



Lower value added tax rates as a tax subsidy

Evaluation of the reduced rate for
food and related sectors



Order address	Swiss Federal Audit Office (SFAO) Monbijoustrasse 45, CH - 3003 Berne http://www.efk.admin.ch/ Publications, Audit reports
Order number	1.5305.100.00373.15
Further information	Competence Centre 6 “Performance Audit and Evaluation“ E-mail: bruno.nideroest@efk.admin.ch Telephone: 031 / 323 10 36
Original text	German
Reproduction	Authorised (please mention the source)



Lower value added tax rates as a tax subsidy: Evaluation of the reduced rate for food and related sectors

Key facts

The Swiss Federal Audit Office chose the reduced VAT rates as the subject of an evaluation, since they represent a largely untransparent form of subsidization. Foodstuffs constitute the highest-turnover group of goods and services subject to the reduced tax rate. The SFAO carried out the evaluation in the framework of a working group of the EUROSAI, the European Organization of Supreme Audit Institutions, which has also analyzed this issue. The results are of interest to the current legislative reform of the value added tax, one goal of which is to simplify the rate structure.

The tax subsidy for selected foodstuffs was introduced by the Federal Council in 1941 in the context of the turnover tax, when expenditures for foodstuffs amounted to more than 35% of all household expenditures and large families with many children were the norm. This measure aimed at relieving the tax burden of households with lower incomes, since such households spent a higher share of their income on basic foodstuffs than wealthy households. The tax subsidy was expanded to include all foodstuffs and non-alcoholic beverages by 1959 and was continued with the transition to the value added tax in 1995 in the form of the reduced tax rate for foodstuffs. Today, the average household only pays 8% of its expenditures on foodstuffs, i.e. approximately one quarter of the share of expenditures in 1941. Accordingly, this form of tax subsidy has lost three quarters of its significance. Since foodstuffs still generate a large part of all turnover subject to a reduced tax rate, the decrease in expenditures on foodstuffs significantly diminishes the redistribution effect of the differentiated tax rates. The remaining social equalization effect of the tax subsidy can be achieved more economically by way of individual premium reductions (IPR), which were introduced in 1996 and also relieve the burden of lower-income households. This increase in economy relates to both efficiency and effectiveness:

Efficiency comparison of reduced VAT rates / individual premium reductions: The differing tax rates create problems in demarcating various taxable goods and services subject to different rates. Such demarcation problems invite taxpayers to misclassify turnover. This problem arises, for instance, in the case of restaurants if "in-house" turnover is filed according to the reduced tax rate, which would only be permissible for takeaway sales. The Swiss Federal Tax Administration suffers a revenue loss of approximately EUR 28 million due to such misclassifications of turnover. Moreover, EUR 5 to 8 million arise for additional staff expenses in the VAT administration, since 10% to 15% of its staffing needs are due to the additional effort required to administer the different tax rates and exceptions. The differing rates cause an estimated EUR 36 million in additional administrative costs to the businesses subject to value added tax.

By comparison, targeted payments to persons in need in the framework of individual premium reductions (IPR) generate additional administrative costs of at most EUR 2 million for cantons and health insurers, under the assumption that cantons take the same approach as with existing IPR.

Effectiveness comparison of reduced VAT rates / individual premium reductions: The reduction of health insurance premiums is more targeted than the reduced value added tax rates. While in some cantons, the premiums of children are reduced without taking account of the income



of parents, and the cantons determine beneficiaries according to different income categories (gross income, gross income after specific deductions, net income, taxable income), these differences in the consideration of the economic situation are insignificant compared with the reduced VAT rates, where the consideration is undertaken only by way of statistical average values of consumption patterns. Consumption tax subsidies benefit both wealthy households and people with lower incomes.

Moreover, passing on the tax benefit from businesses to consumers depends on the supply and demand situation. Various case examples show that the businesses subject to VAT only partially pass on or are able to pass on the reduced rates and the tax itself to consumers by way of the final price. In the case of individual premium reductions, this problem of effectively passing on the benefit to the beneficiaries does not exist, since neither cantons nor health insurers have the possibility of keeping the money of the beneficiaries for themselves.

These comparisons argue in favour of no longer compensating politically undesired burdens entailed by the value added tax by way of a tax subsidy for food, but rather by way of additional premium reductions for basic health insurance. The Swiss Federal Audit Office believes the reason why this has not already happened is that individual premium reductions were introduced in 1996, i.e. one year after the transition from the turnover tax to the value added tax. Prior to 1996, no easily utilizable instrument existed at the federal level with which the undesired tax effect among the lowest-income households could be compensated, since supplemental benefits, for instance, target a significantly different circle of recipients.

Table of contents

1	Introduction	3
2	The current value added tax and its tax rates	5
2.1	The three legal tax rates	6
3	Tax rates and taxpayers in the food industry	9
3.1	Analysis of the tax rates applied in the food retail trade	9
3.2	Analysis of the tax rates applied in the catering industry	9
4	Additional costs due to lower VAT rates	11
4.1	Additional costs of lower tax rates for taxpayers	11
4.2	Additional costs of lower tax rates for the tax authorities	13
4.3	Financing tax loss due to lower tax rates	15
4.4	Development of the tax subsidy for foodstuffs, 1941 to 2007	16
5	Distribution effects of the tax subsidy for food	18
5.1	Shrinking importance of food expenditures for households	18
5.2	The erosion of one main target group: families with many children	19
5.3	Potential distribution effects between households and individuals	22
5.4	Consideration of the tax effect on consumer prices	23
5.5	The effective distribution effect of lower VAT rates	24
5.6	Conclusion on the effective impact of lower VAT rates on consumer prices	28
6	Comparison of VAT rate differentiation and premium reductions	30
6.1	Execution and administration costs for individual premium reductions (IPR)	30
6.2	Distribution of premium reductions	32
6.3	Transparency and political controllability of individual premium reductions	33
6.4	Conclusions	33
6.5	Comparison of differentiated VAT rates and individual premium reductions (IPR)	33
7	Recommendation of the Swiss Federal Audit Office	35

Table of figures

Figure	1: Turnovers and applicable VAT rates	6
Figure	2: Tax rates 1995 - 2007	16
Figure	3: Average expenditures for food 1942 - 2005, in % of total household expenditures	18
Figure	4: Which households spend more or less because of VAT rate differentiation?	20
Figure	5: Family structures in Switzerland 1930, 1960 and 2000	21
Figure	6: Monthly expenditures for food: per household and per capita	22
Figure	7: Passing on of VAT to consumer prices	25
Figure	8: Tax-reduced goods and services without market-determined prices	28
Figure	9: Possible financial flows for individual premium reductions (IPR)	31
Figure	10: Rough estimate of the execution costs for individual premium reductions	31
Figure	11: Comparison of VAT rate differentiation and corrective via IPR	34

Annexes

Annex	1: Bibliography
Annex	2: Development of the VAT Act revision
Annex	3: Study results on the execution costs for VAT and similar taxes
Annex	4: Additional costs of lower tax rates + total costs of VAT for the FTA and taxpayers
Annex	5: Abbreviations
Annex	6: Statement of the Federal Tax Administration

1 Introduction

Under the current Value Added Tax Act, three different tax rates apply to foodstuffs, catering, and lodging. The Swiss Federal Audit Office (SFAO) has decided to carry out an evaluation of the rates applicable to the food sector for three reasons:

1. The different tax rates constitute a tax subsidy. As a special form of subsidies, tax subsidies constitute an important area for the SFAO. For instance, the SFAO has published a report on the extent to which the Confederation guarantees transparency with respect to tax subsidies.¹
2. The SFAO is a member of a sub-working group of EUROSAI,² which has chosen reduced VAT rates as an object of examination. This subgroup is chaired by the German Federal Court of Auditors; in addition to Switzerland, Latvia and Lithuania are also members. 17 countries in all participate in the overall EUROSAI project on tax subsidies, which is divided into three thematic subgroups; in addition to the subgroup on lower VAT rates, there is a subgroup on corporate tax subsidies and a subgroup on transparency and reporting of tax subsidies. All reports prepared in connection with this EUROSAI project will be made public.
3. The two other subgroups examine corporate taxes and transparency of tax subsidies. The three subgroups will each prepare a subgroup report as a synthesis of the individual country reports. Based on these three subgroup reports, the German Federal Court of Auditors will prepare the overall report for the EUROSAI Congress in the second quarter of 2008.
4. The lower rates for various goods are also of interest to the ongoing VAT reform in Switzerland. On 14 February 2007, the Swiss Federal Tax Administration circulated a VAT model with a uniform rate and an additional model with both a normal and a reduced rate for consultations; these consultations will be concluded by the end of July 2007. The Federal Council will then decide on further steps.

A brief description of the legislative project is contained in Annex 2.

Inclusion of the project within the EUROSAI framework and the ongoing VAT reform entail several constraints that the report must respect.

¹ *Federal tax subsidies. Audit of reports by the Federal Finance Administration, 5/2005.*
<http://www.efk.admin.ch/deutsch/prüfungsberichte.htm>

² *European Organisation of Supreme Audit Institutions.*

In a first phase of the project, the SFAO developed a concept for an evaluation.³

In accordance with Module 1 set out in this concept, a series of document analyses and guided interviews were conducted. Module 2 covered an evaluation of the VAT database of the Federal Tax Administration. Of primary interest in this regard were the rates charged in the food sector and the number of affected taxpayers applying the different tax rates.

The experiences over the course of the project demonstrated the utility of long-term data for understanding the development of tax subsidies for foodstuffs, which is why the SFAO paid more attention to the long-term development of tax subsidies than envisaged at the outset of the project.

A further adjustment of the original evaluation concept of 9 November 2006 resulted from the legislative revision, which was progressing in parallel. For instance, the consultation draft of January 2007 circulated by the Federal Department of Finance⁴ and the estimates of the costs for administrating VAT clarified certain points, but also raised new questions – such as how a realistic comparison between the lower VAT rates and the addition reduction of health insurance premiums would turn out. Since the status of the project allowed such a comparison to be made, the Swiss Federal Audit Office added it to its original planning.

The SFAO carried out the project from November 2006 to the end of July 2007.

³ *Rate structure in the value added tax for food and related areas. Concept for an evaluation, 9 November 2006.*

⁴ *Federal Department of Finance: Consultation draft on simplification of the VAT Act. Explanatory report, February 2007.*

2 The current value added tax and its tax rates

The value added tax (VAT) is governed by the Federal Law of 2 September 1999 on the Value Added Tax (VAT Act) and the Ordinance of 29 March 2000 on the VAT Act (VAT Act Ordinance). Only the Confederation may levy VAT. It is a consumption tax owed by taxable businesses on their turnover. As an indirect tax, it must be paid by the businesses, but the businesses should be able to pass the tax burden on to their customers. As an "all-phase tax", VAT covers all deliveries and services for payment, irrespective of whether the recipient of the goods or services is actually the end-user. The term "all-phase tax" also means that the VAT amount to be paid by each taxable business represents the balance of the taxes due on the turnover, minus the input tax (= VAT owed to the business's own suppliers or the VAT levied on imports).

The following turnovers are subject to VAT:

- deliveries and services rendered for payment in Switzerland,
- own consumption in Switzerland,
- the use of services against payment rendered by companies with registered offices abroad,
- the import of objects.

According to article 18 of the VAT Act, the following turnovers in particular are not subject to VAT:

- healthcare,
- social welfare,
- education,
- culture and sport,
- rental of apartments and houses,
- circulation of money and capital,
- insurance.

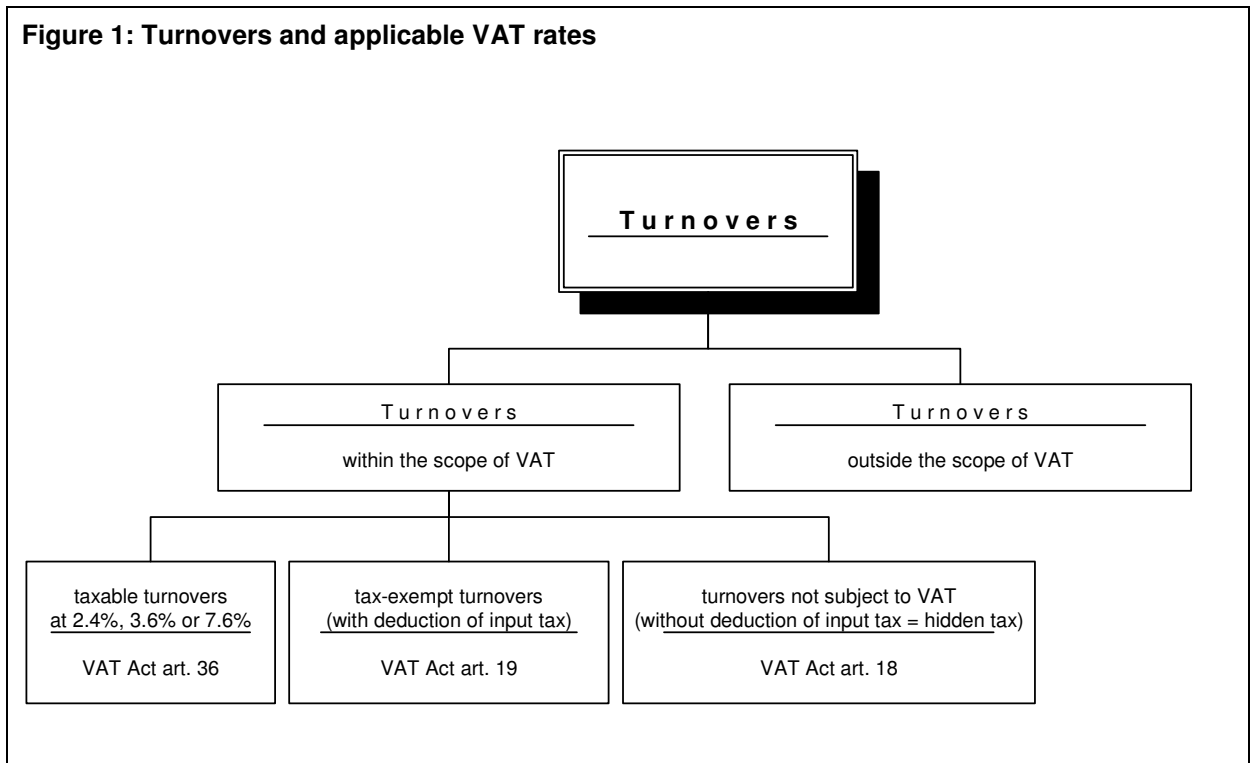
The turnovers not subject to VAT are often referred to as "fictitious tax exemptions". While businesses do not owe VAT for such goods and services, they are also not able to claim input tax deductions for the VAT charged by their own suppliers. The VAT in connection with such goods and services is thus ultimately paid by the businesses. De facto, a hidden tax is charged on these goods and services, since VAT can no longer be charged at the last value added level – the provision of the goods and services to the consumer.

