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Swiss Must Draw Up Plan B on Corporate Taxes to Stay Attractive

Business Politics

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(Bloomberg) -- The Swiss government must come up with a new plan and figure out how to limit economic fallout after voters rejected its bid to reform corporate taxation to keep the country internationally competitive.

Because Switzerland needs to end its current practice of giving thousands of multinationals tax breaks, the government will have to concoct a Plan B to prevent their moving abroad. Their departure would cause a drop in tax revenue and stunt economic growth.

The government is at pains to find a solution at a time when countries such as the U.S. are seeking to gain a competitive edge with their own business tax reductions and after a strong currency-induced slowdown in economic growth. Switzerland, which has succeeded in attracting big global corporations like Procter & Gamble Co. and Caterpillar Inc., already bowed to international pressure and scrapped banking secrecy after a crackdown on tax evasion by other countries.

“Lots of uncertainty about the future has arisen, and there’s concern about reactions by the OECD and the EU, because there’s the risk of a blacklisting of the current regime -- this will force international companies to think about alternatives,” said Andreas Staubli, managing partner at PricewaterhouseCoopers AG in Zurich. “What will happen first is that new investment decisions will be made in favor of a place other than Switzerland.”

Scrapping the current system without a replacement would mean the rates to which holding and domiciliary companies are subjected get reset at the level of domestic firms, which can be more than 20 percent. Yet sticking with the current regime could eventually land Switzerland in hot water with the Organization for Economic Cooperation and Development, which is clamping down on tax loopholes.

Leaving Switzerland

“It’s still in the interest of Switzerland to have a competitive tax regime,” said Christian Stiefel, director of SwissHoldings, which represents the multinationals. “It’s to be expected that cantons will do what they can to stay competitive, it just may cost them a bit more than it would have.”

The short-term impact of highly mobile companies leaving Switzerland would be a 5.6 percent drop in potential economic output, equivalent to 34 billion ($34 billion) francs, according to consultancy BAK Basel.

The number of companies moving to the cantons of Bern, Freiburg, Vaud, Neuchatel, Geneva and Valais already posted a slight decline last year, according to the regional business association GGBa. Recent developments such as Brexit, political situation in the U.S., Switzerland’s tussling over European Union immigration quotas and the strong franc were already causing a delay in businesses’ investment decisions, it said on Feb. 7.

“Swiss companies need the certainty that the way they are taxed is internationally accepted,” said Swiss Textiles, which represents 200 local companies. Tax measures to foster innovation would help the sector, which produces cloth for haute couture designers as well as protective gear for workmen, it said.

International Pressure

The reform was expected to come into effect in 2019. That deadline now won't be met, and Finance Minister Ueli Maurer said a working group will convene soon to figure out the way forward. He didn't spell out what the Plan B might consist of, but said the government could in theory present parliament with a draft bill by the end of 2017.

"There's without a doubt international pressure," Maurer said. "There's a real danger of companies in Switzerland being subject to double taxation."

The government will now also have to restart talks with the EU, which had pushed for Switzerland to revise its tax practices, and there's the threat of reprisals by other countries.

Should the EU assess Switzerland's compliance on company taxation, "we would at the moment not be able to fulfill these points," Joerg Gasser, State Secretary for International Financial Matters, said before the vote. "Then the question is how the EU reacts. If we can plausibly make the case that we'll do that, then nothing happens -- if not, I cannot tell you what will happen."

Voters on Sunday were swayed by opponents' arguments that the reform would've meant more than 2.7 billion francs in lost tax revenue, which they said would led to a higher tax burden for individuals and cuts to public services.

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The Social Democrats, who led the campaign against the reform, haven't published detailed suggestions on what sort of changes they would support. Prior to the vote, SP spokesman Michael Sorg said the government's original proposal should serve as a point of departure, the notional interest rate deduction should be eliminated and the plan shouldn't lead to large shortfalls for the public purse.

The notional interest rate deduction, which opponents had singled out in their criticism, might be eliminated in a Plan B, experts said.

"No one actually knows what the other instruments might be, and it may take quite long -- and in the meantime, I don't think cantons can wait," said Christian Keuschnigg, a professor at the University of St. Gallen, adding that the cantons may lower headline rates of their own accord, crimping their revenue intake. "And that'll be an expensive undertaking."

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