II The Swiss Taxation System

1 Historical background

The Swiss system of taxation has been strongly marked by history. When Switzerland was still a federation of states, the cantons derived the bulk of their revenue from customs duties. In addition, some cantons had also even introduced a wealth tax.

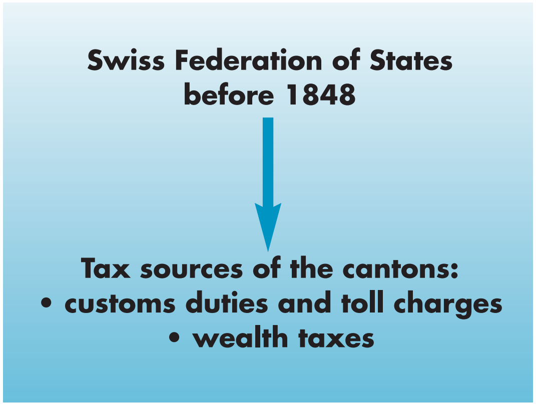
The right to levy customs duties was transferred from the cantons to the Confederation in 1848, the year in which the Swiss Federal State was founded. However, the cantons retained the right to levy tax on income and assets.[1]

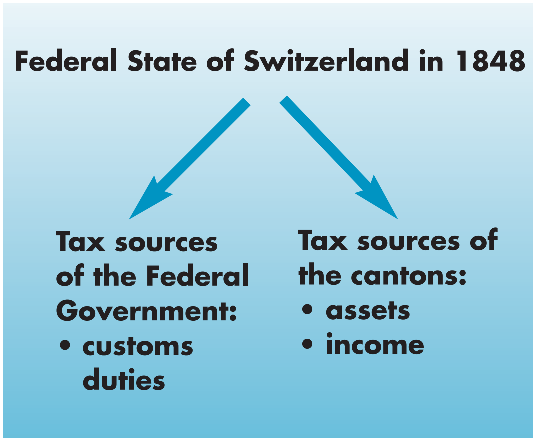
Until the First World War, revenue derived from customs duties was sufficient to cover the Confederation's expenditure. Towards the end of the war, however, stamp duties were introduced. Later on, as the federal government needed additional financial means, it turned to direct taxes, previously a domain granted to the cantons. This evolution culminated in the introduction of the so-called National Defence Tax (1941). Today, along with Value Added Tax, Direct Federal Tax (formerly known as National Defence Tax) is an important cornerstone of fiscal revenue and subsequently of the federal budget.

Initially, wealth tax used to be the principle tax levied by the cantons; taxation on income was merely supplemental. However, a conversion took place over time from the traditional system of taxes on wealth and income to a common system of taxation on income with a supplementary tax on wealth and assets.

[1] Switzerland (the Federal State) is composed of 26 **cantons** (member states) and the **Confederation** (central state). The cantons are made up of some 3,000 **communes.** The cantons are the original holders of sovereignty. The Confederation holds those sovereign rights which are expressly granted to it by the Federal Constitution. The extent of the communes' autonomy is determined by cantonal law.

Originally, these taxes were levied proportionally. Over time, progressive taxation became the rule in taxation on income and wealth, and social deductions were introduced to take account of taxpayers in the lower-income bracket or with families.





Taxes levied on the three levels are apportioned as follows:

2 The three levels of taxation

Taxes on income and wealth	Taxes on goods and services/ Taxes on property and expenditure
Confederation	
Income tax	Value Added Tax
Tax on profits	Tobacco tax
Swiss withholding tax	Beer tax
Military and civil service exemption tax	Tax on distilled spirits
	Tax on mineral oil
	Automobile tax
Stamp duties	Customs duties
26 cantons	
Income and wealth taxes	Motor vehicle tax
Poll tax or household tax	Dog tax
Tax on profits and capital	Entertainment tax
Inheritance and gift taxes	Stamp duties
Immovable property gains tax	Tax on hydraulic power stations
Real estate tax	Sundry taxes
Transfer tax	
Lottery tax	
3,000 communes	
Income and wealth taxes	Dog tax
Poll tax or household tax	Entertainment tax
Tax on profits and capital	Miscellaneous taxes
Inheritance and gift taxes	
Immovable property gains tax	
Real estate tax	
Transfer tax	
Lottery tax	
Trade tax	

3 Constitutional foundations

The Swiss tax system reflects **the federalist state structure** of our country. As shown in the previous table, taxes and other duties are levied on all three levels: the Confederation, the 26 cantons and the some 3,000 communes.

The delimitation of fiscal jurisdiction is regulated by the Constitution. However, the right of these entities to levy taxes is limited by the Constitution. The aim is to apportion fiscal sovereignty in such a way as to ensure that none of the three bodies hinders the others and that the taxpayer does not bear a disproportionately heavy tax burden. As a result, the Federal Constitution authorises the Confederation to levy certain taxes while barring such taxes for the cantons.

The general principles which govern the apportionment of competence between the Confederation and the cantons are laid out in Article 3 of the Federal Constitution (hereafter FC):

"The Cantons are sovereign insofar as their sovereignty is not limited by the Federal Constitution; they shall exercise all rights which are not transferred to the Confederation."

