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Government Proposes Radical Changes to VAT Regime

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COUNTRY DIGEST

Government Proposes Radical Changes to VAT Regime

Switzerland's Federal Council on June 25 approved and submitted to the parliament a two-part draft version of a completely new VAT law that contains some controversial provisions, including the adoption of a single VAT rate and the revocation of most of the existing VAT exemptions.

It is not clear when the Swiss parliament will debate the draft law. However, because some influential Swiss industries would not only benefit, but also could be negatively affected by some aspects of the legislation, it is likely that the new law — at least some of the more controversial aspects — would not become effective before 2012.

Background

VAT, which was first introduced in Switzerland in 1995, now is the most important source of income for the Swiss confederation. Bringing in revenue of CHF 19.7 billion (approximately $19 billion) in 2007, VAT has accounted for more than one-third of Switzerland's total federal income.

At the time of its introduction, future VAT-collecting entrepreneurs were promised that the VAT would be simple to handle in their daily business. That expectation, however, proved far from reality for many entrepreneurs, and their administrative burden has considerably increased since the introduction of the VAT.

The VAT law itself — and particularly its application and interpretation by the Swiss Federal Tax Authority (FTA) — is perceived as complex, formalistic, and inflexible.

In 2005 and again in 2008, the FTA adjusted and simplified its practice on some points. Also, the Swiss Federal Council in 2006 introduced a new provision in the VAT ordinance stating that the FTA can no longer make any adjustments to the detriment of VAT entrepreneurs based merely on formalities if failure to comply with those formalities does not lead to a tax deficit for the Swiss confederation.

All these measures were of course welcomed by VAT entrepreneurs and practitioners, but they are certainly not sufficient. Today's Swiss VAT system remains much too complicated. The industry brochures issued by the FTA contain hundreds of pages, and even VAT specialists often are unable to determine, for example, whether a specific turnover is a delivery of goods or a rendering of services (that determination being decisive on where the respective turnover is rendered — in Switzerland or abroad); or whether a whole bundle of services performed must be considered as one composed service or as several different services (a distinction that is crucial to determine where the respective turnover is rendered, whether the turnover is exempt from VAT, and, if not, which tax rate is applicable).

The Swiss Federal Administrative Court and Swiss Supreme Court have rendered a vast number of rulings in VAT matters. Unfortunately, as in many other tax cases, most of those decisions have upheld the views of the FTA, leading to even more stringent practice.

Proposed VAT Reform

Responding to the ongoing problems with the VAT regime, Finance Minister Hans Rudolf Merz is promoting radical changes to the existing VAT law. The new draft law contains two parts: Part A proposes a completely new VAT law without abolishing the numerous exemptions and varying VAT rates that exist today. Part B contains the whole of Part A, but also would abolish most of the VAT exemptions and varying VAT rates for different turnovers.

Part A

Part A provides for the greatest possible legal certainty for tax-collecting enterprises, an increase in transparency, and an enhanced ''customer orientation'' within the VAT authority. It also would shift some tasks and risks in connection with tax collections from tax-collecting enterprises to the VAT authority. Hence, Part A would considerably reduce the excessive formalities imposed by the VAT authority. Part A also proposes some material changes, as follows:

- VAT-collecting enterprises would have the explicit right to obtain binding answers from the VAT authority on concrete issues, beyond the existing Swiss ruling practice. The draft law also would introduce the right for VAT-collecting enterprises to be audited by the VAT authority and to get confirmation regarding whether the VAT authority had applied the law correctly in the past.
- VAT-collecting enterprises could present tax-reducing facts without meeting formal requirements.
- The statute of limitations would be reduced from 15 years to 10 years.
- Taxpayers' right to claim back input VAT would be extended. The draft law would introduce a general right to claim back input VAT in the context of an entrepreneurial activity. That right would be granted even if an enterprise does not (yet) generate taxable turnover. This change would notably improve the position of start-up companies and businesses that cannot reach the minimum turnover thresholds prescribed by the current VAT law.

The changes are not controversial so it is probable that the parliament will, in a first step, adopt the changes under Part A of the reform legislation. Swift approval of this part of the draft law would be most welcome, although Part A does not radically change the system; it merely introduces some badly needed measures to improve the Swiss VAT landscape. Once introduced, the success of the new VAT law will still depend on the willingness of the VAT authority to adhere to the wishes of the legislature.

Part B

The more radical proposed changes are in Part B of the draft VAT law, which includes all the changes in Part A but also calls for the abolition of the differing VAT rates and of most of the existing 25 tax exemptions.

If approved, these changes would simplify the VAT system considerably. Complex, time-consuming inquiries to avoid definition problems would cease.

The draft law provides for a single VAT rate of 6.1 percent. Hence, inquiries about whether an entity performs services subject to the lower rates or to the ordinary rate would no longer be necessary. On the other hand, businesses currently benefiting from the reduced VAT rates (with the right to fully claim back input VAT) will likely oppose this proposed simplification.

Part B of the draft law would also abolish 20 of the 25 current exemptions, making inquiries about whether a taxpayer performs exempt or taxable services less complicated to answer.

The revocation of 20 of the existing tax exemptions would affect the following industries:

- health care (medical and hospital services);
- welfare services;
- education and research;
- culture (entrance fees for theaters, museums, and so on);
- sports (entrance fees for sporting events); and
- postal service.

Only the following five industries would remain exempt from VAT:

- finance and insurance services;
- turnover in connection with lottery gambling;
- sales and leasing of real estate;
- agriculture; and
- services rendered and received within the same community.

It is estimated that the abolition of the tax exemptions would increase the number of existing taxpayers (VAT entrepreneurs) from 320,000 to about 350,000.

Conclusion

The introduction of a single VAT rate of 6.1 percent would make food products and some services in the areas of culture, sports, education, accommodations, and health care more expensive. Therefore, Part B of the VAT reform bill is expected to be met with considerable opposition by entrepreneurs and service providers in those sectors and also by the consumers affected. In fact, it is questionable whether this radical part of the proposed VAT reform will ever be enacted. Nonetheless, hope remains that these changes will simplify the life of Swiss VAT payers.

Because Part A of the draft law would introduce necessary and uncontroversial improvements and bring increased legal certainty, observers hope and expect that the parliament will rapidly adopt at least that part of the legislation. In principle, it seems the Swiss Federal Council had an idea in giving the parliament the opportunity to discuss two different proposals — one containing the minimum changes necessary, and one that also contains the more radical parts of the reform. However, the result of that approach could well be that the more radical parts of the reform will never be enacted. ◆

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