in a vicious tax competition between states will advocate for corporate tax cuts. Internationalization may therefore also be viewed as a social construct that affects the behaviour of government officials and other domestic actors.

3.2 Tax competition as a globalization outcome

One of the implications of the recent globalization trend is the increased mobility of capital. This trend, in turn, implies that firms may have increased incentives to relocate in another country if they consider that they would be better off by doing so. Several factors can justify such decisions. According to Koellreuter *et al.*, the main localisation factors for firms in Switzerland are the presence and the cost of skilled labour force, the ease in obtaining permissions to build, and the tax burden for business (Koellreuter *et al.*, 1995). The importance of the tax system is even more significant for certain categories of companies (holding, administrative societies) which are not commercially active and employ a limited number of workers, since their activities might easily be relocated in other countries. The corporate tax rate can therefore be considered as a potential tool of international tax competition.

As Genschel and Seelkopf stated, there is proved evidence of mobility and tax sensitivity of companies, especially the multinational ones which usually “increase paper profits of affiliates in low-tax countries and reduce them in high-tax countries” (which is referred

as *tax-planning*; Genschel & Seelkopf, 2012: 8). Given the increased mobility of capital and its implications, governments, which can be considered as jurisdictions that compete for capital, have an incentive to offer business-friendly tax packages for welcoming foreign and multinational investments and for giving local companies motives to not relocate. On this matter, Genschel and Seelkopf (2012: 6) assert that the *competition state*² “spares capital income from heavy taxation by taxing it outside the global income tax at low proportional rates (so-called schedular taxation), by cutting corporate taxes or by offering preferential tax treatment (so-called preferential tax regimes) to particularly tax-sensitive corporate entities (for instance, foreign companies, holding companies, shipping companies, financial services companies) or individuals (expats, high net worth individuals).” What is referred as *tax competition* is defined by Roháč (2006: 87) as “the process of uncooperative setting of tax rates in order to attract mobile tax bases.” Devreux and Loretz (2012: 2) add to this definition the idea that “a country is constrained by the tax setting behaviour of other countries.” Local policy decision-making on corporate taxation issues may therefore be considered as constrained by the competition prevailing at the international level. This trend is often said to lead to a so-called *race to the bottom*, since governments may be encouraged to lower their corporate tax burden in order to reach a certain level of competitiveness.

In several globalization studies³, we find a strong correlation between a country’s degree of trade integration and the reduction of corporate tax rates. According to Exbrayat (2007), the market size can also determine a government’s responsiveness to tax competition. This potentially explain why G7 countries can have higher corporate tax rates, without compromising their attractiveness (Exbrayat, 2007: 16). Similarly, a study by Genschel and Seelkopf (2012: 10) suggests that certain smaller countries (often considered as tax havens) have cut corporate taxes more vigorously than larger countries, since mobile investments constitutes a larger portion of their income. Thus, smaller countries, according to Genschel and Seelkopf, are closer to the model of competition state than

²The notion of *competition state* was coined by Philip G. Cerny (1990) to describe the changing pattern of state economic interventions in order to cope with growing international mobility of capital. According to Cerny (1990: 230), the state is forced “to act more and more like a market player, that shapes its policies to promote, control, and maximise returns from market forces in an international setting.”

³Rodrik, 1997; Swank, 1998; Swank & Steinmo, 2002; Slemrod, 2004; Krogstrup, 2006; Garretsen & Peeters, 2007; Schwarz, 2007 among others.

larger ones. Besides the size of the country, the imperative to compete may also be tempered by other imperatives such as protection of workers, environment, and sub-states equity. Different tendencies were then found concerning governments' tax competition responsiveness. It may be worth noting that, as a relatively small country with open economy, Switzerland is likely to be considered as a country particularly responsive to tax competition.

3.3 The impact on the configuration of local actors

Internationalization does not limit itself to policy, but may affect also the positions of local stakeholders⁴. When it comes to power-sharing, the national executive's position is usually strengthened in internationalized decision-making processes, compared to domestic ones (Putnam, 1988; Sciarini, 1992; Moravcsik, 1998; Mach, 2004 among others). Among economic sectors, the position of the export industry seems to be clearly fortified compared to the domestic economy (Fischer, 2007: 558; Mach, 1999: 429). The results are less clear with regard to unions. Indeed, in some reforms, the unions "asked for side-payments and developed strategies (referendum threat) which empowered them even compared to a purely domestic decision-making process." (Fischer, 2007: 565) Concerning the influence of internationalization on political fragmentation, scholars are not unanimous. On the one hand, according to Armingeon (1998) among others, internationalized policies have a lower degree of conflict than usual due to a perception of a lack of room for manoeuvre. On the other hand, according to Hug & Sciarini (1995), the take-it-or-leave-it character of an internationalized reform reduces the chances of finding compromises.

⁴Putnam, 1988; Hug & Sciarini, 1995; Armingeon, 1998; Mach, 2004; Fischer, 2007 among others.

Chapter 4

Contextual background

4.1 Corporate taxation in Switzerland

As a federal state, the Swiss taxation system is characterized by its federalist structure. The Confederation, the 26 cantons and municipalities perceive their own direct taxes. Both federal and cantonal levels benefit from *fiscal sovereignty*, i.e. the right to levy taxes and to freely make use of the resulting revenues (FTA, 2012: 3). Accordingly, the Swiss taxation system is governed by 27 different legislations (1 federal and 26 cantonal) and is therefore characterized by various tax rates. Limits to the federal fiscal sovereignty are stated in the Constitution: art.3 stipulates that cantons exercise all the rights that are not explicitly conferred to the Federal State. The municipalities, on the other hand, benefit from what is called *delegated fiscal sovereignty*, i.e. the right to levy taxes and to make independently use of the resulting revenues only where authorized by their canton.

Cantonal fiscal sovereignty has been somewhat tempered by the Tax Harmonization Act (THA, CC 642.14), implemented in 1993. This law prescribes principles that must be applied by cantonal and municipal legislators with regard to various formal aspects such as tax liability, tax object, and procedural rules. But the determination of tax rates is under the jurisdiction of cantons (art.129 para.1 and 2 Cst; art.1 para.3 THA).

In the following sections, we will focus on the Swiss corporate taxation system as well as the importance of cantonal tax regimes for all levels of public authorities.

4.1.1 The Swiss corporate taxation system in a nutshell

Given the federalist structure of the Swiss taxation system, a corporate tax on profits is collected by the Confederation, cantons, and municipalities. While taxable profit is determined by the Tax Harmonization Act, each canton can freely fix its profit tax rate. Taking into account the three levels, tax rates vary from 12 to 24% (FTA, 2014b: 12). Abolished in 1998 at the federal level in the context of the first corporate tax reform, the capital tax is only perceived by cantons and municipalities.

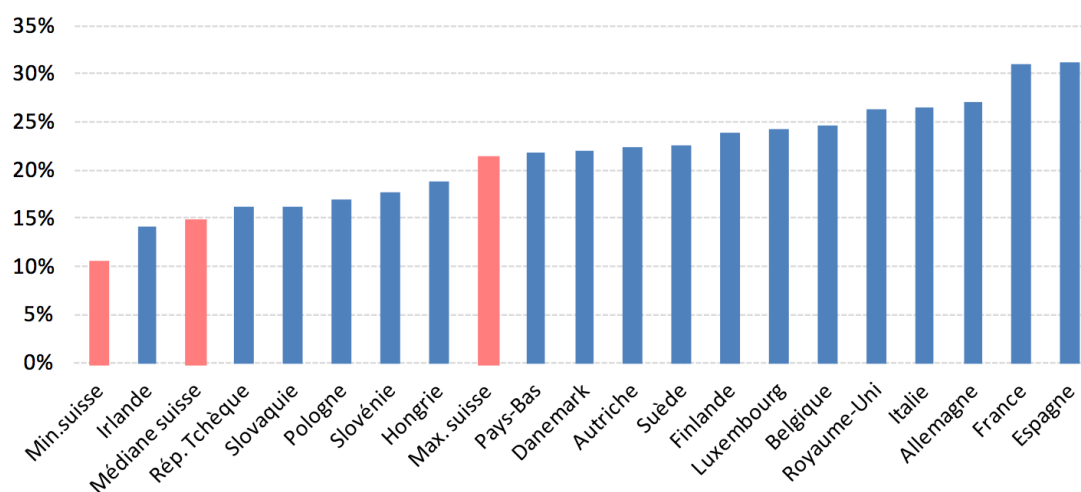
While at the federal level, all types of corporations are subject to the direct federal tax (which rate amounts to 8.5%), special tax regimes can be found at the cantonal level. About 25,000 companies - holding, mixed, and domiciliary companies - benefit from these cantonal tax regimes. In fact, they can be either exempt from tax or subject to lower tax rates (Geiser, 2013). The term *holding companies* comprises companies that are not engaged in commercial activities in Switzerland, whose main purpose is to own controlling interests in other companies. In accordance with the art.28 para.2 THA, the holding status is conferred to companies whose holdings represents at least two thirds of total assets or whose revenues represent at least two thirds of the total revenues (FTA, 2014a: 22). *Domiciliary companies* (art.28 para.3 THA) include companies that perform only administrative (and not commercial) activities in Switzerland. Their operations occur exclusively outside Swiss borders. *Mixed companies* (art.28 para.4 THA) which commercial activities are mostly oriented toward other countries, can also engage in commercial activities in Switzerland provided that these activities remain of lesser importance. Domiciliary and mixed companies are both included in the category of *management companies* (FTA, 2014a: 15). Companies profiting from these tax arrangements are generally taxed at rates that can vary from 7.8 to 12 % (FTA, 2014b: 13). Cantonal tax regimes have allowed Switzerland and its cantons to be competitive in attracting internationally active companies, as shown in FIGURE 4.1. Preferential tax treatments exist also at the federal level. It is worth to mention for instance the favours granted to Swiss Finance Branches⁵ whose combined tax burden is generally around 2% or 3% (Greater Zurich Area AG, 2013) and principal structures⁶ which might benefit

⁵A Swiss Finance Branch is a Swiss entity of a foreign company dedicated to intra-group financing. Its activities comprehend loans, leasing, asset, and treasury management.

