EUROPEAN PARLIAMENT

Directorate General for Research

Directorate A: Medium- and long- Term Research

DIVISION FOR ECONOMIC, MONETARY AND BUDGETARY AFFAIRS

BRIEFING
ECON 541 EN

VAT ON POSTAL SERVICES

The opinions expressed are the sole responsibility of the author and do not necessarily reflect the position of the European Parliament

Luxembourg, June 2003 PE 334.208

This document is available in EN (original) and FR, DE.

You will find the list of the Economic Series' briefings at the end of this publication.

Summary

Most public postal services are currently exempt from VAT. The recent opening up of the market, however, has brought into being alternative operators which are obliged to charge VAT. The effect is to distort competition in a number of ways. The Commission is proposing to remedy the situation by introducing VAT on all postal services, but giving Member States the option to charge a reduced rate on letters and parcels below 2Kg. in weight. This Briefing examines the background and details of the proposal, together with some of the problems it raises.

Publisher: European Parliament
L-2929 Luxembourg

Authors: Ben Patterson and Susanna Hughes

Responsible Official: Ben Patterson
Economic, Monetary and Budgetary Affairs Division
Tel.: (352) 43 00-24114
Fax: (352) 43 00-27721
E-Mail:gpatterson@europarl.eu.int

Manuscript completed in June 2003.

CONTENTS

Figures and Tables

INTRODUCTION

Among the new initiatives listed in the Commission's June 2000 Communication, a *Strategy to Improve the Operation of the VAT System within the Context of the Internal Market*[1], was a draft Directive on the application of VAT to postal services. Originally listed as a "priority" for that same year, the proposal was eventually published on 5 May 2003[2].

Under the 6th VAT Directive of 1977[3], public postal services have been broadly exempt from VAT. The exemptions in different Member States have derived from three possible provisions of the Directive:

1. Article 4(5) which states that "bodies governed by public law" are

    not considered taxable persons in respect of the activities or transactions in which they engage as public authorities, even where they collect dues, fees, contributions or payments in connection with these activities or transactions.

   (The Article adds, however, that they *shall* be considered taxable persons

    where treatment as non-taxable persons would lead to significant distortions of competition.)

2. Article 13A, which outlines "exemptions for certain activities in the public interest". Paragraph 1(a) covers

    the supply by the public postal services of services other than passenger transport and telecommunications services, and the supply of goods incidental thereto;

3. Article 13B, which outlines "other exemptions". Paragraph (e) covers

    the supply at face value of postage stamps valid for use for postal services within the territory of the country, fiscal stamps, and other similar stamps;

These different provisions have led to some variation in application. For example, all stamps – no matter who issues them – are in principle exempt; but two Member States apply VAT to them when they are issued by a limited company.

Distortions of Competition

When the 6th VAT Directive was adopted in 1977, postal services were for the most part carried out by state-run bodies, which were subject to little or no competition. Over recent years, however, the sector has increasingly been opened up to private operators; and services once in the public sector have themselves become private.

Only the services provided by the public operators, however, are exempt.

Exemption means that no VAT is charged on the goods or services supplied. It also means that the VAT levied on inputs is not reclaimable: the charge to the final consumer can contain an element of "hidden" VAT.

Competition between two providers of a particular good or service, one of which is taxable and one of which is exempt, can therefore be distorted in a number of ways.

---

[1] COM(2000)348.

[2] *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 of 5.5.2003.

[3] 77/388/EEC.

From the point of view of the customer.

- Where the customer is a final consumer, or another exempt body like a bank, hospital, charity or small firm below the VAT threshold – in the case of public postal services roughly 20% of total clients and 40% of turnover – no VAT on the purchase is reclaimable. It therefore minimises tax if the purchase is made from the *exempt* supplier.
- Where, on the other hand, the customer is VAT-registered, and therefore able to reclaim VAT on inputs – in the case of public postal services representing 80% of total clients and roughly 60% of total turnover – it is more tax-efficient to purchase from the *taxed* supplier. Purchases from the exempt supplier would contain an element of "hidden", and therefore non-reclaimable, VAT.

From the point of view of the supplier

Exemption means that public postal services are unable to reclaim the VAT paid on their inputs. This unreclaimed VAT varies between 2.2% of total costs (Spain) and 6.8% (Denmark), with an EU average of 4.2%[4] (see Table 1).

Table 1: Estimated reduction in the costs of postal operators (as % of total costs) as a result of input tax deduction

Austria	- 3.8
Belgium	- 3.9
Denmark	- 6.8
France	- 5.3
Germany	- 3.7
Greece	- 2.2
Ireland	- 4.8
Italy	- 4.1
Luxembourg	- 3.5
Netherlands	- 5.5
Portugal	- 4.1
Spain	- 2.7
United Kingdom	- 4.0
EU average	- 4.2

Source: Commission services

One effect of this is that it is more economic for exempt postal services to in-source supplies of goods or services rather purchase from outside VAT-registered suppliers. The UK Royal Mail, for example, has found it more economic to transport mail by road, using their own vehicles, rather than send it by rail and pay VAT[5]. Without the tax-induced distortion, it might nevertheless be more economic (as well as environmentally prefereable) to outsource.

---

4 Not including Sweden and Finland which already charge VAT.

5 See article in the *Guardian* of 6 June 2003.

Savings from being able to reclaim VAT and optimise the sources of supply would not necessarily be passed on to customers (the Royal Mail lost £611m in 2002). Were this to be the case, however, it would benefit all VAT-registered customers, since they would be able, in turn, to offset the VAT now charged by the postal service as input tax. The Commission has estimated that, given full pass-on of savings, VAT-registered utilisers of public postal services in the EU might find the costs of using these services reduced by 4.4% overall (see Table 2).