A "true tax exemption", on the other hand, is when businesses do not owe VAT on certain turnovers, but they may deduct the input tax that has been passed on to them in the course of generating these turnovers. Businesses with high tax-exempt turnovers may very well end up demanding more VAT back from the Federal Tax Administration than they pay (input tax surplus).

The following turnovers in particular are exempt from VAT under article 19 of the VAT Act:

- the delivery of objects abroad,
- services rendered to recipients domiciled abroad, if the use or realisation takes place abroad.

With these provisions, the Swiss VAT system is in general EU compatible.⁵ Figure 1 provides an overview of the various turnovers:



Businesses with annual turnover exceeding CHF 75,000 are taxable. If, after deducting input tax, the tax liability regularly does not exceed CHF 4,000, then tax liability only applies if the annual turnover is CHF 250,000 or higher.⁶

2.1 The three legal tax rates

Swiss VAT has three different tax rates fixed by law:

- the normal rate of 7.6%,
- the reduced rate of 2.4%,
- the special rate for lodging services of 3.6%.

The Federal Tax Administration estimates that 16% to 17% of all taxpayers must apply two or three of the legal tax rates.

⁵ Carey, D., K. Gordon, and P. Thalmann (1999): *Tax reform in Switzerland*. OECD Economics Department Working Papers, No. 222.

⁶ Corresponds to approximately EUR 47,000, EUR 3,000 and EUR 156,000.

2.1.1 The reduced rate of 2.4%

According to article 36 of the VAT Act, the reduced rate applies to the following categories of goods and services:

- a Deliveries and own-consumption of the following objects:
 - 1. Water in pipes,
 - 2. Food and beverages (without alcoholic beverages, hotel accommodation and restaurant services),
 - 3. Cattle, poultry, fish,
 - 4. Grain,
 - 5. Seeds, tubers and bulbs to be bed out, living plants, scions, cut flowers and boughs, also when refined to arrangements, wreaths/rings and the like,
 - 6. Fodder, silage-acids, strew materials for animals, fertilizers,
 - 7. Pesticides, natural cover materials,
 - 8. Pharmaceuticals,
 - 9. Newspapers, magazines, books and other printed products without an advertising character,
- b Services of the radio and television companies, with exception of the services with a commercial character;
- c Admission to cultural services and shows that are directly featured to the audience; admission to sporting events, including entry fees and all additional services; use of sporting facilities; cultural services and objects provided by their authors, publishers and collecting societies for their distributional services for these works;
- d Agricultural inputs that are in direct context with the treatment of the soil, or that are in direct context with initial production.

The reduced rate for certain goods is primarily intended to lessen the tax burden of households and individuals with a low income, since they spend a higher share of their budget on these goods than households or individuals with a higher income. The tax revenue of the Confederation from the reduced rate of 2.4% accounts for approximately 6% of all VAT revenue.⁷

2.1.2 The special rate for lodging services of 3.6%

Lodging services include overnight stays with breakfast in the hotel industry and non-hotel accommodations such as holiday rentals and campgrounds. The application of the special rate requires several demarcation rules, since, for instance, the special rate does not apply to lunch and dinner. For half-board and full-board packages, the Federal Tax Administration therefore permits a

⁷ Information of the Federal Tax Administration, August 2006.

bulk 75 / 25 and 65 / 35 splitting of turnovers, respectively. This means that, if no separate documentation is submitted, 75% or 65% of the turnover, respectively, can be invoiced at the special rate, and the rest at the normal rate. On invoices, the lodging and dining components must be indicated separately with the appropriate tax rates.⁸

The objective of the special rate for lodging services is to benefit a particular branch of the service sector – tourism.⁹

The VAT rate for lodging entails lost tax revenue in the amount of approximately EUR 90 million.¹⁰

2.1.3 The normal rate of 7.6%

This rate applies to all taxable turnovers that are not covered by one of the two lower rates.¹¹ 77% of all taxable turnovers are subject to the normal rate.¹²

2.1.4 The balance tax rate method for simplification of tax accounting

The VAT Act allows taxpayers with an annual turnover of CHF 3 million and a tax burden (= effectively payable tax amount) of at most CHF 60,000 per year to file a simplified tax statement.¹³ The payable tax amount is determined by multiplying the total taxable turnover by the "balance tax rate" applicable to the line of business in question.

The balance tax rate method saves the taxpayer from calculating the deductible input tax. However, the balance tax rates only apply to the calculation of the tax vis-à-vis the Federal Tax Administration. With respect to the recipients of the goods and services, the legal tax rates of 7.6%, 3.6%, and 2.4% must be applied, regardless of the VAT accounting method.

⁸ Brochure no. 8: Hotel and Catering Industry, section 6.3.2, with sample calculations.

⁹ Second report of the Federal Council on the audit of federal subsidies (second draft for agency consultations, p. 82).

¹⁰ Statement of the Federal Tax Administration on the report of the Swiss Federal Audit Office.

¹¹ Federal Tax Administration (2005): The Value Added Tax in Switzerland 2002-2003.

¹² Information of the Federal Tax Administration (cited according to *economiesuisse*, Dossierpolitik no. 16 of 16 July 2007, p. 9).

¹³ Corresponds to approximately EUR 2 million and EUR 37,500, respectively.

3 Tax rates and taxpayers in the food industry

The effects of the VAT system with its different tax rates depend on the actual business sector structures, business models, and business sizes. Different tax rates have an especially complicated effect when many taxable businesses actually generate turnovers subject to different tax rates. The Swiss Federal Audit Office has therefore analyzed the food retail trade and the catering industry on the basis of figures provided by the Federal Tax Administration. These figures rely on the tax statements for 2005, to the extent they had been processed by autumn 2006. Of particular interest was the number of taxpayers subject to application of different tax rates.

3.1 Analysis of the tax rates applied in the food retail trade

The Swiss Federal Audit Office can only make few comments on this part of the food industry, since only two legal tax rates apply, namely the normal rate and the reduced rate. In the food retail trade, 60% of taxpayers (approximately 4,600) use both of these legal tax rates. The other 40% are mainly small businesses that exclusively use the balance tax rate of 0.6%. However, this does not mean that these businesses exclusively generate turnover in foodstuffs, since many smaller food stores – cheese dairies, butchers, bakeries, etc. – also offer goods in their stores that are subject to the normal rate, such as household articles, wine, and cigarettes. As long as the share of these goods does not exceed 50% of the overall turnover, the total turnover may be taxed at the balance tax rate of 0.6%.

3.2 Analysis of the tax rates applied in the catering industry

In another part of the food industry – the catering industry – all three legal VAT rates may apply, i.e. the normal rate, the reduced rate, and the special rate for lodging services.

In the **catering industry with lodging services**¹⁴, 36% of all taxpayers (approximately 2,000) apply all three legal tax rates. Apparently, it happens quite frequently that the guest invoice must, for instance, calculate 7.6% for dining and a ski pass, 3.6% for overnight stay and breakfast, and 2.4% for small deliveries to guest rooms (such as newspapers or flowers). The fact that the reduced rate is applied so frequently may be partially due to the fact that foodstuffs are often sold for consumption outside the restaurant. Larger businesses may also operate a hotel kiosk.

A further 30% of taxpayers use both the normal rate of 7.6% and the lodging rate of 3.6%, and 17% of taxpayers likewise apply two rates – the corresponding balance tax rates of 5.2% and 2.3%¹⁵. The remaining 15% of taxpayers in the catering industry only use one rate, generally the normal rate or the balance tax rate of 5.2%.

Approximately 14% of taxpayers in the catering industry with lodging services did not apply the lodging rate at all in 2005, i.e. neither the legal lodging rate of 3.6% nor the corresponding balance tax rate of 2.3%. Instead, the balance tax rate of 5.2% was generally used, which indicates small businesses with restaurant turnover but no lodging turnover. To assess the plausibility of the figures, the Swiss Federal

¹⁴ *The restaurant industry with lodging services includes hotels, guesthouses and bed&breakfasts, restaurants with lodging, youth hostels, campgrounds, holiday homes, collective lodgings, and similar.*

¹⁵ *The balance tax rate of 2.3% may also be applied in small businesses for lodging and breakfast. The balance tax rate of 5.2% in this connection applies to restaurant services.*

Audit Office also consulted the lodging statistics of the Federal Statistical Office, according to which 389 businesses in the hotel industry actually did not report a single overnight stay in 2005. The surprisingly frequent non-application of the lodging rate indicates that a supply surplus exists in the hotel industry.

In the case of businesses applying the balance tax rates, it cannot be determined precisely which legal tax rates they use. For instance, if a small hotel exclusively uses the balance tax rate of 2.3%, it cannot be assumed that the turnovers are only subject to the lodging rate. This business may also apply the balance tax rate of 2.3% to any turnovers subject to the normal rate, as long as these turnovers account for less than 10% of the total turnover. It could therefore make sense to assume the same circumstances hold for businesses using the balance tax rates with respect to the applicable tax rates as for taxpayers filing effectively calculated VAT statements.

In the **catering industry without lodging services**¹⁶, it is remarkable that a total of 23% of the taxpayers (approximately 4,500) generate both catering and food turnovers; of these, 20% use the normal rate and the reduced rate, and the remaining 3% use the corresponding balance tax rates of 5.2% and 0.6%. Accordingly, the sale of foodstuffs is sufficiently widespread in this sector that the market in foodstuffs cannot be strictly separated from the catering market. The different tax rates entail a certain competitive disadvantage for the traditional catering industry vis-à-vis the providers who are able to apply the reduced rate to a significant portion of their turnover. Different tax rates in general distort competition where differently taxed goods and services are competing with each other directly.

¹⁶ *The catering industry without lodging services includes restaurants, snack bars, tearooms, ice cream parlours, bars, discos, dance clubs, nightclubs, canteens, and off-site caterers.*

4 Additional costs due to lower VAT rates

The costs of a tax should in principle be as low as can be reconciled with the objectives of the taxation. Taxation that everyone considers fair may entail high costs. For the State, VAT is a low-cost revenue source, since it only requires a low level of effort to levy and since the State can focus mainly on supervision. Conversely, the costs for taxable businesses are generally two to five times as high as for the State.¹⁷ In particular for small businesses, VAT entails a considerable administrative burden in relation to their turnover. The administration of VAT with a differentiated rate structure causes additional costs both within the tax administration and among taxpayers.

4.1 Additional costs of lower tax rates for taxpayers

The different tax rates create demarcation problems between different taxable turnovers subject to different rates. The pursuit of a simpler rate structure or even a uniform rate must be seen in this context. The following discussion will outline some of the demarcation problems and how to deal with them.

4.1.1 Demarcation problems in the case of mixed deliveries in the retail trade

Additional demarcation problems must be solved in the case of mixed deliveries. According to article 36, paragraph 4 of the VAT Act, economically joined deliveries linked together in such a way that they must be viewed as an indivisible whole are considered a unitary economic process, subject to the normal rate. If, however, a single delivery includes both objects at the normal rate and objects at the reduced rate, and the delivery is not to be viewed as an indivisible whole, then the supplier must separate out the price in the invoice.

Examples of mixed deliveries:

- gift basket with foodstuffs and alcoholic beverages,
- ceramic articles filled with chocolate or confections,
- book with an enclosed CD or DVD,
- loose art prints with a text component in the form of a book,
- plants and flowers in a flower pot,
- children's gift eggs made of chocolate, with a gift enclosed.

If the supplier has not separated out the price, the entire payment is subject to the normal rate. As a simplification, the Federal Tax Administration allows the entire delivery to be taxed at the reduced rate if the objects taxable under the reduced rate constitute more than 70% of the total payment.

4.1.2 Demarcation problems in the case of incidental costs (packaging, postage and freight)

Packaging includes internal and external containers, decorations, wrapping, and padding serving the purpose of packaging. Packaging supplied by the provider with the object is subject to the same tax

¹⁷ See Annex 3.

rate as the delivery of the packaged object.¹⁸ This also applies to additional incidental costs such as postage and freight. Where invoices include different tax rates, such incidental costs must be separated out according to the share in value of the delivered objects.¹⁹

The case is different, however, if the packaging has a significant utility value for the recipient:

Examples of incidental costs where the packaging has a significant utility value:

- travel bags, flower vases, book covers, cups etc. filled with foodstuffs;
- display cases, display stands and the like filled with merchandise, if designed as selling aids to be refilled;
- steel bottle filled with pressurized gas, refillable siphons, drink containers for serving by the glass or carafe, and the like

Any invoiced deposits on reusable packing are not considered part of the taxable payment, however.²⁰

4.1.3 Demarcation between catered delivery and delivery of food and beverages

When food and beverages are provided as a catered delivery, they must be taxed at the normal rate of 7.6%. A delivery is considered catered if meals are prepared ready-to-eat for the final consumer. The demarcation from deliveries of food and beverages gives rise to several problems. The Federal Tax Administration has undertaken a detailed demarcation between catered deliveries (= normal rate of 7.6%) and deliveries of food and beverages (reduced rate of 2.4%). In determining "special facilities", the ownership under civil law is not decisive, but rather the actual economic circumstances. If a "facility" therefore particularly serves on-site consumption, particularly encourages it or significantly facilitates it, then the normal rate is applied. But even with this specification, the question remains open, for instance, whether the food turnovers of the restaurant cars and minibars in railway trains must be taxed at the normal or the reduced rate.²¹ If – as a further example – a table or chair is set up next to a vending machine for consumption on site, then the sale is considered a catered delivery, otherwise it is considered a delivery of food and beverages. The practicality of such differentiations is debatable, especially since it can no longer be verified after the fact whether such facilities were always made available or not. Due to the difficulties of evidence, it is questionable whether the taxpayer is able to defend himself against a higher rate imposed by the tax administration in the case of an inspection. As of 1 July 2005, the FTA has therefore facilitated practice for take-away operations by introducing bulk accounting (Changes of Practice, section 2.10).