⁶Principal Structures are local unities established by multinationals in order to improve efficiency and centralize functions, risks, and accountability in a given region or country.

from overall effective tax rate as low as 5% (KPMG, 2013).

FIGURE 4.1: Average tax burden of firms in Swiss cantons and certain EU Member States (FDF, 2013: 20).



4.1.2 The importance of cantonal tax regimes

As a whole, corporate profit tax contributions represent approximately 15% of the total revenue of the Confederation⁷. While for cantons and municipalities, profit tax revenues represent 7% of their receipts in 2010 (Avenir Suisse, 2013: 32, 48).

As mentioned in the FTA report for the consultation phase, contributions of special status companies are quite important for the financing of public services at cantonal, municipal as well as federal levels (FTA, 2014b: 18). At the federal level, we can infer from TABLE 4.1 that taxes on special status companies represent, between 2008 and 2010, approximately 48% of total profit tax receipts.

TABLE 4.1: Confederation revenues resulting from cantonal tax regime corporations, average 2008-2010, in Mio. (FDF, 2013: 16)

Sociétés assujetties au barème ordinaire	Sociétés holdings	Sociétés de domicile	Sociétés mixtes	Total de toutes les sociétés	Total moins part cantonale 17 %
3'930.2 (52.17%)	557.7 (7.40%)	556.6 (7.39%)	2'489.4 (33.04%)	7'534.0 (100.00%)	6'253.2 (83.00%)

Source: AFC

⁷Federal Finance Administration, "Federal finances at a glance", <http://www.efv.admin.ch/e/dokumentation/finanzberichterstattung/bufi/index.php>.

At the cantonal level, the importance of special status companies varies by canton⁸. TABLE 4.2 shows us the amount of contributions from special status societies and their share in relation to annual tax revenues resulting from profit tax. We observe that the presence of special status companies appears to be important in the cantons of Basel-City, Zug, Schaffhausen, and Basel-Country for the Swiss German part as well as in the cantons of Geneva, Neuchâtel, and Vaud for the French part. We can expect from these cantons to be particularly active in the decisional phases of the reform out of concern for possible abolition of cantonal tax regimes.

Contributions from special status companies can evidently be fundamental at the municipal level. The Swiss Association of Cities estimates an average share ranging from 20% to 25% of municipal total fiscal revenues. In certain localities, special status societies' contributions share amount up to 50% (SAC, 2015).

Moreover, special status companies have also acquired an importance that goes beyond fiscal considerations. The FTA report states that their share of research and development costs represents 45% of the total private expenses on this matter (FTA, 2014b: 20). Thus, the figures mentioned above illustrate the importance of cantonal tax regimes for the public sector and the economic development in general. Hence the importance of the third corporate tax reform, in which several interests have to be balanced.

⁸See Appendix E.

TABLE 4.2: Estimation of cantonal and municipal annual tax revenues resulting from profit tax by fiscal regime (A, B; in Mio.); Shares of corporations with regard to total annual profit tax revenues at the cantonal and municipal level by fiscal regime (C, D), averages from 2008 to 2010 (FTA, 2014b: 19)

NB: Cantonal shares of the corporate federal tax are taken into account.

	A	B	A+B	C	D
	Ordentlich besteuer- te Gesell- schaften (Mio. Fr.)	Statusgesell- schaften nach Art. 28 StHG (Mio. Fr.)	Total (Mio. Fr.)	Anteil ordentlich besteuer- te Gesell- schaften	Anteil Statusge- sellschaften nach Art. 28 StHG
ZH	1'830.4	148.6	1'979.0	92.5%	7.5%
BE	677.8	54.3	732.1	92.6%	7.4%
LU	249.2	35.8	285.1	87.4%	12.6%
UR	16.2	0.4	16.6	97.5%	2.5%
SZ	64.3	26.2	90.5	71.1%	28.9%
OW	15.5	0.8	16.4	95.0%	5.0%
NW	16.9	3.4	20.3	83.1%	16.9%
GL	16.9	2.8	19.7	85.8%	14.2%
ZG	224.6	233.7	458.3	49.0%	51.0%
FR	162.6	28.5	191.2	85.1%	14.9%
SO	255.0	5.6	260.6	97.9%	2.1%
BS	331.5	455.6	787.1	42.1%	57.9%
BL	145.2	90.9	236.2	61.5%	38.5%
SH	56.2	43.0	99.2	56.6%	43.4%
AR	20.5	1.3	21.8	93.8%	6.2%
AI	4.8	0.9	5.7	84.8%	15.2%
SG	355.3	32.2	387.5	91.7%	8.3%
GR	175.7	10.1	185.7	94.6%	5.4%
AG	610.9	8.3	619.2	98.7%	1.3%
TG	106.8	2.6	109.4	97.6%	2.4%
TI	419.9	137.5	557.4	75.3%	24.7%
VD	708.2	284.4	992.6	71.4%	28.6%
VS	196.3	1.5	197.8	99.3%	0.7%
NE	151.0	65.5	216.5	69.8%	30.2%
GE	902.2	416.9	1'319.1	68.4%	31.6%
JU	48.3	4.4	52.7	91.7%	8.3%
CH	7'762.2	2'095.1	9'857.3	78.9%	21.1%

4.2 International pressures

Since the mid-2000s, corporate taxation is increasingly discussed at the global level. In the last three years, the interest in corporate taxation issues has intensified notably with the various initiatives from the Organization for Economic Cooperation and Development (OECD), the Group of Twenty major economies (G20), and the European Union (EU) (FTA, 2014b: 8). Several States are seeking to limit the flexibility of multinationals on fiscal matters. The practice of Fiscal planning (i.e. when a taxpayer arranges its affairs in order to pay the least amount of tax possible) is particularly targeted since, with such arrangements, certain States suffer a reduction of their revenue and, consequently, tax rates on other categories of taxpayers are likely to increase. These trends are affecting the Swiss fiscal policy as well as the international acceptance of its taxation system. Sources of international pressure will be identified in the two following sections.

4.2.1 OECD's BEPS plan

Over the last 10 years, the OECD, which counts Switzerland as a founding member, has intensified its fight against tax base erosion and profit shifting. Traces of this effort can be found in an OECD report from the late 1990s. In this report, titled "Harmful Tax Competition", it is stated that governments should aim to reduce harmful tax practices. To this end, the "Guiding principles on harmful preferential fiscal regimes", established by OECD State governments, encourages countries with such tax regimes to abolish them (OECD, 1998). OECD's struggle against preferential tax regimes has further intensified in the last three years. The OECD Forum on Harmful Tax Practices (FHTP) identified in November 2012 several harmful tax practices in which, as far as Switzerland is concerned, we can find three cantonal tax regimes (for holding, domiciliary, and mixed societies) and one practice related to federal taxation (FTA, 2014b: 10). G20 Finance Ministers asked OECD to design an action plan aiming to bring coordinated answers to issues of tax base erosion and profit shifting. This action plan will aim to define soft law instruments to address these questions, set deadlines related to their implementation and determine the resources needed as well as the methodology of the agreed actions (OECD, 2013a). As a result, the OECD Base Erosion and Profit Shifting Plan (BEPS Plan) was issued on 19 July 2013 and approved by the G20 governments on 13 September 2013.

The 40-page Action plan comprises 15 work streams⁹ addressed to both domestic and international levels that aim to tackle tax avoidance issues. All 15 actions are due to be completed by December 2015. At the time of this writing, reports have been issued for actions 1, 2, 5, 6, 8, 13, and 15.

4.2.2 Discussions with the European Commission

Perceived as a threat against the European Commission's (EC) goal of a fairer Single Market, corporate tax base erosion has been recognized by the EC as a key issue to be tackled. The Code of Conduct on business taxation, set out in 1997, is a non-legally binding instrument by which Member States engage themselves to abolish harmful tax practices and to refrain from implementing such measures in the future.

