Switzerland delays revised VAT Act

Laurent Lattmann and Patrick Imgrüth of Tax Partner AG – Taxand Switzerland outline proposed changes to the Swiss VAT Act, assess developments in the aviation industry and look at why implementation of the revised Act has been delayed.

Swiss politicians are usually known for not wasting any time when tax changes need to be implemented. However, in the case of the announced revision of the Swiss VAT Act, things are moving surprisingly slowly. The draft changes were initially published on February 25 2015 and, given the nature of the changes, it was likely that these were going to be implemented as of January 1 2016. However, it now seems as if they would only enter into force as of January 1 2018, whereby the enactment date of the new changes has not yet been decided on. Since the amendments will certainly result in an increase of the VAT revenue for the Swiss government, it is difficult to understand the delay. This is particularly surprising given that revenues from other levies are dwindling – for example, mineral oil tax revenue continues to suffer from the erosion of the price of oil.

Some of the changes will only be relevant for Swiss entities, but others will impact foreign entities with activities in Switzerland. Hereinafter we will summarise the most important changes for foreign entities and describe the potential outcome.

Obligation to register for VAT in Switzerland

The most important change concerns the obligation to register for VAT in Switzerland. Based on the current provisions, a company that supplies goods or services within Switzerland in excess of the VAT registration threshold of CHF 100,000 per year ($100,000) must register locally for VAT. The existing rules lead to ridiculous situations whereby a foreign company making billions of turnover is not obliged to register for VAT in Switzerland if its local sales within Switzerland remain below the registration threshold.

This somehow paradoxical situation will change as of January 1 2018. By then, it will no longer be relevant if the turnover resulting from supplies made within Switzerland exceeds the registration threshold or not. The only exemption to register for VAT will apply to foreign suppliers which render only services to Swiss-based recipients for which the reverse-charge provisions apply. It is important to note that, contrary to the VAT systems in the EU member states, a supplier that is already registered for VAT purposes in Switzerland (for example, . due to local supplies of goods) has to account for the VAT on any services rendered to Swiss customers, even if the services would basically fall under the reverse-charge provisions. If a foreign company fulfils the conditions of a VAT registration obligation, all services rendered to Swiss recipients must be invoiced with Swiss VAT.

Provided that the new provisions will enter in force as of January 1 2018, foreign companies supplying goods or services within Switzerland must assess, in the course of 2017, whether or not they will become liable for VAT in Switzerland.

Low Value Consignment Relief (LVCR)

The existing rule for low value consignment supplies provide that import VAT is only levied if the amount is above CHF 5. Contrary to the EU, the Swiss rules do not determine the fixed value of goods, but the relevant tax amount. Taking into account the low applicable VAT rates of 2.5% and 8%, the import value of goods can vary between CHF 62 and CHF 200 without triggering import VAT.

The expected changes will close this loophole, but since this would also increase the administrative workload of the Swiss Customs Authorities for the levying of the import VAT, it has been decided to implement a different approach. The new rules foresee that the place of supply of goods falling under the LVCR provisions will be shifted into Switzerland, if the supplies generate taxable supplies in excess of CHF 100,000 from such LVCR sales. With this change LVCR sales will become liable in Switzerland, even if the import of the goods itself will not lead to a payment of import VAT.

Even though this provision should bring greater parity to the treatment of Swiss and foreign suppliers of low value goods, a competitive distortion will remain. Swiss suppliers generating a taxable turnover of less than CHF 100,000 from such sales will have to charge Swiss VAT, while a foreign supplier that remains below the CHF 100,000 limit will be exempt, since the place of supply will remain outside of Switzerland. It will have to be seen if the concept to shift a place of supply dependant on turnover figures is practicable, or whether the next change of this rule is just a question of time.

Aviation – mixed use of aircrafts

In November 2015, the Swiss Federal Tax Administration (FTA) released its administrative leaflet for the aviation industry. This leaflet was a long time coming, having been expected from 2010 onwards, and sheds some light on the question of when an aircraft is considered as being 'used for entrepreneurial purposes'. The use for entrepreneurial purposes is necessary to assess whether it is possible to claim the input VAT on either the acquisition or the import of the aircraft in Switzerland.

According to the former administrative practice of the FTA, if an aircraft was held by a special purpose vehicle (SPV) and used by its ultimate beneficial owner (UBO), the FTA systematically refused to grant the right to claim back the input VAT. Whether the UBO was charged a market price for the private use of the aircraft, or the extent to which the aircraft was used for commercial purposes and its use charged out to companies held by the UBO, was not considered to be of relevance. The FTA held such structures as entirely abusive, and this interpretation was even confirmed by the Swiss High Court. In 2013, after several attempts, the Swiss High Court finally came to the conclusion that holding an aircraft through an SPV does not constitute an abusive structure *per se* and that the right to claim the input VAT could not be refused just because of the holding structure of the aircraft. The FTA was therefore urged to re-assess its administrative practice, which delayed the publication for several months.

