E-COMMERCE: A SWISS PERSPECTIVE[1]

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1. INTRODUCTION

In Switzerland, electronic commerce is just starting to attract attention. In a precedent contribution, we tried to analyse the tax implications that electronic commerce could trigger in the Swiss direct tax system. This evaluation is indeed difficult, since Switzerland, as far as direct tax is concerned, is a federal country with three different levels of taxation (federal, cantonal and municipal). In addition, it is worth noting that, to the best of our knowledge, there are no published rulings, no tax court decisions and, more surprisingly, no relevant publications focusing on this subject.

In this paper, we will focus on issues related to the value added tax (VAT) treatment of electronic commerce operations. In this respect, the situation is a little bit different. First, the VAT is only levied at the federal level. Second, as far as telecommunication services are concerned, a new official information brochure from the Federal Tax Administration on telecom VAT taxation, published in June 1998, partly covers electronic commerce.[3]

2. GENERAL

Switzerland has levied a VAT at the federal level since 1995. Swiss VAT follows for the most part the general principles embodied in the EC Sixth VAT Directive (hereafter: the Sixth Directive).[4] It is a multi-stage tax on consumption based on the credit method.[5] However, it departs from the EC Model in some aspects relevant to the taxation of telecommunication services and electronic commerce.

VAT is levied on (i) the supply of goods or services in the Swiss territory, (ii) the self-supply of services, (iii) the acquisition of services from abroad and (iv) the importation of goods.[6] The standard rate is currently 7.5%. Reduced rates of 3.5% and 2.3% apply to specific supplies.[7] In general, any person who independently carries out an economic activity and realizes a turnover exceeding CHF 75,000 per year on the supply of goods or services and self-supplies is taxable. Any person (including individuals) who acquires services from abroad over a value of CHF 10,000 per year is also taxable.[8] Specific supplies are exempt from VAT (e.g. health care, rental and sale of immovable property, financial activities) or subject to a zero rate (e.g. exports).

So far, there are no specific VAT regulations under Swiss legislation to deal with electronic commerce. Indeed, Switzerland seems to have chosen a flexible approach, i.e. a broad interpretation of existing rules and concepts to fit the specific nature and features of electronic commerce. It should be noted that new draft VAT legislation is currently under discussion in the Federal Parliament (hereafter: D-VATL).[9] This law, most probably, will not enter into force before 1 January 2000. To the best of our knowledge, this draft contains no provision covering electronic commerce. It generally seeks to adjust some differences between the Swiss system and the rules of the Sixth Directive.

1. This contribution was written within the framework of the IFA project on electronic commerce taxation. A thorough and general analysis on the topic will be found in Doernberg R.L./Hinnekens L., *Electronic commerce and international taxation*, Kluwer, The Hague, to be published. See also Oberson and Piaget, "Electronic Commerce and Taxation: A Swiss Perspective", 52 *Bulletin for International Fiscal Documentation* 12 (1998), p. 535.
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3. See FTA, Brochure n. 610.507-30.
4. Sixth Council Directive (77/388) OJ No. L 145 of June 13, 1977, p. 1.
5. The amount of tax due corresponds to the difference between the tax charged on sales of goods or services (output tax) and the tax payable on purchases (input tax).
6. Art. 4 of the VAT Ordinance of the Federal Council of June 22, 1994 (hereafter VATO). It should be noted that the main features of the Swiss VAT are described in Arts. 8-9 of the transitional provisions of the Swiss Constitution.
7. New rates, effective 1 January 1999, will be 7.5%, 3.5% and 2.3%.
8. The CHF 10,000 limit also applies to enterprises already subject to VAT.
9. See the report of the Federal Commission for Economic and Tax Issues of the Lower Chamber, dated August 28, 1996, followed by a draft legislation, Federal Gazette 1996 V 713, and the comments of the Federal Council of January 15, 1997, Federal Gazette 1997 II 389. See especially, Keller (1997/98), p. 177.

The application of VAT rules to electronic commerce basically raises two different issues: the definition of the transactions (distinction between supplies of goods or services; the classification of services and the treatment of composite transactions) (see 3.); and the definition of the place of supply (see 4.).