Table 2: Possible reductions in the cost of postal services for firms registered for VAT (% of total postal costs)

Austria	- 3.9
Belgium	- 4.1
Denmark	- 7.3
France	- 5.6
Germany	- 3.9
Greece	- 2.3
Ireland	- 5.1
Italy	- 4.2
Luxembourg	- 3.7
Netherlands	- 5.8
Portugal	- 4.2
Spain	- 2.8
United Kingdom	- 4.2
EU average	*- 4.4*

Source: Commission services

Postal Services in the EU

The postal services market is of a significant scale. In 2000, EU postal revenues were about €85 billion or about 1% of EU GDP. Direct postal sector employment is substantial, with more than 1.6 million directly employed and at least another 1 million whose employment is indirectly related to postal services. Direct employment is still mainly in Universal Service Providers (USPs) – about 1.2 million – while nearly 500,000 are employed in the courier and express industry. Overall it is estimated that over 5 million jobs are directly dependent, closely related to, or induced by the postal sector.

Postal services are also strategically important to the EU economy. They are at the intersection of three vital markets: communications, advertising and transportation/logistics. Moreover, financial services are also an important activity area for many of the USPs.

The Postal Directive of 1997

The main objectives of Community policy for postal services have been to improve the quality of service and to implement the internal market for postal services. The principles followed are gradual and controlled market opening to competition and at the same time ensure the provision across the EU of a minimum universal postal service. *Directive 97/67/EC of the European Parliament and of the Council of 15 December 1997 on common rules for the development of the internal market of Community postal services and the improvement of quality of service,* (henceforth known as the "Postal Directive") was adopted by the Council on 1 December 1997. It entered into force on 10 February 1998. It established regulatory provisions, which mainly focus on principles and boundaries, established a Community framework for Member States to adapt to their national context. The Directive:

- defines the minimum universal service to be guaranteed by each Member State (on its territory) to at least one delivery and collection five days a week;
- sets common limits form services which may be reserved for the universal service provider(s) (350g in weight or five times the basic tariff of an item of correspondence);
- lays down the principles to govern the authorisation/licensing of non-reserved services;
- defines the tariff principles applicable to the universal service as well as the transparency of the accounts of the universal service providers;
- governs the setting of quality of service standards for national and intra-Community cross-border services;
- confirms the mechanisms to encourage technical harmonisation in the postal sector;
- deals with the consultation of interested parties; and
- requires the creation of national regulatory authorities independent of the postal operators.

The new Postal Directive

On 10 June 2002, the European Parliament and the Council formally adopted Directive 2002/39/EC, which amends the initial Postal Directive by defining further steps in the process of gradual and controlled market opening and further limiting the service sectors that can be protected from competition. Under the new Directive, Member States can only exempt from competition items of correspondence:

- weighing less than 100 g and costing less than three times the basic tariff from 1 January 2003 (i.e. a 9 % market opening to competition);
- weighing less than 50 g and costing less than two-and-a-half times the basic tariff from 1 January 2006 (i.e. an additional 7 % market opening to competition).

Moreover, all outgoing cross-border mail has been open to competition from 1 January 2003 (i.e. an additional 3 % market opening to competition). However, exceptions are possible where necessary to maintain the universal service – for example if revenue from cross-border mail is necessary to finance the domestic universal service – or where the national postal service in a given Member State has particular characteristics.

Finally, the new Directive sets 1 January 2009 as a possible date for the full accomplishment of the Internal Market for postal services, to be confirmed (or changed) by co-decision procedure. The Directive requires the Commission to make a proposal based on a study assessing, for each Member State, the impact on universal service of further opening up of the postal market.

Implementation of the first Postal Directive

The transposition of the Postal Directive into the national legislative framework of Member States has been a lengthy process. However, it is now almost complete and the Directive can be considered as implemented. Some conformity issues remain, such as those regarding the independence of National Regulatory Authorities (NRAs) and the Commission has launched a number of infringement procedures against Member States.

The Postal Directive has led to the following changes:

- Implementation of a Community universal postal service largely achieved;
- A common maximum reserved area across the Community;
- Additional safeguards for the universal service in most Member States;
- Definition of national requirements for a good and reasonable access to national postal services;
- Transparent and clearly separated cost accounting systems by USPs;
- Definition of quality of service targets both for domestic and cross-border mail;
- Harmonised arrangements for customer complaints;
- On-going definition of European technical standards;
- Establishment of independent national regulatory authorities (NRAs).

However, the level of harmonisation remains limited across the Community aside from the basic regulatory framework set out by the Postal Directive. Regulatory practice varies significantly between Member States, and this may have limited the competition in the EU postal services market. Continuing regulatory asymmetry threatens to distort the market as further steps are taken towards the full accomplishment of the internal market, and there have already been a number of infringement cases on this issue. Further, the coexistence of reservation, variable regulation and competitive market segments has produced perverse incentives for market players and when combined with the corporatisation and the privatisation of the USPs, issues of unfair competition have emerged.

The minimum service exceeds the minimum requirements of the Postal directive in most Member States. For example, 10 Member States have adopted a 20 kg maximum limit for parcel delivery within the universal service area. All Member States meet the requirement of a maximum reserved area at, or below, the limit set out in the directive.

Table 3: The reserved area in the Member States (November 2002)

Member States	Items of correspondance		Specific direct mail being opened up*	Specific outgoing cross- border mail being opened up
	Weight limit (g)	Price limit (multiple of basic tariff)		
Austria	350			
Belgium	350			
Denmark	250	5		0g
Finland	0	0	0g	0g
France	350	5		
Germany	200	5	50g.	
Greece	350	5		
Ireland	350	5		
Italy	350	5	10 000 items	
Luxembourg	350	5		
Netherlands	100	3	0g	0g
Portugal	350	5		
Spain	350**	5	open envelopes	
Sweden	0	0	0g	0g
UK	350	£1		0g

* *The definition of direct mail varies between Member States.*

** *In Spain local mail is excluded from the reserved area.*

Source: Report from the Commission to the European Parliament and the Council on the application of the Postal Directive (97/67/EC) - November 2002

Individual Member States

In addition, the Directive allowed Member States to establish authorization procedures. These are in place in 8 Member States.