¹⁸ Article 36, paragraph 5 of the VAT Act.

¹⁹ Brochure no. 6: Retail Trade, section 3.5. If costs are excessive, the Federal Tax Administration provides that the incidental costs are subject solely to the rate that predominates in the first calculation.

²⁰ Article 33, paragraph 6(b) of the VAT Act.

²¹ Camenzind, Honauer and Vallender S., p. 444. According to the decision of the Federal Supreme Court of 31 August 2004 (BGE 2A.69/2003), minibar turnovers are subject to the normal VAT rate.

4.1.4 Estimate of the additional cost of lower tax rates for taxpayers

The State Secretariat for Economic Affairs (SECO) commissioned research on the cost of VAT for businesses.²² According to these estimates, the total costs of VAT for taxpayers amounted to approximately EUR 320 million (170 million arising from legal information requirements, plus 150 million due to various additional costs). The additional cost of lower rates that could be saved by switching to a uniform tax rate amounted to EUR 36 million.

The SFAO considers these figures currently to be the most reliable. Earlier estimates did not focus exclusively on VAT in Switzerland, but rather on up to a dozen other types of tax in 175 countries²³ - or more than a dozen tax and duty regulations along with costs due to statistics, environmental regulations, and operational costs and special cases in Switzerland and four other countries.²⁴

These estimates do not take into account that the differentiated tax rates increase the risks of the tax for the businesses. The taxpayers must calculate the payable tax themselves. If the FTA discovers errors, it may demand offsets retroactively for five years, which the taxpayers can hardly pass on to their customers. The VAT risks of the 500 companies with the highest turnover in Switzerland and the 20 largest banks and insurance companies were examined in 2004 by KPMG Switzerland in collaboration with the Institute for Accounting and Controlling of the University of Zurich.²⁵ The risk areas examined by this study, namely VAT reconciliation, compliant accounting, qualification and division of the turnovers, and determination of the tax rate partially – or, in the last case, fully – arise from the differentiation of the tax rates.²⁶

4.2 Additional costs of lower tax rates for the tax authorities

The application of different tax rates also creates numerous problems for the tax authorities. First, they entail various opportunities for tax avoidance, which makes the task of the tax authorities more difficult.

²² Rambøll Management (2007): *Messung der Bürokratiekosten der Mehrwertsteuer-Gesetzgebung auf Basis des Standard-Kostenmodells*, commissioned by the State Secretariat for Economic Affairs.

²³ The World Bank and PricewaterhouseCoopers (2006): *Paying Taxes, The Global Picture*.

²⁴ Federal Office of Economics and Labour, Christoph A. Müller, *Study series on structural reporting (1998): Administrative burden of small and medium enterprises in an intercantonal and international comparison. The very broad spectrum of topics in this cost estimation contrasts with the very low response rate of approximately 3%. The study potentially finds overly high costs because it considers accounting to be an administrative expense; however, accounting primarily is used to demarcate private demands. On the methodological reservations, see in particular pages 2 and 9 – 11 of the study. The considerably higher costs according to this estimate by Müller in 1998 compared with the current estimate of SECO in 2007 could partially also be due to an actual decrease in costs; for instance, the VAT administration costs for companies in the UK decreased by 9% of revenue yield to 3.69% of revenue yield within seven years (see Annex 3: Study results on execution costs of VAT and similar types of tax).*

²⁵ KPMG and University of Zurich, Institute for Accounting and Controlling: *Management der Mehrwertsteuerrisiken. Eine Bestandesaufnahme bei Schweizer Unternehmen anlässlich 10 Jahre Mehrwertsteuer, Zurich 2004; available on the Internet at: www.kpmg.ch/library/publikationen_studien/121275.asp.*

²⁶ Federal Department of Finance (2007): *Consultation draft on simplification of the VAT Act. Explanatory report*, p. 167 - 168.

A more complicated rate structure also makes inspection more expensive.²⁷ In 3 – 10% of all VAT inspections in Switzerland, tax rate discrepancies are found.²⁸ This is a lot, when one considers that only about 12% of businesses subject to VAT use more than one legal rate.²⁹ In addition, the retail provisions, which were created due to the tax rate differentiation, contrast with the low probability of discovery.

In contrast, theoretical considerations and numerous case studies indicate that a uniform rate with a tax base that is as broad as possible generates the highest levels of revenue.³⁰

A complicated rate structure creates further problems. If a VAT system has one or more reduced rates for certain goods, then more or less good arguments can always be found to demand such preferential treatment for additional products and services as well. These demands often succeed, so that hardly any countries have been able to keep the categories of goods subject to the reduced tax within the original bounds.³¹ Even if such special interests do not always prevail, the tax authorities must nevertheless deal with the demands in question, instead of, for instance, investing more time and energy in more frequent and more consistent inspections.³²

4.2.1 Estimate of the additional costs of lower tax rates for the Confederation

Demarcation problems with respect to the different tax rates invite taxpayers to misclassify turnover.³³ This problem arises, for instance, in the case of catering businesses if "in-house" turnover is filed according to the reduced tax rate, which would only be permissible for takeaway sales. Within the context of the EUROSAI working group on tax subsidies, the German Federal Court of Auditors examined this aspect. The Federal Court of Auditors concluded that in the fast food industry alone, tax revenue is lost in the amount of double-digit millions.³⁴

²⁷ Agha, Ali and Jonathan Haughton (1996): *Designing VAT Systems: Some Efficiency Considerations*. In: *The Review of Economics and Statistics* 78, p. 303-308.

²⁸ *Inspection concept of the VAT Inspectorate. Final report of the working group, 9 September 2002, p. 9.*

²⁹ *The Value Added Tax in Switzerland 2002 - 2003 (VAT statistics), p. 20.*

³⁰ Bogetic, Bogetic and Fareed Hassan (1993): *Determinants of Value-Added Tax Revenue. A Cross-Section Analysis*. World Bank, Working Papers. The authors of this study compare 20 countries with a uniform rate with 14 countries with two or more tax rates.

³¹ Cnossen, Sijbren (1998): *VAT in CEE Countries: A Survey and Analysis*. In: *De Economist* 146, No. 2, p. 247.

³² *The demand for more and more consistent inspections has also been made for Switzerland, such as in the SFAO report on "VAT Inspections" and an article in Schweizer Treuhänder 12/05 "10-Punkte-Fitnessprogramm für die MWST-Verwaltung" by Gerhard Schafroth (p. 1072 - 1074).*

³³ Cnossen, Sijbren (2002): *Tax Policy in the European Union, p. 26 et seq.*

³⁴ *German Federal Court of Auditors: Mitteilung an das Bundesministerium der Finanzen über die Prüfung: Anwendung des ermässigten Umsatzsteuersatzes in der Fast-Food-Gastronomie, 19 May 2006.*

Empirical research with data from 16 OECD countries shows that one additional VAT rate decreases taxpayer compliance by an average of 7%.³⁵ For Switzerland, a realistic estimate is approximately half of 3.5%, since not only the tax rates are about half the level of those in the investigated OECD countries,³⁶ but also the differences between the rates. For the approximately EUR 690 million in VAT revenue from the reduced rate, this results in tax losses due to misclassification in the amount of approximately EUR 25 million. For the lodging rate, this deficit is about EUR 3 million, so that the total tax loss due to misclassification should be approximately EUR 28 million.

The additional personnel costs arising from the lower rates are 10 – 15% for the VAT Division of the Federal Tax Administration.³⁷ With total costs of approximately EUR 53 million, this corresponds to EUR 5 – 8 million.

Finally, the lower rates and the exceptions also lead to additional costs in jurisprudence. Of the 147 VAT judgments of the Federal Supreme Court between 2001 and 2005, 25 (17%) concerned the different rates or the exceptions.³⁸

The Federal Tax Administration levies VAT on import goods. The different rates do not entail any additional costs, since the staff determines the customs tariff during customs clearance; the system then automatically assigns the corresponding VAT rate.

4.3 Financing tax loss due to lower tax rates

Lower VAT rates are possible if the requisite tax revenue is generated elsewhere, generally via the normal tax rate. This zero-sum game is illustrated using the tax rate adjustments since introduction of VAT in 1995:

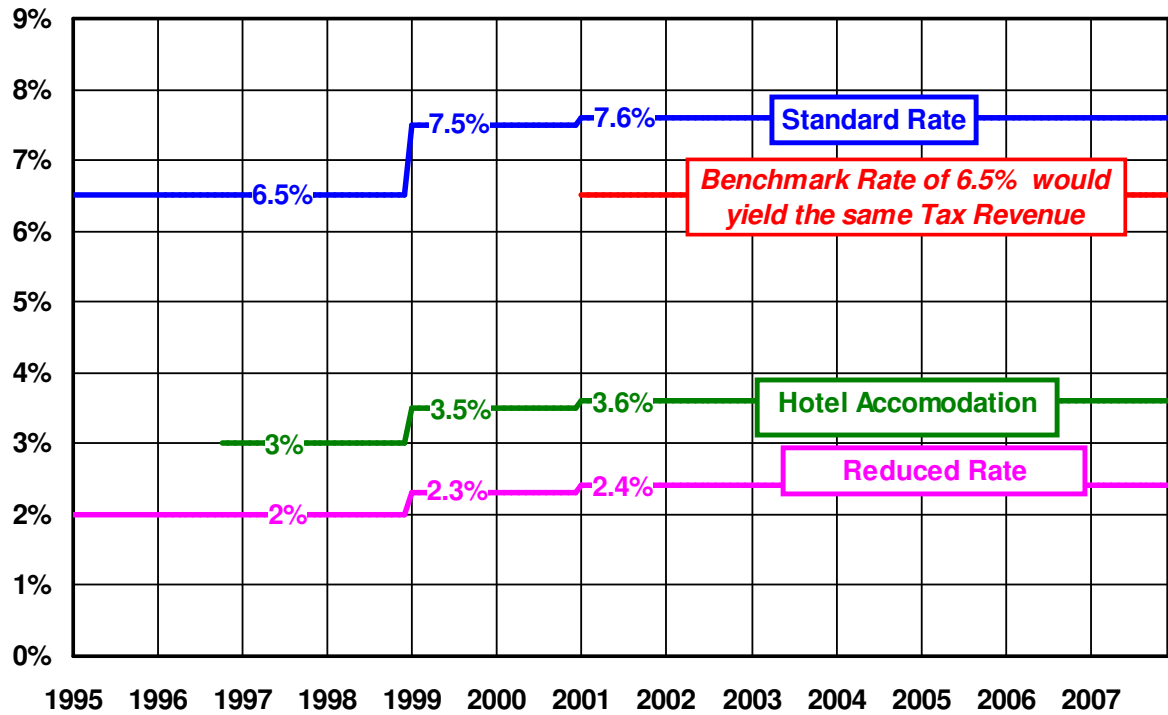
³⁵ Agha, Ali and Jonathan Haughton (1996): *Designing VAT Systems: Some Efficiency Considerations*. In: *Review of Economics* 78, 303-308.

³⁶ The average tax rate of these countries was about 16%. The 16 investigated countries were Germany, France, Italy, the UK, Belgium, the Netherlands, Luxembourg, Denmark, Sweden, Norway, Finland, Spain, Portugal, Greece, Australia, and New Zealand (p. 307, Figure 1).

³⁷ Federal Department of Finance (2007): *Consultation draft on simplification of the VAT Act. Explanatory report*, p. 169.

³⁸ Egger, Daniel J.: *Papierkrieg führt zu dramatischen Problemen. Die Flut an Vorschriften droht KMU zu ertränken*.

Figure 2: Tax rates 1995 - 2007



When the tax rate was increased in 1999, the requisite revenue was generated primarily thanks to the increase of the normal rate from 6.5% to 7.5%, while the two lower rates were only raised by 0.3% (reduced rate) and by 0.5% (special rate for lodging). The example shows how the different tax rates are in a complementary relationship with each other: what is generated in revenue by one rate does not have to be generated by the other rates, and vice-versa. The tax increase in 2001, on the other hand, affected all rates the same. Finally, the uniform rate entails an end to this logic of cross-financing. The revenue resulting from the current tax base could also be achieved with a benchmark rate of 6.5%.³⁹

4.4 Development of the tax subsidy for foodstuffs, 1941 to 2007

The reason for differentiated tax rates – and also for most of the exception clauses – is not to be found in the administrative logic of the value added tax, but rather in the development history of the VAT legislation. This is generally true for countries in the EU,⁴⁰ and a similar observation can be made in Switzerland.⁴¹ The SFAO will therefore take a brief look at the 66-year history of the tax subsidy for foodstuffs.

³⁹ Federal Department of Finance, Consultation draft on simplification of the VAT Act. Explanatory report, p. 164. The application of VAT to the turnover currently subject to the fictitious exemption generates additional revenue of 0.5%. For the funding of retroactive input tax relief and the sociopolitical corrective, the FDF budgets an increase of the uniform rate by 0.1% each. The uniform rate then reaches 6.0% or 6.2%.

⁴⁰ Cnossen, Sijbren (2002): Tax Policy in the European Union, p. 25 et seq.

⁴¹ Camenzind A., Honauer N., Vallender K. (2003): Handbuch zum Mehrwertsteuergesetz (MWSTG), p. 6-11.