3. CHARACTERIZATION ISSUES

3.1. Existing provisions

Under Swiss VAT rules, a supply of goods is defined as a transfer of the right to dispose economically of goods in one's own name (for instance on the basis of a contract of sale or commission) (Article 5 VATO). The definition of a supply of goods is broad, and as a matter of fact broader than under the Sixth Directive in that it includes (i) the supply of goods upon which work has been carried out (examination, control, adjustments, etc.), and (ii) the transfer of goods for limited use or enjoyment (e.g. rental). Both movable and immovable assets, including electricity, gas, heat, cold and similar are deemed to be goods. All transactions that are not characterized as supplies of goods are supplies of services, including, in particular, the transfer of intangibles, values or rights (Article 6 VATO).

The VAT characterization of a specific transaction is relevant, in particular, for the taxable event (imports of services being taxed differently from imports of goods), the place of supply, exemption (the list of tax exempt transactions of Article 14 of the VATO covers mainly services), zero-rated transactions, and the applicable rate (the reduced 2.3% rate only applies to supplies of goods defined under Article 27 paragraph 1 lit a VATO).

3.2. Application to telecommunication services and electronic commerce

In many situations, the definition of the transaction will not be altered by the use of the Internet. For instance, specific goods ordered by a Swiss customer from a foreign seller through the Internet will then be shipped to Switzerland and taxed as an import of goods in the usual way by the Customs Administration. Similarly the supply of services (for example a legal opinion or an advertisement) through the Internet will still be treated as such because the form in which the service is furnished is not relevant for tax purposes.[10]

There are, however, many situations where distinctions are far from clear, especially in the case of the "classic" supply of goods versus services distinction. For instance, a supply of computer software would appropriately be characterized as a supply of goods in the case of a mass-marketed product, and as a service if it is developed for a specific customer. Under the current practice of the Federal Tax Administration, however, the software product would be treated as a service if sold through a telecommunications network, and as a supply of goods if sold as specific goods (e.g. CD-ROM, disk[11]). The distinction is thus based on the form in which the supply is executed: it has not been determined as yet whether a mass-marketed software downloaded from the Internet constitutes a supply of goods or services. Under current practice, it seems to be considered a service.[12] Also, in our view, the possibility of on-line access to a newspaper should be treated as a service (subject to the 7.5% rate) and not as a supply of goods (which would have been subject to the reduced 2.3% rate).

Such distinctions will lead to the application of different rules (e.g. definition of taxpayers, registration threshold). Also each case will involve different competent authorities (Federal Customs Administration in the first case, Federal Tax Administration in the second).

We see from these four examples (legal services, advertisement, software and newspaper) that there is no consistent approach, as there is no reason why the fact that the product is sold through the Internet should matter only in the third and fourth example. In our view, characterization as goods or services should not depend on the means of distribution of the product.[13] The European Court of Justice seems to adopt this view in the *Datacenter* case,[14] where it confirmed that for the purpose of defining a tax-exempt service the electronic form of its supply was of no consequence.

According to the FTA brochure regarding telecom companies and VAT, it should be noted that telecommunication transactions are deemed to be supplies of services under Article 6 of the VATO.[15] Even if characterized as a service, there are more distinctions to be drawn between different kinds of services. A telecom transaction could be considered to fall under different provisions for tax exoneration purposes. Electronic services considered as "telecommunication services" within the meaning of Article 15 paragraph 2 lit f of the VATO will be zero-rated only if supplied from abroad to Swiss territory or across Swiss territory (transit); treated as "other services" according to Article 15 paragraph 2 lit. l and Article 9 of the VATO, they will be zero-rated only if provided to foreign customers and used or enjoyed abroad (see 4.1.).

Moreover, there is a special 2.3% rate for the supply of services by radio and television organizations, excluding supplies of a commercial nature (Article 27 paragraph 1 lit. a n. 2 VATO). Thus, only radio and television fees are subject to a tax at a 2.3% rate. However, all other types of turnover, namely income from reproduction rights, advertising or supplies of goods (sounds or image support), are taxed at the normal rate of 6.5%.[16]

10. See, for instance FTA, Instructions (1997), n. 249 (advertisement).
11. See FTA, Instructions (1997), n. 163.
12. See FTA, Brochure n. 610.507-30, p. 15.
13. Owens (1997), p. 1842.
14. *Sparekassernes Datacenter (SDC) v. Skatteministeriet*, case C-2/95 ; June 5, 1997.
15. See FTA, Brochure n. 610.507-30, p. 14 (5.1.2).
16. See FTA, Instructions (1997), n. 262.

