3. Impact of the 2017 U.S. Tax Reform on the Swiss Economy

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The Tax Cuts and Jobs Act (TCJA)[1)] signed into law on December 22, 2017 made significant changes to the personal and business income tax systems in the United States (U.S.). A major purpose of the law was to lower the tax burden on businesses and encourage them to keep their profits and investments at home. To accomplish this objective, the TCJA lowered the statutory corporate income tax rate from 35 to 21 percent[2)] and introduced international tax provisions designed to incentivize U.S. corporations to repatriate foreign earnings and invest them in the United States. The TCJA offered incentives to companies that conduct cross-border business operations from the United States and penalized U.S. companies that have moved intangible property or operations overseas to controlled foreign corporations (CFCs).

Many articles have been written about the importance of international companies to the Swiss economy, including U.S. companies[3)], and there have been numerous articles outlining the international tax provisions of 2017 tax reform[4)]. This article is not intended to review the technical aspects of the tax reform or the importance of American companies to Switzerland. Rather, this article is designed to focus on the economic consequences that the TCJA will have on Switzerland. It concludes, given that the need for a U.S. company to operate in Switzerland is no longer primarily tax driven, Switzerland should be more creative in finding ways to attract foreign investment.

There are many important and obvious reasons for U.S. companies to have a regional hub in Switzerland:

> Switzerland provides multinational companies (MNCs) with an ideal business location. Switzerland offers an array of advantages to MNCs: a central location in Europe, a stable political and fiscal environment, a well-developed infrastructure, a good quality of life, a highly skilled and multilingual workforce, an attractive tax system, and a business-friendly government, in addition to a long-standing focus on innovation and investment in R&D. In addition, when it comes to attracting MNCs, Switzerland not only has the know-how, it also sets the standard. For the past three years, the World Economic Forum's Global Competitiveness Report has ranked Switzerland the most competitive economy in the world[5)].

For these reasons, Switzerland will remain an important hub as a headquarters for business needs in the region, because all of these advantages are still available. Instead, what has changed is the tax-driven need for operations in Switzerland. This not only negatively impacts employment in Switzerland, but also the use of many services in Switzerland. The two main components of the TCJA that likely will negatively impact the Swiss economy are the one-time "transition tax"[6)] and the new "global intangible low-taxed income" (GILTI) rules[7)].

The Transition Tax

The TCJA enacted a Transition Tax[8)]. The main purpose of the Transition Tax was to a apply a one-time tax on certain earnings of certain foreign corporations that had not been previously taxed in the United States as of certain dates at the end of 2017. This mostly was targeted at large amounts of cash earnings that U.S. publicly traded companies had left offshore and that previously were not subject to tax in the United States until brought back into the United States in the form of dividends. The second purpose of the Transition Tax was to hit "reset" for these foreign corporations and move the United States into a modified-territorial tax system similar to what is more common around the world. However, the shift to a territorial based system is only in part, as the United States chose to keep its anti-deferral regimes, while also adding an additional regime (GILTI). The effect of these rules, together, is that there is far less incentive for a U.S. company to maintain profits abroad.

Although the Transition Tax was imposed only on a limited number of companies, it has resulted in a significant amount of retained earnings held in Swiss subsidiaries being repatriated to the United States. This is because once the Transition Tax applied (at rates of 15.5% or 8%, depending on whether the earnings were in in cash or cash equivalents, or illiquid assets, respectively) U.S. companies generally were able to repatriate the earnings without further U.S. tax. The lower Transition Tax rates applied in lieu of the previous maximum rate of 35 percent or the current rate of 21 percent. This tax may even be paid in installments over an eight-year period, and, when combined with the lower tax rates, this yields a tremendous incentive for U.S. companies to repatriate foreign earnings.

The Transition Tax has impacted a number of significant issues, such as:

(1) many companies no longer keep significant cash reserves in Swiss banks because it is no longer tax advantageous; and
(2) the loss of deferral has reduced the need for substance outside the United States, which allows companies to restructure jobs in methods that are the most efficient from a corporate perspective, without tax-driven concerns.

While Switzerland may have benefitted from a 5% withholding tax at source when funds were repatriated to the United States, these funds previously had been invested with Swiss financial institutions and were viable capital to the Swiss financial services sector. These funds are now gone. In addition to the loss of these funds from Swiss financial institutions, the Swiss government has lost the investment taxes that were generated from their investment earnings. This results in a double blow to the Swiss economy.