The tax subsidy began in 1941 with an exemption from the turnover tax for certain basic foodstuffs,⁴² which the Federal Council justified as follows: “By exempting the turnover of certain types of goods that play a particularly important role in the households of low-income segments of the population (grain, flour and semolina, potatoes, bread, fresh milk, gas, and electricity), a certain regression of the tax effects was aimed for.”⁴³ By 1951, the basket of tax-exempt foodstuffs was expanded to all foods including the stimulants coffee, tea, and cocoa. The last expansion occurred in 1959 with the tax exemption of non-alcoholic drinks. The basket of tax-subsidised foods thus included those now still contained in article 36 of the VAT Act.

More or less in parallel with this 18-year growth phase of the tax subsidy to include a broader range of goods – which from the perspective of the turnover tax represents a narrowing of the tax base – the tax rates were increased, which also enhanced the relative advantage of the tax exemption. This advantage of the rate differential continued to grow in 1982, when the rates of the turnover tax were increased one last time.

With the transition from the turnover tax to the value added tax, the tax subsidy also grew, since the difference between the normal rate (6.5%) and the reduced rate for foodstuffs (2%) amounted to 4.5%. Under the turnover tax, the difference had been 4.3%. It was politically undesirable to increase the burden on the goods in the exemption list. The tax subsidy was decreased, on the other hand, by taxing catering services at the normal rate.

Nevertheless, the tax subsidy continued to grow even under the value added tax. In 1996, the special rate for lodging services was introduced. In 1999, finally, the three tax rates were increased to a differing extent; while the normal rate was increased by 1%, the reduced rate and the lodging rate increased by only 0.3% and 0.5%, respectively, which enhanced the relative advantage compared with normal taxation.

As a result, the current tax subsidy for foodstuffs has remained roughly the same since 1959; the main difference consists in the catering services taxed at the normal rate.

⁴² *The turnover tax was a one-phase tax on deliveries of goods. Compared with the value added tax, it had the advantage that only wholesalers – i.e. only a relatively small number of businesses – were subject to the tax, and the administrative costs were comparatively low. However, since taxpayers were unable to claim any deduction of the input tax, the turnover tax resulted in double taxation of investments (hidden tax).*

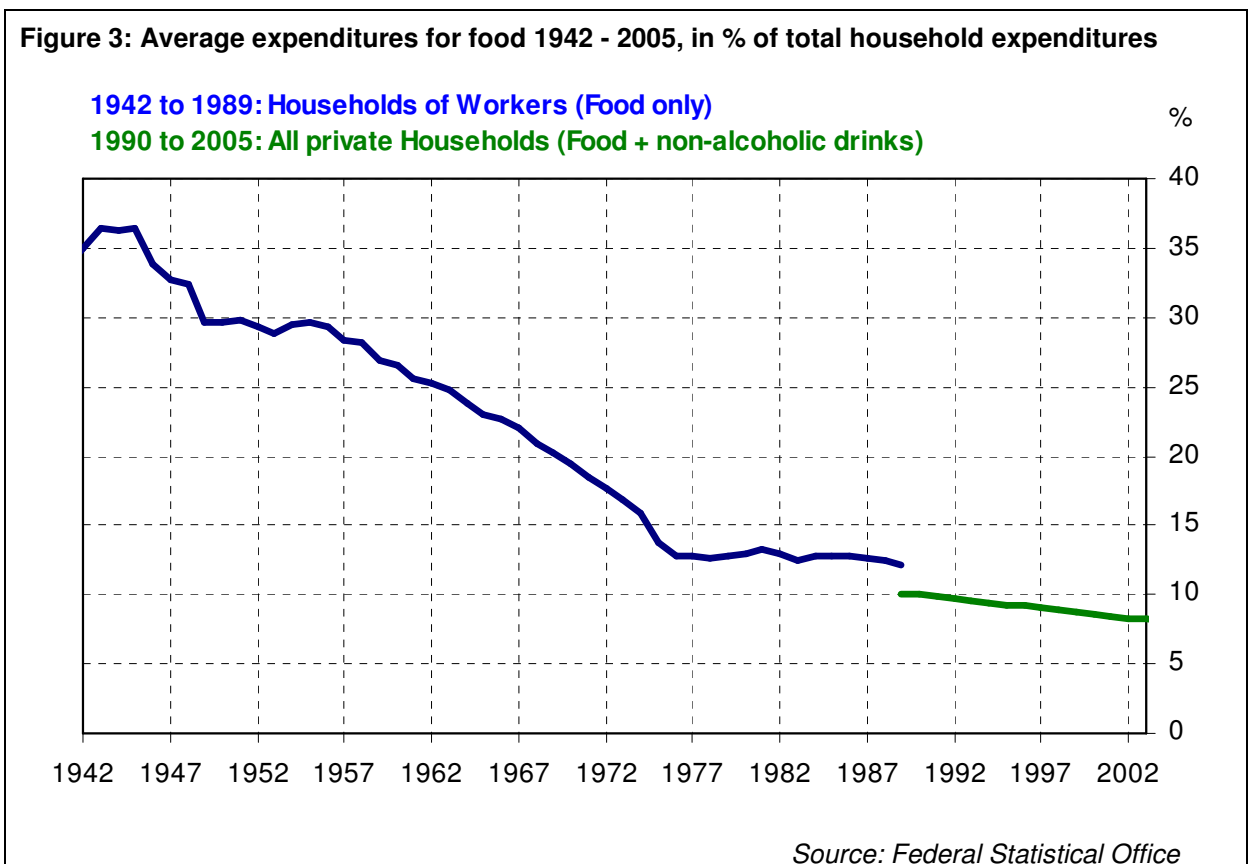
⁴³ *Fifth report of the Federal Council to the Federal Assembly on measures taken pursuant to the extraordinary powers, 4 November 1941, p. 897.*

5 Distribution effects of the tax subsidy for food

The effectiveness of the tax subsidy for food crucially depends on how high the food expenditures of the households are. A social equalization of the food costs between household forms is only achieved if the households differ considerably with respect to their food expenditures; otherwise, the tax subsidy only results in a kind of zero-sum game, in which everyone receives the same amount of tax relief that they have to compensate in other areas again with higher taxes. In the following, the food expenditures and the household forms since introduction of the tax subsidy in 1941 will be briefly outlined.

5.1 Shrinking importance of food expenditures for households

The Federal Council decided to exempt the turnovers of some basic foodstuffs in 1941, since these foodstuffs played a particularly important role in the households of low-income segments of the population, thereby aiming for a certain regression of the tax effects.⁴⁴ Figure 3 shows how the average expenditures for food have developed since then:



The share of food in the total household expenditures dropped from 35% to currently only about 8%. Between 1990 and 2004, the consumption expenditures especially for food, clothing, and furnishing

⁴⁴ Fifth report of the Federal Council to the Federal Assembly on measures taken pursuant to the extraordinary powers, 4 November 1941, p. 897.

continued to decrease, while the shares for housing, health, communications, as well as entertainment, recreation, and culture increased.

The share of consumption in the total household expenditures decreased from 69% to 62% between 1990 and 2004. The share of transfer expenditures has increased in turn, especially due to health insurance premiums including supplementary insurance, the share of which increased from 4.2% to 7.6%.⁴⁵

In the estimate of Swiss retail dealers, both trends will continue presumably for the long term: the share of consumption in total household expenditures will continue to drop in comparison due to growing expenses for health insurance, old age provision, taxes, and energy, and the prices for food will continue their decreasing trend.⁴⁶ The tax subsidy for food will accordingly continue to lose importance in the long term, even after this regressive element has already lost about three quarters of its original effectiveness since 1942.

5.2 The erosion of one main target group: families with many children

The current value added tax with its various rates and exemptions tends to favour low-income households and families with many children. Accordingly, higher-income single-person households tend to pay more tax. The following table shows the revenue surpluses and deficits of the current system in comparison with a budget-neutral uniform rate of 6.5%, which due to taxation of individual exceptions is further decreased by 0.1%:

⁴⁵ Federal Statistical Office: *Statistical Data on Switzerland 2007*, p. 21.

⁴⁶ GDI Gottlieb Duttweiler Institute (2005): *Detailhandel Schweiz 2015. Trends - Szenarien - Perspektiven: Wo stehen wir in 10 Jahren? Mit Unterstützung von Coop, Denner, Manor, Migros-Genossenschafts-Bund, Valora Gruppe, Rewe Schweiz, Promarca. GDI Study no. 23, especially p. 4 and p. 8.*

Figure 4: Which households spend **more or **less** because of VAT rate differentiation?**

Type of household (number of persons)	Monthly income in euros			
	2,800 to 4,200	4,201 to 5,400	5,401 to 7,312	7,313 and more
Single household (1)	1.30	5.00	6.80	-
Couple without children (2)	-7.50	-4.00	0.30	7.60
Couple with one child (3)	-9.20	-6.30	-5.90	-
Couple with two children (4)	-10.70	-10.90	-10.50	-6.00

Empty fields in the table (-) mean that the household group in question does not have sufficient data to generate a reliable figure.

The estimated higher and lower tax burdens – under the assumption that the tax is passed on fully to the consumers – are generally limited to EUR 3 per month and per person, which entails approximately EUR 11 for couples with two children (see bottom row in the table). An unsocial distribution effect is seen in the comparison of couple households without children and with two children: For the two children of a couple with a lower income between EUR 2,800 and 4,200, the additional tax relief is only EUR 10.70 – 7.50 = EUR 3.20, while the two children of a couple with an income between EUR 5,401 and 7,312 receive a tax relief of EUR 10.80 (difference between EUR 0.30 and -10.50). The explanation may be that children from lower-income households must restrict their consumption – and therefore receive less tax relief. At the beginning of the 21st century, families are disproportionately affected by low income and poverty.⁴⁷ The lower tax rates change nothing in this regard.

The tax subsidy does not have a major impact on the small families that are the norm today, especially not for needy families. They were more effective in the era when they were introduced and developed, since large families with many children were widespread in the 1930's and 1960's:

⁴⁷ Bauer, Tobias, Strub Silvia, Stutz Heidi (2004): *Familien, Geld und Politik* (Research Project 4045-59627 as part of NRP 45).

Figure 5: Family structures in Switzerland 1930, 1960 and 2000



1960 is suitable as a reference year, since the basket of tax-subsidized foodstuffs under the turnover tax in use at the time was largely identical to the basket of goods and services currently reduced under the value added tax. The share of families with three or more children has fallen by 50% since then, and in particular large families with five or more children have almost entirely vanished.

Together with the decrease in household expenditures for food by over two thirds, the changed household forms have largely deprived the tax subsidies of their original effect. For this reason, it makes little difference for consumers at the beginning of the 21st century whether the current VAT system is compared with a uniform rate of 6.5% and the same tax base or with a uniform rate of 6.0% and a broader tax base.

Notable in a long-term comparison is the development of the number of persons responsible for administering the tax. In 1975, the turnover tax administration employed approximately 310 staff members to supervise 88,000 taxpayers, when the share of food in household expenditures was 12%.⁴⁸ For today's VAT, there are approximately 2 times as many staff members and 3.5 times as many taxpayers. Approximately 3,100 of VAT taxpayers in the food retail trade (40%) generate their entire turnover with food and beverages.⁴⁹ These taxpayers would have been tax exempt under the old

⁴⁸ *Message of the Federal Council to the Federal Assembly on the Constitutional Reorganisation of Federal Financial and Tax Law, 24 March 1976, 76.024, BBl p. 1490. Notably, the Federal Council addressed a problem that is still current, namely the limited personnel resources; due to ongoing recruitment difficulties and a hiring freeze, "the currently employed accounting experts in the field are unable to conduct sufficient inspections in the taxpayer businesses."*

⁴⁹ *See chapter 3.1.*

turnover tax, since foodstuffs were not subject to the tax. In this form, the tax subsidy for food kept the number of taxpayers low and avoided the associated enforcement costs. When the tax subsidy was continued as a reduced rate within the VAT system, this advantage was lost. Today, high costs are employed to achieve a small social effect.

5.3 Potential distribution effects between households and individuals

5.3.1 Lower and higher taxes per group of consumer goods

The differentiated tax rates and exceptions in the current VAT system aim to relieve the tax burden of households with children and households with multiple persons of retirement age.

The tax subsidy for foodstuffs aims to provide particularly significant tax relief for low-income households and families, since they are assumed to spend a disproportionate share of their expenditures on food.

The food subsidy now grants the wealthiest 20% of households a tax subsidy that is twice as high as the poorest 20% of households.⁵⁰ This is true at the aggregate level of households, but a look at the individual level is also worthwhile, since the average number of persons per household is also roughly twice as high among the wealthiest 20%:

Figure 6: Monthly expenditures for food: per household and per capita

		Gross income per month in five household classes of equal size				
		- EUR 2,895	2,896 - 4,229	4,230 - 5,583	5,584 - 7,437	EUR 7,438 -
Average number of persons		1.39	1.85	2.35	2.78	2.93
Median disposable income	EUR	1,559	2,706	3,652	4,781	6,843
Median disposable income	<i>per capita</i> EUR	1,121	1,461	1,556	1,721	2,331
Expenditures for food and non-alcoholic beverages	EUR	255	309	384	463	539
Expenditures for food and non-alcoholic beverages	<i>per capita</i> EUR	183	167	164	166	184
<i>Expenditures for food and non-alcoholic beverages, in % of median disposable income</i>		16.4%	11.4%	10.5%	9.7%	7.9%

Source: Surveys of income and expenditures, 2003 to 2005, of the Federal Statistical Office

The third row shows the available median income per capita. The average member of the poorest households (left) has roughly half as much disposable income as the average member of the

⁵⁰ Spicher, Beat und Fischer Claudio: Vereinfachungen der Mehrwertsteuer: Grundlinien und Auswirkungen. In: Die Volkswirtschaft. Das Magazin für Wirtschaftspolitik 4 - 2007, p. 59.

wealthiest households (last column on the right). However, both spend almost exactly the same amount on food and non-alcoholic beverages (fifth row), so that the food expenditures represent 16.4% and only 7.9% of median disposable income, respectively (last row). The fact that the average member of the poorest households spends more money on food than the members of the middle-class households (second-to-last row) is, given the small size of the household, likely because the poorest households generally consist of adults who need larger quantities of food than children. The somewhat higher food expenditures per capita in the wealthiest households are likely due to the more frequent purchase of brand-name articles, etc.