Austria

In 1999 the Postal Services and Postal Transport Divisions were separated from *Post and Telecom Austria AG* and transferred to the newly founded *Österreichische Post AG*, which operates the two divisions. This was the beginning of the conversion from a monopoly towards a competition-oriented enterprise. It is now a subsidiary to *Post and Telecom Austria AG.* Its core business activities are provision of postal and parcel services as well as handling financial business in co-operation with the *Postsparkasse*.

Belgium

La Poste- De Post was transformed from an independent public company into a public limited company in March 2000. A number of large and small courier services are active in the market. There is free competition outside the reserved area, but the provision of services must be reported to the NRA. *La Poste-De Post* sets its rates itself according to principles laid down in law, mainly regarding affordability and the fact that prices must be based on real costs, and geographical uniformity.

Denmark

Post Denmark, one of Denmark's largest companies, is an independent public company managed by a board of directors established in 1995 and 100% owned by the Ministry of Transport. It has been granted a concession as a public postal operator. A number of postal operators are present on the Danish market. *Post Denmark* determines postage rates. For domestic letters covered by the reserved area, the total sum of revenue is subject to approval by the Minister of Transport. For this purpose a price-ceiling model is applied. The model provides for adjustment of total revenue by the percentage change in the consumer price index, less one percentage point.

Finland

The Act on Postal Services, passed in 1994, separated postal operational and regulatory functions. At the same time *Finland Post* became a limited liability company 100% owned by the State. Postal services on the Åland islands are provided by *Åland Post* governed by a separate statutory order. Although Finland has had a licensing system since 1994, the only active licence is held by the USP. Other than the USP only one private operator *Suomen Suoramainonta Oy*, which already distributes newspapers and unaddressed mail, has applied for a licence. In April 1997 this company was granted a three-year licence to provide a delivery service for bulk mail (at least 50 items) to companies, schools and local authorities in Helsinki.

There is no reserved area. *Finland Post* itself establishes the rates for all its products and services. However, the legislation gives certain rules for pricing (prices should be reasonable, fair and they shall allow all users to have access to the services).

However, a Bill introducing a fee to protect the postal service in sparsely populated areas was introduced in March 1997, after the licence application. The Bill meant that the company would have had to pay a fee of 20% of its postal revenue. In view of the fee the company did not take up the licence. The company then applied for a licence for a larger area around Helsinki. No fee would have been payable for operating a licence in this area, which has a lower population density. The application was initially refused, but, following an appeal, a licence for three years was granted in June 2000.

The terms of the licence require a service to the public. Hence, the licensee is unable to provide a service only for bulk pre-sorted mail, which the experience of *CityMail* in Sweden suggests, is a more promising area for an entrant. The terms of licence may explain why it has remained inactive, although the USP suggested that the uncertain prospects for the letters market was a factor. The possibility of competition created by the licensing system may have stimulated the USP to be more efficient. However, the USP took the view that the real competitive threat did not come from other postal operators but was on the demand side where technology was creating electronic substitutes for mail. The role of the licensing system both in restricting more direct competition and in stimulating efficiency is unclear. So, it is hard to draw any general conclusion from Finland about the extent of competition likely to follow full liberalisation.

France

The USP is *La Poste*, which since 1991 has been an independent operator under public law. Its activities comprise: mail; financial services; parcels and logistics. The activities in the financial services, parcels and logistics sectors are carried out in fully competitive markets. In the mail sector, there is direct competition in all markets outside the reserved area. *La Poste* is free to set tariffs for its services in the area open to competition. In the reserved area, *La Poste* guarantees geographically adjusted tariffs.

Germany

The German licensing system has operated since 1998 when it was stated for the first time that after a transitional period all postal services had to be offered under competitive conditions. Hence, the executive licence of *Deutsche Post AG* was set to expire on 31 December 2002, but this was extended by five years in 2001. The company covers about 75% of letter service turnover. In 2001 a total of 854 companies had licences, of which 600 were still active. The number of licences is larger than the number of companies as there are different categories of licence and an operator may have more than one licence. Although there is a licence application fee, the licensing system is not an appreciable barrier to entry. The main purposes of licensing are to enable the establishment of a compensation fund and to introduce controlled competition in the regulated area. The national legislation envisages that a compensation fund may be established after full liberalisation.

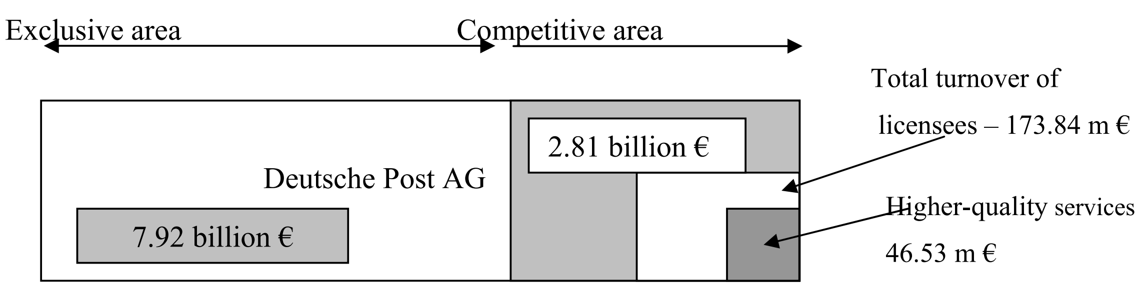
Table 4: Market entry conditions in Germany

Market entry without licence	Newspapers and magazines; freight items; courier services
Market entry with licence	From 1 January 2003 letter post items between 200 g and 1 kg; bulk items between 50 g and 1 kg
Exclusive licence of Deutsche Post AG	Letter post items and addressed catalogues weighing less than 100 g from January 2003; bulk items weighing no more than 50 g

Source: The postal sector faced with radical change - objectives of the German postal policy and outlook, The Federal Ministry of Economics and Technology, Germany July 2002

Because of the exclusive licence competition is only possible in niche markets. The market share of other private companies in the licensed field was less than 1 % in 2002.

