



## Key facts

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Due to certain inconsistencies in the assessment of direct federal tax (DFT) relief, brought to light in 2010 by comparing the data of the Reorganisation of Financial Equalisation (NFA) with data from the State Secretariat for Economic Affairs (SECO), the Swiss Federal Audit Office (SFAO) began an analysis of this area in 2010, focusing on SECO's supervision. It was found that the extent of such tax relief largely exceeded the amounts disclosed to Parliament and that the associated measures were disproportionately concentrated in production-related service companies and in certain cantons (Vaud and Neuchâtel accounted for, respectively, 22 % and 23 % of all exemptions and 48 % and 14 % of the total volume of earnings before direct federal tax relief in 2008<sup>1</sup>). The exam identified some serious shortcomings with regard to supervision, in particular the absence of any coordination between the Federal Tax Administration (FTA) and SECO, and no clear definition of how long such relief should apply (ten calendar years or ten fiscal years?).

Continuing its analysis in 2011, the SFAO took a sample of 32 companies (26 production-related service companies and six production companies) that were granted direct federal tax relief under the Federal Act of 6 October 1995 (AERZ<sup>2</sup>) and the Ordinance of 10 June 1996 in Favour of Economic Regeneration Zones (OERZ<sup>3</sup>). The sample was chosen according to the risks identified by the SFAO (production-related service companies, special tax status, amount of earnings subject to direct federal tax before relief, large increase of the tax relief decisions in 2007<sup>4</sup>) and in the four cantons granting the most cases of such tax relief under the aforementioned law, i.e. Fribourg, Neuchâtel, Schaffhausen and Vaud. For these 32 cases, the SFAO verified two aspects: the legal compliance of the decisions taken by the Federal Department of Economic Affairs (FDEA) and the companies' observance of the conditions set out in such decisions. The SFAO obtained details from the companies regarding their headcount and investments made as well as information on their collaboration with Swiss universities and the local economy. This made it possible for the first time to compare the official reporting data with actual employment and investment figures.

In six cases (all of which were production-related service companies), the SFAO found that the FDEA's decisions did not adequately specify the conditions explicitly provided for in the legislation on economic regeneration zones, particularly the impact on the regional economy and collaboration with Swiss universities as per Art. 4a OFERZ introduced on 1 February 2005. Future decisions should therefore be more precise in this respect. The tax consequences of non-compliance with the requirements, or of only partial attainment of targets, should also be defined more realistically in decisions on tax relief.

Among its sample, the SFAO found two separate cases of non-compliance with the FDEA's decisions. Another case emerged from meetings with the cantonal managers. A study of these cases has highlighted the need for a more precise definition of the concepts of "job created" and

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<sup>1</sup> In 2007, Vaud and Neuchâtel accounted for, respectively, 20 % and 27 % of all exemptions and 73% and 14 % of the total volume of earnings before direct federal tax relief

<sup>2</sup> RO 1996 1918, 2001 1911, 2006 4301

<sup>3</sup> RO 1996 1922, 2000 187, 2001 3033, 2004 5113, 2006 4305

<sup>4</sup> The last year of the Federal Act on Economic Regeneration Zones before the new federal law on regional development policy came into effect on 1 January 2008 (SR 901.0; Regional Policy Act of 6 October 2006)

"investment". For example, some multinational companies include employees who are not liable to Swiss tax in their headcount numbers. In general, the SFAO found a low proportion of local hires (approx. 20%), with most jobs created being filled by employees transferred from abroad. Given the service nature of their business, most investments were made in office fittings or construction. This report includes actual examples for the sake of comprehension and observance of the criteria for direct federal tax relief; however, it does not disclose any information that could serve to identify the companies in question.

Tax relief decisions generally apply for five years and may be renewed for a second five-year period. The companies are supposed to have met certain job-creation and investment targets after the first five years. They inform the cantonal authorities of the actual figures, which are then forwarded to SECO. The SFAO found discrepancies in how the first five-year period is measured, with some companies taking calendar years and other taking fiscal years; the interpretation chosen may influence the decision on whether the targets have been met. There is also the issue of when exactly targets should be checked and on what basis. Practice differs in this area according to the canton. Targets of some companies are checked several months before the end of the initial period, based on estimated figures. Targets of others are not checked until the actual figures are available, which could result in the tax relief period extending beyond the initial five-year period, even if the conditions are not met.

The supervision system was found to be incomplete and inefficient, based on a principle of trust regarding the companies and the cantons in which they are established. Supervisory tasks have been informally delegated to the cantonal departments responsible for the establishment of new companies. Acting as advisors and partners to companies granted tax relief, these departments are often faced with conflicts of interest or do not receive the necessary information from their own tax offices. Since 2004, however, Schaffhausen's economic development body has had access to its canton's aggregate tax data for the purpose of calculating the volume of tax receipts generated by exempted companies and their employees.