With respect to the reduced rate on foodstuffs and non-alcoholic beverages, these expenditure patterns mean that its average effect is equivalent to a reduction of a head tax (assuming that the taxable businesses fully pass on the tax reduction). Individual expenditure patterns are of course not reflected in these averages, but in practice the food expenditures of heavy workers, small children, diabetics, high-performance athletes, etc., are not identical. An increase of VAT from 2.4% to 6.0% would increase the average per capita expenditures for food by approximately EUR 6 per month (3.6% x EUR 175), while the effect of this measure on individuals may vary considerably. Overall, food expenditures represent the single item which, if a uniform tax rate were to be introduced, would entail by far the greatest taxation difference for households.⁵¹

5.4 Consideration of the tax effect on consumer prices

The lower VAT rates are intended to reach consumers in the form of lower prices. The effectiveness of this measure is uncertain, however, since the prices determined by the taxable businesses do not depend only on the tax they have to pay, but rather on numerous market conditions and price elasticities. Price elasticity is the reaction of several economic quantities to price changes, especially the reaction of demand. Experience shows that price changes of luxury goods such as caviar, champagne, brand-name articles, etc., entail strong changes in demand, while the demand barely changes or does not change at all for vital goods and medicine. A business may also pass on the tax burden and relief not only to consumers, but also to all partners and groups with which it maintains economic relationships, such as suppliers and employees. The more elastic the reaction of these groups to price changes, the lower the tax burden the business can pass on.

These considerations rely on a simplifying theory of the equilibrium price, according to which supply and demand clear the market. This theory assumes that the market consists of a large number of small and rationally behaving suppliers and consumers. In many real markets, this model assumption does not apply, since individual buyers or sellers do not have sufficient market power to influence the price to their advantage. Looking at the supplier structure in the Swiss food retail trade, an exceptional situation immediately becomes apparent in comparison with the rest of Europe: The two large chains of nearly equal size – Migros and Coop – have a substantial market share.

⁵¹ *Federal Department of Finance: Consultation draft on simplification of the VAT Act. Explanatory report, p. 174. The second largest taxation difference, but only half as large as for food, would be insurance, with respect to all four described household forms.*

In the simplified theory of market equilibrium, the prices immediately adjust to the new conditions. In reality, the prices react more sluggishly due to numerous price rigidities (contractually fixed prices, regulated prices, transaction costs, etc.). For this reason, the market clearing approaches only describe the long-term economic development.⁵²

With respect to tax subsidies for food, this means that the food purchaser has no right to receive the benefits from the reduced rate; however, the taxable business also has no right to continue its previous demand or profit margin in the case of a tax increase. For instance, the introduction of the value added tax of 6.5% in public transport resulted in a decrease of transport and transport revenue of at least 5%.⁵³ End-consumers can apparently lower their VAT burden by reducing freedom of choice in consumption or switching to less expensive goods.

5.5 The effective distribution effect of lower VAT rates

Depending on market conditions, the reduced rate benefits the consumer or the suppliers; only if fully elastic supply is assumed, does the tax reduction reach the consumer in full.⁵⁴ The question of whether the tax or tax reduction is effectively passed on is particularly acute in the case of changes to the tax rate. The following case studies show that an immediate passing-on effect occurs only partially.

5.5.1 Case study 1: Passing on of VAT in 1995 and 1999

The analysis of the actual passing on of the tax upon introduction of VAT in 1995 shows that, in the case of food, only 33% (beverages) or 40% (foodstuffs) of the tax was contained in the prices. The potential for passing on the tax was, however, primarily exhausted in those sectors where the **price formation does not depend or only partially depends on the supply and demand situation** (see table below). This is true, for instance, of pharmaceuticals, the prices of which are regulated. In the case of prices for energy, radio and television licenses, or transport services, which are largely fixed by the public sector, the potential for passing on the tax was likewise realized between 89% and 94%. Passing on the tax in these lines of business was generally simultaneous with the change in the tax, since the suppliers were guided by the higher tax and only partially took account of the discontinuation of the hidden tax.⁵⁵ In the case of book prices, where price fixing was abolished in the spring of 2007, VAT was also immediately and fully passed on to the consumer prices.⁵⁶

⁵² http://en.wikipedia.org/wiki/Economic_equilibrium

⁵³ *Report of the Federal Council on Improvements to VAT (10 Years of VAT)*, p. 9.

⁵⁴ *Federal Department of Finance: Consultation draft on simplification of the VAT Act. Explanatory report, February 2007*, p. 39, footnote 44.

⁵⁵ *Federal Statistical Office: National index of consumer prices in January 1995. Press release 07/95, February 1995.*

⁵⁶ *Information from the Office of the Price Supervisor.*

Figure 7: Passing on of VAT to consumer prices

Individual items in the national index of consumer prices	Potential for passing on of VAT from December 1994, in %	Price increase due to VAT in % by end of September 1995	Potential for passing on of VAT exhausted in %
Foodstuffs	2.0%	0.8%	40%
Beverages	0.9% ⁵⁷	0.3%	33%
Clothing and shoes	3.0%	0.1%	3%
Sport + recreation activities	6.5%	2.5%	38%
Communications	6.5%	3.3%	51%
Mountain railways + ski lifts	6.5%	4.3%	66%
Books, newspapers, magazines	2.0%	1.5%	75%
Meals in restaurants	6.5%	4.9%	75%
Beverages in restaurants	6.5%	5.4%	83%
Transport services	6.5%	5.8%	89%
Hairdresser services	6.5%	5.9%	91%
Energy	6.5%	6.1%	94%
Radio and television licenses	2.0%	2.0%	100%
Pharmaceuticals	2.0%	2.0%	100%

(Source: 1995 inventory of policy measures relevant to price, December 1995, FSO)

When VAT was increased in 1999, the pattern of passing on the tax observed in 1995 was basically repeated, so that the SFAO will refrain from presenting the figures. In the first nine months after the rate increase, an average of two thirds of the tax was passed on to the prices. This average value includes the outliers observed in 1995, namely goods with and without market-determined prices: In the case of foodstuffs, beverages, and tobacco, only approximately 25% of the tax was passed on, while 100% was passed on in the case of goods with regulated prices (100% transfer especially in the case of prices for energy, medicine, and telephone subscriptions with the monopolist at the time; nearly 100% transfer in public transport).⁵⁸

5.5.2 Case study 2: Passing on of the special rate for lodging services?

Effective 1 October 1996, the value added tax for overnight stays and breakfast sank from 6.5% (normal rate) to 3%, the level of the special tax rate applicable to lodging services from that time onward. The index for hotel rates only sank by 0.8% in 1997 instead of the expected 3.5%. Because of gaps in the data provided by the hotel industry, the Federal Statistical Office was unable to break down this price decrease between VAT-related and other changes, as was generally possible for other

⁵⁷ In the case of individual goods, the price increase was effective even before the foreseeable introduction of VAT, for instance in the case of beverages and clothing + shoes.

⁵⁸ Federal Statistical Office: Price statistics 1999. Inventory of policy measures relevant to price, p. 4 - 5.

adjustments to VAT.⁵⁹ This is not a serious problem, however, since inflation was effectively zero during the time in question.

It can be considered certain that the VAT reduction was not immediately passed on to the customers. A survey by the Associated Press⁶⁰ indicated that 14 of 30 surveyed hotels did not want to pass on the tax reduction, which was generally justified with reference to the fact that the VAT introduced in 1995 had not been passed on to the prices, either. In the other 16 hotels, the guests were expected to benefit from the tax reduction upon the start of the winter season.

A survey by the *Sonntagsblick*⁶¹ among 71 randomly selected hotels showed that only 27 reduced their prices immediately, 41 did not reduce their prices at all, and the other 3 had not decided yet. Those hotels not passing on the tax reduction referred to the introduction of VAT in 1995, which had also not been passed on.

The representatives of Switzerland Tourism, the Swiss Tourism Federation, and *hotelleriesuisse* were disappointed by the results of the surveys, since they had urgently requested the hotels to reduce their prices or offer additional services.⁶²

5.5.3 Case study 3: Differentiated tax rates versus mixed calculation of final prices

A mixed calculation is a calculation in which the sales prices of products and services are not determined solely by their different costs – such as taxes. The providers expect that the lower profits or even losses resulting from a low calculation of the product price will be compensated by higher profits attained with other products. Mixed calculations may, for instance, set a particularly low price for certain products to attract the interest of customers and to encourage them to visit the shop, where it is then hoped they will buy products with a very good profit margin (so-called loss leader price). Mixed prices may also simplify pricing.

In regard to passing on the reduced rate, it is relevant that numerous providers of take-away food demand the same price for their products, regardless of whether the facilities provided on site are used for consumption or not. Confectioneries and tearooms are the suppliers most likely to set different final prices for consumption in the restaurant and for take-away sales. A mixed calculation is apparent whenever the price indication in front of or in the restaurants and on the menus always indicates a single price for the same product, regardless of where the product is consumed. In all these cases, the

⁵⁹ 98.3061 *Interpellation: Special VAT rate. Price effects for the hotel industry, 2 March 1998. In its response dated 8 June 1998, the Federal Council erroneously assumed that the hotel industry did not pass on approximately 2.5% of VAT to the prices, since the hotel prices did not rise by 6.5%, but rather by 4%. In fact, however, the hotel prices already contained a hidden tax of approximately 2% under the turnover tax, so that the hotel industry did not need to pass on the full 6.5% VAT. The fact that the new lodging rate in 1996 hardly led to lower prices is therefore not due to the fact that only part of VAT had been passed on in 1995.*

⁶⁰ *Hotelpreise sinken trotz Steuerreduktion nicht überall. Umfrage der Nachrichtenagentur AP. In: Neue Zürcher Zeitung, 27 September 1996, p. 15.*

⁶¹ *Hoteliers geben nicht weiter. Umfrage zeigt: Gäste gehen oft leer aus. In: Sonntagsblick, 29 September 1996.*

⁶² *Neue Zürcher Zeitung, 27 September 1996, p. 15, and Sonntagsblick, 29 September 1996.*

end-consumer is not subject to any distribution effect of the differentiated VAT rates, since any such effect is eliminated by the mixed calculation.

5.5.4 Case study 4: No passing on of the reduced rate for food in Lithuania

In the framework of the EUROSAI working group on tax subsidies, the National Audit Office of the Republic of Lithuania examined the effects of the reduced VAT rate. This tax subsidy was introduced over the course of the years 2003 to 2006 for certain foodstuffs and agricultural goods and services, art and culture, sport, medical equipment and services, housing construction and renovation, insulation work, and lodging services.⁶³

The report of the National Audit Office shows that the reduced rate had no direct effect on the prices of products and services, even though the associated tax subsidy was 13% (normal rate of 18% - reduced rate of 5%). Individual prices were indeed reduced, but they rose again to their original level within a few months. Other prices – especially for art and culture and for sport – were not reduced at all, which is why the National Audit Office concludes that the reduced rate does not entail any direct benefit for the consumer, but rather creates special conditions for the producers and suppliers of the goods and services in question.

5.5.5 Case study 5: The reduced rate for labour-intensive services in the EU

In 1999, the European Council allowed its Member States to experimentally apply a reduced VAT rate to certain labour-intensive services, in order to increase employment and reduce the size of the black economy.⁶⁴ Nine Member States took part in the experiment, during which a reduced rate could be granted for small repair services, renovation and repair of private dwellings, window cleaning, domestic care services, and hairdressing. The evaluation of this measures showed, inter alia, that the tax reduction "never was fully passed on to consumer prices. Part of the reduction was therefore used to increase the profit margin of the service providers."⁶⁵ In Luxembourg, for instance, 40% of hairdressing businesses and even 80% of shoe repair businesses did not reduce prices following the VAT rate reduction. Where a sector did immediately pass on part of the VAT reduction, as was the case in the Netherlands with respect to repair services for shoes, bicycles, and clothing and in France with respect to the renovation and repair of private dwellings, these sectors subsequently tended to increase prices significantly above the inflation rate. The effect mechanism hoped for (tax reduction → price reduction → more demand for labour-intensive services → extra employment) therefore did not apply.⁶⁶

⁶³ *National Audit Office of the Republic of Lithuania (2006): Public Audit Report on the Application of reduced Value-Added Tax Rates.*

⁶⁴ *Commission of the European Communities (2003): Evaluation report on the experimental application of a reduced rate of VAT to certain labour-intensive services, SEC(2003) 622.*

⁶⁵ *ibid p. 5.*

⁶⁶ *ibid p. 28.*

5.6 Conclusion on the effective impact of lower VAT rates on consumer prices

Experience shows that the frequently assumed passing on of lower VAT rates to consumers effectively only occurs in sectors with regulated prices. Where, however, the prices are determined by supply and demand, the lower VAT rates only partially are reflected in the final prices, so that both suppliers and consumers receive part of the tax subsidy – at least in the first year or two during which the prices have been observed. The SFAO does not know of any example of a sector in which the full tax subsidy was immediately and permanently passed on to the consumers, where the final prices were determined by the market.

With a view to the goods in Switzerland currently subject to the reduced rate (see chapter 2.1), it is remarkable that historically, the legislative power has in general only reduced the rate on goods whose prices are NOT determined by supply and demand:

Figure 8: Tax-reduced goods and services without market-determined prices

Goods taxed at the reduced rate under article 36 of the VAT Act	Supplier / pricing system
Water in pipes	Public water supply (generally municipalities or cities)
Cattle, poultry, fish Fodder, silage acids, strew materials for animals, fertilizers Plant protection products, mulch, and other natural cover material Agricultural inputs that are in direct context with the treatment of the soil, or that are in direct context with initial production Seeds, tubers, and bulbs to be bed out, living plants, scions, cut flowers and boughs, also when refined to arrangements, wreaths and the like	Pricing under agricultural policy
Books, newspapers, magazines, and other printed products without an advertising character	Book price fixing (until 2 May 2007)
Pharmaceuticals	Prices for pharmaceuticals subject to compulsory insurance are fixed by the Federal Office of Public Health (Specialities List)
Services of the radio and television companies	Swiss Radio and Television Corporation SRG (public monopoly)

Foodstuffs and beverages (without alcoholic beverages and catering services) are an exception to the rule that tax reductions only apply in areas with regulated final prices. However, resale price fixing existed until 1967 in the case of many food items, especially brand-name articles. The stronger the price formation by market forces in sectors subject to the reduced tax, the more uncertain is the exclusive enjoyment of the benefit by the consumer due to the reduced VAT rate.