Figure 1: Letter mail market in Germany, 2000



Source: The postal sector faced with radical change - objectives of the German postal policy and outlook, The Federal Ministry of Economics and Technology, Germany July 2002

Greece

Greece has introduced a licensing system for operators within the universal service. *The Hellenic Post (ELTA)* is a public service enterprise and the Ministry of Transport and Communications is responsible for postal rates as a whole. Greece requires operators outside the universal service to register. 224 companies, mainly providing express services, were registered in 2001. A registration fee was set at 0.5% of turnover, but, following a warning letter from the Commission, the fee has been lowered.

Table 5: Authorisation procedures in Member States

	Licensing system	Number of licenses issues
Austria	No	None
Belgium	Under development	None
Denmark	No*	One concession to Post Denmark
Finland	Yes	Two - Finland Post Corporation and Suomen Suoramainonta
France	No	None
Germany	Yes	> 1000 licenses issued - 850 are active
Greece	Yes	1 special one to ELTA and > 150 general licenses operators servicing up to 2kg for mail items and 20 kg for parcels need special licence
Ireland	No	None
Italy	Yes	150 licenses issued
Luxembourg	No, but authorisation must be obtained for outside reserved area services	17
Netherlands	No	None
Portugal	non reserved but uso services are subject to license	3 individual licenses and 6 general authorisations
Spain	Yes	Geneal authorisations > 1500 and single authorisations almost 400
Sweden	Yes to Posten AB	+/- 40 licenses are active
United Kingdom	Yes	+/- 15 licenses

** All operators must have a concession agreement*
Source: Posteurop

Ireland

The USP is *An Post* was established in 1984 and is a public company which has a mandate to conduct its operations on a commercial basis. There are legal provisions to designate additional USPs, but so far this has not been made. Outside the reserved area there is free competition and no licensing required. The NRA must approve all applications for tariff increases witin the universal service.

Italy

Poste Italiane SpA is a state-owned limited liability company supervised by the regulating authority the Ministry of Communications. In addition to postal services it also provides financial services, electronic communication and telecommunication services. In the field of postal services multinational courier companies represent the competition. The tariffs for universal services are subject to the approval of the regulatory authority.

Luxembourg

The Post and Telecommunications Corporation is a public corporation. All non-reserved areas are open to competition.

The Netherlands

The USP is *TPG Post* TPG which was the first mail company to 'go public' and is listed on the stock exchange. *TPG Post's* main business is post: collecting, sorting, transporting and delivering letters and parcels. Services outside the reserved area are provided in competition with Dutch and foreign companies. The rates for the universal service are subject to a statutory price control system. Price adjustments may not exceed an index of composed wage increases in the private sector.

Portugal

The Portuguese Post *CTT - Correios de Portugal* was converted from a public corporation into a publicly owned joint stock company in 1992. The regulatory body is the *National Communications Authority (ANACOM).* Pricing in the reserved area is set by an agreement between *CTT*, the regulator and the Government.

Spain

The USP is *Correos y Telégrafos* which was set up in 1991 and transformed from a state enterprise into a commercial public company (wholly state owned) in 1998. Operators within the universal service, with the exception of the USP, must register to receive *autorizaciones singulars*, which correspond to individual licences. There are 55 such authorisations. Other operators outside the universal service, including the USP, must register for *autorizaciones generales*. 803 operators, who may also hold *autorizaciones singulares*, are registered for *autorizaciones generales*. Virtually all licences, which were first issued in 2000, are active.

Prices in the reserved area are set based on market conditions in accordance with legal framework. The ministry of Public Works may issue maximum prices for services within the universal service. Prices in the non-reserved area are freely set.

Sweden

In 1997 Sweden introduced a licensing system for postal operators. There are no licence application fees, but there are annual licence fees. The licensing system does not involve any restrictions on postal operators without universal service obligations designed to guarantee the universal service. So, the licensed market in Sweden is, unlike the licensed postal markets of Finland and the United Kingdom, fully liberalised.

Competition to the USP in the letters market started in 1991 when *CityMail* offered a service for the delivery of pre-sorted bulk mail. This was before full liberalisation in 1993, but there was some uncertainty about the scope of the letters monopoly. Initially, *CityMail* was subject to what the competition authority found to be unfair competition from the USP and suffered serious financial problems. However, *CityMail*, which is now owned by the USP in the United Kingdom, is well established as Sweden's second largest postal operator with more than 5% of the national market. *CityMail* provides a delivery service twice a week to three cities in Sweden and also, through a local operator, to the island of Gotland. The USP, *Posten*, is a limited liability company. *Posten* establishes the prices, which have to conform to legislation. The contract with the government also includes a price-cap for individual domestic letters up to 500 g, with the maximum allowed increase the average net price index over a three-year period.

Table 6: Market shares in Sweden

Operator	Dispatches (millions)	Dispatches (% share)
Posten (USP)	3 100.3	93.87
City Mail	185.2	5.61
Others	17.3	0.52
TOTAL	3 302.8	100