No clear rules have been set with respect to composite supplies either. Some principles have evolved in practice; in particular, the prevailing aspect of a transaction involving supplies of both goods and services is from the point of view of the economic interest of the recipient of the transaction.[17]

Our Supreme Court had recently to examine whether the supply by a Swiss company of pizzas at home should be treated as a supply of food (taxed at the reduced 2.3% rate) or a service (taxed at the ordinary 7.5% rate).[18] The Court confirmed that, according to Article 27 of the VATO the presence of installations allowing the consumer to eat the prepared pizzas at the premises of the seller was a defining element of the service offered by a restaurant; if the supply of food and beverages at home by the restaurant was made from premises effectively distinct from the ones of the restaurant, the reduced rate of 2.3% applied. One can thus deduce from this case that the definition of a purchase of food at home via on-line service over the web site of a grocery store will not be affected by use of the Internet. If there are no installations allowing food consumption at the premises of the seller, the supply will be treated as a supply of goods subject to the reduced rate of 2 per cent.

4. THE PLACE OF SUPPLY

4.1. Existing provisions

In general, supplies of goods are deemed to be made (a) at the place where the goods are located at the time of the transfer of the right to dispose of them economically, at the time of their delivery, or of their transfer for use or enjoyment; or (b) at the place where the transportation or the dispatch of the goods to the purchaser starts (Article 11 VATO).

The place of supply of services is usually the place where the supplier has his registered seat ("siège social") or a permanent establishment from which the services are rendered. In the absence of such a seat or permanent establishment, the place of supply is the place of domicile or the place from which the supplier carries out his activities. In addition, there are specific place of supply rules for services connected with work on immovable property, and transportation services (Article 12 paragraph 1 VATO; see also Article 9 paragraph 1 Sixth Directive).

It is interesting to note that the location of the place of supplies of cross-border services departs from the EC Model. Contrary to the Sixth VAT Directive, there are no specific localization rules similar to Article 9 paragraph 2(e) for so-called "immaterial services". This results in a risk of double or no taxation that the draft VAT legislation will try to reduce. However, even if localized in Switzerland, immaterial services are zero-rated if supplied to beneficiaries with private domicile or business abroad and used or enjoyed abroad (Article 15 paragraph 2 lit. l VATO).

It should be mentioned that new place of supplies rules will be introduced under the new draft VAT legislation, with the intention of bringing Swiss legislation closer to the EC regime. Immaterial services (intangible, advisory services, advertising, data processing or banking and insurance services, in particular) should be localized at the business seat or the permanent establishment of the recipient of the services, or, in the absence of such a seat or permanent establishment, at his domicile or the place from which his activity is exercised (Article 13 paragraph 3 D-VATL). As a consequence, the provision of Article 15 paragraph 2 lit. l of the VATO would be deleted.

Special rules for telecommunication services

The Swiss and EU rules regarding the place of supply of telecommunication services seem quite different. Thus, there is a risk of double or no taxation of these services between EU Member States and Switzerland.

Diverging from Article 9 paragraph 1 of the Sixth Directive, the European Union recently adopted a different approach with respect to telecommunication services. Under a new derogatory system, each of the Member States is authorized to include telecommunications services within the scope of Article 9 paragraph 2(e) of the Sixth Directive.[19] Thus, the place of supply of telecommunication services becomes that of the business establishment of the customer or of the fixed establishment to which the services are supplied, private and non-taxable customers excepted. For private and non-taxable customers, the place of supply remains defined under Article 9 paragraph 1 of the Sixth Directive. As a consequence, operators outside the European Union who provide telecommunication services to private customers within the Community are not subject to VAT. However, under the 1997 derogatory system, Article 9 paragraph 3(b) of the Sixth Directive also applies to telecommunication services. Under this provision, the place of services is deemed to be the place of the country where the service is effectively used and enjoyed, if necessary to avoid non-taxation or distortion of competition. Thus, telecommunication operators from outside the European Union could still be taxable in the European country where their services are used and enjoyed.[20]

Telecommunication services, following the general Swiss rule, are localized, according to Article 12 paragraph 1 of the VATO, at the place of the business seat (respectively permanent establishment) of the supplier. However, one has to distinguish between telecom services in general on the one hand, and "specific" telecom services on the other hand.