6 Comparison of VAT rate differentiation and premium reductions

It is generally recognised that specific policy objectives can be better met using more targeted instruments than the value added tax, which is designed as a general consumption tax.⁶⁷ The effects of lower VAT rates as a tax relief measure have been described in the preceding chapters. The introduction of a uniform VAT rate would in particular entail an increased tax burden for the lower income classes of approximately EUR 216 million per year, compared with the status quo.⁶⁸ This relief granted to lower income households by way of the tax rate differentiation can in principle also be achieved by way of targeted payments. Due to federalism, however, only few national distribution channels exist that would allow consideration of the income of the recipient when granting subsidies. Supplemental benefits or a negative income tax with tax credits would, for instance, hardly be an option, since they refer to a different group of beneficiaries than the VAT rate differentiation or would have to be newly introduced, which would entail considerable new enforcement costs. In the social sector, a reduction of health insurance premiums is therefore the main option worth considering.

The Federal Council envisages a model to compensate these effects outside the value added tax system ("sociopolitical corrective" for a maximum of eight years). For this purpose, the uniform rate of 6.0% would be increased by 0.1 percentage points, and the resulting surplus revenue would be distributed in a targeted way to low-income households via individual premium reductions. The following sections discuss the advantages and disadvantages of the distribution system using reductions of health insurance premiums.

6.1 Execution and administration costs for individual premium reductions (IPR)

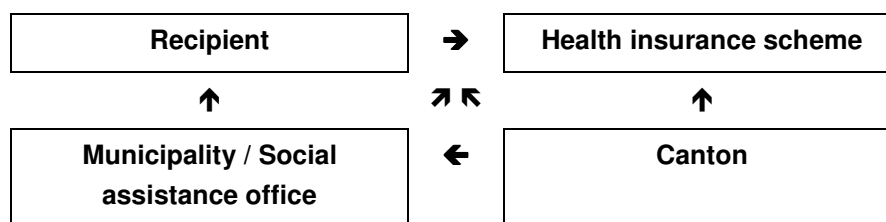
In 2005, EUR 2 billion (thousand million) were distributed by the Confederation and the cantons as individual premium reductions (IPR). The share of the cantonal contributions amounts to a total of 50% of the federal contributions. The cantonal contributions are determined by the size of the population and the financial power of the canton. In 2005, 2.262 million persons received premium reductions nationwide.

In simplified terms, the cantonal execution of premium reductions can be divided into the following work steps: public information, compilation and review of the required documentation including access to tax information, calculation of the premium reductions, notification of the decision, and payment. Very significant differences exist among the cantons with respect to organisation of execution. The situation within a single canton may also vary if the recipient additionally receives social welfare assistance or supplemental benefits. In principle, there are several different payment routes by which the premium reductions may be transferred from the canton to the health insurance schemes:

⁶⁷ See e.g. among many others: Weisbach David A. & Nussim Jacob: *The Integration of Tax and Spending Programs*. In: John M. Olin Program in Law & Economics Working Paper, n° 194 (2d series), University of Chicago, September 2003.

⁶⁸ Federal Department of Finance: *Consultation draft on simplification of the VAT Act. Explanatory report. February 2007, section 5.1.2.2.*

Figure 9: Possible financial flows for individual premium reductions (IPR)



In general, health insurance schemes are interested in receiving the premium reduction directly from the canton, since this reduces potential collection costs, especially in the case of recipients whose premiums are fully funded by the premium reduction. An early transfer to the health insurance schemes additionally gives them an interest advantage, which represents a compensation for their execution costs. This execution gives rise to various administrative costs for those involved. These costs will be explained below, with the goal of estimating the costs that arise due to additional premium reduction contributions paid as social compensation for introduction of a uniform VAT rate.

6.1.1 IPR administration costs for cantons, municipalities, and health insurance schemes

Various factors influence the **costs for cantons and municipalities**, such as the share of applications processed individually, the involvement of municipal offices, and the requirement of submitting a new application each year. The administrative costs for determining the income and asset situation by the tax authority are not taken into account, since they are necessary anyway for tax assessment. The same is true of the determination of claims to supplemental benefits or social assistance. According to a study of the cantons of Geneva, Neuchâtel, Basel-Stadt, Zurich, Lucerne, and Appenzell Ausserrhoden (Balthasar 2001), the execution costs for the cantons and municipalities amount to between EUR 7 and 17 per recipient.

The total **administrative costs for health insurance schemes** are EUR 84 annually per insured person. With respect to the costs for the health insurance schemes entailed by implementation of the premium reductions, Balthasar (2001) assumes EUR 3 per recipient as paid by the canton of Basel-Stadt to the insurers; the canton of Aargau paid EUR 4.

Overall, the premium reductions cause the following execution costs:

Figure 10: Rough estimate of the execution costs for individual premium reductions

Entities involved in execution of IPR	Annual execution costs for IPR	
	in EUR per recipient	in EUR million for all recipients
Cantons, municipalities	between 7 and 17	between 15 and 38
Health insurers	between 3 and 4	between 7 and 9
TOTAL	between 10 and 21	between 22 and 47

These figures should be understood as a rough estimate.

6.1.2 Additional administrative costs for the sociopolitical corrective

So that the available resources can be distributed via IPR, the funds must first be divided among the individual cantons by the Confederation. The additional federal resources would be distributed among the cantons according to their population size, in accordance with the existing rule for the distribution of IPR contributions.

The proposal envisages that the cantons would decide which population groups would receive the cantonal share of the corrective. A direct relationship to IPR must exist, or at least a comparable mechanism must be used that takes the income and asset situation of the recipients into account. In general, the cantons would pay the allocated share for the corrective to the recipients in the same year.

According to the message of the Federal Council, the additional distribution costs for the corrective would be compensated to the cantons by way of the interest advantage arising from the earlier transfer. At an annual interest rate of 3.5%, the cantons would receive an approximate monthly interest advantage of EUR 0.6 million on the EUR 216 million paid by the Confederation.

The costs for the cantons would be minimised in that, in principle, the cantons would not be required to deviate from their existing IPR systems. Provided that the Confederation does not require the cantons to deviate from the existing IPR systems, the SFAO estimates that the corrective would give rise to additional administrative costs in the amount of EUR 1 to 2 million for the following cost items:

- Cantonal administration:
 - Calculation of the new contributions to be distributed
 - Accountability with respect to payment and provision of data, for purposes of verifying sociopolitical effectiveness
- Cantonal administration or health insurance schemes:
 - Separate statement of the amount paid to the recipient as a federal benefit
- Health insurance schemes:
 - IT adaptation costs

6.2 Distribution of premium reductions

The cantons are largely free with respect to distribution of the funds, so that currently 26 different premium reduction systems exist. When distributing the funds, the cantons primarily take different income categories into account (gross income, gross income after specific deductions, net income, taxable income). In addition, there are various political and technical factors that may influence distribution.

6.2.1 Distribution of the sociopolitical corrective to the uniform VAT rate

According to the consultation draft, EUR 216 million raised with a uniform VAT rate of 6.1% would be distributed in a targeted manner to the two fifths of households with the lowest income by way of individual premium reductions. According to the Federal Council, this would eliminate the additional burden for approximately 30% of the population, which corresponds to the circle of persons reached by IPR.

6.3 Transparency and political controllability of individual premium reductions

The IPR funds distributed by the Confederation and the cantons are regularly reported in the State financial statements. Moreover, various monitoring and evaluation reports are available on the sociopolitical effectiveness of the premium reductions in the cantons.

The parliaments are informed accordingly, and it often happens that they adjust the distribution of resources to their political priorities. Since introduction of IPR in 1996, the cantons have undertaken several improvements with respect to distribution of resources. Various effectiveness studies show that the development with respect to premium burden is due both to changes in the tax laws as well as the rules for calculating premium reductions. By means of such changes, the cantons have, for instance, expanded the circle of recipients or adjusted the premium reductions for middle-class families, single parents, or large families.

6.4 Conclusions

1. Without deviating from the existing cantonal IPR system, the additional administrative costs for distributing the corrective to the uniform VAT rate amount to between EUR 1 and 2 million.
2. When distributing IPR, the cantons primarily refer to the income of the beneficiaries. The most important exceptions concern the favourable treatment of families regardless of income in some cantons. Other important differences among the cantons arise from the use of different income categories, the inclusion of the asset situation as a reference value, and the degree of automatization of the distribution system.
3. The IPR corrective to the uniform VAT rate outlined in the consultation draft of the Federal Council represents a feasible option for compensating the politically undesired additional burden on low-income households arising from a uniform VAT rate.

6.5 Comparison of differentiated VAT rates and individual premium reductions (IPR)

The following table illustrates the advantages and disadvantages of the distribution system by IPR compared with lower VAT rates for specific products. The information presented in the table is discussed in more detail in the preceding chapters of the report.

The comparison between the two measures shows that the politically undesired VAT burden imposed on low-income households can be better compensated outside the VAT system. The corrective via IPR benefits the target group more effectively and efficiently and is associated with lower risks than VAT rate differentiation:

Figure 11: Comparison of VAT rate differentiation and corrective via IPR

Object of comparison Comparison criteria	VAT rate differentiation (+ = <i>advantages</i> / - = <i>disadvantages</i>)	Corrective to uniform VAT rate via individual premium reductions
Entitlement of beneficiaries	<ul style="list-style-type: none"> - No right to effective passing on of tax advantage (dependent on market forces) + Automatic benefit with every purchase (no administrative effort on the part of the beneficiary) 	<ul style="list-style-type: none"> + Legal right, if cantonal conditions met - Must be applied for, if no automatic entitlement + Transparent – the beneficiaries see what they receive
Distribution effect	<ul style="list-style-type: none"> - Competitive passing on of tax advantage to consumers - Social effect depends on consumption expenditures that households make for goods and services subject to higher or lower tax - Strongly scattered effect, since lower rates also benefit wealthy households 	<ul style="list-style-type: none"> + Distribution depends mainly on the financial situation of the beneficiaries - Use of non-income distribution criteria in some cantons (“families”)
Validity	<p>Unlimited in time.</p> <p>However, the social redistribution effect is likely to further decrease due to reduction of expenses for daily needs and the long-term reduction of the share of consumption in relation to income.</p>	<p>Limited to at most eight years (due to sinking expenses for daily needs, sinking share of consumption in relation to income, reduced tax burden on housing investments thanks to uniform rate, and growth impulses)</p>
Additional administrative costs (public administration)	<ul style="list-style-type: none"> - EUR 5 to 8 million, since 10% to 15% of the staff of the VAT administration is used for administering the various tax rates and exceptions 	<ul style="list-style-type: none"> + Approx. EUR 0 - 1 million, if no deviation from existing cantonal IPR systems
Additional administrative costs (businesses)	<ul style="list-style-type: none"> - EUR 36 million for taxable businesses having to use several VAT rates 	<ul style="list-style-type: none"> + Approx. EUR 1 - 2 million for health insurers
Public controllability	<ul style="list-style-type: none"> - No regular information on the amount of tax subsidy in the State financial statement - Untransparent execution, since largely the responsibility of private businesses. Tax secrecy hardly allows for discussions on execution. 	<ul style="list-style-type: none"> + Transparency: regular information (federal and cantonal financial statements, monitoring, and various evaluations) + No restrictions on controllability in principle. Confederation and cantons can control their system so that it corresponds to their policy priorities. Possibility of improvements.
Other risks	<ul style="list-style-type: none"> - EUR 28 million tax loss due to misclassification of turnovers taxed at lower rates instead of the normal rate 	

7 Recommendation of the Swiss Federal Audit Office

The tax subsidy for selected foodstuffs was introduced by the Federal Council in 1941 in the context of the turnover tax, when average expenditures for foodstuffs amounted to more than 35% of all household expenditures and large families with many children were the norm. This tax exception aimed at relieving the tax burden of households with lower incomes, since such households spent a higher share of their income on basic foodstuffs than wealthy households. The tax subsidy was expanded to include all foodstuffs and non-alcoholic beverages by 1959 and was continued with the transition to the value added tax in 1995 in the form of the reduced tax rate for foodstuffs. Today, the average household only pays 8% of its expenditures on foodstuffs, i.e. approximately one quarter of the share in 1941. Accordingly, this form of tax subsidy has lost three quarters of its significance. Since foodstuffs still generate a large part of all turnover subject to a reduced tax rate, the decrease in expenditures on foodstuffs significantly diminishes the redistribution effect of the differentiated tax rates. The remaining social equalization effect can be achieved more economically by way of the existing reductions of health insurance premiums (IPR), which were introduced in 1996 and also relieve the burden of low-income households. This increase in economy resulting from IPR relates to both efficiency and effectiveness:

Efficiency: The differing tax rates create problems in demarcating various taxable goods and services subject to different rates. This problem arises, for instance, in the case of restaurants if "in-house" turnover is filed according to the reduced tax rate, which would only be permissible for takeaway sales. Such demarcation problems invite taxpayers to misclassify turnover. The Federal Tax Administration suffers a revenue loss of approximately EUR 28 million for this reason. Moreover, EUR 5 to 8 million arise for additional staff expenses in the VAT administration, since 10% to 15% of its staffing needs are due to the additional effort required to administer the different tax rates and exceptions. The differing rates cause an estimated EUR 36 million in additional administrative costs to the businesses subject to value added tax.

By comparison, targeted payments to persons in need in the framework of reductions of health insurance premiums generate additional administrative costs of at most EUR 2 million for cantons and health insurers, under the assumption that cantons take the same approach as with existing premium reductions.

