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 (SFAO) 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 organization of the highest-level audit authorities in Europe, 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 Reduction: 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 CHF 45 million per year due to such misclassifications of turnover. Added to this are CHF 8 to 13 million for additional staff expenses in the Value Added Tax Division, 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 CHF 58 million in additional administrative costs per year 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 CHF 3 million for cantons and health insurers, under the assumption that cantons take the same approach as with existing IPRs.

Effectiveness comparison of reduced VAT rates / Individual Premium Reduction: 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.

Original text in German