The Enactment of a Value-Added Tax in Switzerland

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PRÉCIS

Le 28 novembre 1993 les électeurs suisses approuvèrent le remplacement de l'impôt sur le chiffre d'affaires (Warenumsatzsteuer) (à l'origine une taxe prélevée uniquement sur les ventes en gros, mais s'étendant progressivement au niveau des ventes au détail) par une taxe sur la valeur ajoutée ou TVA qui serait appliquée en 1995, à partir du 1[er] janvier. En Suisse, aucun changement important ne peut avoir lieu dans la structure fiscale sans l'approbation de la majorité des électeurs et des cantons. Les électeurs avaient déjà rejeté trois propositions de loi précédentes visant à instaurer une TVA. Quand ils approuvèrent la proposition de novembre 1993, ils approuvèrent également d'augmenter le taux de 6,2 pour cent à 6,5 pour cent. Les inquiétudes suscitées par le déficit du gouvernement semblent avoir été le motif principal de cette approbation; de plus, les défauts de la loi précédente, principalement son effet de cascade, étaient de plus en plus reconnus. Par ailleurs, les liens entre la Suisse et la Communauté européenne favorisent l'instauration d'une taxe sur la valeur ajoutée. Ce sont les industries de services, exemptées de l'ancienne taxe, qui ont manifesté la plus grande opposition à cette réforme. Enfin il y eut aussi les arguments habituels contre une taxation plus élevée en faveur de plus grandes économies au niveau gouvernemental.

Les caractéristiques de la nouvelle taxe sont semblables à celles de la TVA appliquée dans l'Europe continentale. En soi aucune marchandise n'est exemptée. Tous les services sont taxés, sauf pour ce qui concerne les exclusions habituelles comme, par exemple, dans les domaines des services postaux, de la santé, de l'éducation, de la culture et des opérations financières. Les ventes et les locations d'immeubles sont exclues. Les domaines couverts sont significativement moins nombreux que ceux soumis à la taxe sur les produits et services (TPS) au Canada. Les exportations sont détaxées; la loi n'utilise pas l'expression "taux nul

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de taxe" mais, en ce qui concerne les exportations, elle accorde un crédit de taxe complet sur les intrants.

Plusieurs catégories d'entreprises sont exemptées de l'obligation de s'enregistrer, notamment les fermes et les entreprises de nature connexe, et certains métiers comme ceux de peintre et de sculpteur. Le seuil prévu pour l'enregistrement est relativement élevé; les entreprises qui totalisent moins de 75 000 F.S. en ventes ne sont pas tenues de s'enregistrer; les firmes dont les ventes annuelles totalisent moins de 250 000 F.S. en sont exemptées également, si le montant annuel qu'elles doivent pour la TVA est régulièrement inférieur à 4 000 F.S. par an.

Deux taux ont été prévus : un taux de base de 6,5 pour cent et un taux réduit de 2 pour cent. Ce taux réduit s'applique aux produits considérés comme des nécessités de base, notamment des aliments spécifiés, les médicaments, les livres et les journaux, et quelques autres articles. Le Parlement a le droit d'imposer un point de pourcentage supplémentaire pour le fonds du régime de sécurité sociale si celui-ci tombe à court d'argent. Pour éviter l'effet de cascade des taxes sur les produits agricoles, les acheteurs enregistrés de ces produits ont droit à un crédit de taxe sur intrants de 2 pour cent des montants payés pour ces articles.

Les déclarations doivent obligatoirement être faites une fois par trimestre; les entreprises dont les crédits de taxe sur intrants sont élevés peuvent faire des déclarations mensuelles. En plus des 145 000 entreprises enregistrées aux termes de l'ancienne taxe de vente, on estime à 75 000 le nombre des entreprises supplémentaires qui s'enregistreront. L'administration qui s'occupe présentement des impôts directs sera chargée de la nouvelle taxe. Les entreprises auront droit à des crédits de taxe sur intrants pour les marchandises qu'elles ont en leur possession et qui étaient soumises à l'ancienne taxe de vente, mais selon diverses restrictions.