Effectiveness: The reduction of health insurance premiums is more targeted than the reduced value added tax rates. While in some cantons, the premiums of children are reduced without taking account of the income of parents, and the cantons determine beneficiaries according to different income categories (gross income, gross income after specific deductions, net income, taxable income), these differences in the consideration of the economic situation are insignificant compared with the reduced VAT rates, where the consideration is undertaken only by way of statistical average values of consumption patterns. Consumption tax subsidies benefit both wealthy households and people with lower incomes.

Moreover, passing on the tax benefit from businesses to consumers depends on the market situation. Various case examples show that the businesses subject to VAT only partially pass on or are able to pass on the reduced rates and the tax itself to consumers by way of the final price. In the case of individual premium reductions, this problem of effectively passing on the benefit to the beneficiaries

does not exist, since neither cantons nor health insurers have the possibility of keeping the money of the beneficiaries for themselves.

For these reasons, the SFAO recommends that politically undesired burdens entailed by the value added tax should no longer be compensated by way of the tax subsidy for food. The additional burden for low-income households associated with a uniform tax rate can be compensated more economically by way of additional reductions in health insurance.

The Swiss Federal Audit Office believes the reason why this has not already happened is that reductions of health insurance premiums were introduced in 1996, i.e. one year after the transition from the turnover tax to the value added tax. Prior to 1996, no easily utilizable instrument existed at the federal level with which the undesired tax effect among the lowest-income households could be compensated. The Swiss Federal Audit Office believes it makes sense to seriously consider introducing a uniform VAT rate as part of the ongoing VAT Act reform.

Annex 1 : Bibliography

Legal foundations

Brochure no. 6: Retail Trade.

Brochure no. 8: Hotel and Catering Industry.

Commentary on the VAT Ordinance, BBI 1994 III p. 530 et seq.

FDF Ordinance of 20 June 2000 on the Tax Exemption for Domestic Deliveries of Private Objects for Purpose of Export in Passenger and Border Traffic (641.201.41).

Federal Law of 2 September 1999 on the Value Added Tax (VAT Act 641.20).

Federal Resolution of 20 March 1998 Increasing the VAT Rates for AHV/IV (641.203)

Message of the Federal Council to the Federal Assembly on the Constitutional Reorganisation of Federal Financial and Tax Law, 24 March 1976, BBI 1976 76.024.

Message on the Replacement of the Financial Order (91.079), BBI 1992 I 785.

Ordinance of 29 March 2000 on the Federal VAT Act (VAT Act Ordinance 641.201).

Ordinance of the Federal Assembly of 4 June 2004 on the Use of the Revenue from VAT as of 1 January 2004 (641.204).

Ordinance on the Value Added Tax (VAT Ordinance) of 22 June 1994 (AS 1994 II p. 1464 et seq.)

Parliamentary Initiative. Federal Law on the Value Added Tax (Dettling). Report of the Committee for Economic Affairs and Taxation of the National Council (93.461). BBI 1996 V p. 811.

Parliamentary requests

93.461 Parliamentary Initiative. Federal Law on the Value Added Tax (Dettling). Report of the Committee for Economic Affairs and Taxation of the National Council. BBI 1996 V p. 811.

98.3061 Interpellation. Special VAT rate. Price effects for the hotel industry, 2 March 1998; Response by the Federal Council of 8 June 1998.

04.3655 Motion. Amendment of the VAT Act. Submitted by Hans Hess.

05.3797 Motion. Inclusion of the taxation objective of "end consumption" in the VAT Act, submitted by the Christian Democratic parliamentary group on 14 December 2005.

07.3275 CSSH-S Motion. Payment of premium reductions.

Reports

- Balthasar A. (2007), Schweizerische Sozialhilfestatistik, Unterstützung bei der Interpretation der Sozialhilfestatistik im Bereich Krankenkasseprämien und -verbilligung, report by the Interface Institute for Policy Studies commissioned by the Federal Statistical Office.
- Balthasar A. (2005), Die Prämienverbilligung in den Kantonen: Übersicht über Bemessungsgrundlagen, Berechnungsmodelle und Bagatellgrenzen in den 26 Kantonen.
- Balthasar A. (2001), Evaluation des Vollzugs der Prämienverbilligung, eine Untersuchung in den Kantonen Genf, Neuenburg, Basel-Stadt, Zürich, Luzern und Appenzell Ausserrhoden.
- Balthasar A. (1998), Die sozialpolitische Wirksamkeit der Prämienverbilligung in den Kantonen. Evaluationsergebnisse und Monitoringkonzept. Beiträge zur sozialen Sicherheit, FSIO Research Report no. 21/98, Berne.
- Bodmer, Frank: Globalisierung und Steuersystem in der Schweiz; Study commissioned by the State Secretariat for Economic Affairs, Structural reporting no. 16, Berne 2002.
- Bodmer, Frank: Die Mängel der (schweizerischen) Mehrwertsteuer und einige Reformvorschläge; Mimeo., Center for Economic Sciences, University of Basel, 2003.
- Commission externe d'évaluation des politiques publiques (CEPP 2000): Subsidies en matière d'assurance-maladie. Evaluation de la politique cantonale, Genève (www.geneve.ch/cepp). CEPP.
- Commission of the European Communities (2003): Evaluation report on the experimental application of a reduced rate of VAT to certain labour-intensive services, SEC(2003) 622.
- Federal Department of Finance: Consultation draft on simplification of the VAT Act. Explanatory report. February 2007.
- Federal Office of Economics and Labour, Christoph A. Müller, Study series on structural reporting (1998): Administrative burden of small and medium enterprises in an intercantonal and international comparison.
- Federal Office of Public Health (2005): Health insurance statistics. Statistics on compulsory health insurance, 2005.
- Federal Statistical Office: Price effects of VAT; BFS aktuell, Federal Statistical Office, December 1994.
- Federal Tax Administration: Inspection concept of the VAT Inspectorate. Final report of the working group, 9 September 2002.
- Fifth report of the Federal Council to the Federal Assembly on measures taken pursuant to the extraordinary powers, 4 November 1941.
- German Federal Court of Auditors: Mitteilung an das Bundesministerium der Finanzen über die Prüfung: Anwendung des ermässigten Umsatzsteuersatzes in der Fast-Food-Gastronomie, 19 May 2006.
- Ireland, Commission on Taxation, Third Report: Indirect Taxation (Dublin: Stationery Office, 1984), Appendix 9.
- Kleven, Henrik J.; Richter, Wolfram F. and Sorensen, Peter B.: Optimal Taxation with Household Production; Mimeo, 1999.

KPMG and University of Zurich, Institute for Accounting and Controlling: Management der Mehrwertsteuerrisiken. Eine Bestandesaufnahme bei Schweizer Unternehmen anlässlich 10 Jahre Mehrwertsteuer, Zurich 2004; www.kpmg.ch/library/publikationen_studien/121275.asp.

Mottu, Eric: Progressivité de l'Impôt Fédéral Direct et de la TVA en Suisse, Schweizerische Zeitschrift für Volkswirtschaft und Statistik, 133, 1997, p. 709 - 740.

National Audit Office of the Republic of Lithuania (2006): Public Audit Report on the Application of reduced Value-Added Tax Rates.

OECD (2001): Businesses' Views on Red Tape. Administrative and regulatory burdens on small and medium-sized enterprises.

OECD: Value-Added Taxes in Central and Eastern European Countries. A Comparative Survey and Evaluation; Paris 1998.

Rambøll Management (2007): Messung der Bürokratiekosten der Mehrwertsteuer-Gesetzgebung auf Basis des Standard-Kostenmodells, commissioned by the State Secretariat for Economic Affairs (SECO), <http://www.seco.admin.ch/themen/00374/00459/02118/index.html?lang=de>

Report of the Committee for Economic Affairs and Taxation of the National Council of 29 August 1996, BBl 1996 Vol. V p. 713 et seq.; on the VAT Act of 2 September 1999.

Report of the Federal Council on Improvements to VAT (10 Years of VAT), Berne 2005.

Second report of the Federal Council on the audit of federal subsidies (second draft for agency consultations).

Swiss Federal Audit Office: Federal tax subsidies. Audit of reports by the Federal Finance Administration, 5/2005.

Swiss Federal Audit Office: VAT inspections. Evaluating the strategy, implementation and results of external inspections, 2005.

The World Bank and PricewaterhouseCoopers (2006): Paying Taxes, The Global Picture. <http://rru.worldbank.org/paperslinks/open.aspx?id=7381>

Literature

Agha, Ali and Jonathan Haughton (1996): Designing VAT Systems: Some Efficiency Considerations. In: Review of Economics and Statistics, 78, 303 - 308.

Bauer, Tobias, Strub Silvia, Stutz Heidi (2004): Familien, Geld und Politik. Research project 4045-59627 as part of NRP 45.

Bogetic, Bogetic and Fareed Hassan (1993): Determinants of Value-Added Tax Revenue. A Cross-Section Analysis. World Bank, Working Papers.

Camenzind, Alois / Honauer, Niklaus / Vallender, Klaus A.: Handbuch zum Mehrwertsteuergesetz (Mehrwertsteuergesetz), 2. A. Berne/Stuttgart/Vienna 2003.

Carey, D., K. Gordon, and P. Thalmann (1999): Tax reform in Switzerland. OECD Economics Department Working Papers, No. 222.

Cnossen, Sijbren (2002): Tax Policy in the European Union.

Cnossen Sijbren: Global Trends and Issues in Value Added Taxation; OCfEB Research Memorandum 9802, 1998.

Cnossen, Sijbren (1998): VAT in CEE Countries: A Survey and Analysis. In: De Economist 146, No. 2.

Colombier, Carsten: Gefährdet die Aufhebung des VAT-Sondersatzes die Wettbewerbsfähigkeit der Schweizer Hotellerie? In: Die Volkswirtschaft. Das Magazin für Wirtschaftspolitik 3 / 2003.

Egger, Daniel J.: Papierkrieg führt zu dramatischen Problemen. Die Flut an Vorschriften droht KMU zu ertränken.

Evans, Christopher Charles (2003): The operating costs of taxing the capital gains of individuals: a comparative study of Australia and the UK, with particular reference to the compliance costs of certain tax design features.

Federal Statistical Office: National index of consumer prices in January 1995. Press release 07/95, February 1995.

Federal Statistical Office: Press release on the national index of consumer prices, November 1995.

Federal Statistical Office: Price statistics 1999. Inventory of policy measures relevant to price.

Federal Statistical Office: Statistical Data on Switzerland 2007.

Federal Tax Administration (2005): The Value Added Tax in Switzerland 2002 - 2003 (VAT Statistics).

Frei, Benno (2002): Das Mehrwertsteuergesetz (VATG). Handbuch für die Praxis, Berne.

GastroSuisse: Branchenspiegel 2006.

GDI Gottlieb Duttweiler Institute (2005): Detailhandel Schweiz 2015. Trends - Szenarien - Perspektiven: Wo stehen wir in 10 Jahren? Mit Unterstützung von Coop, Denner, Manor, Migros-Genossenschafts-Bund, Valora Gruppe, Rewe Schweiz, Promarca. GDI study no. 23.

Gottfried, Peter und Wiegand, Wolfgang: Exemption versus Zero Rating; Journal of Public Economics, 46, 1991, p. 307 - 328.

Haniotis, Tony: Steuerinzidenz: Ein Überblick; Eidgenössische Finanzverwaltung, Mimeo., 18 January 2001.

Homburg, Stefan: Allgemeine Steuerlehre, 2nd edition; Munich: Vahlen, 2000.

Howard, Christopher (1997): The Hidden Welfare State. Tax Expenditures and Social Policy in the United States.

Kocher, Martin (2005): Tafelkommentar zum VATG, Berne.

Mollard, Pascal: Histoire de la TVA: les étapes de la genèse. In: Revue de droit administratif et de droit fiscal, RDAF, 1997, p. 1 - 32.

Neue Zürcher Zeitung, 27 September 1996, p. 15: Hotelpreise sinken trotz Steuerreduktion nicht überall. Umfrage der Nachrichtenagentur AP.

Schafroth, Gerhard: "10-Punkte-Fitnessprogramm für die VAT-Verwaltung". In: Schweizer Treuhänder 12/05 (p. 1072 - 1074).

Sonntagsblick, 29 September 1996: Hoteliers geben nicht weiter. Umfrage zeigt: Gäste gehen oft leer aus.

Spicher, Beat and Fischer Claudio: Vereinfachungen der Mehrwertsteuer: Grundlinien und Auswirkungen. In: Die Volkswirtschaft. Das Magazin für Wirtschaftspolitik 4 - 2007, p. 59.

Spycher, S. (2003): Kopfprämien oder einkommensabhängige Prämien? Grundsätzliche Überlegungen aus schweizerischer Sicht.

Weisbach David A. and Nussim Jacob: The Integration of Tax and Spending Programs. In: John M. Olin Program in Law & Economics Working Paper, n° 194 (2d series), University of Chicago, September 2003.

Annex 2 : Development of the VAT Act revision

The draft law circulated for consultations on 14 February 2007 is based on extensive preliminary work. Relying on the results of a broadly based survey conducted by the Federal Tax Administration (FTA) among businesses, academia, and tax authorities, the Federal Council published its report on "10 Years of VAT" in January 2005 (available in German at www.estv.admin.ch, Dokumentation, Zahlen und Fakten, Berichte, Bericht des Bundesrates über Verbesserungen der Mehrwertsteuer).

At the beginning of November 2005, Minister of Finance Hans-Rudolf Merz commissioned the tax expert Peter Spori, in cooperation with the Federal Tax Administration, to assess the needs and options with respect to a comprehensive VAT reform and to research how the VAT system can be simplified. Peter Spori presented his report in May 2006.