Given the tax secrecy they sometimes face, two measures are necessary to ascertain that the jobs created are actually in the given region:

- A new annual jobs reporting form – one that is detailed and individual – should be drawn up by SECO and forwarded to all cantons without delay.
- Where there is no exchange of data between the cantonal tax office and economic development body, the cantons should check the employees' tax liability.

Although direct federal tax relief for companies produces additional tax receipts by way of employees' payroll taxes and the taxation of the non-exempt part of profitable operations, such relief measures may also have the result of increasing the canton's NFA (i.e. fiscal equalization) contribution. Considering only those companies with direct federal tax exemptions (and not the taxable companies of the same group possibly based in that canton), the SFAO found that, for ten companies, the increase in the canton's NFA contribution was higher than the tax receipts generated. For three of these (one based in Fribourg, one in Vaud and one in Neuchâtel), this exceeded ten million francs a year. This collateral impact could be avoided for these cantons if the rate of relief granted at both federal and cantonal level was less than 100 %. The NFA aspect

should thus be given more consideration in cantonal decisions as well as in proposals for direct federal tax relief. As the only canton to show a positive net result among the four examined by the SFAO, Schaffhausen appears to be setting a good example with its partial exemptions.

The SFAO did not study the other indirect components in the granting of such relief, like the impact on the housing and labour markets, the regional infrastructure or the repercussions on companies already established in that region (specifically the spin-off and maintenance effects). SECO will carry out such an analysis as part of its scheduled assessment of the new regional policy for 2013. The SFAO believes this study should include companies granted tax relief under the previous legislation (AERZ).

The departments responsible in the Canton of Vaud voluntarily sent SECO their feedback on the SFAO's findings. They questioned the negative net result on the cantonal budget of direct federal tax relief for certain companies, referring to the interventions undertaken with the largest of these to correct such effects. With regard to taking account of the NFA impact, they claimed that the more sensitive companies were overrepresented in the sample and that there was a "methodological bias" by virtue of the fact that the NFA came into force subsequently (in 2008).

The Canton of Fribourg, no longer included in the scope of application of direct federal tax relief, expressed a desire to estimate in advance the NFA impact of companies applying for cantonal tax relief. Meanwhile, the Canton of Neuchâtel's departments of finance and the economy focused on the informal manner in which supervisory tasks are delegated to the cantons, highlighting the absence of any real coordinated control between the cantonal departments of taxation and the economy with regard to the data submitted by companies.

The Canton of Schaffhausen identified some elements of the decision-making process for certain companies with tax exemption which the SFAO hasn't taken into account, specifically the renewal clause and the conditions of the obligation to maintain company headquarters. It also pointed out certain evidence of the audited companies' close ties to their regional economy.

SECO has noted the SFAO's findings and recommendations. It questions the SFAO's focus in its sample on production-related service companies, which are not representative of the majority of companies granted tax relief. The criterion of tax liability for jobs created is not considered pertinent with regard to the underlying legislation. On 21 November 2011, SECO nevertheless brought the concept of "place of work" to the attention of the cantons. As to the two cases where the FDEA's decisions were not respected, SECO claims that these were old cases, and that such practices were no longer in use.

The federal parliamentary Finance Delegation took note of the case at its sixth ordinary session of 28 to 29 November 2011.

The SFAO has considered the different viewpoints and additional information furnished by SECO and the relevant cantonal departments for the four cantons. It notes that SECO has worked out a concept for supervision and controlling which was put into force on 21 December 2011 by the Head of the FDEA. A revision of the principles of application in granting tax relief within the new regional

policy of SECO is planned for the first half of 2012. The basic principles of how to handle tax relief granted under the former law were specified by SECO in the context of the renewal of tax relief after five years. At the initiative of SECO and based on data collected by the SFAO, the FTA has filed an appeal against the DFT taxation of a production-related service company by the cantonal tax administration for non-compliance with the tax relief decision of the FDEA. SECO has also demanded the canton's confirmation of the company's achievement of objectives after five years, and has declared this a precondition for the extension of the tax relief for an additional five years.

Furthermore, the SFAO believes that it is methodologically correct to take the NFA impact into account for tax relief decisions that were granted before it came into effect in 2008 because, since 2003, the NFA rules have explicitly referred to earnings prior to direct federal tax relief. Through its successive interventions, the SFAO has shown the deficiencies of the system, in particular the 100 % direct federal tax relief granted to production-related service companies. It also identified critical companies, pointed out best practices and stimulated discussion on the use of this regional policy tool and the evaluation of its impact.

The SFAO intends to conduct a follow-up audit of the measures taken by SECO and the cantons concerned in 2014/2015, with the relief decisions granted under the previous legislation remaining applicable until 2017, or even longer in the case of those cantons with reimbursement clauses.

**Original text in French**