



European Economic and Social Committee

ECO/113
VAT - postal sector

Brussels, 10 December 2003

OPINION

of the European Economic and Social Committee

on the

**Proposal for a Council Directive amending Directive 77/388/EEC as regards
value added tax on services provided in the postal sector**

COM(2003) 234 final - 2003/0091 (CNS)

On 13 May 2003 the Council decided to consult the European Economic and Social Committee, under Article 262 of the Treaty establishing the European Community, on the

Proposal for a Council Directive amending Directive 77/388/EEC as regards value added tax on services provided in the postal sector
COM(2003) 234 final - 2003/0091 (CNS).

The Section for Economic and Monetary Union and Economic and Social Cohesion, which was responsible for preparing the Committee's work on the subject, adopted its opinion on 26 November 2003. The rapporteur was **Ms King**.

At its 404 plenary session (meeting of 10 December 2003), the European Economic and Social Committee adopted the following opinion by 101 votes in favour and 4 votes against, with 6 abstentions

1. **Commission's proposal – background**

1.1 The European Commission proposes to amend the Sixth VAT Directive by making services provided by the postal sector subject to VAT. Postal services are exempt from the Sixth VAT Directive dating from the 1970s.

1.2 The reason for this exemption is two-fold:

- firstly, they were seen as part of the state-funded activities in the public interest for which the VAT system has always included a series of exemptions;
- secondly, when the VAT system was established, the postal sector was characterised by monopolies and a limited range of services. These postal services were not subject to any competition.

1.3 VAT is a tax on consumer spending and not on the goods and services a commercial enterprise buys as part of its profit-making activities. Since no distinction is made as whether the purchaser is a private person or a business, the business purchaser reclaims the VAT via the tax authorities.

1.4 Certain sectors are exempted which means these do not have to pay VAT on their receipts but it also means that VAT paid on products and services purchased cannot be reclaimed. So, although no VAT is charged on sales, the customer pays VAT on the purchases made by the exempt suppliers (i.e. the non-reclaimed VAT), which is "hidden" in the sales price.

1.5 This exemption gives a competitive advantage to the public postal sector when selling to customers who are not able to claim back VAT - such as individuals, financial institutions and non-profit organisations – as these customers will benefit from a lower price despite the hidden tax. The

Committee has produced the Appendix - compare situation 2 columns (c) and (e) with situation 3 columns (f) and (h).

1.6 Public postal sector operators have a competitive disadvantage when selling to VAT registered businesses when compared to the private sector. This is because although the overall price of the private operator may be higher, the business customer can reclaim the VAT which generally results in a lower net cost to the business. This is illustrated in the Committee's Appendix – compare situation 2 column (d) with situations 3 column (g) and 4 column (j). Where a taxable business is the consumer of an exempt supply it will incur costs from the exempt business that will include hidden VAT which it will be unable to deduct. The result is higher costs to the taxable business. When this taxable business charges VAT on its own sales, the value-added calculation will include the hidden VAT in its tax base. As a result the final consumer will pay more tax, as it will pay VAT on the hidden VAT. The Commission estimates that this type of business is currently responsible for just over 60% of the public postal operators' turnover for mail services within the European Community.

1.7 The public operators have two further disadvantages as a result of the exception in that their inability to reclaim the VAT on the purchases of goods and services discourages investment and favours self-supply. An example of self-supply given by the Commission is the Royal Mail in the UK, that recently decided to stop using rail services, and to transport the mail by road with its own fleet of lorries.

2. Commission's proposal - recommendations

2.1 The Commission states that the situation described above where the public and private operators are not able to compete effectively in all markets – due to the exemption – is increasingly hard to justify as public and private operators as well as customers are all disadvantaged in one way or the other. This also regularly gives rise to complaints on the part of both private and public operators.

2.2 The Commission is therefore proposing to end the exemption, with the result that postal services should in future be subject to VAT. The Commission realises that making all postal services subject to the normal VAT rate would mean that prices for private customers would rise substantially, even if not to the full extent of that normal rate (as postal operators would themselves be entitled to reclaim input tax).

