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Once the ball starts rolling...
Why lack of compliance in the area of VAT and customs can also be relevant from a direct tax perspective

Authors: Christoph Drexl, Linda Graff Brakemeier, Zsuzsanna Serra, Stéphanie Fuchs, Dominique Tunesi

The Federal Supreme Court recently ordered an art collector to pay back import taxes of around CHF 11 million plus interest on arrears of around 2.5 million. However, it became really expensive for the art collector when the tax investigators of the cantonal tax office examined the files seized by customs in detail.

BACKGROUND

The background was that the import into Switzerland was carried out by a gallery that had a permit to use the postponed (import) VAT accounting procedure. Apparently wrongly, because as the court confirmed in its ruling 2C_219/2018 of April 27, 2020, only the person who has the economic power of disposal over the imported goods immediately after the import is entitled to act as importer of records. The fact that the gallery had the power of disposal over the works was denied in the present case and as a result the art collector, who actually had the power of disposal at the time in question and therefore should have acted as importer, was obliged to pay the import taxes.

THE POSTPONED VAT ACCOUNTING PROCEDURE

Under the postponed VAT accounting procedure, the importer does not pay the import tax to the Swiss Federal Customs Authorities, but declares it on a separate form as part of the corresponding quarterly VAT statement and at the same time claims it as input tax (which is why no money flows). The application of the postponed VAT accounting procedure is subject to various cumulative requirements, including that the licensee is liable to pay tax in Switzerland.

In the case under review, the art collector was not registered for VAT in Switzerland, for which reason alone he was not authorized to use the postponed VAT accounting procedure and was generally not entitled to deduct input tax.

THE "RIGHT" IMPORTER

In principle, and irrespective of the application of the postponed VAT accounting procedure, it applies on the basis of customs legislation that the only person who can be a lawful importer is the person who can economically dispose of the imported item immediately after importation. In concrete terms, this means that the importer must be entitled to consume or use the item himself or to resell it in his own name (e.g. as part of a commission transaction). Or as the ECJ puts it: economic power of disposal means being able to dispose of an object like an owner.

In the present case, the gallery used its authorization to apply the postponed VAT accounting procedure for the import of the various works of art and thus acted as importer of records. In order to prove that it also had the power of disposal, it referred to various commission agreements according to which the gallery was to resell the works in its own name. However, the Federal Supreme Court considered it proven that these commission contracts were merely simulated, essentially with the aim of being able to illegally use the authorization for the gallery to apply the postponed VAT accounting procedure for the import of the works (and thus not only to profit from the cash flow advantage, but also from the fact that the gallery reclaimed the import taxes as input taxes - and thus, as a result, the state was deprived of the VAT).

THE STONE STARTS ROLLING

After the Federal Customs Administration questioned the taxpayer in connection with the importation of these art objects, it also confiscated extensive files. Based on a request for administrative assistance, these documents finally ended up in the hands of the cantonal tax office. In the course of their analysis, the cantonal tax office later determined that the taxpayer's activities qualified as commercial art trading and that his profits from the sale of art objects should have been subject to income tax as income from self-employment. As a result of this, the cantonal tax office opened supplementary and penalty tax proceedings against the taxpayer in the amount of approximately CHF 270 million, which was ultimately confirmed by the Federal Supreme Court (2C_799/2017, 2C_800/2017).

Despite its central importance, the concept of self-employment is not regulated either in the Federal Law on Direct Federal Tax or in the Federal Law on Tax Harmonization. Rather, the case law of the Federal Supreme Court must be relied upon in this regard. In contrast to hobby, self-employment is generally assumed to exist in situations where there is an intention to make a profit, i.e. the aim of making a profit by providing services to third parties against payment. Further factors that are examined by the tax authorities with regard to self-employment are the use of labor and capital, the activity at one's own risk, the exercise of the activity in a freely chosen organization, the participation in economic transactions as well as the planned and permanent activity. On the part of the taxpayer, it is advisable to keep an eye on the various determining factors and to regularly check whether they are fulfilled. In the present case, the decisive factors for the assumption of self-employment are, on the one hand, the employment of personnel and, on the other hand, the

presence of comprehensive office infrastructure, as well as the control and management of foreign, partly insubstantial companies.

CONCLUSION

This case shows, on the one hand, the importance of careful (and in this case also truthful) documentation and internal organization of certain processes related to VAT. With the necessary compliance structures and an ICS (Internal Control System) for VAT, the risks of incorrect application of a legal procedure or systemic wrong decisions could be reduced. After all, it does not always have to be criminal energy that leads to considerable VAT offsets. It is sufficient, for example, that the legitimate importer of records is accidentally not recorded in order to have serious consequences. In this context, this case illustrates the central importance of constant monitoring of the factors that distinguish hobby from self-employment for direct tax purposes.

On the other hand, this case vividly illustrates that authorities do not only fulfill their own tasks. In this case, the interdepartmental cooperation between the customs administration, the VAT authorities and the cantonal tax office had far-reaching consequences. By way of administrative assistance, the effectiveness of individual tax audits can be extended to other tax areas of a tax subject. An isolated examination of individual tax types without a view of the entire tax situation, as could be achieved with a comprehensive ICS - be it at the level of an individual or a company - can therefore lead to a spiral of tax consequences or reclassifications and offsets, as in the present case. It is therefore all the more important to assess relevant transactions holistically.