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3. Switzerland, In or Out for US Multinationals?

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Introduction

Large multinational companies ("MNCs") have, historically, tended to commercially segregate markets whereby the home market was managed separately from the rest of the world ("ROW"). Generally, MNCs' businesses in non-US markets were managed through a series of regional headquarters ("HQs") based in Europe, Asia, Latin America, and Africa. This generally remains the case today.

The tax landscape for US MNCs has undergone dramatic changes. The tax environment for MNCs is dynamic and is expected to remain so. A primary example of this dynamism is the Organization for Economic Cooperation and Development ("OECD") Base Erosion and Profit Shifting ("BEPS") project[1] and the transposition of this endeavor into ever-changing tax laws in jurisdictions around the globe. The ultimate outcome of the BEPs project remains unclear. Only time will tell whether BEPs was an effective tool for mitigating global tax arbitrage or just a means by which spendthrift governments, like the US, extract more tax dollars from successful enterprises without accepting blame for the damage higher taxes inevitably creates.

The BEPS project has more recently introduced a minimum tax levy for companies with revenues of at least EUR 750 million. Ostensibly, the intention behind the minimum tax levy is to create a level playing field, potentially reducing the scope for tax arbitrage by MNCs. Arguably, one may expect that there could be a shift in the preference of MNCs regarding the location of their HQs, potentially resulting in an exodus of HQs from Switzerland. If that were the case, Switzerland could be at risk of becoming a less attractive location for regional HQs. However, this does not seem to be true, as in our daily practice, we are not seeing evidence of departures of regional HQs from Switzerland, nor a standstill in new companies establishing HQs in Switzerland.

This begs the question, "Is the perception that Switzerland may lose out on retaining regional HQs correct or are we on the verge of unseen, dramatic change?".

Importance of MNCs to Swiss Economy

The Swiss economy is home to significant number of Fortune 500 companies relative to its GDP[2]. Swiss and non-Swiss MNCs' contribution to the Swiss economy has been remarkable. Albeit these MNCs represent not more than 5% of the number of companies operating in the Swiss market and employ slightly over 25% of the workforce. Most importantly, these companies account for more than one-third of Swiss GDP. Furthermore, MNCs' federal corporate tax revenue amounts to nearly 50% of total Swiss income taxes (federal and cantonal tax) collected.

Background on Swiss HQs of US Quoted Companies

Shortly after the second world war, large US MNCs began to incorporate overseas HQs. After the introduction of the US Subpart F rules in 1962, MNCs needed to structure their business to meet the various requirements of the new provisions to avoid current US federal corporate tax assessments. Otherwise, low-taxed non-US sourced income would have been subject to immediate US income taxation.

In the 1990s supply chains became more global and the need arose to centralize business models. This centralization was primarily possible for certain tangible goods that could easily be shipped, targeting high net operating margins. One of the business segments well suited to this operating structure was the pharmaceutical industry.

Over the past 25-35 years a substantial number of HQ companies were established in Switzerland. One of the drawbacks of these arrangements in Switzerland was, and remains, the operating costs in Switzerland tend to be high as compared to other locations. The price level indices highlight Switzerland's position as one of the most expensive countries in the OECD[3].

While Switzerland's high wages have a direct impact on labor costs and are closely linked to a higher cost of goods, they also contribute to a high standard of living. To a certain extent the high costs borne by MNCs in Switzerland were balanced through Switzerland's attractive tax regime. In consideration of the higher costs MNCs were staffing Swiss HQs leanly.

Location criteria

MNCs generally assess the location of their foreign operations on a combination of cost and quality factors. The following comprises the most important location factors that MNCs commonly consider when assessing the establishment of regional HQs, a segment of their enterprise, or a division.

As regards quality factors, one of the very decisive factors is the availability of an educated labor force and the quality and skills of employees. Switzerland has a well-earned reputation in the talent rankings[4]. This is, amongst others, the result of its world-class education system, universities, and engineering schools.

Switzerland's liberal labor laws are also attractive offering significant advantages over neighboring countries, particularly in terms of increased hiring flexibility. These benefits include the freedom to terminate employment contracts, and the absence of a minimum wage.

Of particular importance in the pharma and biotech industry are industry clusters with access to world-class talent. This concentration can have an impact on the availability of qualified employees[5] and creates a competitive environment. Clustering can also have an impact from an educational aspect, as the demand for specialists make the offering of special educational curricula more attractive for universities or engineering schools.

What has become essential for HQs are digital supply chain capabilities as organizations with advanced supply chain technologies can better overcome external challenges. Therefore, it remains to be seen to what extent the supply chain workforce develops towards a data-driven mindset.

In the last decade numerous initiatives were launched, such

as the mass immigration and the "Minder" initiative, and approved by the Swiss electorate. Other initiatives were ultimately rejected, such as the "Responsible Business Initiative" (Konzernverantwortungsinitiative). Nevertheless they still represent potential business threats that can lead to legal and economic uncertainty.