On the basis of these reports, the Federal Tax Administration prepared a draft law with input by external experts and circulated it for consultations from February to the end of July 2007. The extensive content of the proposal consists primarily of the following three modules:

- Under the Tax Law module, the VAT Act would undergo revisions with respect to more than 50 substantive points, and its systematic structure would be simplified. This is intended to improve legal certainty and reduce formalism.
- The Uniform Rate module envisages that, instead of the three existing tax rates, a budget-neutral uniform rate of 6% will be introduced and 20 of 25 exceptions will be eliminated, thereby removing many problems of demarcation and reducing the administrative burden. Under this new rate, goods previously taxed under the existing normal rate of 7.6% would be taxed somewhat less heavily, while goods subject to lower rates or exempt goods (especially in the areas of food and health) would be taxed more heavily. The social consequences of the uniform rate would be compensated by additional reductions of health insurance premiums for basic insurance.
- Another module envisages replacing the two lower rates with a single reduced rate. This two-rate system would accept more complexity and a higher rate relative to the Uniform Rate module, so that certain products and services could be taxed at a reduced rate.

Once the evaluation of the consultation results is completed in the second half of 2007, the Federal Council will decide on the next steps and submit a message and draft law to Parliament.

Annex 3 : Study results on the execution costs for VAT and similar taxes

Year(s) under review Year of publication Author(s)	Taxes studied Country (population studied)	1. Methodology 2. Sample frame 3. Respondents, Response rate	Compliance costs of tax payers	Administrative costs of tax administrations
1978-1980, 1981, Sandford, Godwin, Hardwick & Butterworth	VAT United Kingdom (UK VAT registered traders and their advisers)	1. Documentary analysis for administrative costs; for compliance costs (a) postal survey, followed by (b) telephone and personal interviews and (c) interviews with advisers (sample and responses not published for this element) 2. a) 9,094, b) 445 3. a) 2,799 b) 263 4. a) 31% b) 59%	9.0% of revenue yield Gross compliance costs for VAT estimated as £392m in 1977-78, "exceptionally regressive in their incidence". Cash flow benefits (£73m) and managerial benefits (difficult to quantify) exacerbate the regressiveness; net compliance costs affected by size of firm, sector (relatively lower compliance costs in primary production and higher in financial and services sector), payment or repayment situation	2.0% of revenue yield 22% of compliance costs £85m Likely to be regressive
1986-87, 1989, Sandford, Godwin & Hardwick	VAT United Kingdom (registered traders)	1. Postal survey 2. 3,000 3. 680 (24%)	3.69% of revenue yield, fallen since 1977-78 Aggregate compliance costs were £791m, cash flow benefits (disproportionately enjoyed by larger firms) were £580m, net compliance costs were 1% of revenue yield; compliance costs very regressive	1.03% of revenue yield 28% of compliance costs £220m
1992-93, 1994, National Audit Office	VAT United Kingdom	1. Update of earlier VAT surveys conducted by Sandford et al. 1981 und 1989 2. not relevant 3. not relevant 4. not relevant	Compliance costs of VAT were £1.6b off set by compliance benefits (cash & management) of £750m; compliance costs regressive	25% of compliance costs £399m
2000, 2002, Hasseldine & Hansford	VAT United Kingdom (tax payers)	1. Postal survey 2. 6,232 3. 1,449 (23%)	Increased compliance costs are associated with increased turnover, newly registered businesses, increased complexity and perceived psychological costs; no significant differences in patterns of core compliance costs and planning costs; businesses with computerised systems faced relatively higher compliance costs than businesses with manual procedures	Not addressed

Year(s) under review Year of publication Author(s)	Taxes studied Country (population studied)	1. Methodology 2. Sample frame 3. Respondents, Response rate	Compliance costs of tax payers	Administrative costs of tax administrations
1984, 1985, Arthur Anderson & Co. for the Department of Finance, Canada	Federal sales and excise tax, Canada (Canadian businesses)	1. Documentary analysis for administrative costs; for compliance costs (a) face to face interviews (using survey instrument) with large firms (b) postal survey for other firms 2. (a) 76 (b) 1,600 3. (a) 36, 47% (b) 171 (11%)	7.56% of revenue yield C\$731.4m Significant variation depending on size of firm, with compliance costs being higher for smaller firms	0.8% of revenue yield C\$76.4m 11% of compliance costs
1984, 1985, Arthur Anderson & Co. for the Department of Finance, Canada	Ontario retail sales tax, Canada (Ontario businesses)	1. Documentary analysis for administrative costs; postal survey for compliance costs 2. 600 3. 43 (7%)	5.85% of revenue yield Significant variation depending on size of firm, with compliance costs being higher for smaller firms	0.6% of revenue yield C\$39.9m 10% of compliance costs
1993, 1993, Plamondon	Goods & Sales Tax, Canada (Canadian small businesses)	1. Interviews (face to face) conducted by accountants with questionnaire 2. 200 3. 200 (100%)	Compliance costs were not as high as previous studies had shown, but were regressive; businesses using computers for accounting routines had compliance costs 20% to 40% lower than those operating manually	Not addressed
1995, 1995, Plamondon	Goods & Service Tax GST (Quick method of accounting for GST), Canada (Canadian small businesses)	1. Interviews (face to face) conducted by accountants with questionnaire 2. 200 3. 200 (100%)	Small businesses were not using the Quick Method of Accounting for GST due to a lack of awareness; those who knew of it but did not use it were not overly concerned about compliance costs; savings in tax were more important than savings in compliance costs	Not addressed
1990-91, 1993, Pope, Fayle & Chen	Wholesale sales tax Australia (Australian businesses)	1. Postal survey 2. 2,467 3. 593 (24%)	Net compliance costs were 2.1% of revenue yield AU\$201m Compliance costs were highly regressive; Wholesale sales tax generated a cash flow cost overall rather than a benefit	Not addressed

Year(s) under review Year of publication Author(s)	Taxes studied Country (population studied)	1. Methodology 2. Sample frame 3. Respondents, Response rate	Compliance costs of tax payers	Administrative costs of tax administrations
1998-2000, 2002, Rametse & Pope	Goods and Services Tax GST (start-up costs) Australia	1. Postal survey 2. 3,199 3. 868 (27%)	Estimated GST start-up compliance costs for small businesses were AU\$7,600; this included owner/manager time of 131 hours; start-up costs were considerably higher than official government estimates	Not addressed
2004, 2005, EIM, Ministry of Finance, the Netherlands (Update of a earlier study of 1994)	VAT Netherlands	Standard Cost Model	Cost for administrating the VAT per business and year: 807 Euro Number of businesses that paid VAT: 987,000 Costs include parts of the invoicing obligation (determining VAT amount) and the customs act. The latter represents a substantial amount of total cost (approx. 1/3).	Not addressed
2004, 2005, Rambøll Management, Danish Commerce and Companies Agency	VAT Denmark	Standard Cost Model	Cost for administrating the VAT per business and year: 180 Euro Number of businesses registered for VAT: 282,723	Not addressed
2004, 2005, Rambøll Management, Ministry of Trade and Industry, Norway	VAT Norway	Standard Cost Model	Cost for administrating the VAT per business and year: 430 Euro Number of businesses registered for VAT: 258,370 - businesses that report VAT 1x a year: 84,150 - businesses that report VAT 6x a year: 173,460	Not addressed
2004, 2005, Rambøll Management, Swedish Business Development Agency	VAT Sweden	Standard Cost Model	Cost for administrating the VAT per business and year: 344 Euro Number of businesses registered for VAT: 836,141 - businesses that report VAT 1x a year: 471,933 - businesses that report VAT 12x a year: 364,208	Not addressed

Year(s) under review Year of publication Author(s)	Taxes studied Country (population studied)	1. Methodology 2. Sample frame 3. Respondents, Response rate	Compliance costs of tax payers	Administrative costs of tax administrations
1998, 1998, Müller, Swiss Institute for Industrial Economy of the University of St. Gallen, Federal Office of Economics and Labour, Switzerland	17 labour + social law provisions in Switzerland , 16 tax and duty provisions in Switzerland , including VAT Four reference countries: Germany, UK, Netherlands, Austria	1. Postal survey among 5,349 small and medium enterprises, time measurements among control group of 38 SMEs over 6 – 8 weeks 2. 5,349 / 38 3. 166 (3%) / 18 (47%) Comparison with UK not possible because questionnaire not returned	7.2% of revenue yield for SMEs, 1.3% of revenue yield for large enterprises 8.5% of revenue yield for all taxable enterprises (estimate according to consultation draft for simplification of the VAT Act, p. 279) 4.1h work per month and SME for VAT. Not included are expenditures for customs, VAT reimbursement, archiving, consultation of accountants and tax consultants. The study considers accounting as an administrative expense, however, which leads to an overestimate of the costs. Accounting is primarily used to demarcate private demands.	Not addressed
2006, 2006, World Bank and PricewaterhouseCoopers LLP	Basically all taxes and mandatory social insurance contributions in 175 countries	1. Survey, supplemented by additional data sources 2. 175 countries 3. 175 (100%)	Costs for VAT in Switzerland : 1 day per year and taxable enterprise; <i>assuming 9h and EUR 44, this is equivalent to EUR 400, which is about 1/4 below the Rambøll estimate for average taxpayer.</i> (only very strongly generalised result, due to broad spectrum of topics and very high number of countries)	Not addressed
2007, 2007, Rambøll Management, State Secretariat for Economic Affairs (SECO), Switzerland (interim report, May 2007)	VAT, Switzerland	Standard Cost Model	2.7% of revenue yield - average cost per taxpayer EUR 544 - taxpayers using effective calculation EUR 713 - taxpayers using balance tax rate EUR 226 costs due to information requirements approx. EUR 170,000,000 <u>additional costs for various processes</u> approx. EUR 150,000,000 total costs approx. EUR 320,000,000 - additional costs due to lower VAT rates approx. EUR 36,000,000	Not addressed

CONCLUSION: For **Switzerland**, the SECO/Rambøll Management study currently represents the most reliable estimate, since it is up-to-date and only estimates VAT costs in Switzerland. The considerably higher costs according to the estimate by Müller in 1998 could be partially due to an actual decrease in costs; for instance, the VAT administration costs of enterprises in the UK decreased from 9% of revenue yield to 3.69% of revenue yield from 1978-80 to 1986-87. Due to the very low response rate and the very broad range of topics in the Müller report, the question also arises a) whether the VAT-relevant results may be inflated because of a low number of especially cost-conscious SMEs responding, and b) how many of the 18 participating control group members actually dealt with quarterly or half-yearly (balance tax rate!) VAT accounting over the measurement period of 6-8 weeks.

Annex 4 : Additional costs of lower tax rates + total costs of VAT for the FTA and taxpayers

	Administrative costs of the Federal Tax Administration	Compliance costs of the 310,000 taxpayers 49% taxed at normal rate, 1% taxed at reduced rate 33% taxed at balance tax rates and lodging rate, 12% taxed at several legal tax rates, 6% with no tax on turnover ⁶⁹
Additional costs due to lower tax rates, annually recurring	EUR 28,000,000 Tax loss due to misclassifications of lower VAT rates EUR 5,000,000 to EUR 8,000,000 10% to 15% of workload in the VAT Division of the Federal Tax Administration ⁷⁰	EUR 36,000,000 Additional costs due to lower tax rates, corresponds to 12% of total taxpayer costs ⁷¹
Total costs of VAT, annually recurring	EUR 53,000,000 Personnel, material, and investment costs of the VAT Division of the Federal Tax Administration ⁷²	EUR 320,000,000 Total for all taxpayers ⁷³ EUR 713 per taxpayer using effective calculation EUR 226 per taxpayer using balance tax rates

⁶⁹ Federal Tax Administration (2005): *The Value Added Tax in Switzerland 2002 - 2003*, p. 25.

⁷⁰ Federal Department of Finance (2007): *Consultation draft on simplification of the VAT Act*, p. 169. On average, this estimate indicates that 12.5% of the staff of the VAT Division of the Federal Tax Administration is absorbed by the differing VAT rates and the differentiation between taxable and tax-exempt turnovers.

⁷¹ Rambøll Management (2007).

⁷² State Financial Statement 2006, p. 479.

⁷³ Rambøll Management (2007). The EUR 320 million are composed of EUR 170 million for the information costs under current law, plus EUR 150 million for additional costs due to various processes (consultation of a tax consultant, externalisation of accounting, VAT training, storage costs, and decision-making costs specific to individual cases).

Annex 5 : Abbreviations

AHV/IV	Old Age and Survivors' Insurance/Disability Insurance
CSSH-S	Committee for Social Security and Health of the Council of States
FDF	Federal Department of Finance
FSIO	Federal Social Insurance Office
FSO	Federal Statistical Office
FTA	Federal Tax Administration
IPR	Individual Premium Reductions
NRP	National Research Programme
SECO	State Secretariat for Economic Affairs
SFAO	Swiss Federal Audit Office
VAT	Value Added Tax

Annex 6 : Statement of the Federal Tax Administration

In the present report, the Swiss Federal Audit Office examined whether and to what extent reduced value added tax rates, especially on food, represent an efficient and effective way to achieve the envisaged political objectives, namely a reduction of the tax burden of low-income households.

The report concludes that reduced value added tax rates constitute a largely untransparent and inefficient form of subsidy and are therefore not suitable for equalising politically undesired VAT burdens.

Research on this topic conducted in other countries, most recently a study commissioned by the European Commission⁷⁴, reaches similar results. This is one of the reasons why the Federal Council proposes a model with only one VAT rate in its consultation proposal on VAT reform.

In its investigation, the Swiss Federal Audit Office primarily considers the food sector. Under current law, however, the reduced rate also applies to other goods and services, such as the sale of pharmaceuticals and of newspapers and magazines. In contrast, other goods of great importance to our society, such as clothing and furniture, as well as services relating to transport and the Internet, are taxed at the normal rate. This shows that, in addition to the efficiency of reduced tax rates, the division of turnovers into those subject to the reduced rate and those subject to the normal rate also gives rise to numerous questions and inconsistencies.

The Federal Tax Administration views the present extensive study as an important and valuable contribution to the discussion on the number and amount of VAT rates. It is pleased that the sense and utility of a radical simplification of the value added tax are confirmed by this study by the SFAO as an independent and critical body.

⁷⁴ *Copenhagen Economics: Study on reduced VAT applied to goods and services in the Member States of the European Union, 21 June 2007.*