2.3 To limit the impact on the consumer the Commission proposal contains an option for the Member States to introduce a reduced VAT rate for standard postal services – addressed envelopes and packages with an individual weight of no more than 2 kg per item. This range would also cover a part of the commercial postal service. As the Committee's Appendix demonstrates the impact in terms of price increases to consumers would be negligible. This is so because once the postal operators are subject to VAT, they will also be able to reclaim input VAT paid thus lowering their overall costs. The Commission estimates that, on average, costs will go down by some 4.2%

even taking account that wage and related costs account for 40-60% of total costs, depending on country.

2.4 For non-standard services, services relating to unaddressed mail and services relating to items greater than 2 kg the Commission is proposing that these should come under the normal VAT place-of-supply rules for transport services and will therefore be ineligible for reduced rate.

3. General comments

3.1 While the EESC agrees with the Commission that exemption of public-sector postal services is creating distortions in a situation where these services are increasingly being liberalised in a number of Member States, it also notes the Commission has made no reference to the vital social role of stamped mail and other postal services as stipulated in the universal postal provision each Member State has a statutory requirement to provide. This means that an affordable postal service must be available to all – including those in geographically remote areas.

3.2 Therefore the Committee strongly believes that the impact on the consumer in terms of affordable postal services and the universal commitment must also be given equal priority. Although the 2 kg weight limit goes some way to address this the EESC feels this should be made more explicit and that the Council need to ensure that private individuals do not face any price increases for postal services, with the removal of the VAT exemption.

3.3 To ensure that any price increases are negligible, the EESC proposes that each Member State should aim to choose the rate that ensures that the removal of the exemption has no impact on the private consumer of postal services.

3.4 The EESC recognises that if no action is taken in the legislative field, that VAT at the standard rate could be imposed by the European Court of Justice. This is because the Court presently is considering how the current exemption should be interpreted in an ever more liberalised postal market. Of particular interest is case C-169/02 *Dansk Postordreforening v. Skatteministeriet* where Advocate General Geelhoed recently concluded that:

“A Member State is required to levy VAT on services which are not ‘reserved’ under Article 7 of Directive 97/67/EC /.../. The concept of ‘public postal services’ used in Article 13(A)(1)(a) of the Sixth Directive 77/388/CEE/.../ must be interpreted as applying equally to commercial undertakings, in so far as they have services reserved for them as described in Article 7 of Directive 97/67.”

If that line is followed by the Court in its judgement, it would mean that everything that falls outside the reserved area in the individual Member States would thus, taking into account the direct and immediate effect of the jurisprudence of the Court, be subject to VAT at the standard rate.

4. Specific comments

4.1 The EESC notes that taxation of private-sector operators while exempting the public sector infringes the principle of neutrality, which is one of the merits of VAT. However, the EESC strongly believes it is important that there is no price increase and no reduction in the universal commitment for consumers of postal services.

4.2 The Committee is concerned that the introduction of the full taxation at the standard rate could lead to price increases to private consumers and exempt organisations.

4.3 The Committee welcomes the solution to provide for the possibility of a limited reduced VAT rate for letters and small packages as it would mean no price increases for those persons and organisations that do not have a right of deduction.

4.4 The Committee however does not agree that *"it does not matter that the reduced rate is also available to business"* as financial and insurance companies will continue to be exempt which means end-consumers for these services will continue to pay more tax, by having to pay the hidden VAT of these companies.

4.5 Ideally the EESC would prefer that the removal of the VAT exemption should coincide with the complete liberalisation in this sector.

4.6 The Committee welcomes the proposal that all postal services concerning all addressed items weighing 2 kg or less will have a special place-of-supply-rule minimising the impact on both the final consumers and the control systems.

4.7 The EESC accepts that non-standard services (e.g. express mail) and services relating to items greater than 2 kg will come under the normal VAT place-of-supply-rules for transport of goods and will be ineligible for reduced rate as they are more generally services supplied to business customers and is the area where most of the competition is focussed.

4.8 However, the Committee does not agree that services relating to unaddressed mail should be ineligible for the reduced rate. There is no reason for such a distinction. In the case of certain Member States, charities send direct mail as a key method for recruiting new donors and monies for their charitable causes. As charities are exempt this would significantly increase their postal costs. Secondly this may place an undue burden and complication on the postal service, therefore contradicting the Commission's statement *"to simplify control systems"*.