ABSTRACT

On November 28, 1993, the voters of Switzerland approved the replacement of the single-stage *Warenumsatzsteuer* (originally a wholesale sales tax but increasingly collected at the retail level) by a value-added tax (VAT) to be implemented on January 1, 1995. No major changes in the tax structure in Switzerland can be made without the approval of a majority of the voters and of the cantons. Three previous VAT proposals had been turned down by the voters. When the voters approved the change to a VAT in November 1993, they also approved a rate increase, from 6.2 percent to 6.5 percent. Concern about the government deficit seems to have been the most important reason for voter approval; also the defects in the old tax, particularly cascading, were increasingly recognized; and finally the relationship of Switzerland to the European Community encourages the use of the value-added form of tax. Most of the organized opposition came from the service industries, not subject to the old tax, and there were also the usual arguments against higher taxes and for greater government economy.

The new tax closely follows the patterns of VATs in continental Europe. There are no commodity exemptions per se. All services are taxed, except for the usual exclusions—for example, postal, health, educational, cultural, and financial transactions. Sales and rentals of buildings are excluded. The coverage is significantly less than that of the Canadian goods and services tax (GST). Exports are free of tax; the law does not use the term "zero-rated," but full credit for taxes on inputs is provided for exports.

Several sets of firms are excluded from the registration requirement, including farmers and their related activities as well as art painters and sculptors. A relatively high threshold is set for registration; firms with sales under SFr75,000 a year are not required to register; firms with annual sales under SFr250,000 a year also need not register if their annual net VAT due is regularly under SFr4,000 a year.

Two rates are provided: a basic figure of 6.5 percent and a reduced rate of 2 percent. The reduced rate applies to goods regarded as basic necessities, including specified foods, medicaments, books and journals, and a few other items. Parliament has the right to impose an additional 1 percent for the social security system fund if required, if the fund runs short of money. To prevent cascading of tax on farm products, registered purchasers of such products are permitted an input tax credit of 2 percent of the amounts paid for the items.

Returns will be required on a quarterly basis, with the possibility of monthly returns for firms with large input tax credits. About 75,000 additional registered firms are expected, in addition to the present 145,000 firms registered under the old sales tax. The present indirect tax administration will take over the administration of the tax. Firms will be allowed input tax credit for goods on hand that were subject to the previous sales tax, with various restrictions.

INTRODUCTION

Switzerland was the last country in western Europe still to employ a single-stage sales tax, a levy in force for over 50 years, instead of a value-added tax (VAT). Referred to usually as the sales tax (*Warenumsatzsteuer* or l'impôt sur le chiffre d'affaires), it was technically imposed at the wholesale level, but in recent decades was more and more often collected at the retail level; the tax was thus often classified as a retail sales tax.

THE BACKGROUND

In early years, the sales tax was subject to little criticism, but there have been increasing objections in recent decades, leading to a number of government studies and proposals for reform, and to four efforts to obtain voter and canton approval of change. All significant tax changes in Switzerland must be approved by popular vote and by a majority of the cantons. The country's possible entry into the European Community increased interest in the change to a value-added tax. In 1989 this author detailed the tortuous path to possible reform that had been followed till then.[1] Proposals for a VAT had been submitted to Swiss voters in 1977 and in 1979, and both had been defeated.

In 1990 and 1991, following exhaustive studies, features of a VAT proposal to be voted on in 1991 were set forth in two documents.[2] In the vote of June 2, 1991, however, that proposal was also defeated. The Federal Council, stressing the need for action, then proposed a two-step approach in a document[3] dated December 18, 1991: first, approval by the voters of authorization for a VAT, and subsequently the enactment by Parliament of the necessary Act. Parliament, however, rejected that approach and instead provided for a single action that would establish a VAT. In 1993, the Federal Tax Department (Administration fédéral des contributions) issued a document[4] that presented such a single-step proposal for a VAT.

VOTER APPROVAL

The need for change was increasingly recognized: first, the cascade elements in the old sales tax put the country at a disadvantage in a situation in which other European countries had shifted to VAT; second, there was the need for additional revenue; and finally, Switzerland might possibly enter into the European Community. Thus the new proposal was developed, and was approved by the voters on November 28, 1993. Four taxation decrees were voted on; all were approved:

1) the Act,

2) the tax rates,

3) authorization to Parliament to add 1 percentage point to the VAT rates for social security, and

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[1] John F. Due, "The Evolution of the Swiss Federal Sales Tax" (1989), vol. 37, no. 3 *Canadian Tax Journal* 693-717.