Located at the center of the European continent but without EU membership, Switzerland has been pressured by the EC since 2005 to change its corporate tax system (FTA, 2014b: 10). The EC stated in 2007 that cantonal tax regimes are incompatible with the state aid provision of the Swiss-EU free trade agreement of 1972. Swiss tax regimes considered as harmful for tax competition comprise favours granted to holding, mixed, and domiciliary societies at the cantonal level as well as to principal structures and the so-called Swiss Finance Branches. In 2009, an attempt to solve this conflict has failed and, in the following year, Switzerland rejected the "Code of Conduct dialogue" proposed by the EC. Among EU Member States, Italy blacklisted Switzerland and blocked the deductibility of payments to Swiss companies as well as the implementation of the double taxation agreement. In December 2012, the EC recommend EU Member States to take similar measures to encourage third countries (such as Switzerland) to "respect minimum standards" (EC, 2012). In the first semester of 2014, a Swiss-EU Joint Statement brought an end to years of conflicts. In this document, the Federal Council expresses its intention to abolish the five above-mentioned controversial regimes and to conform the new regimes to both OECD and EU standards. In return, any countermeasures by EU Member States regarding the controversial regimes will be removed as soon as they are abolished (FC & EU, 2014: part 3 and 4).

⁹see Appendix B.

FIGURE 4.2: Cartoon by Chappatte illustrating EU-Switzerland discussions about fiscal issues (Economiesuisse, 2014a: 17)



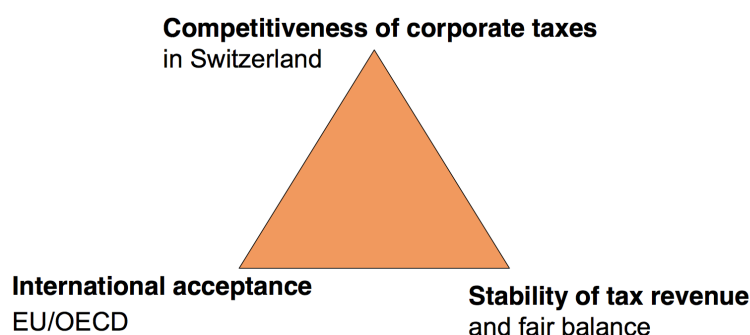
Chapter 5

The Corporate Tax Reform III

Back in November 2008, the Federal Council mandated the Federal Department of Finance (FDF) to draft a project concerning a third corporate tax reform. However, the international acceptance of the Swiss fiscal regime drafted was not sufficiently guaranteed (FTA, 2014b: 21). In June 2012, the Federal Council asked the FDF to pursue its work by collaborating with cantonal finance directors and selected economic actors in order to suggest measures. This collaboration resulted in a report (FDF, 2013), which has been used as a basis to consult cantons. By an instruction dated 30 April 2014, the Federal Council acknowledged the results of this consultation. The more formal consultation phase addressed to the various stakeholders took place between 1 October 2014 and 31 January 2015. The Message of the Federal Council as well as the bills for the federal chambers have been issued in June 2015. The Parliamentary phase is expected to occur from autumn 2015 until mid-2016. Ideally, the reform will be implemented on 1 January 2019¹⁰. It could however be subject to a referendum.

¹⁰The provisional calendar has been found on the Métropole lémanique's slides (Métropole lémanique, 2014: slide no. 11.).

FIGURE 5.1: The three main objectives of the CTR III (Economiesuisse, 2014a: 13)



As illustrated in FIGURE 5.1, through the CTR III, the Swiss Confederation pursues three main objectives:

International acceptance: This objective is a result of the pressure of the OECD and the EU to abolish a number of preferential tax regimes that are considered as harmful.

Competitiveness of corporate taxes: Endangered by the abolition of certain preferential tax treatments, Swiss corporate tax competitiveness is at stake. Hence the Swiss government willingness to implement new measures aimed at maintaining the Swiss fiscal attractiveness.

Stability of tax revenue and fair balance: Several measures seeking to compensate the potential revenue reduction are currently being discussed. The implementation of a tax on capital gains and a Tonnage tax were recently rejected by the Federal Council after the consultation phase. Fair balance at the vertical¹¹ and horizontal¹² levels is another objective of the reform. Since the Confederation and the cantons are said to benefit similarly from the presence of special status societies (on the basis of special status firms and their employees' taxation)¹³, the Confederation will share the costs through a vertical compensation, which will then be distributed to all cantons in the long-term in order to avoid further inter-cantonal inequalities. Compensation allocation issues will not be further developed in this paper since they are not directly subject to external influence. But, as we will see in the next chapter, there appears to be a clear influence by international actors on the other objectives of the reform.

¹¹ Between the Confederation and the 26 cantons.

¹² Among cantons.

¹³ According to a study from the University of Lausanne mandated by the canton of Geneva: Nilles, 2012.

Chapter 6

Internationalization dynamics in the Corporate Tax Reform III

As it emerged from the previous chapters, local public policies might be influenced by or even result from external factors. This phenomenon is referred to as *policy internationalization*. Internationalization processes are more likely to occur in countries that are more dependent on their international or regional environment. As the figures show, Switzerland's economy is deeply embedded in international markets. For instance, the Swiss financial centre, notably due to its banking sector, has acquired a major international importance¹⁴. Swiss companies are also recognized as highly competitive at the international level, particularly in watch, chocolate, and dairy sectors¹⁵. Swiss pharmaceutical companies represent approximately 10 % of the global pharmaceutical market¹⁶. However, as mentioned by the Federal Council in one of its foreign policy reports, the openness of Swiss economy causes a significant dependency toward global and regional developments (Federal Council, 2009: 5690).

According to scholars, there are various degrees of policy internationalization. Indeed, an internationalization process can originate from a voluntary choice or from a coercive

¹⁴SwissBanking website, http://www.swissbanking.org/fr/facts_figures.htm.

¹⁵SwissWorld website, http://www.swissworld.org/fr/economie/contexte_international.

¹⁶InterPharma, "Les entreprises suisses représentent 10% du marché mondial", <http://www.interpharma.ch/fr/faits-et-statistiques/2787-les-entreprises-suissees-representent-10-du-marche-mondial>.

measure. From one extreme to the other, the estimated local autonomy varies. Including various measures to address different issues, we can posit that the CTR III comprises two distinct policy internationalization processes:

- Compliance with internationally-defined standards;
- Competitiveness-enhancing policies.

The next sections will further develop both processes by considering their source and the measures undertaken. In the third section, we will assess the impact of such externally-influenced measures on the power relations between local stakeholders.

We will illustrate the impact of external factors on the CTR III by considering the following measures, which are currently discussed:

- Abolition of the controversial tax regimes;
 - Cantonal tax regimes for holding, domiciliary, and mixed societies;
 - Favours granted to Swiss Finance Branches and principal structures.
- Patent box at the cantonal level: a legislatively prescribed measure that gives preferential tax treatment to certain revenues from intangible assets;
- More deductions for R&D expenditures: cantons are encouraged to implement tax incentives to promote research and innovation activities;
- Capital tax changes: the Federal Council encourages cantons to implement a tax relief on equity capital related to patents and participations;
- Step-up: Hidden reserves created by currently special status companies would be subject to privileged taxation (or even treated as tax-free) and could be amortized in the following years;
- Abolition of stamp duties on equity; measure which seeks to reduce the tax burden of companies that are issuing new equity capital;
- Reduction of cantonal corporate tax rates.

The Notional interest deduction (NID) - the deduction of notional interest on equity capital from the assessment basis - has been rejected by the Federal Council after the consultation phase. Even though it will not be implemented, I have found interesting to include this measure in the analysis since it was subject to the influence of external factors.

6.1 Compliance with international standards

The G20, the OECD, and the EU seek to limit the freedom of multinational companies on fiscal matters in order to address the issue of tax base erosion. By doing so, these institutions are redefining what is acceptable in terms of fiscal policy. To be seen as attractive, an economic center should also provide legal security, without which companies might choose to relocate because of an uncertain environment on the medium/long-term. For Switzerland, which offers certain controversial corporate tax regimes, the status-quo might then be viewed as a costly and undesirable option.

The need for international acceptance will notably result in the abrogation of art.28 THA on cantonal tax regimes. The international acceptance will affect the compensatory measures as well.

The next subsections will, firstly, provide an overview of OECD and EU expectations with regard to Swiss corporate tax policy and, secondly, demonstrate how these expectations are addressed by the Swiss Federal Department of Finance (FDF).

6.1.1 OECD's soft law instruments

By definition, as a soft law provider, the OECD cannot enforce laws or coerce a country into changing its legislation. It can however influence national legislation by issuing recommendations, guidelines, principles or models that governments and companies can refer to. Governments' compliance with internationally accepted soft law instruments can be obtained through peer-pressure as well as by market forces, but not by formal sanctions (Weber & Gertsch, 2005: 17).

Through its action plan against base erosion and profit shifting, the OECD is providing soft law instruments that aim to become internationally-recognized standards such as

the OECD Model Tax Convention. Basically, the Swiss government is not compelled by the OECD to apply these standards. However, the terms of the Joint Statement with the EU, which mentioned that Switzerland must consider OECD standards, as well as the inherent risk to legal security generate an important pressure for Switzerland to conform its corporate tax legislation to these guidelines. Thus, even if it is only soft law instruments, the pressure to conform is such that the Swiss government plans to comply with the OECD standards.

A tax regime is essentially described as harmful by the OECD (1998: 26) if:

- The effective tax rate is non-existent or very low;
- There is a divergent fiscal treatment between national and foreign companies (*ring fencing*);
- There is a lack of transparency;
- There is a lack of actual exchange of information.