4.9 The Committee accepts the general provisions that postal services should be treated as a single supply of transport services and that stamps will be treated as evidence of advance payment.

4.10 However, the proposal that the supply of stamps for philatelic purposes should be a supply of goods at the standard rate needs to recognise that this can only apply to first day covers or if the philately is sold from a dedicated area. Otherwise there would be a heavy and unacceptable burden placed on the postal sector to identify and separate philately purchases from other over-the-counter stamp purchases.

5. Conclusions

5.1 The EESC strongly believes that the Universal Postal commitment guaranteeing affordable postal provision for all must be safeguarded and be given the same importance as the removal of competitive distortions in the postal market. The EESC also strongly believes that the removal of the exemption should have no impact on the private consumer of postal services.

5.2 The Committee welcomes the recommendation to introduce a reduced rate for standard postal services but has the misgiving that some Member States may not do this.

5.3 The Committee believes that any temptation for postal authorities to use the ending of exemption as an excuse for increasing postal charges would be resisted by the regulator.

5.4 The Committee accepts the Commission's proposal for postal services for packages greater than 2 kg.

5.5 The EESC agrees with the paragraphs covering the treatment of terminal dues and the treatment of reply-paid mail.

5.6 The Committee is concerned about the proposal for the special tax accounting scheme for postal operators that would require them to account for VAT at three levels (standard rate, reduced rate and zero-rated). The Commission is recommending that each Member State should tailor its own alternative method to work out the amount of VAT due from its postal operations.

5.7 From past experience the Committee knows that bespoke Member State solutions can often lead to confusion, divergence and inconsistency within the Community. Even if each Member State introduces a system that works perfectly within its territory, it may be incompatible with one or more Member State system. It is very important that any system that is developed works cross EU borders.

5.8 For these reasons the Committee strongly recommends that the Commission provides guidance on this special scheme by which postal operators develop an alternative method to calculate the amount of VAT due from their postal operations.

5.9 The Committee also notes that the Commission does not propose, or even mention, how business customers are going to get a refund on the VAT for postal services. It is vital that any

system developed is not complex or resource heavy, especially with regards to small and medium-sized enterprises.

5.10 Nor does the Commission discuss the effect on Member States' tax receipts from VAT. It may seem obvious that changing from exemption to taxation will increase receipts, but this is not necessarily so. This is because each Member State would receive VAT on its public postal sector sales, but would have to make two refunds. The first would be to the public postal service on the goods and services it buys, the second refund would be to the postal service's VAT registered customers. The two refunds could exceed the tax received especially if the proportion of the postal service receipts from VAT-registered customers is high.

5.11 The Committee agrees with the Commission's surmise that the removal of the exemption would slightly increase the Community's VAT own resource base. This benefit to the Community would not be affected by the VAT rate, for postal services, chosen by Member States.

Brussels, 10 December 2003.

The President
of the
European Economic and Social Committee

The Secretary-General
of the
European Economic and Social Committee

Roger Briesch

Patrick Venturini

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N.B.: Appendix overleaf

APPENDIX

VAT on Postal Services

To see how VAT affects a business it can be helpful to start by showing what the situation would be if VAT did not exist. Here are some imaginary figures. They show the Post Office's expenses and selling price for a sale to a final consumer; they then show the same sale to a business customer and that business sale to a final consumer.

Situation No. 1: without VAT

	Postal services to an end-consumer	Postal services to a business
Purchases by the post office	100	100
Wages and profit	200	200
Price to the PO's customer	300	300
Cost of postage		300
Purchases		1000
Wages and profit		1000
Price to end-consumer	300	2300
Reference letter for this total:	(a)	(b)

We are marking the totals "(a)", "(b)" and so on to make comments easier to follow.