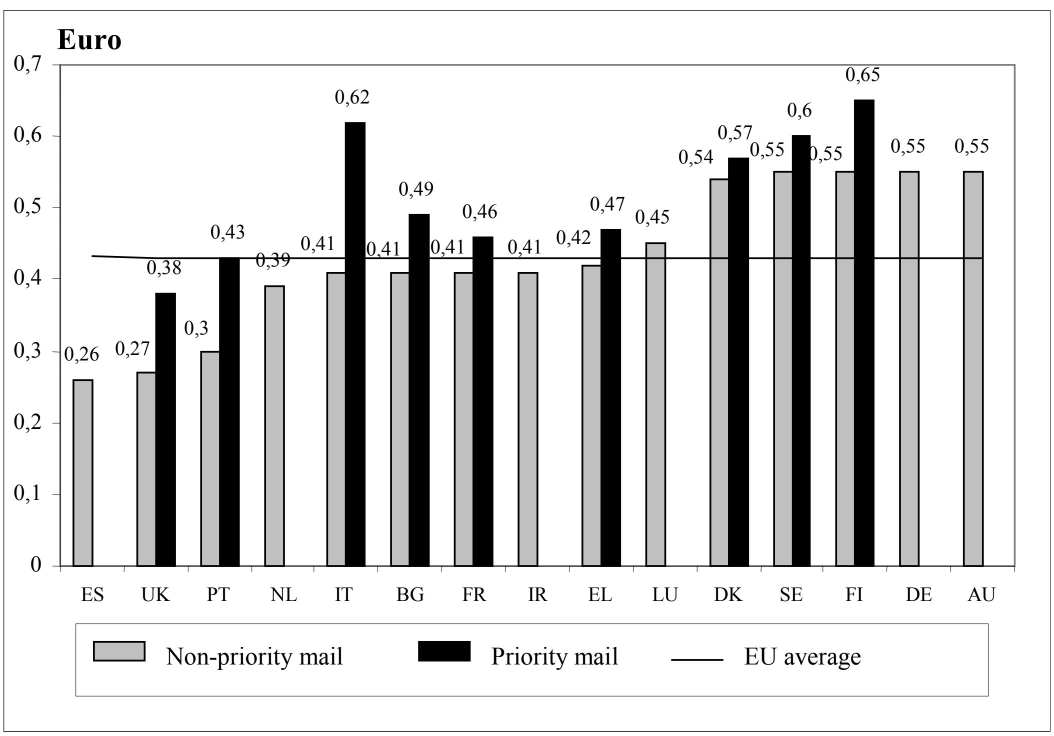
Source: Service och Konkurrens 2003*, PST-ER 2003:18, Post- och Telestyrelsen, Sweden 2003*

United Kingdom

The United Kingdom is the earliest example of the licensed area model. The licences place strict limits on the activities of licensees and have had a negligible effect on the overall postal market. The Postal Services Act 2000 continued the previous licensing system, but from March 2001 the new NRA has been the licensing authority in place of the Ministry. From 2003 the market above 100g and tree times the basic tariff the market is fully open to competition. Below this threshold is the licensed area and the regulator has a mandate to introduce more competition where appropriate in the interest of consumers.

In 2001 the USP *the Royal Mail* became a public limited company wholly owned by the UK Government. In 2002 the NRA *Postcomm* had granted a licence to the USP and a number of niche licences. Changes in basic tariffs can only be made with the approval of the NRA.

Figure 2: Basic tariffs for letters in the Member States



The tariffs for Sweden include VAT at a rate of 25% and the tariffs for Finland include VAT at a rate of 22% for domestic dispatches. In domestic currency the charge in the UK is 0.28£ and 0.20£ respectively, in Denmark 4.25 and 4.00 DK and in Sweden 5.50 SEK and 5.00SEK respectively.

Table 7: VAT rates on postal services in Member States

Member State	VAT rate, USP (%)	VAT rate, other service providers (%)
Austria	exempt	20
Belgium	exempt	21
Denmark	exempt /25[8]	exempt /25[6]
Finland	22[7]	22[12]
France	exempt	19.6
Germany	exempt /16[8]	16
Greece	exempt /18[9]	18
Ireland	exempt	21
Italy	exempt	20
Luxembourg	exempt	exempt /15[12]
Netherlands	exempt /19[10]	19
Portugal	exempt	19
Spain	exempt [9]	16
Sweden	25	25
UK	exempt	17.5

Source: own research

6 Dispatches that the UPS is *not* under an obligation (USO) to distribute are subject to VAT. The USO encompasses:

(1) Addresses letters up to 2 Kg.

(2) Other addressed items that are not packages up to 2 Kg.

(3) Newspapers, weekly and monthly publications up to 2 Kg.

(4) Addressed parcels up to 20 Kg, and

(5) Literature for the blind up to 7 Kg.

7 For mail with destinations within the EU. Otherwise no VAT.

8 Postal services within the scope of the universal service obligation are not taxed.

9 Supply of the "Greek Postal Service" other than postal services are subject to VAT at the standard rate. In addition, in some Greek islands the standard VAT rate is reduced by 30%. This reduction is applied to services by operators established on these islands.

10 All letters weighing up to 100 g are exempt from VAT. As this is the reserve area these deliveries are not open to competition. For the USP all letters between 100 g and 2 kg, domestic deliveries up to 10 kg and deliveries up to 20 kg are exempt from VAT if they are single billed. Other operators have to charge the standard VAT rate. Bulk billed services in the non-reserved area are not exempt, regardless of the operator and are subject to the standard rate.

The Commission Proposal

The "best and most straightforward" solution to the problems of distorted competition and "hidden VAT" – described in the Introduction – the Commission argues, would be "to tax all postal services at the standard rate".

> *Taxation would bring to the public postal operators the right to deduct VAT incurred on purchases, this removing the hidden VAT from the system for everyone and solving most of the problems of distortion for suppliers.*

The Commission, however, does not propose this. Instead, the possibility of *two* rates is introduced:

- A compulsory standard rate of VAT on items of mail over 2Kg. in weight.
- A reduced rate of VAT, to be introduced optionally by Member States on items of addressed mail under 2 Kg. in weight.

The reason is the possibility of price rises for users of postal services not registered for VAT, and therefore not able to deduct the new VAT as input tax. The price rises would not necessarily be as high as the full standard rate of tax – suppliers might pass on some of their own savings (see above). But, "given the margins applied by postal operators", some increases would be likely "unless this additional income from taxation is used by Member States to increase their postal subsidies..." The Commssion estimates a rise in price on a normal letter of + €0.064 overall, ranging from + €0.049 in Luxembourg and the Netherlands to + €0.094 in Denmark and Italy (see Table 10).