Among the 15 BEPS action points, there is notably the ambition to limit base erosion via interest deductions (Action 4) and to develop more effective solutions to counter harmful tax practices through the improvement of transparency and the requirement of substantial activity for any preferential regime (Action 5).

The BEPS directives might be subject to modifications, regarding notably intangible assets taxation, the concepts of stable establishment, and profit distribution. As stated in the FDF report, States' interests being sometimes contradictory, there is a difficulty in anticipating what the ultimate requirements will be (FDF, 2013: 21). The Swiss administration should therefore closely monitor the developments of OECD corporate tax guidelines, especially with regard to the above-mentioned issues.

6.1.2 Swiss-EU Joint Statement

The bilateral discussions with the EU have resulted in a Joint Statement, in which the Federal Council has committed itself to conform its company tax policy to “generally accepted standards” as reflected “in specific principles and criteria at the OECD and within the EU at EU level” (FC & EU, 2014: 2.II. and 3.). This commitment ensures,

on the one hand, that the Swiss tax policy will comply with OECD and EU principles and, on the other hand, puts an end to years of Swiss-EU disputes on this matter. In the drafting of the CTR III, the Swiss Confederation should therefore take into account both OECD and EU principles. This is in line with a trend observed over the last few years, which scholars would call *Europeanization* of public policies, i.e. the growing influence of EU laws on the Swiss legislation (Maiani, 2013b).

The Swiss Confederation must base its assessment of conformity to EU principles on two main sources: the EU Code of Conduct on company taxation and art.107 of the Treaty on the Functioning of the European Union (TFEU) on the prohibition of state aid to corporations.

EU Code of Conduct on company taxation

In the EU Code of Conduct on business taxation, a measure can be considered as harmful by assessing (ECOFIN, 1998: 3):

- Whether an effective level of taxation is significantly lower than the general level of taxation in the country concerned, or;
- whether advantages are awarded only to non-residents or on transactions carried out with non-residents, or;
- whether advantages are ring-fenced from the domestic market, in a way that they do not affect the national tax base, or;
- whether advantages are granted even without any real economic activity and substantial economic presence within the Member State offering such tax advantages, or;
- whether the rules for profit determination on activities within a multinational group of companies depart from internationally accepted principles, notably the rules agreed upon within the OECD, or;
- whether the tax measures lack transparency, including where legal provisions are relaxed at administrative level in a non-transparent way.

Company state aid prohibition (Art.107 TFEU)

Art.107 para.1 TFEU stipulates that “Save as otherwise provided in the Treaties, any

aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market.”

The EU Commission identifies company state aid measures that are incompatible with the Common Market by considering the following criteria (FDF, 2007: 26):

- The measure provides an advantage to its beneficiaries that reduces the burden on their budget;
- The advantage is provided by the State or by State resources;
- The measure affects competition and trade between Members States;
- The measure is specific or selective.

The aid might be eventually justified by the peculiarities of the relevant fiscal system.

6.1.3 Abolition of controversial tax regimes

The third corporate tax reform is primarily a result of external pressures on the following Swiss preferential tax regimes:

- Cantonal tax regimes for holding, domiciliary, and mixed societies;
- Favours granted to Swiss Finance Branches and principal structures.

As mentioned throughout this paper, these pressures originate from the OECD, the G20, and the EU. For both the OECD and the EU, the above preferential tax regimes are no longer accepted primarily due to the divergent fiscal treatment between national and foreign companies that may lead to tax base erosion and profit shifting. What is referred to as *Ring-fencing* is denounced in the OECD’s “Harmful Tax Competition” report (OECD, 1998: 26), and in the EU Code of Conduct on company taxation (ECOFIN, 1998: 3).

The planned abolition of the controversial tax regimes, resulting notably in the abrogation of art.28 THA para.2-4, will end the Swiss-EU dispute on company taxation as well as the qualification of these regimes as harmful tax practices in OECD reports¹⁷.

6.1.4 Replacement measures' conformity with international standards

As stated in the Swiss-EU Joint Statement on company taxation, all replacement measures will have to comply with both OECD standards and EU principles of fiscal policy.

Patent box

Since the proposed Patent box model was initially based on an existing measure from a EU Member State - United Kingdom - the FTA stated that it should comply with OECD and EU fiscal policy principles (FTA, 2014b: 134-135). However, recent international developments concerning the UK Patent box have led to changes in the proposed Swiss Patent box.

At the European level, there has recently been uncertainty with regard to the acceptability of Member States' boxes. The ECOFIN Council asked the Code of Conduct group to review all Member States' boxes. Moreover, the EC has issued enquiries concerning the compatibility of Member states' boxes with art.107 TFEU on company state aid prohibition. The UK Patent box was particularly targeted by these initiatives. Nevertheless, an Anglo-German proposal that aims to comply the UK Patent Box with international standards was welcomed by the FHTP group, the Code of Conduct group and the ECOFIN ministers. The EC has subsequently withdrawn its enquiries. In this proposal, it is stated that the existing UK Patent box will be abolished and future preferential tax regimes on intangible assets will be based on revenues resulting from the Research & Development (R&D) activities of the British company in the British territory (the so-called *Nexus approach*). In other words, to benefit from a UK Patent box, the British company should not subcontract its R&D activities to a member company located in a third country with an attractive preferential tax regime. According to professor Robert Damon, contrary to what was believed by Swiss policy makers, there is a growing international consensus with regard to the Nexus approach (Favre, 2014b). To ensure international acceptance, the

¹⁷Swiss controversial tax regimes are currently mentioned in the Action 5 report of the OECD's BEPS Plan (OECD, 2014: 58).

Swiss administration is currently seeking to implement a similar approach. The OECD is currently discussing certain aspects of the Nexus approach (notably, clarifying rights which, other than the patents, are eligible for the box). Once the OECD has established standards on these issues, it is planned to include them in the provision relating to the THA (FC, 2015b: 27-28).

Moreover, in accordance with the 5th work stream of the BEPS Plan, in cases of rulings on the granting of Patent box advantages to a foreign company, Swiss authorities would have to spontaneously exchange information on this matter (FTA, 2014b: 135).

Step-up

In the FTA consultation report (2014b: 136), few lines were dedicated to the international acceptance of the Step-up mechanism. According to the department, this measure is conform with OECD and EU standards. However, its international acceptability is challenged by several stakeholders such as the State Councillor in charge of the Geneva Cantonal Department of Finance who stated that it “maintains the privilege granted at present by the special status” (Dal Busco, 2014: slide 24).

Notional interest deduction (NID)

Based on a similar measure adopted in Belgium, the notional interest deduction has finally been abandoned by the Federal Council. According to Boder in *Le Temps* (2015), this measure has probably been rejected to ensure international acceptability. However, there was little indication in the FTA report that this measure would be rejected for international compliance reasons. According to the FTA report (2014b: 135-136), the proposed Swiss NID was internationally acceptable since a similar measure in Belgium is currently not contested. The FTA stated that it would have also been conform with art.107 TFEU, since it would be applied to all companies without discrimination. As for the Patent box, all ruling on this matter should have been followed by a spontaneous exchange of information.

6.2 The tax competitiveness imperative

A large number of countries have a differentiated fiscal policy that takes corporate mobility into account. Switzerland is currently among the countries with the lowest tax burden for companies. With the implementation of the CTR III, the tax competitiveness of Switzerland and its cantons is subject to debate. On the one hand, the abolition of cantonal tax regimes, as requested by OECD and EU, is likely to weaken Swiss and cantonal tax competitiveness. On the other hand, apart from the apparent necessity to make Swiss corporate tax policy internationally acceptable, the purpose of the reform is to find replacement measures enhancing Swiss and cantonal attractiveness.

The sections that follow will provide an overview of the international corporate tax competition pattern and brief descriptions of the reform measures that are supposed to maintain the Swiss fiscal attractiveness.

6.2.1 International tax competition framework

FIGURE 6.1 illustrates the corporate tax competition framework at the international level. Since this map is based on commercial profit tax rates, it is not representative of actual States' fiscal attractiveness. However, it allows us to acknowledge the diversity concerning profit tax rates, which can range from 7% to 339%. If we focus on Western Europe, we can see that Switzerland, along with Ireland, Luxembourg, and Denmark, is among the States with the lowest profit tax rates.

We can find empirical evidence asserting that international tax competition has really occurred. Genschel and Seelkopf (2012: 15) have concluded that most countries, tax havens or not, have - to varying degrees - reduced statutory rates on business profits and/or implemented preferential tax regimes in order to attract special categories of capital. Within OECD member states, corporate tax rate fell by 20 percentage points between 1986 and 2010 (Genschel & Seelkopf, 2012: 7). In the EU, the average corporate tax rate has fallen from 35% in 1995 to 23% in 2009 (Devereux & Fuest, 2009). Despite their leading role in fighting determined harmful tax practices, neither the OECD nor the EU have taken initiatives against the downward trend of general tax rates.