[2] Arrêté fédéral sur le nouveau régime des finances fédérales (February 1, 1991); and in detail in Administration fédéral des contributions, *Explications des dispositions constitutionnelles ayant pour objet l'introduction d'un nouvel impôt sur le chiffre d'affaires (TVA)* (Bern: Administration fédérale des contributions, February 1, 1991). Various aspects of the proposed tax were discussed in a series of government press releases (*Journée de la presse du DFF du 19 février 1991*): "Le nouvel impôt sur le chiffre d'affaires: Documentation de base établie par l'Administration fédérale des contributions"; Otto Stich, "Les répercussions financières et fiscales du nouveau régime financier"; François Gendre, "Le nouvel impôt sur le chiffre d'affaires: Opérations imposables—Taux d'impôt"; Dieter Metzger, "Le nouvel impôt sur le chiffre d'affaires: Assujettissement—Modalités de fonctionnement—Procédure de décompte"; and U. Gygi, "Le nouveau régime financier: ses incidences économiques et financières."

[3] Conseil fédéral suisse, *Message concernant le remplacement du régime financier et les impôts de consommation spéciaux* (Bern: Conseil fédéral suisse, December 18, 1991).

[4] Administration fédéral des contributions, *Explications relatives au projet de taxe sur la valeur ajoutée (remplacement de l'IChA actuel par un impôt sur le chiffre d'affaires perçu à plusieurs stades avec déduction de l'impôt préalable = TVA) selon les décisions prises par les Chambres fédérales le 18 juin 1993* (Bern: Administration fédéral des contributions, 1993).

4) a change in petroleum and car levies from customs to excise.

The basic change to a VAT was approved by 66.7 percent of the voters and by all cantons except Wallis (Valais). The proposal for a higher rate was approved by 57.8 percent of voters and by all cantons except five (Geneva, Jura, Wallis, Tessin, and Schwyz). The authorization to add 1 percentage point for social security was approved by 62.7 percent of the voters and by all cantons except Wallis; and the minor change on petroleum and car levies from customs to excise was approved by 60.7 percent and by all cantons except three.

THE COVERAGE OF THE VALUE-ADDED TAX

The 1991 and 1993 proposals were similar in most respects; the features of the 1993 proposal are discussed below, and a later section notes their few differences from the 1991 proposal.

Commodities

The tax will apply to both domestic transactions and imports. There are no exemptions of commodities (the 1991 proposal had exempted firewood, water distributed through pipes, and new energy sources, such as solar power). All commodities, therefore, are covered.

Services

In the 1991 proposal, only specified services would have been taxable. The 1993 Act reversed that, making all services taxable except those specified; the net difference is more one of approach than of substance.

Exempt services include

- postal services (letters and parcels) of Swiss PTT (the postal, telephone, and telegraph system);
- health services, including hospital and medical services;
- social assistance and social security;
- education, and protection of infants and children;
- a wide range of cultural services including, for example, services of authors;
- insurance;
- financial services;
- sales and rental of buildings, except, for example, transient accommodations and parking lots;
- lotteries and gambling;
- services of religious organizations and other non-profit organizations offered to their members against an annual membership fee; and
- postage stamps.

Taxable services will thus include, for example, the leasing of taxable goods; the transport of goods and persons; the services of architects, engineers, and construction contractors; publicity; the provision of information; the use of patents and trademarks, etc.; research and development activity; various consulting activities; the provision of electronic information; hotel and restaurant services; hairdressing; travel agent services; and telecommunications.

Exports and Related Activities

The law does not use the term "zero-rating," but the effect is the same: not only are exports and related activities exempt from tax, but also the exporter receives full credit for any input tax paid.

Exemption from Registration

Various activities are exempt from the requirement to register, collect, and remit tax. One group includes farmers, horticulturalists, lumber producers, and cattle merchants, but not vineyards producing wine for sale. A second group consists of painters and sculptors. Firms jointly controlled may apply to be treated as a single taxable unit.

Threshold

Firms whose annual sales do not exceed SFr75,000 are not required to register—but, of course, they do not receive input tax credit.

To meet the problem of firms that regularly have little taxable value added, firms whose annual sales are less than SFr250,000 need not register if the net annual tax due on their sales does not regularly exceed SFr4,000.