17. Camenzind/Honauer (1996), p. 78.
18. Supreme Court judgment of January 31, 1997, ATF 123 II 16.
19. See especially EC Council Decision of March 17, 1997, OJ No L 86/5 of March 28, 1997.
20. See also Lejeune/Vanham/Verlinden/Verbeken (1998), p. 5.

General telecom services follow Article 12 paragraph 1 of the VATO rule. When imported from abroad, such services can be taxed under Article 9 and 18 of the VATO, providing the person acquires those services from abroad above a value of CHF 10,000 per year and enjoys or uses them in Switzerland. In this case, the acquirer (not the foreign operator) is subject to Swiss VAT. Conversely, if such telecom services are provided by a Swiss company to an acquirer abroad, they will be zero-rated under Article 15 paragraph 2 lit. l of the VATO.

Under Article 15 paragraph 2 lit. f of the VATO, "specific" telecommunication services supplied to Swiss territory from abroad or from abroad across Swiss territory to foreign territory (transit) are zero-rated; these "specific" telecommunication services are, however, taxable if supplied from Swiss territory to a foreign country. Thus, they will neither be taxable as imports of services within the scope of Article 9 and 18 of the VATO, nor zero-rated as export of services under Article 15 paragraph 2 lit. l of the VATO.

This leads to the difficult and important characterization issue mentioned above between general telecommunication services ruled by Article 9 and 15 paragraph 2 lit. l of the VATO (place of recipient of service) and those "specific" telecommunication services governed by Article 15 paragraph 2 lit. f of the VATO (place of supplier of service). The FTA has been changing its practice with a view to finding an interpretation of Article 15 paragraph 2 lit. f of the VATO consistent – as far as the text of the VATO allows it – with the EC Model.[21] These modifications took the following steps.

Firstly, until the end of 1997, the FTA tended to restrict the application of Article 15 paragraph 2 lit. f of the VATO to telecommunication transactions supplied through Telecom PTT, the Swiss public enterprise providing telecommunication and mail services.[22] As a consequence, other telecommunication transactions supplied from abroad were not treated as "telecom operations" within the meaning of Article 15 paragraph 2 lit. f of the VATO but as "other services" for the purpose of Article 9 and 15 paragraph 2 lit. l of the VATO. Thus, services provided by foreign telecom companies (as opposed to the Swiss Telecom PTT) to Swiss customers (private or enterprises) were taxable as imports of services under Article 9 of the VATO if used or enjoyed in Switzerland.

Secondly, the FTA has changed its practice since 1 January 1998, following the liberalization of the telecommunication market in Switzerland; it now applies Article 15 paragraph 2 lit. f of the VATO to all companies involved in the telecommunication sector. However, according to the new brochure dealing with VAT and telecommunication services, only telecommunications from a fixed connection are within the scope of Article 15 paragraph 2 lit. f of the VATO.[23] In this respect, the place of access to the network is the relevant criterion to localize this particular kind of service.[24]

In any event, it is obvious that in practice the taxation of telecommunication resources is for the moment unsatisfactory. They lack clarity and can give raise to possible distortions when cross-border transactions are concerned. The constant changes of rules and administrative practice exacerbate the uncertainty of the sector. We believe that Article 15 paragraph 2 lit. f of the VATO should be deleted;[25] all telecommunication services would then fall under the regime of Article 15 paragraph 2 lit. l of the VATO. They would then be zero-rated if supplied to customers located abroad, and used or enjoyed abroad. Conversely, all telecommunication services supplied from foreign operators to Swiss customers would be subject to VAT if used or enjoyed in Switzerland (Article 9 VATO; over a threshold of CHF 10,000). This seemingly simple solution would not, however, solve all the problems since it implies handling the problematic concept of "effective use and enjoyment". It would still bring a clear improvement to the present situation.

