# Playing with fire – Switzerland deviates from international standards

The Federal Administrative Court recently rendered its judgment in a case that might cause substantial headaches to companies supplying goods to Switzerland. Laurent Lattmann and Désirée Högger of **Tax Partner AG – Taxand Switzerland** explain the relevant aspects of this case and the potential fallout if this judgment is upheld by the Federal Supreme Court.

## What happened?

At first glance, nothing spectacular. The Swiss VAT authority carried out an audit of a foreign trading company (TradingCo) registered for VAT in Switzerland that sourced goods from abroad, and sold them on to a Swiss-based distributor (DistributionCo). TradingCo ordered the goods from various foreign third party suppliers and was partly responsible for the transport to Switzerland. TradingCo was registered for Swiss VAT purposes ever since, filed its VAT returns and paid its taxes on time. The VAT audit did not uncover any mistakes and no re-assessment notices were issued by the Swiss VAT authority. However, the responsible VAT agent informed Swiss Customs that he suspected fraudulent behaviour because the import values used for the customs clearance of the goods were too low.

Soon after having received the report from their colleagues at the VAT authority, Swiss Customs started an investigation against TradingCo. They carried out a thorough onsite investigation and seized almost 7,000 pages of documents. Besides its fraud investigations, Swiss Customs also initiated a penal investigation against staff members of DistributionCo, who filed the import declarations on behalf of TradingCo. Last, but not least, Swiss Customs requested administrative assistance from the country in which TradingCo is established in order to conduct an interrogation of the person in charge of the in-house tax department of TradingCo. This case shows how quickly a company can be facing serious allegations, even if completely unsubstantiated.

Swiss Customs accused TradingCo of having committed import VAT fraud of approximately CHF 100 million ($99.2 million) by having under-declared the value of the goods. TradingCo cleared the goods through Customs using the purchase price paid to its various foreign third party suppliers, and was clearly of the opinion that this is in line with the import rules, not only in Switzerland but also worldwide. TradingCo did use its purchase price for the import clearance, as any other Swiss or foreign entrepreneur would have done, and claimed the import VAT paid in full. Which other value should TradingCo have used for the import clearance, given the fact that the goods were imported in the course of a purchase or sourcing transaction?

Swiss Customs claimed that the goods should have been imported using the expected sales value in Switzerland, minus a 10% discount for the coverage of local costs (e.g. warehousing, distribution, etc.). It is worthwhile to mention that TradingCo is fully entitled to claim back the

import VAT and that no advantage whatsoever resulted for the company. Moreover, since Switzerland levies import duties based on the weight and not ad valorem, the allegations on the import VAT fraud was limited to the import VAT that could be fully claimed by TradingCo.

## Federal Administrative Court

Surprisingly, the Federal Administrative Court (FAC) supported the position taken by Swiss Customs, but with different arguments.

The court held, in essence, that the prices charged by the foreign suppliers were not to be taken into account for import clearance purposes because TradingCo was partially organising the transport of the goods from abroad to its own warehouse in Switzerland. The FAC concluded that since the transport was partially conducted by TradingCo, the company had already received the power to dispose the goods outside of Switzerland and that, therefore, the price paid to the foreign suppliers was no longer relevant for the import of the goods. In other words, the sale of the goods from the foreign supplier to TradingCo could no longer be considered relevant as this transaction was overruled just by the fact that TradingCo carried out a part of the transport to Switzerland.

The FAC, therefore, ruled that the involvement of TradingCo in the transportation of the goods changed the value to be used for the import into Switzerland. Even though the FAC did not expressly say so in its judgment, the value to be used for the customs clearance formalities would have been different if the foreign suppliers had arranged the entire transport to Switzerland.

Contrary to Swiss Customs, the court correctly concluded that the import value could not be the subsequent sales price from TradingCo to DistributionCo minus a discount of 10% for the coverage of local costs. The subsequent sales transactions were only carried out after the goods were stored in the Swiss warehouse of TradingCo and could, therefore, not be taken into account in order to determine the value of the goods at the time of import. The FAC established that the sale transactions carried out between the foreign suppliers and TradingCo were irrelevant due to the transport arrangements between the parties, and also that the sales price between TradingCo and DistributionCo could not be taken into account since the sales transactions happened after the goods were cleared by Customs in Switzerland. As a result, the court correctly came to the conclusion that in such a case, where the purchase transaction is to be disregarded and no sales transaction is leading to the import of the goods, that the value must be the market value.

However, this is where it gets really odd: The court first followed the Swiss VAT Act by the word and the international rules of the General Agreement on Tariffs and Trade (GATT) and concluded correctly that the market value is to be understood as the value of the goods in the country of origin.

However, the FAC ruled that it was not the price paid by TradingCo as the importer of records that is relevant for the Swiss import clearance, but the purchase price that DistributionCo would have paid to third-party suppliers in the country of origin in order to receive the identical goods. This is despite the fact that the court held TradingCo as the right importer of records and that the sales transaction to DistributionCo could not be relevant for the import.

So, even if the court ruled that the local sales price charged by TradingCo for the sales out of its Swiss warehouse was to be disregarded, it considered that the value to be used is the price that the Swiss distributor would have been paid in the country of origin of the goods, even though the court confirmed that TradingCo was the correct importer of records.

