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FEP submission on the Review of existing legislation on VAT reduced rates

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The Federation of European Publishers (FEP) represents 28 national associations of book and learned journal publishers of the European Union and of the European Economic Area and acts on behalf of its members in discussions and negotiations with the Institutions of the European Union particularly concerning legislation, regulation and taxation. FEP is the voice of the large majority of European publishers.

FEP welcomes the opportunity to make a submission to the consultation on the Review of existing legislation on VAT reduced rates.

Introduction

The well-known benefits provided by books and journals across all formats – digital, print and audio – include the education, literacy, life chances, employment opportunities and social enhancements which engaging with professionally published content brings. It was for these social and personal advantages that reduced rates of VAT on printed publications were first introduced, and now apply in 25 out of 27 EU Member States and a majority of countries worldwide.¹

VAT discrimination between “online” and “offline” products is harming the competitiveness of the sector, threatening to hold back developments in fields as crucial as scientific and educational publishing and exposing European publishers to the competition of others in countries such as the US, where the absence of sales taxes on electronic publications has been one of the reasons for impressive growth rates in the domestic market over the past few years. Low (or zero) VAT on e-books and learned journals would make for a more

¹ The Federation of European Publishers provided a wide range of arguments to support the application of reduced rates of VAT to books and journals published in all formats and accessible through any means in its submission on the *Green Paper on the future of VAT - Towards a simpler, more robust and efficient VAT system*.



competitive market and also – via lower prices – contribute to limiting the phenomenon of digital piracy.

The European Commission has already started modernising the fiscal treatment of books through the VAT Directive of 2009, which extended the application of the reduced rate to books “on all physical means of support”. Furthermore, the Communication on the future of VAT issued by the Commission in December 2011 acknowledges the existence of inconsistencies in the VAT rates applied to comparable cultural products or services online and offline.

Given the market for digitally published content is developing rapidly, now is the right time to take this process to its next logical step. Legislation should be enacted to allow reduced rates to be applied to professionally published content available in all formats and on all kinds of support. Insofar as VAT on books is a tax on reading, VAT on e-books is both that and also a tax on technological progress. The fiscal regime should be indifferent as to whether a book is printed or digital, downloadable or available digitally on a physical support; what matters is the content it embodies, to which should be applied the lowest VAT rate possible.

For these reasons, FEP warmly welcomed the inclusion in the Communication of December 2011 of the principle that *“Similar goods and services should be subject to the same VAT rate and progress in technology should be taken into account in this respect, so that the challenge of convergence between the on-line and the physical environment is addressed”*; as well as we are very pleased that this principle also underlies the present consultation.

Since the last adaptation of the VAT Directive the FEP has been consistent in calling for the EU adopt a legislative proposal allowing Member States to bring their VAT rates on digital publications to match those on print/physical ones.

Technology is constantly evolving. The publishing sector has both embraced and led this change and is finding more and more new ways to reach its readers and to provide them with the reading experience that best meets their preferences. As part of this development, it is arguable that the book is undergoing its biggest transformation since the invention of the printing press. Nonetheless, such technical transformation has not altered the underlying essence of the book, nor has it changed its purposes; what we are witnessing is simply an enhancement of the book (sometimes enriched by functional elements) and an increase in its potential and accessibility made possible by its transition into the digital age.

Therefore our call is simply for the existing VAT legislation to be amended so as to take this phenomenon into account. It is not about increasing the number of products which can

benefit from a reduced rate of VAT, but rather about ensuring the VAT regime reflects the ways in which existing products are now designed, produced and distributed.

It is worth here recalling a number of arguments that support our proposition and dispel some claims to the contrary:

- *Reduced rates of VAT are a good policy instrument.* As the FEP amply illustrated in our reply to the Green Paper on the future of VAT, reduced rates on books have actually proven very effective in promoting readership and maintaining a healthy supply value chain, including in the retail sector. Moreover, VAT is a neutral, stable and non-invasive tool – as opposed to other fiscal tools such as direct subsidies – for promoting the consumption of books and journals, which generate positive externalities.
- *Reduced rates of VAT will be passed on to consumer in form of lower prices.* From what we can discern from experience in EU member states which have seen a reduction in VAT on e-books, both in France (where e-books on physical supports were allowed a reduced VAT soon after the adoption of the 2009 Directive) and Sweden (where VAT on print books was reduced from 25% to 6% in 2001), a reduction in VAT on e-books did result in a lower price to the consumer. It should also be noted that in those Member States, such as the UK, where legislation does not permit the determination of prices by publishers, retailers are mainly responsible for the pass-on cost to the consumer.
- *Reduced rates of VAT on e-books will not distort the internal market by making firms move to where the rates are lowest.* The switch to an imposition system for VAT based on the place of destination (where the consumer is located) in 2015 will eliminate the risk completely. Such risk would have been quite low for publishers anyway, since publishing is an activity that is mainly rooted on a lingual-geographical basis. Indeed, this is one of the reasons why different rates of VAT on printed books across Member States have not created any distortions in the past.
- *Producing e-books is not significantly cheaper than producing p-books, therefore removing the different VAT treatment will not have a distortive effect on supply of either.* Producing e-books is actually not substantially cheaper than producing printed books. Electronic publishing in fact generates many of the same costs which are associated with print publishing, as well as a host of additional costs not present in the print world. The payment of royalties to authors, the editorial work required to make a quality publication, marketing costs for the work, distribution costs, and (electronic) storage and archiving costs, all remain part of a publisher's calculation in the digital world. In addition, the costs of tackling online copyright infringement, investing in digitisation systems, staff and technology, maintenance of digital infrastructure and secure

distribution systems as well as the costs of file conversions into the relevant formats, updating of formats, file preservation and the application of DRM – not to mention the commissions to large distribution platforms – are all new costs that are specific to electronic publishing. Most estimates indicate that the share of costs of the physical production and delivery may amount to 15, maybe 20% of the total production cost, however the extra costs specific to digital are likely to offset any savings. Indeed, because the costs of production are broadly the same, it is all the more incongruous that the print and digital outputs should be subject to such widely divergent tax treatment. All the more since many of the new costs are fixed costs that need to be recovered via the sale of large numbers of units. Given that publishers are already largely operating in the print-plus-digital paradigm, the related concern that changing VAT rates for digital will alter the patterns of production and supply is equally misplaced. What VAT differentials may do, however, is disadvantage consumers – i.e. hit the demand side - by depriving readers of e-books of the tax benefits enjoyed by readers of print books.

- *Without a clear definition, allowing reduced rates of VAT on e-books will not create a loophole and include many other products that are not e-books.* This concern is understandable, but speaks to the need to create a suitable definition of e-books to prevent such loopholes opening up. It is not a principled reason to dismiss the possible application of reduced VAT rates to books in all formats. We address this issue in the following sections of this paper.

Reply to questions

- *Q1 Are there any concrete situations that you are aware of whereby the application of a reduced rate on certain goods and services by one or more Member States is effectively resulting in material distortion of competition within the Single Market? Please explain and, if possible, give an indication of the economic impact of the distortive effects.*

It is widely recognised that the application of reduced rates on printed books – including the marginal difference between rates across Member States – has produced no distortions whatsoever within the Single Market. Distance sales are generally subject to the VAT rate of the country of destination, so there is no risk of distortion from that side. As already pointed out, the destination principle will, from 2015, be applied also to electronically delivered products such as e-books. This will place electronic products under the same regime as physical products, thus moving towards an equal fiscal system for comparable products and avoiding Internal Market complications. Cross-border sales, which fall under the country-of-origin principle, do

not pose any problems either: books can be traded across borders, but there are minimal incentives for cross-border trading given the importance of language. In addition, empirical observation has shown that unlike products with a significantly higher unit price, it is not likely to be financially beneficial to cross a border in order to purchase published content.

Actual distortion occurs where the alignment of reduced rates between digital and physical publications is not permitted. Member States may in fact apply a reduced VAT rate to books on all physical supports, but have to apply the standard rate to their competing online equivalent, e-books. As full rates are applied to downloads and online reading, books (even the same book in different formats) can be subject to wide tax differentials according just to the way they are accessed by their users. Currently, the gap between the reduced rates applied to books and the standard rates ranges from a minimum of 6% up to a maximum of 23%. All other things being equal, this would translate to a comparable range of price differentials, putting electronic books at a clear – as much as unwarranted – disadvantage. A higher VAT rate on electronic publications creates an unjustifiable market distortion, which violates the principle of fiscal neutrality by introducing an element of unfair competition between printed and electronic versions. It also puts European companies at a disadvantage towards foreign companies from countries such as the U.S., where e-book sales are subject to the same beneficial conditions of printed books or even better (in the U.S. e-books are mostly not subject to sales taxes, for example).