4.2. Application to electronic commerce

The tax treatment of electronic commerce will, according to its character, mostly fall either under the provisions applicable to "general" telecommunication services (Article 9 and 15 paragraph 2 lit. l VATO) or to "specific" telecommunication services (Article 15 paragraph 2 lit. f VATO).

For instance, with a view to obtaining connection to the Internet, customers will use the services of an access provider. Following the FTA brochure, access to the Internet and data transfer capabilities are deemed to be "general" telecom services falling under Article 12 paragraph 1 VATO, 15 paragraph 2 lit. l VATO and Article 9 VATO.[26] The tax treatment is therefore as follows:

Access provider	Customer	VAT
Swiss	Swiss	taxable 7.5% Article 12 paragraph 1 VATO
Swiss	foreigner	exonerated export of services (Article 15 paragraph 2 lit. l VATO)
foreigner	Swiss	taxable 7.5% import of services (Articles 9 and 18 VATO)

21. See, in particular Räber (1997) and (1998).
22. Since 1 October, the Telecom PTT is now SWISSCOM.
23. See FTA, Brochure n. 610.507-30, p. 16. See also Räber (1998), p. 106.
24. Id.
25. Räber (1998) p. 107. The Federal Council, in its comments to the D-VATL also suggests to delete art. 18 par. 2 lit f of the draft legislation which in fact corresponds to the current art. 15 par. 2 lit. f. VATO, Federal Gazette 1997 II 389.
26. FTA, Brochure n. 610.507-30, p. 32 (6.12.2).

The definition of the concept of permanent establishment referred to under Article 12 paragraph 1 of the VATO (place of supply of services) raises the most difficult issues. For instance, does the creation of a web site in Switzerland constitute a permanent establishment? There is no case law as yet in Switzerland dealing with the definition of this concept for VAT purposes, and little guidance from commentators.[27] We believe that the Swiss authorities and courts will tend to follow the interpretation of the European Court of Justice, as the general practice of the Federal Court of Appeal for federal tax matters is, in its jurisprudence, to refer to the main guidelines (*grandes orientations*) of the Sixth Directive to interpret Swiss VAT rules.[28] Thus, a web site with a server in Switzerland would not constitute a permanent establishment, in the absence of the necessary human and technical resources; neither would local independent agents offering Internet access or on-line services.[29] In particular, despite the contrary opinion of some commentators[30], it seems clear to us that the definition of a permanent establishment for VAT purposes cannot simply be derived from its definition for direct tax purposes. However, according to the above-mentioned recent brochure on telecoms and VAT, the FTA could deem a telecommunication router ("installation de commutation") to be a permanent establishment for VAT purposes.[31]

Finally, foreign companies offering on-line services to Swiss customers through a web site in Switzerland should not have to register for VAT. In most cases, however, these services will be treated as imported and taxable under the rules of Article 9 and 18 of the VATO. Thus, the recipient (private or enterprise) of these services, resident in Switzerland, will be taxable if those services exceed the limit of CHF 10,000 a year and are used or enjoyed in Switzerland. For enterprises already subject to VAT in Switzerland, such VAT may be reclaimed as input tax. It is possible, although difficult to ascertain, that few private customers will exceed the CHF 10,000 limit, as electronic commerce is only beginning to take off. However, should electronic commerce, as is foreseen, increase dramatically, the number of private VAT taxpayers will also rise. The system will certainly create problems because of the difficulty of control. Indeed, it will be almost impossible for the FTA to check in every PC the quantity of data imported from abroad.

5. CONCLUSION

At first glance it appears that Swiss VAT departs from the EU system, notably in the definition of the place of supply of services. This could create double taxation or non-taxation of electronic commerce and thus produce distortions. However, the broad interpretation by the FTA of existing provisions of the current VATO leads to solutions which in essence comply with the European approach.

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27. See, in particular, Buchel (1997), p. 103 ff.
28. See e.g. Decisions of the Federal Court of Appeals for federal tax matters of September 22, 1996, Revue de droit administratif et fiscal 1997, p. 301, and of November 13, 1997, 66 Archives de droit fiscal, p. 584 ff.
29. See also Hinnekens (1998), p. 57.
30. Camenzind/Honauer (1996), p. 126.
31. See FTA, Brochure n. 610.507-30, p. 13.