When applied to taxes, this apportionment of competence has the following consequences:

- The **Confederation** may only levy those taxes which the Federal Constitution expressly authorises it to collect.
The fact that the Constitution empowers the Confederation to levy a tax does not automatically bar the cantons from also levying a similar tax; there must be a specific prohibition to this effect. As a result, in some situations both Confederation and cantons levy direct taxes, such as on income and profits.

- The **cantons** on the other hand are in principle authorised to levy any type of tax and decide how the resulting revenues should be used, unless the FC specifically bars them from levying a given tax or specifies exclusive jurisdiction for the Confederation.
As the Confederation may only claim exclusive jurisdiction for relatively few types of taxes (Art. 130 FC: VAT; Art. 131 FC: special expenditure taxes; Art. 132 FC: Stamp duties and Swiss withholding tax; Art. 133 FC: Customs duties), the cantons are given broad scope to define their own tax legislation.
As a result, each canton has its own tax legislation and taxes as appropriate the income and assets of individuals, the profits and capital of legal entities, inheritances and donations, property gains, etc.

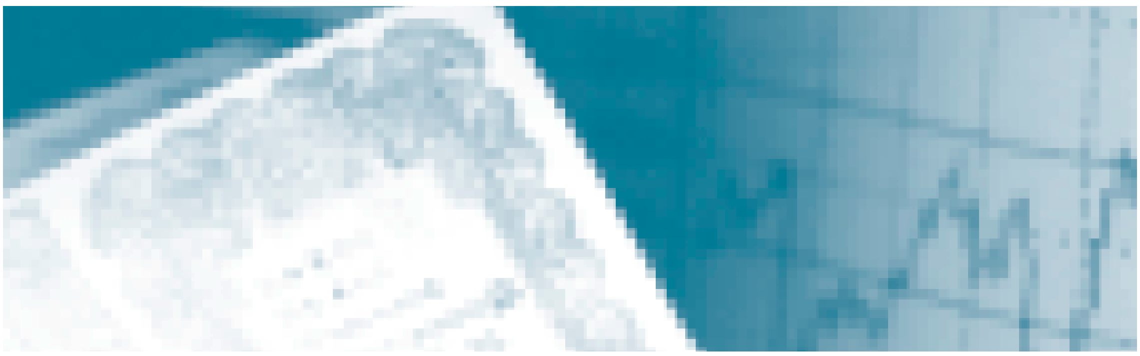
- The approximately 3,000 **communes** may only levy taxes which their canton empowers them to levy.[2]
In contrast to original sovereignty, here we are dealing with **derived or delegated fiscal sovereignty.** However, this does not alter the fact that this represents a genuine fiscal sovereignty which operates, in addition to that of the Confederation and the cantons, as an essential component of the Swiss tax system.
In practice, the communes often levy such taxes as multiples of the cantonal basic rate, i.e. the basic State tax, or as a multiple of the State tax effectively owed.
The cantonal constitutions define the types of taxes that the communes are entitled to levy.

[2] The communes are granted the right to levy taxes because, as autonomous self-governing entities, they have a very important role in the social structure of our country. In addition to the duties they perform as local communities, the communes are also authorised to a broad extent to perform duties whose execution lies elsewhere in the exclusive sphere of state competence, such as primary education, social welfare and health.
Even though these duties are partly under state supervision and enjoy financial assistance from the State, the resultant costs are to a large extent borne by the communes. This in turn makes it necessary to permit the communes to share in existing sources of financing. Consequently, the resultant fiscal autonomy goes hand in hand with the functional autonomy of the communes.

The taxes levied in Switzerland are subdivided into **taxes on income and wealth** as well as **consumption, property and expenditure taxes.** The Confederation, the cantons and the communes all levy individual taxes from both categories, usually termed as direct or indirect taxes.

Swiss tax legislation is characterised by the following **principles of form** enshrined in the FC:

- Principle of equality before the law (Art. 8 FC)
- Principle of economic freedom (Art. 27 FC)
- Principle of right to property (Art. 26 FC)
- Principle of freedom of religion and philosophy (Art. 15 FC)
- Prohibition of intercantonal double taxation (Art. 127, para 3 FC)
- Prohibition of unjustified tax advantages (Art. 129, para 3 FC)



4 International double taxation

Double taxation results from the overlapping of different tax jurisdictions. As a consequence, the taxpayer is simultaneously subject to similar taxes on the same item by two different fiscal jurisdictions. Double taxation occurs both in intercantonal and in international relations. Intercantonal double taxation conflicts are settled on the basis of the practice established by the Federal Supreme Court. The avoidance of international double taxation is achieved by means of international double taxation conventions.

So far, Switzerland has concluded comprehensive double taxation conventions with more than sixty countries.

There are two principal methods for the elimination of double taxation, namely, the **exemption method** and the **credit method.** Under the exemption method, the country of residence is required to exempt from tax those items of income and/or capital allocated to the source country. Exempted items may nevertheless be taken into account in determining the rate of tax applicable to the remaining income (exemption with progression). Under the credit method, both countries keep the right to tax a specific item. However, the country of residence must credit the source country's tax against its own tax.

The annex contains two tables under figure 1:

- a list of double taxation conventions concluded by the Confederation;
- an enumeration of tax relief for Swiss dividends and interest.