FIGURE 6.1: Map of corporate tax rates on commercial profit, 2010-2014 (World Bank)

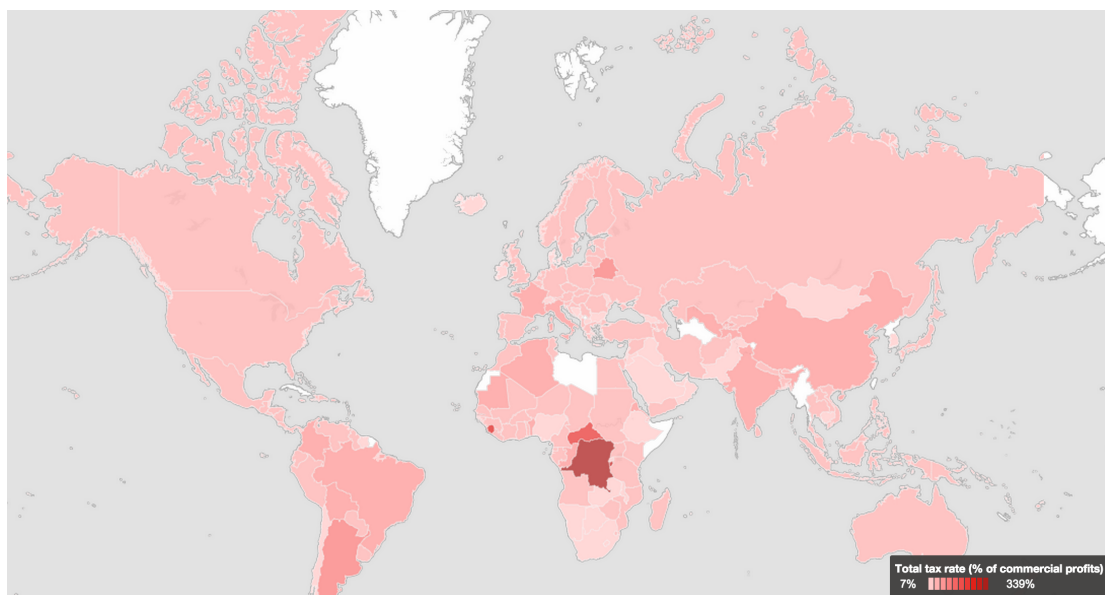


FIGURE 6.2 adds a temporal dimension by which we can assess the evolution of tax burden in several Swiss cantons (in red) and a number of international locations between 2003 and 2013. We can observe for instance that, except for the cantons of Geneva and Valais, all cantons in the graph have reduced their corporate tax burden, notably the canton of Grisons with a 10.5% decrease. EU capitals Amsterdam and Vienna have also reduced their corporate tax burden substantially.

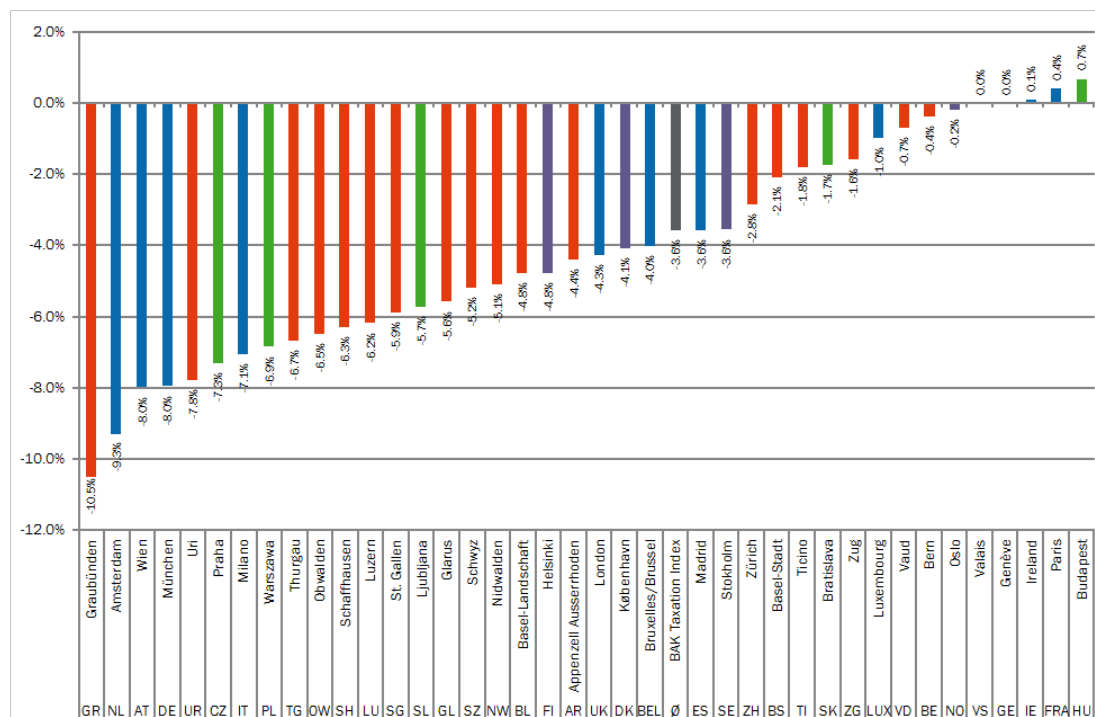
6.2.2 Competitiveness-enhancing measures

To compensate the possible loss of fiscal attractiveness at the national and cantonal levels, the following measures are currently discussed:

Patent box, deductions for R&D spending and capital tax changes at the cantonal level

These measures are aimed to promote research and innovation activities in the Swiss territory and to strengthen the position of Switzerland with regard to research- and innovation-oriented companies in the international competition framework. Profits of current special status companies that might be eligible for the Swiss Patent box would be subject to a tax burden similar to the current one. For profits subject to ordinary taxation and eligible for the Patent box regime, cantonal and municipal tax burden would be alleviated (FTA, 2014b: 115). These measures would be particularly beneficial for Basel-City, canton of the chemical and pharmaceutical industry.

FIGURE 6.2: Changes in tax burden for corporations in Swiss cantons (red) and certain European locations (blue, green, purple), 2003-2013 (ZEW/BAKBASEL)



Step-up

According to the FTA, the Step-up mechanism might improve Swiss fiscal attractiveness in situations where companies based in tax havens which are losing their own attractiveness decide to relocate in Switzerland. Companies from other countries would not benefit from this measure, since the inclusion of hidden reserves would be counterbalanced by taxation at the country of origin (FTA, 2014b: 115).

Abolition of stamp duties on equity

With the abolition of stamp duties on equity, the tax burden on companies that are issuing new equity capital will be reduced. Companies with important capital will be the main beneficiaries of this measure (FTA, 2014b: 117). Currently, the Confederation collects, save for some exceptions, a 1% stamp duty on the issuance of equity securities. The FDF estimates that the abolition of stamp duties would result in a 240 millions per year revenue loss for the Confederation (FDF, 2013: 44).

Reduction of cantons' corporate tax rates

Benefiting from fiscal sovereignty, cantons, particularly those with an important presence of special status companies, have an incentive to reduce their own effective tax rates for ordinary companies, in order to compensate for the abolition of cantonal tax regimes and

to maintain their fiscal attractiveness. For instance, in the canton of Geneva, the profit tax rate for ordinary firms is currently equal to 24.2% and 11.6% for special status firms. In case of abolition of cantonal tax regimes, the canton has planned a unique tax rate for both ordinary and formerly special status firms of 13%. Among the most affected cantons, Vaud plans to decrease its ordinary tax rate from 22.3% to a unique profit tax rate of 13.79%. Fribourg, for its part, will change its profit tax rate from 19.9% for ordinary firms and 9.9% for special status companies to a unique tax rate of 13.72%¹⁸. Cantons are also encouraged to reduce their capital tax rates.

TABLE 6.1: Summary of the influence of international factors on the content of the CTR III

	+ Swiss autonomy	-
	←	→
Internationalization process	Competitiveness imperative Patent box and other R&D-related measures Step-Up	Compliance with Internationally-defined standards Abolition of controversial tax regimes
CTR III measures	Abolition of stamp duties on equity Reduction of cantons' corporate profit tax rates	Adaptation of replacement measures with OECD and EU standards and principles Swiss-EU Joint statement on business taxation
Sources of the internationalization process	International corporate tax competition framework	OECD's BEPS Action Plan EU Code of Conduct on business taxation Art. 107 TFEU

¹⁸See Appendix C for more details on current cantonal tax rates.

6.3 Impact on actors configuration

By providing opportunities to a large panel of local stakeholders, internationalization processes are said to redistribute power among domestic actors (Börzel & Risse, 2000). As asserted by Kriesi and Trechsel (2008: 115), “Swiss *consensus democracy* is characterized by a high degree of power sharing between different institutions and political actors, and by a large number of veto points, where policy proposals can be blocked by coalitions of opposing actors.” Among local stakeholders and potential veto players, we can find public authorities, political parties as well as major interest groups and social movements. Since the reform is currently about to enter in the parliamentary phase, we cannot provide an exhaustive study on the influence of internationalization on actors’ configuration. Nevertheless, consultation documents and press releases can provide us with a glimpse on political fragmentation.