The Act authorizes the Federal Tax Department to permit the registration of firms not otherwise required by law to register so that they may gain the advantage of the tax credit on their inputs, if that proves to be necessary to avoid competitive disturbances, for instance.

Rates

There are to be two rates—a basic rate, for most goods and services, and a reduced rate, applicable to some goods considered to be basic necessities (premières nécessités). For the basic rate, voters were asked to choose between the old sales tax rate of 6.2 percent and a new, higher rate of 6.5 percent. They also had to choose between two reduced rates—1.9 percent (the old rate) and 2.0 percent. Voters approved the 6.5 percent basic rate and the 2.0 percent reduced rate. Thus, in addition to shifting from a wholesale-retail sales tax to a VAT, voters also approved an increase of the rates from 6.2 and 1.9 percent to 6.5 and 2.0 percent.

The basic necessities to which the reduced rate applies are as follows: water supplied by pipes (exempt in the 1991 proposal); basic foodstuffs and non-alcoholic beverages; cattle, poultry, and fish; cereals; seeds, living plants and the like, and cut flowers; silage, bedding for livestock, and fertilizer, etc; medicaments; and journals, books, and other designated printed matter.

A separate decree that was voted on gave Parliament the authority to add 1 percentage point to the above rates for the financing of old age pensions, if necessary. (It is expected that the social security fund will run short of money in five or six years.)

DIFFERENCES BETWEEN THE 1991 AND 1993 PROPOSALS

The 1991 and 1993 proposals differed only slightly:

1) In the 1991 proposal, services to be included were specified; all others were to be exempt. In 1993 the procedure was reversed; all services are taxable, unless specified as exempt.

2) In the 1991 proposal, hotels were subject to a lower rate, 4 percent, during the first five years, because of the strong opposition of the hotel industry and the fear of adverse effects on the tourist trade. The 1993 law does not set a lower rate for hotels, but authorizes the Federal Parliament to do so.

3) In the 1993 election, voters were given the option of voting for higher rates—6.5 and 2.0 percent—over the old 6.2 and 1.9 percent, and chose the higher figures. No such option had been provided in the 1991 proposal.

OTHER FEATURES

Input Tax Credit, Invoices, and Taxable Price

The taxable price includes charges for services rendered in conjunction with the sale if the services are taxable themselves. Any charge by the seller to recover the VAT from the customer is excluded from the taxable figure. Invoices must be issued; they may show the amount of the tax separately, or the tax may be included in the price, but in either case the rate applied must be obvious. Most large firms are expected to show the tax separately.

To prevent cascading of the tax on agricultural product inputs, registered firms purchasing such products may subtract an amount equal to 2 percent of the purchase price as an input tax. Studies show that figure to be the typical percentage constituted by tax on farm input prices relative to the selling prices of the farm products.

There are few restrictions on the deduction of input tax on any inputs purchased for production use. No deduction of input tax is allowed on entertainment, sail and motor boats, and certain motor bicycles; and only a 50 percent deduction is allowed on accommodations, meals and beverages, business journeys, and private automobiles. Of course, tax on items purchased for individual personal use or for non-taxable business purposes is not deductible.

Operational Aspects

Returns must be filed and tax paid on a quarterly basis, but firms with recurring net credit, primarily exporters, may file on a monthly basis so that their refunds will be more current.

It is estimated that about 75,000 additional firms will be registered as well as the 145,000 currently registered under the old sales tax. The present administrative staff numbers 320; it is expected that 180 additional persons will be required. Relatively few of those hired have university degrees, and most do not have the desired background in accounting; training is to be provided for newly hired persons, much of it on the job. For auditors, however, an accountancy diploma is required.

Input Tax Credit for Sales Tax

When the transition from the single-stage sales tax to the VAT occurs, input tax credit will be allowed for sales tax, but only on the inventory of goods to sell, and materials for manufacturing.

THE ADVANTAGES OF THE VALUE-ADDED TAX

The levy is in part designed to eliminate the undesirable features of the previous sales tax. More specifically, the advantages can be outlined as follows.

First, the change will end the "taxe occulte" or hidden tax—the cascading that results from the failure to exclude all inputs from the tax. Accordingly, it will aid Switzerland's foreign trade position, improving the competitive position of Swiss firms both in the internal market and in foreign markets. The change will also end competitive disturbances that arise from unequal tax burdens on various production and distribution structures and from non-uniform ratios of tax to final consumer prices. Finally, ending the taxe occulte will encourage real investment and long-term economic growth by eliminating the tax burden on new real investment.

