The Exemption of Functions of Arbitration from VAT under Swiss Law

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Under the applicable Swiss law, fees and charges arising in connection with the exercise of functions of arbitration are exempted from VAT. Specifically, the respective section of Article 23(1) of the Swiss Federal Act of 2 Sept. 1999 on Value Added Tax ("VATL") reads as follows:

"[…] For services which they perform in sovereign right, the departments mentioned above, institutions, persons and organizations are not tax-liable, even if they levy fees, contributions or other charges for such services. The exercising of functions of arbitration qualifies as sovereign. […]" [non-official translation].

On 19 June 2009, the Swiss Federal Court deliberated and decided upon the scope of the exemption of arbitration from VAT liability. The underlying case was that, from October 1997, a Swiss law firm had acted as the secretariat of the Claims Resolution Tribunal for Dormant Accounts in Switzerland ("CRT-I") which was composed of a total of 17 arbitrators of various nationalities. The law firm did not add VAT to its invoices to the CRT-I for the period from 1 January 1999 to 31 December 2000 since, in its view, it was – in its function as the secretariat of the CRT-I – exercising "functions of arbitration". After conducting a tax audit, however, the Federal Tax Administration found that the work of the secretariat did not qualify as a "function of arbitration" and issued a supplemental ruling ordering the

law firm to pay VAT at a rate of 6.5 % on all amounts invoiced to the CRT-I in the relevant period (the ruling was based on Art. 17(4) of the former Ordinance on VAT which was identical to Article 23(1) VATL and – before being replaced by the latter – still in force in 1999/2000).

The law firm appealed against the supplemental ruling before the Federal Board on Tax Appeals. Before the Federal Board took a decision, the matter was transferred to the Federal Administrative Court which had been established by a new Federal Law and commenced its function on 1 January 2007. The Federal Administrative Court upheld the decision of the Tax Administration. Whereas it was undisputed that the exemption from VAT for functions of arbitration applied to the CRT-I as an independent arbitral tribunal, the Federal Administrative Court held that the law firm acting as the secretariat of the CRT-I was not part of the arbitral tribunal but rather an outsourced service provider acting on the basis of a service contract between the CRT-I and the law firm. Therefore, the law firm should have added VAT to its invoices to the CRT-I. Specifically, the Federal Administrative Court found that there was an inner, economic link between the services of the law firm and the compensation of such services by the CRT-I. In its view, the law firm rendered its services to the CRT-I rather than to the litigating parties and was, thus, neither exercising a "function of the arbitration" nor performing its services in "sovereign right".

The law firm filed an appeal against the decision of the Federal Administrative Court before the Swiss Federal Court. As in its prior appeal, the law firm argued that the secretariat was an integral part of the arbitral tribunal forming an inseparable legal, organizational, economic and practical unit with the arbitral tribunal. The law firm set forth that, since the exemption from VAT applied to all "functions of arbitration", the Federal Administrative Court was wrong in that it (restrictively) interpreted the term "sovereign right" rather than the term "functions of arbitration". Also, both the appointment of the law firm to act as the secretariat and the appointment of the arbitrators of the CRT-I were made in accordance with the rules of arbitration of the Independent Claims Resolution Foundation (which was founded for the purpose of setting up the CRT) and were, thus, to be treated consistently. There was no service contract between the CRT-I and the law firm.

Furthermore, the law firm made reference to the rules of International Arbitration Institutions enabling arbitral tribunals to appoint administrative secretaries, e.g. to

the Swiss Rules of International Arbitration as well as to the Note from the Secretariat of the ICC Court Concerning the Appointment of Administrative Secretaries by Arbitral Tribunals dated 1 October 1995 supplementing the ICC Rules of Arbitration. On this note, the law firm highlighted the importance of a clear and viable interpretation of the term "functions of arbitration", pointing out that a clear distinction between the work of arbitrators and its secretaries would prove nearly impossible from a practical perspective.

The five judges of the Swiss Federal Court, in their (public) deliberation of 19 June 2009, granted the appeal in a 4:1 vote. The specific grounds for the Court's decision are not yet published. However, the oral deliberation conveyed a first impression of the reasons leading to the majority decision. The following is a summary of the individual supporting votes:

– Both in state courts and arbitration, clerks render legal services and may have a consultative vote. They are part of the tribunal/court and, in case of arbitration proceedings, exercise "functions of arbitration". Other services (e.g. administrative services) qualify as auxiliary services which, under the VATL, are to be treated like the principal services.

– The term "functions of arbitration" may be interpreted broadly. Supporting services are encompassed by said term, regardless of whether such services are outsourced or performed by internal personnel (except for e.g. technical functions or expert services).

– The arbitrators and the secretariat were appointed in accordance with the same arbitration rules. The rules, thus, envisaged that the CRT-I was going to need secretarial infrastructure which could, according to the rules, be provided by a law firm. The services rendered by the secretariat were, thus, not genuinely outsourced.

– As opposed to judges and clerks in state courts, both arbitrators and secretaries are appointed on a contractual basis and compete with other service providers. The fact that the secretariat provided marketable services is, thus, not relevant in regard to the question whether its services qualify as "functions of arbitration".

– It is for the parties of the arbitration to define the scope of the tribunal's task and the means of its work. As far as the applicable rules allow for certain auxiliary means, such as the appointment of a secretariat, such means qualify as "functions

of arbitration".

As mentioned above, the specific reasons for the grant of the appeal are not yet published. Also, the particular setting of the case certainly differs from common arbitration cases. Nevertheless, very generally, the decision of the Swiss Federal Court appears appropriate with a view to the handling and the predictability of the exemption of arbitration from VAT liability in Switzerland. Also, the Court's interpretation of the VAT exemption may be seen as a commitment to the importance and the future role of arbitration within the legal system in Switzerland.

The VATL will be subject to considerable changes in the near future. Although the exemption of arbitration from tax liability will no longer be resulting from a fiction of sovereignty, the exemption will, in principle, persist. With a view to the specific functions being exempted from tax liability under the new VATL, the accompanying report of the Federal Government sets forth that any legal advice rendered for the purpose of settling disputes qualifies as a "function of arbitration". Whereas such definition seems to promote a broad interpretation of said term on the one hand, it might also entail further discussions, in particular with regard to the exemption of services rendered in connection with alternative dispute resolution methods, on the other hand.

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