The increases would, moreoever, not just affect individual consumers.

> *Full taxation could also have a significant impact in some sensitive areas of business such as charities and health, where non-deductible costs will increase.*

By contrast, application of a reduced rate of VAT might result in only negligible price rises, and in some cases an actual price reduction. This would be because the VAT charged could be offset by the supplier passing on the savings from being able to deduct input tax.

The effect on prices of charging a 5% VAT, the Commission estimates, would be + €0.002 on a standard letter, ranging from a price *reduction* of €0.012 in Denmark to a rise of + €0.011 in Greece (see Table 10).

The 2 Kg. threshhold

These proposals, however, give rise to a number of problems, the first of which is to distinguish between those items of mail to which the standard VAT rate would apply from those eligible for a reduced rate.

The Commission's choice of the relatively high weight of 2 Kg. has been set at this level, the draft Directive explains,

> *[...] to reduce the need for different sets of stamps in practice and to reduce the possibility of error or abuse through the use of incorrect stamps. The high weight limit means that it is virtually impossible to put mail for which a standard rate stamp would be required, in a letterbox.*

It has to be recognised, nevertheless, that all threshholds of this kind create problems. Weight and bulk are not necessarily correlated. There is a tax incentive to break down mail into separate parcels of under 2 Kg. each, which is unlikely to be economically justified. Policing the application of the standard rate to mail at or just above 2 Kg. will be difficult. And although most commercial parcels of over 2 Kg. are likely to be charged through the use of franking machines rather than the purchase of stamps, this will not necessarily be true of mail sent by individuals: there could be a residual "two stamps" problem.

Which services?

The draft Directive also limits the potential coverage of the reduced rate other than by weight. The rate would only be available, for example, for mail

> *[...] addressed to a named person. Direct mail addressed "To the Occupier" will not therefore be eligible.*

Secondly, it would only be applicable to "standard postal services". This is defined as "the basic standard service, sometimes referred to as the 'second-class' service"; and also to the "accelerated delivery service sometimes referred to as 'first-class' or '*courrier prioritaire*'". It would *not* be applicable, however, to "express services".

Deliveries outside the EU

Removing the VAT exemption for postal services would immediately create a major problem in the case of mail dispatched outside the EU. Although internal mail would be positively taxed with the right of deduction, mail for external delivery would be exempt with the right of deduction: that is, rated at zero. This would effectively mean that there would need to be, even for mail under 2 Kg. to which a reduced rate would apply, two sets of stamps: one set including reduced rate VAT for internal mail, and one taxed at zero for external delivery.

To avoid such complexity, the draft Directive therefore contains a special place-of-supply rule for items weighing under 2 Kg.:

> *[...] all such supplies destined for delivery* outside *the Community should be treated as if they are for delivery* within *the Community.*

However, for services excluded from the scope of a reduced rate – i.e. packages over 2Kg. in weight, unaddressed mail, express services, etc. – the normal place-of-supply rules would continue to apply: i.e.

- post for delivery within the EU would attract VAT at the standard rate applying in the country of dispatch;
- post for delivery outside the EU would be exempt with the right to deduct (i.e. taxed at 0%).

In this case, a need for two sets of stamps could clearly arise.

In addition, there will also need to be a change in the way transport charges are taxed on items collected in a Member State for delivery outside the EU. It is proposed that they will be taxable in that Member State, at the zero rate, for any part of the journey within the EU.

Optionality and the choice of rate

The introduction of an option to charge a reduced rate of VAT on mail weighing below 2Kg. does not, of course, mean that all Member States will actually do this.

First, experience with the options already available, and listed in Annex H of the 6th. VAT Directive, indicate that Member States' will make wide use of the ability to "pick and choose".

Table 8: VAT rates, May 2003

Member State	Standard	Reduced	Super Reduced	"Parking"
Austria	20	10		12
Belgium	21	6		12
Denmark	25			
Finland	22	17 / 8		
France	19.6	5.5	2.1	
Germany	16	7		
Greece	18	8	4	
Ireland	21	13.5	4.3	(13.5)
Italy	20	10	4	
Luxembourg	15	6	3	12
Netherlands	19	6		
Portugal	19	12 / 5		
Spain	16	7	4	
Sweden	25	12 / 6		
United Kingdom	17.5	5		

Source: Commission

Secondly, some Member States have more than one reduced rate, and most do if "super-reduced" rates are included[11]. Three countries also have 12% "parking" rates.

Thirdly, the spread of reduced/super-reduced rates between Member States is very much wider than in the case of the standard rate: i.e. betwen 2.1% and 17%. The rates on under 2Kg. mail in different Member States might therefore vary widely, even if all applied a reduced rate.

Adding a new category of transactions to Annex H, indeed, goes very much in the opposite direction to the Commision's declared policy in other contexts[12].

Table 9: Rates of VAT on mail under the Commission proposals

	Addressed mail under 2Kg. in weight.	**Mail over 2Kg; express mail; "to the Occupier" mail, etc.**
For delivery within the EU	Reduced rate option, otherwise standard rate.	Standard rate.
For delivery outside the EU	Reduced rate option, otherwise standard rate.	Exempt with right of deduction (i.e. zero)

11 The Commission's estimates of price effects already quoted are based on a reduced rate of 5%. This implies that "super-reduced" rates *are* included.