Moreover, because the court pretended that it could not be established what DistributionCo would have paid in the country of origin in order to purchase similar goods, they concluded that Swiss Customs was entitled to make an educated guess and that therefore the 10% discount on the purchase price payable by DistributionCo was to be confirmed. So, even though the court held that the arguments brought forward by Swiss Customs were incorrect and not justified, it basically confirmed the position taken by Swiss Customs.

How absurd the entire case is shows that Swiss Customs, after having engaged penal proceedings against the staff of DistributionCo for filing incorrect customs declarations, closed the file without any further actions against the staff. On the one hand, Swiss Customs claimed that TradingCo committed tax fraud of approximately CHF 100 million, but on the other hand they closed the penal investigations without coming to a conclusion on who committed, or was at least involved, in the CHF 100 million tax fraud. It goes without saying that this result is grotesque and that the decision of the FAC lacks courage to make Swiss Customs see reason.

## The final say

TradingCo appealed against the decision of the FAC and the Federal Supreme Court will have the final say on the question over which value must be used for the import should the power to dispose over the goods be transferred as a result of a split transport organisation.

Since every cautious tax adviser knows that the chance to succeed in a court case is at best 50%, the outcome of this fundamental case is yet uncertain. However, it would be more than questionable should the decision be confirmed, and Switzerland would certainly have to explain to foreign parties in the World Trade Organisation how a detail like a split transport responsibility can result in a different value for import purposes and why the local sales price is to be taken into account to estimate a market value in the country


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of origin, especially if the goods come from developing countries where such prices would never be charged.

### Potential fallout for companies supplying goods from abroad

This decision – should it be confirmed by the Federal Supreme Court despite being not only technically wrong but also clearly against Swiss law and international agreements that Switzerland committed to observe – could have severe impacts on companies selling goods into Switzerland and operating central warehouses in Switzerland from where the goods are distributed to their Swiss customers.

First and foremost, Swiss or foreign traders would be at risk for having committed tax fraud, if they were partially involved in the transportation of the goods to their own warehouse and used the purchase price paid to their foreign suppliers as relevant value for the import clearance process.

According to our understanding, this would potentially hit all companies who are involved in the transportation of goods to Switzerland irrespectively whether they organise the transport in full or just partially.

A closer look of the decision rendered by the FAC indicates that the reason for using a different import value is that the power to dispose over the goods has already been transferred from the foreign supplier to its client. If the power to dispose over the goods becomes decisive for the definition of which import value is to be used, this could also impact the import value of goods supplied to Switzerland using consignment or call-off stocks agreements.

For now, Swiss Customs accept that the value agreed upon between the foreign consignor and the Swiss consignee is the value to be used for the import declaration, but if the court decision is confirmed by the Federal Supreme Court and the power to dispose becomes relevant, Swiss Customs might as well claim that the Swiss consignee should have used the price that he would have paid in the country of origin of the goods. Moreover, due to the lack of information, Swiss Customs could estimate the value to be the sales value in Switzerland, less the 10% discount for the coverage of Swiss-based costs of the consignee. Should the margin of the Swiss consignee be higher than 10% of the sales price, he might be at risk as well.

As the FAC held that the involvement of the purchaser in the transportation leads to a different value for customs purposes, it could also be that the agreed Incoterms may become relevant to assess which import value should be used for the import clearance. Unless the foreign supplier pays for the entire transportation of the goods up to the Swiss border, the purchase price of the goods could in principle be rejected, should the decision of the FAC be confirmed.

### Outlook and recommendations

The worst-case scenario for Switzerland has not yet been confirmed and trading entities operating either through

their own warehouses in Switzerland, or using Swiss consignment or call-off stocks or even Incoterms where the purchaser is partially responsible for the transportation of the goods, do not need to take immediate action.

However, should the Federal Supreme Court confirm the judgment of the FAC, traders sourcing goods from foreign suppliers should review their import procedures and adapt accordingly.

It is important to note that neither the existing Swiss VAT Act, nor the Customs Act, contain legal provisions that other values than the purchase price paid by the importer of records, or alternatively the market value to be paid by the importer of records in the country of origin of the goods, must be used. Anyone importing goods into Switzerland that uses these two values is entirely in line with the Swiss legislation and should not in anticipatory obedience change the value being used when clearing goods.

Since hope always dies last, it is hoped that the Federal Supreme Court makes Swiss Customs withdraw from its wrong position.

## Update - March 27 2017

The Federal Supreme Court of Switzerland reached its decision in the above case within only eight weeks after the filing of the administrative appeal. The Court held that the value to be used for the import of goods into Switzerland that are stored by the importer of records is the purchase price paid to the foreign supplier. The Court held that it is not at all relevant if the transport is partially or entirely organized by the importer of records. If there is a sales transaction that leads to the import of the goods, this value must be used for import clearance purposes. Furthermore, it held that in case the value of the sales transaction leading to the import cannot be determined, the market value in the country of origin is decisive. It rejected the position taken by Swiss Customs that a fictitious value in Switzerland should be used for import purposes. Given the very concise decision and the fact that the Federal Supreme Court came to its conclusion within only two months, the decision is to be seen as crystal clear and wipes out all doubts that the re-assessment of Customs Authority and the overruled decision of the Federal Administrative Court left. Importers can continue to use their purchase prices for import clearance and do not have to implement new processes to comply with Swiss regulations.