



SVENSKT NÄRINGSLIV

# Is VAT a consumption tax or a corporate tax?

Summary

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# Summary

Value Added Tax or VAT is what is usually referred to as an indirect tax. This means that the tax burden is borne by someone other than the person who pays the tax to the state, ie. is tax liable. At the EU level, VAT is directly expressed as a consumption tax (ie. the purpose is to tax consumption). In Sweden, this is expressed indirectly in the preparatory works for the VAT Act (*Mervärdesskattelagen, 1994:200*). Comparing the VAT with income tax, VAT can be said to tax actual consumption, whereas income tax the ability to consume.

For VAT to be considered as a consumption tax, it is required that the tax burden can be passed on from those who are tax liable, ie. pay the tax to the state, to what is to be considered as consumption. Private consumption done by consumers is commonly referred to as consumption, but there may also be other players in the market who, for various reasons, are considered to fall within the scope of what constitutes consumption. Taxable persons eligible to pay VAT to the state are primarily companies, those who conduct economic activities. In order to achieve a transfer of the tax burden from the taxable persons to those who consume; technical legal solutions are used, such as deductions for input VAT and the right to a refund of input VAT for those taxable persons who carry out economic activity by selling taxable goods and services.

This report identifies the purposes of the Swedish VAT Act and its preparatory work to determine if the Swedish VAT can be regarded as a consumption tax, ie. that the burden of the tax can be passed on from those who are taxable to the consumer. The object or purposes of VAT have been discussed before, in terms of whether it is to be regarded as a consumption tax or corporate tax. If legal preconditions for passing the tax burden are wholly or partly lacking in various areas, the question arise whether VAT is to be considered as a corporate tax instead of a consumption tax, or a hybrid where one part of the tax burden is carried by companies and one part of the tax burden is carried by those who consume. In that case, VAT is both a consumption tax and a corporate tax.

Whether the cost of input VAT actually can be passed onto the consumer is affected by the market where the company is located and the price elasticity of the goods and services it provides. In such an assessment, the design of the business models needs to be taken into account because a taxable consideration entails a requirement that the compensation received has a direct connection with the product or service sold. What can be transferred financially, however, is not covered by the report.

After a review of all bills to the Swedish VAT Act, one conclusion is that the objectives with the legislation often is indirectly expressed.

The focus in the preparatory works is instead on explaining the substantive meaning of the provision that is amended or added to the law. Also, several changes and amendments have been made to the Swedish VAT Act and no fundamental review considering the underlying principles of the VAT has been made of the Swedish VAT Act, not even in connection with the EU accession. One important recommendation made in this report, is that a fundamental review of the Swedish VAT Act is needed in order to simplify and clarify the legislation which is technically complicated. Such a fundamental review needs to implement the underlying principles at both EU and national level. Complicated legislation may be ineffective, which means that it costs more for companies and the state to administer and fulfill obligations that follow from the legislation. It is also easier to make mistakes if a law is complicated, which leads to increased compliance costs. It can also be argued that a fundamental review is needed to achieve greater compliance with EU law as the same basic foundation exists, but principles are given different meanings and function in the application of the law. Hence, the different parts of the VAT system need to be placed in a VAT-based context in relation to the basic purpose of only taxing value added in order to tax actual consumption. The design of the preparatory works also affects the courts' interpretation and application of the provisions. Another recommendation is therefore to clarify the purpose of the Swedish regulations and their relationship to the purposes of the corresponding EU legal provisions.

All cases from the Supreme Administrative Court (HFD) regarding the Swedish VAT Act have been analyzed until 1 January 2015, which induce one important conclusion drawn in the report that the court often uses an EU conform interpretation, but that does not mean that the purpose of the Swedish provision is set in relation to the purpose of the EU legal provision. Instead, the starting point is whether Swedish law leads to a substantive result that complies with the EU law or not. Compared with the European Court of Justice's methods of interpretation, an important difference is that the European Court of Justice considers, to a large extent, both the context of the provision and its purpose. This difference leads to parallel legal developments at national level and EU level as the methods of interpretation used by the European Court of Justice and the HFD differ. One consequence of parallel legal developments may be that a provision is applied in a way that over time contradicts its purpose in terms of how the provision was originally intended to function within the VAT system, for example a too broad or narrow interpretation of the right to deduct can lead to distortions of competition and problems with the shifting of the tax burden. A fundamental review of the Swedish VAT Act could counteract this, as such a review can observe the problems following from parallel legal developments and maintain the constitutional requirements imposed on tax legislation. Examples of when the issue shifting the tax burden is raised in practice are the cases of permanent residence (*stadigvarande bostad*) as a Swedish VAT concept delimiting the scope of the right to deduction of input VAT and the cases in Swedish courts following the *Graphic Procédé* – case.

The various objectives that have been identified in the preparatory works to the Swedish VAT Act are summarized in the checklist below. It is based both on the general justifications and the specific justifications for various provisions found in the preparatory works. The checklist is not an order of priority of which purposes

that are more important than others. However, what is discussed in the conclusions of the report is whether a VAT has only one purpose or more. The only purpose could be purely fiscal, to tax the added value in each step of the production- and distribution chain and thus create tax revenue for the state. The remaining purposes may then be complementary or conflicting.