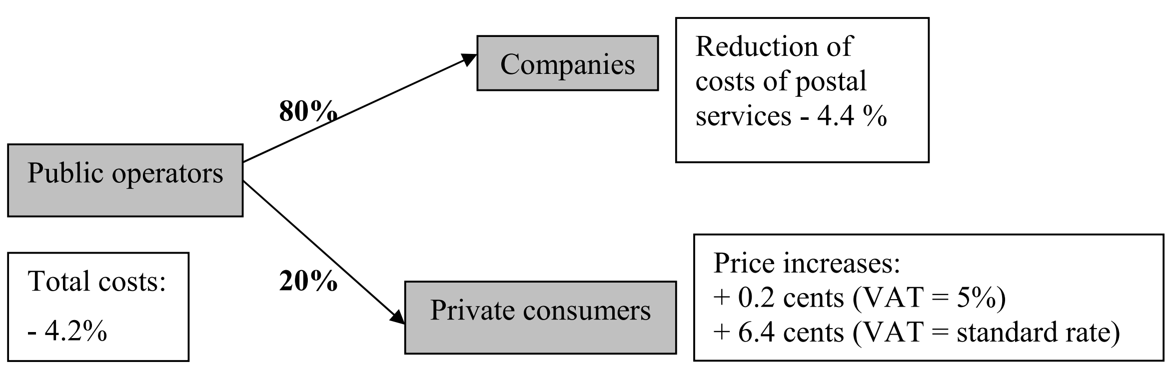
12 See, for example, COM(97)559 of 13.11.1997 and COM(2001)599 of 22.10.2001. The general problems associated with optional reduced rates are outlined in Briefing ECON 540, *The Rates of VAT,* European Parliament DGIV, May 2003.

Table 10: Estimated rise in the price of first class mail with 5% and standard VAT rates

Country	Current price in cents	Price rise/fall in cents with 5% VAT	Price rise in cents with standard rate VAT
Austria	51	+ 0.5	+ 7.9
Belgium	49	+ 0.4	+ 8.0
Denmark	57	- 1.2	+ 9.4
France	46	- 0.3	+ 6.1
Germany	55	+ 0.6	+ 6.4
Greece	43	+ 1.1	+ 5.8
Ireland	41	0.0	+ 6.2
Italy	62	+ 0.5	+ 9.4
Luxembourg	45	+ 0.6	+ 4.9
Netherlands	39	- 0.3	+ 4.9
Portugal	43	+ 0.3	+ 5.3
Spain	26	+ 0.5	+ 3.8
United Kingdom	41	+ 0.3	+ 5.2
EU average	**46**	**+ 0.2**	**+ 6.4**

Source: Commission services

Figure 3: Summary effects of taxing postal services



Source: "Effets économiques de la taxation des services postaux". Commission TAXUD/C5/PhD D(2003)22128.

Terminal Dues

When mail is posted in one country for delivery in another, the customer pays for the full costs of collection and delivery when buying the appropriate stamp. This revenue is paid to the operator in the country of collection. The actual costs of getting the mail to the recipient, however, are shared between the operator in the country of collection and the operator in the country of delivery. Accordingly, the first makes a payment to the second to cover delivery, called a "terminal due".

How are these payments to be taxed?

- In the case of mail to third countries, it is suggested that the dues should be exempt with refund: i.e. zero-rated. The alternative of charging VAT, and obliging the operator in the third country to obtain a refund through the 13th VAT Directive mechanism is rejected.
- In the case of deliveries between Member States, the situation would at first sight appear more complicated, since accounting for VAT would in theory depend upon which country the mail was in when the operator of delivery took over the transport. When the handover takes place in the country of collection, the VAT is due there since it is the place of departure of the transport (Article 28B(C)(1) and (2) of the 6th VAT Directive). An operator of delivery registered for VAT there is accountable for the tax. Otherwise the operator of collection is liable under the reverse charge procedure (Article 21(1)(b)). When the handover takes place in the country of delivery, the place of supply is nevertheless still the country of original collection, though for a different reason (Article 28(B(C)(1) and (3)). An operator of delivery registered for VAT there is still accountable for the tax; otherwise the operator of collection is liable under the reverse charge procedure.

Reply-paid mail

Postal operators generally offer a Business Reply Service, under which firms which can send their customers pre-paid envelopes for return mail. The operator makes a flat-rate charge for registration, and a further charge per item delivered.

It is proposed that both these charges would be subject to VAT: the flat-rate charge presumably at the standard rate (though the Commission does not say so); the charge per item at standard or reduced rate, depending on weight, etc.

No problems would arise where the business and the customer were in the same country. Where they were in different countries, however, the situation would be "more complex". The registration and item charges would be subject to VAT in the country where the business was registered with an operator. But there would also be additional charges from the operator in the country of the customer (i.e. the country from which the mail will be posted), similar to terminal dues but in this case not for delivery but for collection.

Various combinations of country are possible: for example, reply-paid envelopes can be sourced in one country for posting in a second for delivery to a third. The incidence of VAT is determined by the country to which the letter will ultimately be delivered.

- When the delivery is to a third country (for example, the United States) the collection charges will be exempt with refund: i.e. taxed at the zero rate.
- When the delivery is to another Member State it will be taxable in the Member State of departure in accordance with the general rule governing the supply of goods dispatched. The reverse charge procedure will apply where the operator responsible for delivery is not registered for VAT in the Member State of departure.

Special Tax Accounting Scheme

The effect of implementing the Commission's proposals would be that postal operators might have to apply three different levels of VAT, varying according to the type of mail and the destination: the standard rate; a reduced rate; and exemption with refund (i.e. zero).

Without the special place-of-supply rule for items weighing under 2 Kg. outlined earlier, this would almost certainly require separate sets of stamps; and even with the rule, separate sets might prove necessary in certain instances.

For this reason, the Commission is proposing that postal operators should have an option to account for VAT in alternative ways. Operators might, for example, establish aggregate figures for the volumes of transactions taxable at the different rates, the methodology depending upon the systems and technology available.

Such schemes, the Commission observes, would need to provide evidence for business customers that VAT had been accounted for and could be deducted as input tax. Under such schemes, stamps themselves might also need to be treated as zero-rated goods in order to avoid double taxation.