Global Intangible Low-Taxed Income (GILTI)

The TCJA also established the global intangible low-taxed income ("GILTI") rules, which created a new anti-deferral regime to discourage companies from using intellectual property to shift profits to foreign tax haven jurisdictions. The GILTI regime

requires U.S. shareholders of a CFC to include as income a deemed distribution equal to their allocable share of the earnings and profits that are considered GILTI earnings. The deemed distribution creates what is referred to as "phantom" income for U.S. taxpayers--money that taxpayers are taxed on even though they have not received any cash related to that income.

"GILTI" is somewhat of a misnomer, because it is not a tax on income from intangibles or low-taxed income. Instead, GILTI requires income inclusion for those earnings that exceed a 10 percent return on a U.S. company's invested foreign assets. It is often referred to as a "global minimum tax." From a high-level perspective, GILTI earnings include all of a CFC's income above a 10 percent return on fixed depreciable assets.

U.S. corporate shareholders are allowed a deduction equal to 50 percent of GILTI for 2018 through 2025, and this deduction decreases to 37.5 percent in 2026. Thus, the effective tax rate on GILTI for U.S. corporations is 10.5 percent before 2026, and 13.1 percent thereafter. This system collects more tax on the foreign income of the MNCs, since it taxes some foreign income as it is earned rather than when it is repatriated. The GILTI rules most likely will heavily impact those Swiss operations where profit margin is high relative to the fixed asset base. Such business segments include the services industry, distributors, and software and technology companies.

Consequently, this means U.S. companies will be less incentivized to place operations abroad, especially into countries like Switzerland where low tax rates are available. The reason is because the effective U.S. tax rate increases as the foreign tax rate is lower.

Impact of Populist Initiatives

As a result of the impact caused by the TCJA, coupled with some perceptions that Switzerland is less stable as a result of various populist initiatives, Switzerland has dropped in rank from first place to third place for headquarters locations of multinational companies in Europe. Switzerland also has not attracted globalizing technology and Chinese companies. Not only is Switzerland losing share among relocating multinationals, but multinationals currently present in Switzerland are moving some of their activities abroad. In the past, multinationals' movement out of Switzerland has mainly been confined to relocating transactional and labor-intensive activities into shared services centers abroad.

Additionally, Switzerland's historical perceived strength, its reliability as to law, has been eroding. Issues like the Minder Initiative, aggressive anti-foreigner legislation, the difficulty of enacting corporate tax reform, and the continuous slew of populist initiatives have created a perception of regulatory insecurity in the business sector. Consequently, the populist initiative, combined with the negative impact caused by the TCJA, make it less likely that jobs will be moved to Switzerland, or, even worse, the jobs that exist will not stay and move to perceived labor-friendly environments, such as Singapore or Ireland.

Conclusion

The TCJA has led to a fundamental reshaping of tax planning by U.S. corporations. Historically, U.S. tax on investments was viewed as less favorable when compared to many other countries. As a result of the TCJA, the United States has a more attractive corporate income tax system, which minimizes a U.S. company's desire to shift profits abroad. The TCJA not only impacts investment decisions but also profit distribution. The TCJA has negatively impacted Switzerland, a country that has historically benefitted from regional headquarters in the country stimulating economic growth. While not the exclusive reason some companies are choosing not to relocate to Switzerland or leaving jobs in Switzerland, it is a major impact. Switzerland, as a result, needs to find ways to be more competitive to attract further foreign investment that are not tax-driven.

1) Pub. L. No. 115-97, § 11001, 31 Stat. 2054 (2017).
2) IRC § 11(b) (2020).
3) https://www.amcham.ch/publications/downloads/20120612_bcg_amcham_study_en.pdf.
4) Tobias F. Rohner, Jacopo Crivellaro and Kevin T. Keen, *U.S. Tax Reform and Its Impact on Swiss Companies*, Steuern (2018), available at https://www.bakermckenzie.com/-/media/files/people/rohner-tobias/ar_zurich_ustaxreformswisscompanies_mar2018.pdf (last visited April 1, 2020.
5) https://www.amcham.ch/publications/downloads/20120612_bcg_amcham_study_en.pdf.
6) IRC § 965.
7) IRC § 951A.
8 IRC § 965.

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