Identified purposes:

- 1) VAT is a value added tax, which means that the basic structure of the tax must enable taxation of the value added at each stage of the production and distribution chain.
- 2) According to the VAT principle, the tax should not lead to cumulative effects or hidden VAT.
- 3) VAT should not distort competition, ie. neutrality aspects must be considered in the design and application of the tax.
- 4) VAT must be economically efficient (bring in more funds to the state than it costs to administer and comply with, or fulfill), lead to securing employment and promoting production (has also been expressed in terms of VAT promoting a cyclically stabilizing economic policy and promoting economic progress).
- 5) VAT must be adapted to EU legislation.
- 6) VAT should be a general tax with few exceptions and special schemes (has also been expressed in terms of that VAT should contain few indirect or hidden subsidies).
- 7) VAT is intended to promote the Swedish business community's international competitiveness (mainly refers to how VAT is technically imposed or deducted on import and export).
- 8) VAT should not lead to double taxation or non-taxation (counteracts the basic principle of value added taxation at every stage of the production- and distribution chain and that the tax should be generally designed).
- 9) VAT must lead to a rational tax result.
- 10) VAT must be easy to apply or practically applicable and controllable (the latter means, for example, that special schemes are justified by technical difficulties).
- 11) VAT should reduce the risk of tax evasion balanced against not taxing more than the value added (also expressed in terms of preventing tax evasion or abuse such as VAT fraud).
- 12) VAT should not make housing more expensive, but should charge private living costs.
- 13) VAT should not lead to liquidity strains.
- 14) At the EU level, economic efficiency is taken into account on the basis of the EU as a whole, in terms of established or non-established companies, but not from a national perspective found in Sweden.

The report states that there are contradictions between several of the listed purposes. Discussion of these contradictions is often lacking in the preparatory works.

In addition, VAT is technically complicated. There are several cross-references at different levels, both between paragraphs within chapters and between chapters as well as references to other laws. Complex legislation makes it difficult to achieve several of the objectives and, among other things, makes it difficult to interpret and apply.

The degree of cross-border co-operation in both trade and legislation raises further problem areas that the court must ultimately decide on in individual cases. The international coordination that takes place through the OECD's work with international guidelines and the ongoing harmonization work within the EU has different effects both in the legislative process and in the interpretation and application of the regulations. For example, EU directives are binding regarding the result to be achieved and one thesis is that this affects HFD's use of an EU conform interpretation and that this to such an extent is aimed at the substantive result. If the corresponding substantial results are achieved with the Swedish provision as the EU legal provision, Sweden is considered to fulfill its obligation following from EU law.

Another difficulty for courts to deal with is that the facts of the cases have also become more complex due to increased cross-border trade patterns, new business models and payment methods. A more principled and systematic argumentation for reasons of judgment could justify and clarify why deviations from taxing the value added are carried out, which would increase transparency and possibly also the predictability for taxpayers.

The contradictions that have been identified between the purposes are:

- 1) VAT is technically difficult, which leads to a contradiction in terms of its practical application and striving for simplicity (also expressed in terms of the fact that VAT should be easy to apply for both authorities and taxpayers).
- 2) Neutrality aspects can be downgraded based on practical reasons or "other reasons", the latter is not fully defined (the latter should also include what is referred to in later preparatory works as redistributive policy purposes). The influences on neutrality distortions should amount to "some notable extent" which should be considered as disturbances of neutrality to a lesser extent.
- 3) Likewise, the aim of avoiding cumulative effects (thus the maintenance of a tax on value added) may be residual in relation to practical reasons and "other reasons".
- 4) As VAT must comply with the value added tax principle, there is a risk of an administrative burden that may counteract, for example, the economic efficiency of the tax and possibly also counteract production (difference between collector and taxpayer).
- 5) Difficulties in the practical application can lead to control problems, increasing the risk of abuse, fraud or tax evasion, even when these are also identified as objectives in the preparatory works. However, the risk of abuse and fraud depends not only on difficulties in practical application but also on the fact that the VAT system as such creates gaps that can be used for unjust purposes (ie. lead to an irrational tax result).

- 6) Democratic reasons and cultural policy reasons are objectives that justify deviations from the basic principles by, for example, introducing exemptions and reduced tax rates (can also be regarded as redistributive policy reasons).

According to the author, there is a call for an increased discussion and coordination of the purpose of different parts of the VAT system in order to not contradicting the functioning of the VAT, ie. to tax consumption in an economically efficient way by taxing the added value at each stage of the production- and distribution chain. At the top of the list is a desire for a fundamental reform including the underlying principles of the Swedish VAT Act.

Finally, the author also calls for an increased discussion about the objective or *objectives* of the VAT system and its various parts. How do the different parts align to achieve the objectives, or how are deviations from objectives justified due to the fact that there are built-in contradictions in the system? What principles should be taken into account when balancing conflicting interests?

An increased discussion is the basis for increasing transparency and can also be a step in an analysis of the basic functioning of VAT, ie. to tax consumption through a taxation of value added at each stage of the production- and distribution chain. If, on the other hand, the shift of the tax burden is not maintained, for various reasons, a further discussion is required as to whether VAT is a hybrid, ie. both a consumption tax and a corporate tax, a taxation with the purpose of taxing transactions constituting turnover, whether they constitute consumption or not.

Summarized recommendations are therefore to make a fundamental reform of the Swedish VAT Act. A fundamental reform means that the objectives at the Swedish level are made visible and set in relation to corresponding or conflicting purposes at the EU level. Furthermore, such a reform means that the various parts of the VAT system are clarified in relation to both the basic function and the functioning of different parts in order to simplify and clarify the Swedish VAT Act, and to systematically analyze any problems with parallel legal developments.

The report *Momsrapport – Är mervärdesskatten en konsumtionskatt eller företagskatt?* (svensktnaringsliv.se) contains the following sections (in Swedish):

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