The recently published leaflet goes into more detail when it comes to aircrafts that are owned by SPVs, but the new rules still have shortcomings. Importantly, they are not in line with the local VAT Act. In fact, the FTA is willing to accept a private use up to 20% of the yearly flight time of the aircraft provided that the UBO or any related party using the aircraft is charged a market price. If the private use is above the 20% limit, the FTA will perform additional checks to assess, on a case-by-case basis, whether the aircraft has been used for entrepreneurial purposes or whether the use should be considered as a non-entrepreneurial activity.

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Tax Partner is one of the leading tax firms in Switzerland. With a team of 37 professionals, the firm advises a range of multinational and national corporate clients as well as individuals. In 2005, Tax Partner co-founded Taxand – the first global network, with more than 2,000 tax advisers and more than 400 partners from independent member firms in nearly 50 countries.

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Even though the new rule constitutes a significant improvement compared to the previous situation, it does not accurately reflect other legal provisions. Based on the respective article in the VAT Act, the input VAT incurred on goods that are being used for mixed purposes is deductible to the extent it is used for taxable purposes. The Swiss provisions even foresee that the input VAT on such goods can be claimed in full during the calendar year if the goods are used predominantly for taxable purposes. A correction that reflects the non-taxable use (that is, VAT exempt or non-entrepreneurial use) must be made only once a year when the last quarterly return is due. Compared with the legal provisions, the rules introduced by the administrative leaflet for aircrafts are more restrictive and new court proceedings are to be expected. Even though the FTA may justify such a restrictive practice with the fact that high amounts of input VAT are at stake, it seems to forget that most of the flights that are made with such aircrafts are taking place outside of Switzerland and are thus zero-rated. The UBO therefore does not benefit from an unjustified VAT deduction when he uses his aircraft for a cross-border flight and pays a market price. He has no VAT advantages whatsoever compared with the situation when he charters an aircraft operated by a third-party where he would also be charged with 0% VAT. Owners of aircrafts that are held by an SPV and who use the aircraft for both entrepreneurial and private reasons must remain vigilant and must maintain proper records on the use of the aircraft. Correspondingly, should the private use alone be above the 20% limit, they will have to enforce their right to claim the input VAT.

Aviation – commercial air carriers

The Swiss VAT Act contains a provision according to which providers of international air transportation services, typically international air carriers, can benefit from a zero-rated acquisition of services and goods within Switzerland. The zero-rate is, however, only applicable to goods and services that are closely linked to the operation of the aircraft, such as maintenance, fuelling and catering. This rule is well-known to suppliers in the aircraft industry and typically applied. International airlines therefore acquire most of their goods and services without paying Swiss VAT.

However, these suppliers usually charge Swiss VAT to operators of aircrafts that are not easily recognisable as providers of international air transportation services, with the effect that such operators must claim their input VAT using the VAT refund procedure similar to the 13th EU VAT Directive. Subsequently this is where the complication starts, as the FTA refuses to refund amounts for which a zero-rate could have been applied. This might sound logical to many VAT experts or tax directors as identical rules apply in the EU, but neither the Swiss VAT Act nor the corresponding VAT ordinance contains such a restriction. Based on the applicable legal provisions, the FTA is not entitled to refuse claims of VAT that has been charged, whether erroneously or intentionally.

The Administration considers every foreign supplier of international air transport services that is on the list of Eurocontrol (the European Organisation for the Safety of Air Navigation) as an international air carrier. If a foreign company qualifies as an international air carrier according to Eurocontrol, the FTA does not reimburse any VAT charged in connection with the operation of an aircraft. Only input VAT incurred which is not closely connected with the operation of the aircraft will be reimbursed, such as on hotel costs for the crew. Foreign suppliers of international air transport services would therefore be obliged to enforce the application of the zero-rate towards their Swiss suppliers. So how should one proceed if the FTA refuses the claim, while the supplier does not want to credit the VAT amount that should not have been charged, according to the FTA, without taking a risk? Despite the fact that the FTA just published a new industry leaflet, it did not mention that it is willing to issue letters confirming the status of a foreign provider of international air transport services. If a foreign company provides his Swiss supplier with a copy of the confirmation letter, the latter can issue its invoices using the zero-rate without risking a re-assessment during a VAT audit. Should a supplier not be willing to rectify invoices issued in the past, the VAT claim towards the FTA must be pursued in the course of court proceedings. Given the fact that the refusal of the FTA is not supported by legal provisions, the chance of success in court can be considered as being high.