6.3.1 Empowerment of the state executive?

According to a number of scholars¹⁹, internationalized or europeanized decision-making processes strengthen the position of the State at the expense of non-state actors such as interest groups, political parties or cantons. This may be explained by the fact that, in cases of international agreements, only state executive actors participate both in the national and the international negotiations (Putnam, 1988). Therefore, their legitimacy to decide on the content of such policies is likely to be recognized. In cases of autonomous adaptation, if the state executive is in line with the reforms promoted by external entities, its position may be legitimated, according to Fischer (2005: 154f), by referring to international pressure.

To analyze the case of the CTR III, it is important to highlight the take-it-or-leave-it character of the reform. As we will see in the next sections, a large majority of local actors (including potential veto players) agree on the necessity to conform business taxation policy to international standards. Most of the disagreements are on the replacement measures that are part of the reform. To date, only the Socialist Party and unions have used the referendum threat, even though they recognized the necessity of compliance with

¹⁹Putnam, 1988; Sciarini, 1992; Moravcsik, 1998; Mach, 2004 among others

OECD standards. Will disagreements with replacement measures cause a rejection of the whole reform? To answer this question, we will have to wait for the decision-making developments over the next years. The relative empowerment of both the Federal Council and the federal administration compared to political parties, parliament, and interest groups cannot be assessed yet.

However, elements of answer can be found concerning the empowerment of the state executive at the expense of subnational entities. Due to the abolition of determined preferential tax treatments and the subsequent reduction of cantonal corporate tax rates, Cantons and municipalities' finances are particularly affected by the reform. Their fiscal revenues and competitiveness at the national and international level are among the main preoccupations in the CTR III. Reunited in the Cantonal Governments Conference (CGC), the cantons have adopted a common position. Providing legal security to local firms is important for the cantons' development. This is why, even though they are likely to lose funds, cantons strongly support the CTR III. The Fribourg Finance Director Georges Godel stated on this matter that Confederation and cantons are "condemned to reach an agreement" in order to prevent a referendum. He suggests that a rejection of the reform would be harmful for Swiss economy and result in a disturbing climate of uncertainty (Goumaz, 2014). One can infer from this statement that external pressures are such that cantons and the Confederation are constrained to find a common ground. Moreover, the Federal Council has rejected in April 2015 the cantons' request of increasing the amount of the vertical compensation from 1 to 1.2 billions. Given the rejection of this request as well as the fact that only the Confederation participates at both national and international negotiations, we are tempted to posit that its position is empowered at the expense of cantons. Nevertheless, this assertion might be tempered by the actual decision-making process. Firstly, cantons were involved in the earliest phase of the decisional procedure. Indeed, as mentioned in Chapter 5, the FDF collaborated with cantons' representatives to draft a first report on the reform back in 2013. Cantons were then consulted on the basis of this report before the formal consultation phase. Secondly, in April 2015, the notional interest deduction measure was abandoned by the Federal Council after acknowledging that a clear majority of cantons rejected it (FC, 2015a). Therefore, the position of cantons does not appear to have been significantly weakened. The same cannot be said for now with regard to municipalities. Through a press release, the Swiss Association of Cities (SAC) claims that cities are not consulted

enough in the current policy formulation, even though they are likely to be strongly affected by the reform. This is why, although they find the reform necessary, the SAC asked the Confederation to force cantons to distribute vertical compensation fairly across both cantonal and municipal levels. No such measure is planned yet and the SAC has stated that cities reject the reform in its current form. At least for the time being, their position can be seen as quite weakened compared to both Confederation and cantons.

6.3.2 Business community vs. trade unions

Several Swiss scholars addressed the issue of the impact of internationalization on the export-oriented and domestic-oriented sectors as well as on trade unions. Compared to domestic economy, the export-oriented economy is said to be better prepared for internationalization processes since it is more likely for export-oriented businesses representatives to ensure that their interests are already taken into consideration at the international level (Fischer, 2007: 558; Mach, 1999: 429). Indeed, they “have more competencies in the international arena and more channels of access to European institutions and the WTO.” (Fischer, 2007: 559) The results are less evident if we consider a possible empowerment of the export-oriented economy compared to trade unions. As Fischer puts it (*ibid.*), “the strategic skills of the actors are an important intervening variable, all the more so in policy domains in which the export-oriented economy cannot automatically count on a majority among the voters but which are – despite being internationalized – part of the direct democratic game.” Network analyses suggested for instance that, in the context of the Swiss-EU Agreement on the Free Movement of Persons, trade unions managed to use an internationalized process to strengthen their position by obtaining compensations in the field of wage policy (Fischer, 2003; Sciarini *et al.*, 2004: 368; Fischer, 2005: 180ff.). Fischer (2007: 560) concluded that “actors in support of and with high expectations for a given internationalization measure must now count on having to meet high compensatory demands if they need the support of others for the domestic adoption of that measure”. In the CTR III, where it is planned to alleviate tax burden for multinationals and domestic businesses in order to maintain a certain fiscal attractiveness for companies, we can expect trade unions to exercise their power of veto.

What emerges from the CTR III case is that the business community is, on the whole, in favour of the broad lines of the reform. Economiesuisse, the major group representing the Swiss export-oriented industry, and the Swiss Arts and Crafts Union (SACU), an organization which represents Small and Medium sized companies, issued similar opinions on the CTR III (Economiesuisse, 2014b; SACU, 2015; Favre, 2015). Both support the implementation of the Patent box and the cantonal reductions of corporate tax rates. They are also opposed to the introduction of new taxes as well as to the *Step-up* measure. According to Economiesuisse and SACU, this last measure would slow down cantonal tax rate reductions processes (Favre, 2015).

As expected, the Swiss Public Sector Trade Union (SPSTU) and the Swiss Federation of Trade Unions (SFTU) are among the current major opponents to the reform. According to the SFTU (2012), the CTR III could be considered as harmful to citizens since, in case of cantonal tax rate reductions, fiscal losses could be compensated through natural person tax increases. Public authorities are also likely to reduce the quantity and the quality of the public services provided according to the SPSTU (2015). The SFTU considers that firms are not that sensitive to tax rate variations and that corporate tax rates reductions are more harmful than helpful. The SPSTU explicitly rejects the reform, as proposed by the Confederation, since, due to fiscal losses, budgetary savings are likely to occur at the federal, cantonal and municipal levels. If this problem will persists, the SPSTU threatens to launch a referendum against the CTR III. Thus, to ensure a better local acceptability of the reform and to alleviate the referendum risk, the government should take into consideration concerns from unions. For the time being, the recent decision of the Federal Council to abandon the capital gains tax is likely to lead to an increased polarization between the business community and trade unions.

6.3.3 Political parties configuration: toward a bourgeois alliance?

Political parties' positions matter since the approval of the National Council is required and, like other stakeholders mentioned in this chapter, they are potential veto players. To get a precise idea of the political parties configuration, we should wait for the votes during the parliamentary phase as well as for the vote recommendations in case of a referendum. However, few elements of political fragmentation can already be identified.

At the time of this writing, a bourgeois alliance seems to be the most probable political configuration.

Scholars are not unanimous on the effect of internationalization on political fragmentation. On the one hand, some scholars assert that internationalization facilitates domestic reforms, due to pressure from external entities and a perception of a lack of room for manoeuvre which prevent reform initiators from being blamed (Sciarini, 1994; Armingeon, 1998; Grote & Schmitter, 1999). Internationalized policies would then be subject to a lower degree of conflict than usual. On the other hand, there is usually a take-it-or-leave-it character in internationalized reforms, which might lead, according to Hug & Sciarini (1995), to an institutional rigidity that reduces the chances of finding a compromise with veto players.

On the whole, all the Swiss major parties are not reluctant to the idea that the Swiss fiscal system should be reformed in order to provide legal security to companies. Given the recent Swiss National Bank (SNB) decision to let the franc-euro exchange rate float, the Liberals (FDP) go so far as to claim that political and administrative authorities should speed-up the CTR III decisional process (FDP, 2015a). The Swiss People's Party (SPP) however considers that the CTR III decisional process should be suspended since, according to the party, the content of the OECD's BEPS Plan is not precise enough to anticipate the future international fiscal framework and the reform could be linked with the renegotiation of the bilateral agreements with the EU (renegotiations supported by the SPP, following the acceptance of their initiative against the free movement of persons) (SPP, 2014). The timing of the reform is therefore subject to discussion between the SPP and other major parties. It should be noted however that no referendum threat was made by the SPP to date.

The political fragmentation is clearer when it comes to the replacement measures. The Socialist Party (SP) claims to support the reform but on the condition that firms and shareholders compensate entirely the resulting fiscal losses. SP vice-president Marina Carobbio stated that "The SP will not tolerate the idea that the citizens have to compensate the fiscal losses resulting from corporate tax reductions." (SP, 2015b) Similar worries were expressed by the Christian Democratic People's Party (CDP), but to a lesser extent. After the abandon of the capital gains tax, the SP has explicitly used the referendum threat, along with the Green party and unions (Sda, 2015b). Right-wing

parties and CDP, on the other hand, were satisfied by the conditions proposed by the Federal Council after the consultation phase. The SPP expressed its willingness to go even further with tax cuts by reducing the federal profit tax from 8.5% to 7.5%. Concerning replacement measures at least, a bourgeois alliance (SP *versus* CDP, FDP, and SPP) is under way.