Situation No. 2: VAT at 20% with exemption for the Post Office

We now imagine that VAT is imposed at 20%. We might expect that the price paid by the end-consumer would go up to 360 in the first column and to 2760 (2300 plus 460) in the second. But because of exemption that is not what happens. Besides the exemption of the Post Office itself we consider (in the third column) what happens if the business buying the postal services is exempt. Here are the figures:

	Postal services to an end-consumer	Postal services to a business	Postal services to an exempt business
Purchases by the post office	100	100	100
Add VAT at 20%	20	20	20
Wages and profit	200	200	200
Subtract VAT recovered	nil	nil	nil
Price to the PO's customer	320	320	320
Cost of postage		320	320

	Postal services to an end-consumer	Postal services to a business	Postal services to an exempt business
Purchases		1000	1000
Add VAT at 20%		200	200
Wages and profit		1000	1000
Subtract VAT recovered		-200	nil
Total so far		2320	2520
Add VAT at 20%		464	nil
Price to end-consumer	320	2784	2520
Reference letter for this total	(c)	(d)	(e)

In the first column the end-consumer benefits from the Post Office's being exempt, but in the second column he loses. Instead of 2760 he pays 2784; the extra 24 is the 20 of VAT incurred by the Post Office, which is passed on as a cost to business and then to the customer. And because it is added to the business's selling price it increases the VAT by 4 (20 at 20%).

In the third column VAT is costing the end-consumer only 220, the difference between total (b) and total (e). If it were not for exemption, VAT would cost him 460, i.e. 20% on 2300.

The third column shows the position of a non-trading organisation such as a charity as well as the position of an exempt business.

Situation No. 3: VAT at 20 % with no exemption for the Post Office

We now show what happens if the Post Office's exemption is removed:

	Postal services to an end-consumer	Postal services to a business	Postal services to an exempt business
Purchases by the post office	100	100	100
Add VAT at 20%	20	20	20
Wages and profit	200	200	200
Subtract VAT recovered	-20	-20	-20
Total so far	300	300	300
Add VAT at 20%	60	60	60
Price to customer	360	360	360
Cost of postage		360	360
Purchases		1000	1000
Add VAT at 20%		200	200

	Postal services to an end-consumer	Postal services to a business	Postal services to an exempt business
Wages and profit		1000	1000
Subtract VAT recovered		-260	-nil
Total so far		2300	2560
Add VAT at 20%		460	nil
Price to end-consumer	360	2760	2560
Reference letter for this total	(f)	(g)	(h)

In the first column the cost to the consumer has gone up and is the same as would be charged by a private delivery service. But in the second it has gone down and is now the right amount of 2760.

In the third column the cost to the end-consumer is up by 40 from (e) to (h). This is because the VAT included in the Post Office's price has gone up from 20 to 60 and the exempt business is not entitled to recover this VAT.

Situation No. 4: VAT at 20% but with a reduced rate of 6 % for postal services

We now show how a reduced rate would work. If introduced it would apply to private delivery firms as well as the Post Office:

	Postal services to an end-consumer	Postal services to a business	Postal services to an exempt business
Purchases by the post office	100	100	100
Add VAT at 20%	20	20	20
Wages and profit	200	200	200
Subtract VAT recovered	-20	-20	-20
Total so far	300	300	300
Add VAT at 6%	18	18	18
Price to customer	318	318	318
Cost of postage		318	318
Purchases		1000	1000
Add VAT at 20%		200	200
Wages and profit		1000	1000
Subtract VAT recovered		-218	nil
Total so far		2300	2518
VAT at 20%		460	nil
Price to end-consumer	318	2760	2518

	Postal services to an end-consumer	Postal services to a business	Postal services to an exempt business
Reference letter for this total	(i)	(j)	(k)

The reduced rate benefits the end-consumer in the first column and in the third column. In the second column the reduced rate has no effect on the 2760. If the Post Office is in the VAT system, it makes no difference to registered businesses what rate of VAT the Post Office charges, since they recover the VAT.

Summary

1. Situation No. 1: without VAT

Price to end-consumer	300	2300
Reference letter for this total:	(a)	(b)

2. Situation No. 2: VAT at 20% with exemption for the Post Office

Price to end-consumer	320	2784	2520
Reference letter for this total	(c)	(d)	(e)

3. Situation No. 3: VAT at 20% with no exemption for the Post Office

Price to end-consumer	360	2760	2560
Reference letter for this total	(f)	(g)	(h)

4. Situation 4: VAT at 20% but with a reduced rate of 6% for postal services

Price to end-consumer	318	2760	2518
Reference letter for this total	(i)	(j)	(k)