Conclusion: Issues and Alternatives

There is little doubt that the exemption from VAT of some postal operators, but not others, distorts competition within the Single Market – within the UK couriers competing with the Royal Mail have sought to have the exemption declared illegal on precisely these grounds. Some exempt operators (like the Royal Mail) are nevertheless resisting taxation on the grounds that non-VAT-registered customers – e.g. individuals, SMEs and charities – would be unable to reclaim the VAT as input tax. Postal charges in fact form a very small proportion of normal household expenditure. On the other hand, the imposition of VAT could prove a significant new cost for charities which rely on mail for fund-raising.

The Commission proposal seeks to mitigate such an effect by enabling Member States to charge a reduced rate of VAT on addressed mail weighing under 2Kg. If this rate were 5% throughout the EU, the rise in postal charges would be a negligible: + €0.002 on average. Several objections can nevertheless be raised against the proposal.

- Since the reduced rate is optional, there is no guarantee that it will be applied, nor any certainty as to the rate; and adding a further category of transactions to Annex H of the 6th VAT Directive goes in the opposite direction to Commission policy for simplifying the VAT system. The Commission's projected cost-reductions for business depend on full pass-through of savings by postal operators.
- Like all such schemes, varying tax rates above and below a particular threshold may in itself create distortions. To avoid the need for multiple sets of stamps, the Commission proposes a special place of supply rule for under 2Kg. mail destined for third countries, and an optional special accounting schemes for postal operators. Such arrangements, however, could further complicate the VAT system.

Other alternatives to the current situation exist might be to:

1. Extend exemption to all postal services

This would mitigate distortions of competition, but exacerbate the problem of "hidden VAT". Exemption also destroys the coherence of the VAT system as a whole. In addition, there might be some loss of revenue.

2. Charge VAT at the standard rate on all postal services

This is the Commission's "best and most straightforward" solution; but could produce price rises of 6.4 cents on average. Sweden and Finland, however, already charge the full 25% and 22% respectively on mail.

3. Charge VAT at zero (exemption with refund) on all postal services

This solution would remove distortions of competition, and would at the same time align VAT on mail for internal and external delivery. It would also end the "tax-on-tax" problem. There would, however, be a loss of revenue since

- all currently "hidden" VAT would now be reclaimable. This should be equal to 4.2% of the costs of exempt postal operators (see Table 1); and
- the VAT currently collected by non-exempt postal operators on sales to non-VAT-registered cutomers would be lost. No estimate of this amount is available; but it is likely to be limited, given the incentive for non-registered customers to use exempt services.

Economic Affairs Series Briefings

The following publications are available on line on the Intranet at: http://www.europarl.ep.ec/studies.
To obtain paper copies please contact the responsible official (see page 2) or Fax (352) 43 00 27721.

Number	Date	Title	Languages
ECON 542	June 2003	VAT on services	EN, FR, DE
ECON 540	May 2003	The Rates of VAT	EN, FR, DE
ECON 539	forthcoming	Stability and convergence programmes 2002/2003 updates	EN, FR, DE
ECON 538	June 2003	Public Debt	EN, FR
ECON 537	February 2003	Consequences of Rating & Accountancy Industries Oligopoly on competition	EN, FR, DE
ECON 536	February 2003	State aid and the European Union	EN, FR, DE
ECON 535	March 2003	Financial Services and the application of Competition Policy	EN, FR, DE
ECON 534	July 2002	Corporate Governance	EN, FR, DE
ECON 533	forthcoming	Potential Ouput & output gap in EU 15	EN, FR
ECON 532	June 2002	The Luxembourg Economy	EN, FR, DE
ECON 531	March 2003	The Taxation of Energy	EN, FR
ECON 530	July 2002	The Irish Economy	EN, FR
ECON 529	June 2002	The Austrian Economy	EN, FR, DE
ECON 528	July 2002	The taxation of income from personal savings	EN, FR, DE
ECON 527	May 2002	VAT on Electronic Commerce	EN, FR, DE
ECON 526	May 2002	VAT and Travel Agents	EN, FR, DE
ECON 525	May 2002	Currency Boards in Bulgaria, Estonia and Lithuania	EN, FR, DE
ECON 524	May 2002	The Greek Economy (rev)	EN, FR, EL
ECON 523	April 2002	Stability and Convergence Programmes:the 2001/2002 updates	EN, FR, DE
ECON 522	May 2003	The Italian Economy (rev.2)	EN, FR, IT
ECON 521	Sept. 2001	Competition Rules in the EEA	EN, FR
ECON 520	Sept. 2001	Background to the €	EN, FR, DE
ECON 519	July 2002	The Belgian Economy (rev)	EN, FR, NL
ECON 518	Dec. 2002	Enlargement and Monetary Union (rev7)	EN, FR, DE
ECON 517	July 2001	The Taxation of Pensions	EN, FR, DE
ECON 516	July 2002	The Finnish Economy (rev)	EN, FI, FR
ECON 515	May 2002	Die deutsche Wirtschaft (rev)	DE, EN, FR
ECON 514	April 2001	The Euro and the Blind	EN, FR, DE
ECON 513	May 2001	Tobacco Tax	EN, FR, DE
ECON 512	May 2001	The Euro: Counterfeiting and Fraud	EN, FR, DE
ECON 511	May 2002	The Consequences of EMU for the EEA/EFTA countries	EN, FR, DE
ECON 510	April 2001	Margine di Solvibilità	IT, EN
ECON 509	March 2001	Stability and Convergence Programmes: the 2000/2001 Updates	EN, FR, DE
ECON 508	March 2002	The Swedish Economy (rev)	EN, FR, SV
ECON 507	March 2002	The Economy of the Netherlands (rev)	EN, FR, NL
ECON 505	May 2000	The Portuguese Economy	EN
ECON 504	July 2000	The French Economy	EN, FR
ECON 503	July 2001	The Spanish Economy (rev)	EN, FR,ES
ECON 502	June 2000	Le "Troisième système"	FR
ECON 501	April 2002	The Danish Economy (rev)	EN, FR, DA

* * *