To summarize, the necessity of a third corporate tax reform given the evolution of international standards is commonly accepted by the major Swiss actors. Only the Swiss People's Party expressed doubts with regard to the timing of the reform since it fears that concessions may be premature. However, debates around compensatory measures are clearly less consensual. The Socialist Party, Public Sector Trade Union and Federation of Trade Unions call into question companies' supposed tax sensitivity and reject the idea of corporate tax rates reductions. They are the more likely to use the referendum threat to obtain compensatory measures. This rather high level of conflict should not be considered as a direct consequence of external pressure. The few elements resulting from explicit international pressure are not contested by the SP and unions. What are contested however are the replacement measures, which are supposed to enhance competition and which are more or less freely chosen by the administration.

Chapter 7

Concluding remarks

The main purpose of this paper is to provide an early overview on how international factors influence developments of the third Corporate Tax Reform, by focusing on its content and the local stakeholders' configuration.

Two distinct types of internationalization processes, which vary with the degree of autonomy granted to the Swiss government, have an impact on the content of the reform. Ranked by descending level of flexibility toward international factors, we can find:

- *Compliance with internationally-defined standards*: After years of controversy with the OECD and the EU, the CTR III would improve the international legitimacy of the Swiss corporate tax regime. To make its corporate tax system compliant, the Swiss government plans to abolish controversial tax treatments such as the cantonal tax regimes for holding, domiciliary, and mixed societies as well as favours granted to Swiss Finance Branches and principal structures. As stated in the Swiss-EU Joint Statement on business taxation, all replacement measures have to be conform with OECD standards as defined in the BEPS Action Plan and EU principles mentioned in the EU Code of Conduct on business taxation and art.107 TFEU.
- *Tax competitiveness measures*: Within a context of international corporate tax competition, the fiscal attractiveness of Switzerland and its cantons is threatened by the abolition of certain preferential tax treatments. Hence the necessity to design new competitiveness-enhancing measures that are conform to both OECD

standards and EU principles. Among the currently discussed replacement measures, we can mention the implementation of a Patent box at the cantonal level, the Step-Up mechanism, the abolition of stamp duties on equity and the reduction of some cantonal corporate profit tax rates.

Besides the content of the policy, internationalization might also impact local actors' configuration. What emerged from the CTR III case is that the necessity of international standards compliance is commonly accepted and that the existing fragmentations are mainly related to the replacement measures. As it often occurs in the context of economic reforms, the business community and right-wing parties are at odds with the unions and the Socialist Party, which have already used the referendum threat. Among public authorities, we can affirm that the cantons, which were consulted by the federal administration in the earliest steps of the decision-making process, broadly agree with the reform. The same cannot be said concerning municipalities, which appear for now to be in a weakened position since the state executive is willing to put their fate on the hands of cantons' officials. Will left-wing parties, unions and cities promote a referendum at the expense of corporate legal security? Will these veto players benefit from effective compensation measures as it happened in the past? Will the reform be implemented? Only time will tell.

While the reform will soon be discussed in the federal chambers, the interest in company taxation issues is continuously growing at both global and European levels. 30 country tax regimes have been or are currently reviewed by the OECD to determine whether they can be classified as harmful or not. At the European level, the "LuxLeaks" scandal²⁰ has recently been the subject of various media headlines. As a consequence, the European Commission has planned a series of tax transparency initiatives. The Swiss CTR III is therefore embedded in a context characterized by increasing international regulation on corporate tax practices. At the time of this writing, these regulations concern only certain preferential tax treatments. But what about the downward trend of profit tax rates? Reducing profit tax rates to enhance fiscal attractiveness can also potentially lead to base erosion, profit shifting and increase citizens' tax burden. One can however claim that attracting foreign firms is beneficial to citizens, since additional job opportunities

²⁰In November 2014, opaque fiscal arrangements between several big companies and Luxembourgian tax authorities were revealed by the International Consortium of Investigative Journalists.

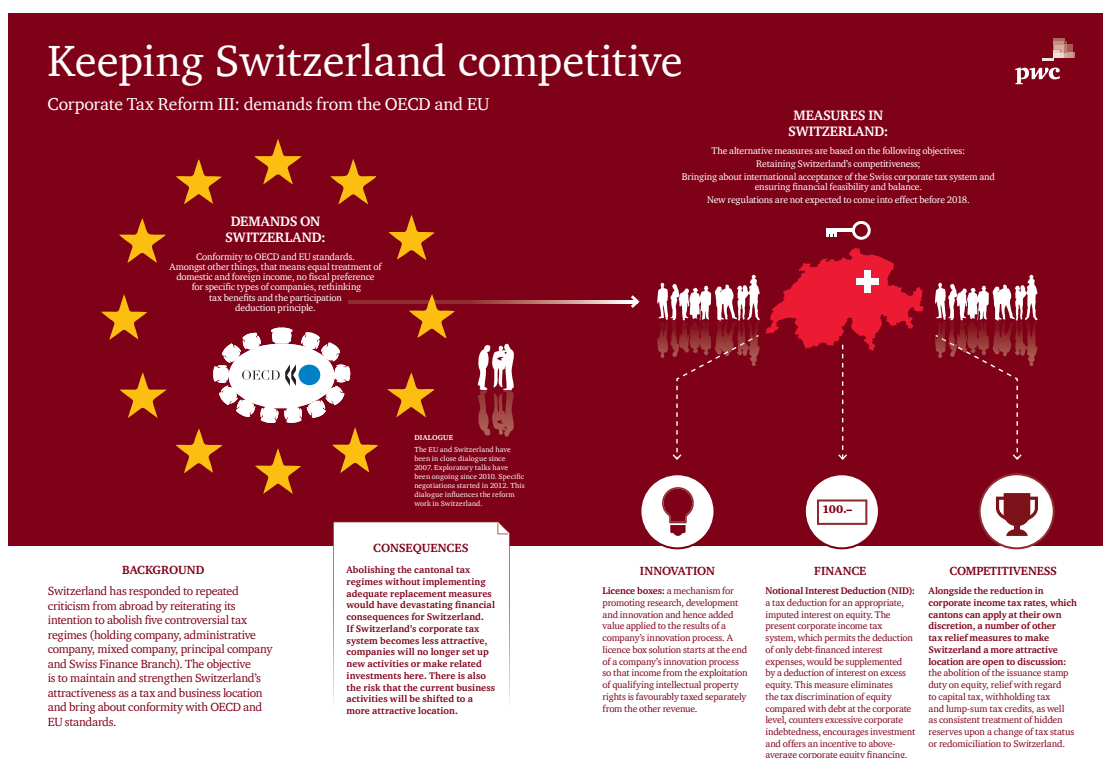
may be created. The question remains open. Nevertheless, the fact that the downward trend of profit tax rates is not yet criticized by international and European institutions could be a sign that nations still matter. We could imagine that most of the governments desire a certain level of flexibility when it comes to decide on profit tax rates. Further research could be made on the influence of States' actors on initiatives of international or European bodies with regard to business taxation. These initiatives might be officiously driven by the willingness of certain States to bring certain preferential tax treatments which are harmful to them to an end, instead of ideals transcending nations' boundaries. This could call into question the assertion according to which globalization goes together with a decline of nation states and bring proof that, in accordance with *neo-realist* scholars²¹, the States' influence overshadows the international and regional organizations' autonomy.

²¹Neo-realism is a current in International Relations theory according to which International Relations' analyses should be based on relations between States in an anarchic international system.

Appendix A

Overview of the CTR III (PwC)

FIGURE A.1: Overview of the CTR III (PwC)



Appendix B

The content of the OECD's BEPS Action Plan

To tackle tax base erosion and profit shifting at the global level, the following actions are planned (OECD, 2013b):