The second, and closely related, change will be to bring the Swiss indirect tax structure in line with the structures in European Community countries. Third, the change will eliminate rate differentials by sector—different retail, wholesale, and construction figures—and avoid competitive disturbances and nuisance for the firms. Fourth, the change will broaden the base of the tax substantially, primarily by including many services within the scope of the tax. This will bring the tax closer to a complete consumption levy. Fifth, the responsibility for correct application of the tax will be shifted from the seller to the buyer, who is in a much better position to determine taxability. The tax change is expected to have little effect upon the cost of living.

REVENUE EFFECTS

If the old rates (6.2 and 1.9 percent) had been maintained, the general effect of the change to a VAT would have been to maintain the same sum of revenue, offsetting the loss of taxe occulte revenue by extensions of the tax to services, including those of real property contractors. Since the old sales tax had exempted food and some other goods entirely, their inclusion under the new tax, even at the reduced rate, would have added SFr560 million. The Federal Council argued, however, that a raise in rates—to 6.5 and 2.0 percent—was essential for the financial security of the country. The voters accepted that argument.

THE MAJOR OBJECTIONS RAISED

As has happened in most countries when a VAT has been proposed, the argument was raised that the tax would be too complicated. The government has sought at length to disprove this, pointing out its present use worldwide, even in many third-world countries. Little public attention was given to the major problem usually encountered with new VATs—the tendency of firms to claim excessive credit for tax paid on inputs.

The major arguments for and against the change were summarized in the *Journal de Genéve* on November 19, 1993 shortly before the election. Arguments in support of the measure stressed the removal of the tax from the means of production, as well as the tax's superiority over increased payroll tax for financing social security. Opponents argued several points: (1) that the taxe occulte was not an important deterrent in international trade compared with the exchange rate; (2) that there was a tendency in other countries for the VAT rate to rise rapidly once the tax was imposed; (3) that because of the work of lobby groups, favourable treatment had been given to certain groups, such as banks; (4) that the tax would allow the government to spend more; and (5) that the change would aggravate inflation.

The use of two tax rates is certain to be a complicating factor in the operation of the tax; it is, however, designed to improve the overall distribution of the tax burden.

Organized opposition came from restaurants, hotels (which sought a lower rate provision in the law), and other service activities (for example, hairdressing). Since the enactment of the new tax, banks have complained that their foreign financial management activity is not sufficiently excluded from the tax.

ANALYSIS OF THE VOTING AND THE REASONS FOR APPROVAL

A question of interest to other countries is why the voters finally approved the proposal after having voting it down three times in the last two decades.

Election Results by Community

A detailed study of the data of the election results was made by the Federal Statistical Office (Bundesamt für Statistik), comparing the voting patterns by communities (local geographical areas).[5]

[5] Bundesamt für Statistik, *Informationsdienst*, no. 11/94, "Die Volksabstimmung vom 28. November 1993 über die Einführung der Mehrwertsteurer: Eine Analyse der Gemeinderesultate," February 1994.

1) High-income communities showed stronger support for the proposals than low-income ones. Of the lowest-income communities, the bottom 9 percent showed a favourable vote of under 40 percent; of the top 8 percent, the vote was 75 percent favourable.

2) There was a substantial variation by language area; German-speaking Switzerland voted 69 percent in favour of the change, French-speaking areas, 61 percent, and Italian-speaking, 51 percent. There was a wide range by canton, with a favourable vote of 74 percent in Zurich, a low of 44 percent in Wallis, and 51 percent in Tessen (Ticino). Figures in Geneva and Jura were well below the overall figure, but only Wallis failed to provide a majority.

3) By social structure, the communities with a high percentage of workers without professional status (Kaderfunktion) showed a lower affirmative vote than those with fewer non-professional workers. In German-speaking Switzerland, a high of 73 percent favourable votes in areas with few non-professional workers contrasted with a 58 percent favourable vote in areas with more non-professionals.

These results were not unexpected; the surprise is that most of the areas with higher percentages of non-professional workers and of lower-income persons on the whole still favoured the tax change, even though by smaller majorities than did the professional and higher-income areas.