Because political stability is one of the cornerstones of the Swiss economy, it is in Switzerland's best interest to preserve the status quo and avoid losing one of its primary differentiators.[6]

Closely related, is Switzerland's monetary stability. A strong Swiss Franc, as one of the most stable and leading of the world's currencies, contributes to a healthy business environment. This contributes to factors such as access to governmental bodies, e.g. department of labor for working permits, department of construction, and tax administration.

As executives of HQs travel frequently, the infrastructure is also critically important. To successfully operate a regional HQ in Switzerland, reliability of infrastructure and technology is essential. Switzerland's infrastructure is still among the top ranked globally, but concerns exist that this advantage is gradually diminishing compared to its competitors[7].

There remains a risk that Switzerland may have been spoiled by past successes and may not recognize the potential headwinds that may be eroding the cornerstones of Switzerland's historic success. Accordingly, significant, and innovative change is needed to maintain Switzerland's global competitiveness.

Expected Headwinds on US HQ Groups

The headwinds for US multinationals could be substantial.

The US continues to have an increasingly difficult political situation. The current administration has performed very poorly on foreign policy, the economic front, crime, and immigration. However, there is significant opposition to a second Trump administration, even though during its first iteration it showed itself to be far more competent on matters pertaining to tax policy, economic and regulatory reform, and foreign policy.

Further, with the unsustainable level of national debt, topping $34 trillion as of this writing, there is only one direction tax revenues can travel, regardless of who occupies the White House. This is compounded by the seemingly insatiable appetite of profligate US politicians, from both parties, that seems to grow unabated and without much regard for the working populace or the inevitable bond market upheaval that is sure to come.

Tax policy going forward will continue to create controversy and will make the US a less attractive place for inbound investment. However, if the US continues to dominate the technology space the opportunity for US MNCs appears great and may ease some of the coming economic bumps.

On the brighter side, the US has historically been resistant to many of the changes the BEPs project has demanded. However, the current administration is a strong proponent of higher taxes on businesses and working people and prefers strong government control over the levers of industry in the US, as this has always been the preferred mechanism of America's Far Left, which has exerted significant influence over this administration.

Conclusion

What are the opportunities for Switzerland? The Swiss Domestic Top Up Tax is set to be levied at a rate of 15% as an effective tax rate of 15% is now what was previously an effective tax rate of 0% when classical tax havens were in vogue. Therefore, MNCs located in low-tax cantons have a good starting position. It remains to be seen in what form those cantons will refund the additional tax MNCs are being forced to contribute via the top-up tax. In addition, with the implementation of a global minimum tax, there is an opportunity to attract MNCs, located in current low-tax havens who are adhering to the minimum tax regime but who offer fewer economic and commercial advantages, to Switzerland.

Looking at the latest developments in the tax global landscape, those do impact companies differently, depending on their footprint.

- Smaller companies may choose to exit Switzerland with their effective tax rate arbitrage decreasing. However, those most likely would have always struggled to bring the prerequisite substance to Switzerland.
- Medium-sized companies might experience less of a change as they are already operating with cost-effective substance. If these businesses have a broad business case, those are likely to stay in Switzerland to avoid disruption to their businesses and to their employees.
- Larger companies are looking at an effective tax rate of at least 15%. Accordingly, they may have a favorable position if they remain in Switzerland. This would be seen as a beneficial outcome, considering that migrating larger HQs generally has a substantial disrupting effect.

The latest developments should not lead to an exodus of robust HQs, nor should it discourage US based MNCs to set up their regional HQs in Switzerland. Our analysis seems to support the notion that the correlation between tax incentives and the location where HQs may be located has diminished. Other factors are of much more importance. Our recent experience indicates that for US based MNCs, Switzerland remains, despite more recent developments, an attractive place to locate their regional HQs.

[1] OECD, Understanding tax avoidance, https://www.oecd.org/tax/beps/, visited on April 18, 2024.

[2] BearingPoint The Contest for Multinationals – An assessment of Switzerland's location attractiveness: Page 5: https://www.bearingpoint.com/en-ch/insights-events/insights/switzerland-location-attractiveness visited on April 18, 2024

[3] See above: BearingPoint, Page 26

[4] See above: BearingPoint, Page 11

[5] Martin Naville, Raphael Buck, Felix Wenger, Jan Mischke, Alexander Klei, Switzerland Wake Up, Reinforcing Switzerland's Attractiveness to Multinationals, April 2019, https://www.mckinsey.com/ch/~/media/McKinsey/Featured%20Insights/Europe/Reinforcing%20Switzerlands%20attractiveness%20to%20multinational%20companies/Switzerland-wake-up-Full-report.ashx, visited on April 18, 2024, p. 27.

[6] See above: BearingPoint P. 25

[7] See above: BearingPoint P. 20

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