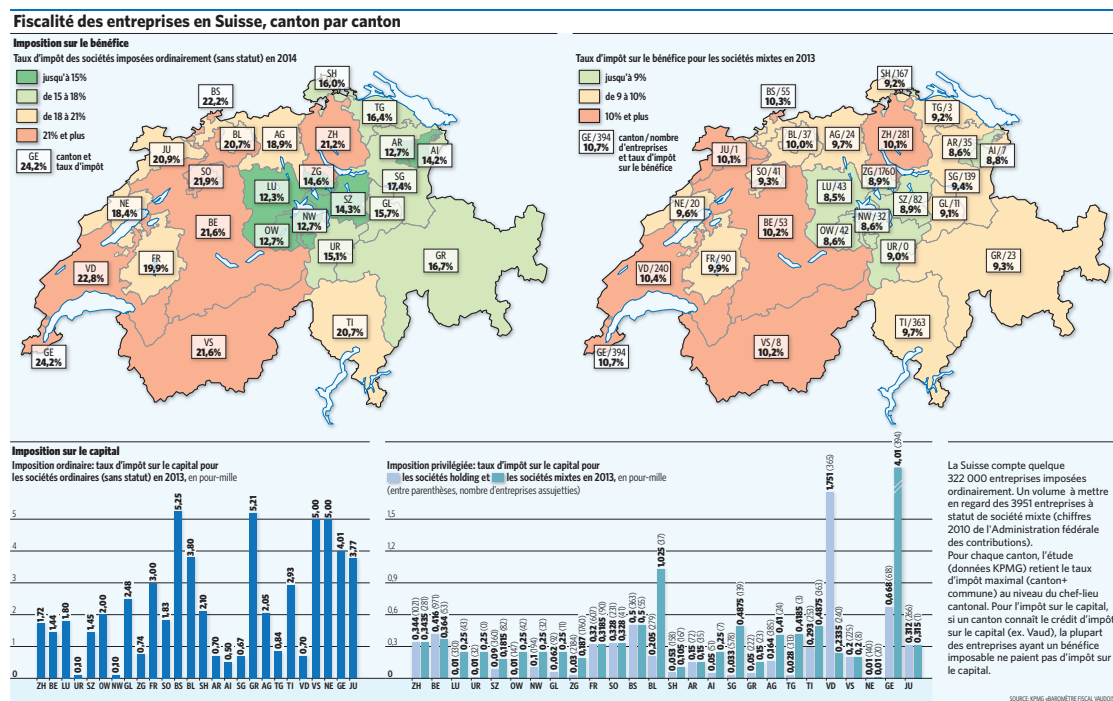
- Action 1 - Address the tax challenges of the digital economy;
- Action 2 - Neutralize the effects of hybrid mismatch arrangements;
- Action 3 - Strengthen CFC rules;
- Action 4 - Limit base erosion via interest deductions and other financial payments;
- Action 5 - Counter harmful tax practices more effectively, taking into account transparency and substance;
- Action 6 - Prevent treaty abuse;
- Action 7 - Prevent the artificial avoidance of permanent establishment status;
- Action 8, 9, 10 - Assure transfer pricing outcomes are in line with value creation;
 - Action 8 - intangibles;
 - Action 9 - risks and capital;
 - Action 10 - other high-risk transactions.

- Action 11 - Establish methodologies to collect and analyze data on BEPS and the actions to address it;
- Action 12 - Require taxpayers to disclose their aggressive tax planning arrangements;
- Action 13 - Re-examine transfer pricing documentation;
- Action 14 - Make dispute resolution mechanisms more effective;
- Action 15 - Develop a multilateral instrument.

Appendix C

Cantonal tax rates for ordinary and special status firms

FIGURE C.1: Cantonal tax rates for ordinary (in 2014) and special status (in 2014) firms (Le Temps on the basis of the figures provided by the KPMG report (2014))



Appendix D

The CTR III schedule

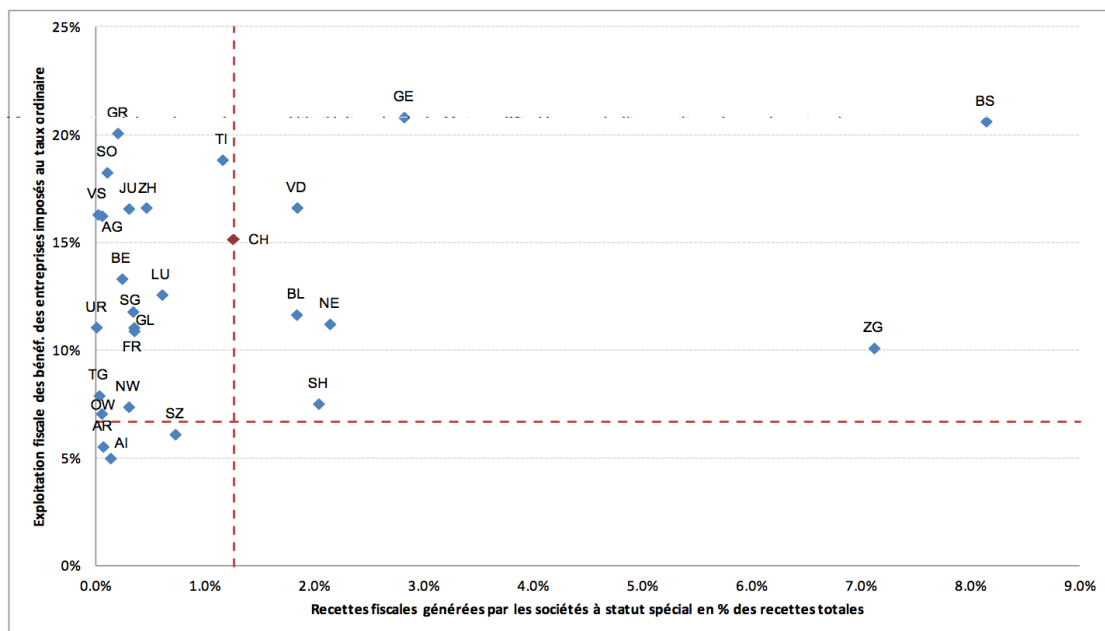
Dec 1997	EU Code of Conduct for business taxation was set out in the conclusions of the ECOFIN Council.
Apr 1998	Issuance of OECD recommendation on Counteracting Harmful Tax Competition.
Feb 2007	The European Commission has stated that cantonal tax regimes are incompatible with the state aid provision of the Swiss-EU free trade agreement of 1972.
Nov 2008	The Federal Council has mandated the FDF to draft a first CTR III project. However, international acceptance of Swiss fiscal regime was not sufficiently guaranteed.
Jun 2010	The EU proposed to Switzerland a dialogue on the EU Code of conduct. This proposition have been rejected by the Swiss government.
Jun 2012	The Federal Council has mandated the FDF to pursue the drafting of the CTR III, with the collaboration of cantons' representatives.
Nov 2012	The OECD Forum on Harmful Tax Practices has identified several harmful tax practices, including 3 cantonal tax regimes and one practice related to federal taxation.
Jul 2013	The OECD BEPS Action Plan has been issued.
Sep 2013	The OECD BEPS Action Plan has been approved by the G20.

Dec 2013	The report of the CTR III project organization has been issued. Cantons will be consulted on this basis.
Apr 2014	The Federal Council has acknowledged the results of the cantons consultation.
Sep 2014	First OECD reports on several BEPS Actions have been published.
Oct 2014	The Federal Council and the EU have signed a Joint statement on company tax issues.
Oct 2014-Jan 2015	CTR III Consultation phase.
Apr 2015	The Federal Council communicates the withdrawal of the notional interest deduction and the tax on capital gains.
Jun 2015	Publication of the Message of the Federal Council on the CTR III and the bills for the federal chambers.
Autumn 2015	Beginning of the CTR III Parliamentary phase.
Dec 2015	Completion of OECD BEPS actions.
mid-2016	Expected ending of the CTR III Parliamentary phase.
Jan 2019	Implementation of the CTR III.

Appendix E

Importance of cantonal tax regimes for cantons in 2013

FIGURE E.1: Distribution of the cantons on the basis of the importance of fiscal revenues resulting from special status firms (horizontal scale) and fiscal exploitation of ordinary firms' profits (vertical scale) (FDP, 2013: 77)



Appendix F

International comparisons in company taxation

TABLE F.1: Statutory tax burden (in %) related to ordinary businesses' benefits in 2014 in different countries (FTA, 2014b: 16)

Pays	Taux	Pays	Taux	Pays	Taux
Bulgarie	10,00	Finlande	20,00	Canada	26,50
Suisse, minimum, Meggen LU	11,48	Croatie	20,00	Norvège	27,00
Irlande	12,50	Russie	20,00	Nouvelle-Zélande	28,00
Liechtenstein	12,50	Estonie	21,00	Luxembourg	29,22
Chypre	12,50	Grande-Bretagne	21,00	Allemagne	29,58
Lettonie	15,00	Suède	22,00	Australie	30,00
Lituanie	15,00	Slovaquie	22,00	Espagne	30,00
Roumanie	16,00	Portugal	23,00	Italie	31,40
Hongkong	16,50	Corée, République	24,20	France	33,33
		Suisse, maximum, diverses communes			
Singapour	17,00	GE	24,43	Belgique	33,99
Slovénie	17,00	Danemark	24,50	Malte	35,00
Pologne	19,00	Pays-Bas	25,00	Japon	35,64
Tchéquie	19,00	Autriche	25,00	USA	40,00
Hongrie	19,00	Grèce	26,00		
Source: KPMG					

TABLE F.2: Average effective tax burden (in %) of firms subject to the ordinary rate in the cantonal chief-towns and in foreign economic centres (FTA, 2014b: 17)

Lieu	Taux	Lieu	Taux	Lieu	Taux
Hongkong	9,9	SG	14,4	Copenhague	22,1
AR	10,0	Ljubljana	15,1	Vienne	22,4
NW	10,1	Singapour	15,6	Péking	23,3
LU	10,2	Prague	16,2	Londres	23,8
OW	10,8	Varsovie	17,0	Milan	24,6
SZ	11,3	BE	17,2	Bruxelles	24,7
UR	11,9	ZH	17,5	Luxembourg	24,8
ZG	12,2	Budapest	18,9	Oslo	25,7
GL	13,0	Stockholm	18,9	Munich	29,3
GR	13,1	BS	19,6	Madrid	31,2
TG	13,2	Bratislava	19,7	Paris	32,5
SH	13,5	Amsterdam	20,9	New York	41,1
Dublin	14,1	Helsinki	21,7		
Source: ZEW / BAK Basel					

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