Individual Voting Behaviour

A thorough investigation of voting patterns and of the reasons given for affirmative or negative votes was undertaken by a research institute for practical social research, the GfS Forschungsinstitut,[6] and the political science research institute of the University of Zurich, the Forschungsstelle für Politische Wissenschaft der Universität Zürich, based on interviews of a scientifically selected sample of voters.[7] The results of this investigation in part reinforced the Bundesamt für Statistik study.[8]

One question raised was the perception of voters about the various aspects of the proposal. The most significant perception was that the government would gain more revenue. There was much greater interest in the revenue aspect than in the nature of the VAT or in its merits compared with the old sales tax.

Review of the voting pattern by age showed that the strongest support came from the 70-and-over age group, followed by the 18-to-29 age group but with a range of only 65 to 76 percent favourable vote over the entire age spectrum. There was a strong positive correlation between income

[6] Forschungsinstitut der Schweizerischen Gesellschaft für praktische Sozialforschung.

[7] The results of the investigation were published: Daniel Schloeth, *Analyse der eidgenössischen Abstimmungen vom 28. November 1993* (Bern: Forschungsstelle für Politische Wissenschaft, 1994).

[8] See supra footnote 5.

level and favourable votes, and greater support came from those with higher education levels. By occupation, the strongest support came from higher level employees, lower but positive support came from other workers, and negative reactions came only from farmers. Support was stronger in the larger cities, lower in smaller and middle-size cities, and lowest (but positive) in the rural areas.

On the reasons for support of the change (the totals exceed 100 percent since some voters interviewed indicated more than one motive), 40 percent indicated the need of the government to raise more revenue, to reduce the deficit, and to provide a more stable source of revenue. A smaller but still important percentage (35 percent) wanted a more satisfactory form of tax—a modern sales tax to replace an outmoded one. Some 24 percent indicated the importance of following the pattern in Europe generally, but only a few, 12 percent, specifically mentioned making Switzerland more competitive internationally. Although only 3 percent mentioned the taxe occulte, that element may have influenced the group wanting a more satisfactory tax structure.

On the negative side, most voters opposing the change did so because they objected to higher taxes, and they argued that the government should economize instead of raising taxes. The other main objection given was the higher cost of living that would result. A few opposed the VAT in principle. And a very small number opposed the greater burden of work likely to fall on small businesses.

In comparison with the 1991 vote, the support shown in 1993 based on the government's need for more revenue reflected the much greater Federal deficit in 1993; the Swiss appear to be more concerned about government deficits than the citizens of many other countries, and they are willing to raise taxes to eliminate those deficits. While elimination of the taxe occulte did not appear to be the major motive for favouring the change, it was certainly an element, and a much more important one in 1993, with a 5 percent unemployment rate, than with the 1 percent rate typical of earlier years.

It has been suggested that this vote may have passed more easily because it was not held at the same time as the election involving Switzerland's entry into the European Community (even though some voters favoured the change on the basis of greater conformity with the tax structures of western Europe). Also, while earlier proposals provided for a tax increase, in 1993 this issue was separated from that of the change in the tax structure. Increased concern about the financing of social security also played a part.

Lessons can be learned by other countries seeking to change their tax structures and gain additional revenue. One is to separate the two types of change, seeking popular approval on the structural change separately from the level of taxes, as a preliminary step to the latter. More important still, in getting popular approval, may be to stress the undesirable consequences of budget deficits. And the government should commit itself to seeking expenditure reduction, except for highly popular programs such as social security.

CONCLUSION

By any usual standards, the new tax will constitute a major improvement over the previous levy. Operationally there would be merit in the use of a single rate, and solving the problems of the resulting regressivity by making changes in other taxes and expenditures. The tax is simpler than those of many other countries, however, and the relatively low rates should minimize any possible adverse consequences.

While the publicity information supporting the change stressed the improved nature of the VAT compared with the old tax, voter approval reflected primarily the desire to eliminate the deficit, despite the strong anti-tax sentiment found in Switzerland, as elsewhere, even though the overall Swiss tax burden relative to national income is relatively low, and its VAT rate is one of the lowest in the world.[9]

The measures will be effective until the year 2006, when new action will be necessary.

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[9] Except for the tax in Japan, which is substantially different in character.