Existing high VAT rates on electronic products can drive decision makers to forgo online products and services in favour of print books and periodicals. Reduced VAT rates on electronic publications would not only enhance the purchasing power of cultural institutions but also enable libraries, universities and other educational organisations to provide the leaders of tomorrow with the digital resources necessary to fuel European competitiveness in a digital world.

In this scenario, the only risk comes from the possibility of unilateral actions by some Member States, which could create distortions in the e-book market by allowing large retailers (much more likely than publishers, who are as mentioned before mostly rooted in their linguistic areas) to use fiscal discrepancies to gain an unfair if not illegitimate advantage on most local competitors.

- *Q6 Do you agree that those electronic services that would qualify for the reduced rate will have to be precisely defined in a uniform way at an EU level or do you consider that a broad definition in the VAT Directive would be sufficient?*

We understand the notion of proposing a precise definition of the digital publications that would qualify for a reduced rate, in order to avoid creating a legal loophole through which products other than those intended could be included. A definition at EU level will also help to avoid creating an overly complicated situation of different definitions in different Member States.

We would note that the reasoning here should take into account the two axes along which the question can be elaborated. First, whether a definition is EU wide or established at national level. Secondly, whether a definition is broad or narrow. This gives rise to a matrix, and the challenge will be to position the definition in order to strike the best balance.

An EU wide, precise definition will lower the chance of complications due to different interpretations at national level; and reduce the threat of loopholes. However, such a definition would risk being quickly rendered obsolete.

On the other hand, broad definitions introduced at national level would create a patchwork quilt of regimes across the Single Market, each with varying degrees of precision.

In our view, the present Directive goes a long way to addressing this potential problem and we do not believe that books and journals will be much more difficult to recognise in the digital world than they are where they are sold in physical form. We think therefore that the best solution would be to propose a simple adaptation of Annex III:

“supply including on loan by libraries, of books (including brochures, leaflets and similar matter, children’s picture, drawing or colouring books, music written or in manuscript form, maps and hydrographic or similar charts), newspapers and **serials, accessible on all means of support and formats (including – but not limited to – print, digital, audio) and via any technological means (both offline and online), other than material wholly or predominantly devoted to advertising”**

- *Q7 Considering the need for a uniform and future proofed approach at EU level, what should be the definition of an e-book in EU-law?*

If the proposed adaptation of Annex III of the VAT Directive were not to be deemed sufficient, we think the defining exercise should propose a solution that is of course not excessively vague but at the same time that retains the necessary degree of flexibility to be reasonably future-proof, as all legislation should aim to be.

The following is our proposed definition:

An electronic book is a work, conceived as a whole in one part or within a finite number of parts by its publisher/author(s), consisting predominantly of textual, photographic and/or graphic content or else in the reading or in the audio rendering of the same content, which is made publicly available in an electronic format. An electronic book can be interactive and can contain non-textual elements, presented in different formats (such as audio, video, hypertext), functionally connected to that predominant content.

As representatives of publishers of learned journals, we would also like to propose a definition of serials for the same purposes:

A serial is a scientific, academics, or practitioner learned publication, involving collections of articles published in volume format from time to time, online and/ or in physical form, consisting predominantly of textual, graphical or diagrammatic content. An electronic serial can be interactive and can contain non-textual elements, presented in different formats (such as audio, video, hypertext), functionally connected to that predominant content.

If required, this definition could be accompanied by some interpretative guidelines, which could both help increase its precision and render it more easily adaptable to technological developments and other relevant conditions than possible solely through the means a Directive.

As stated above, the FEP would support a definition that is future-proof and which takes into account technological progress without becoming obsolete in a very short time. We seek to find the ideal wording which affords sufficient precision to prevent all manner of products being considered e-books, but which at the same time is not so narrow that it will require re-writing it in 3 years' time because it will have gone out of date. We believe the proposed language above strikes this balance: it meets the needs of a harmonised single market, brings certainty, and reduces the potential for loopholes. This said, we'd like to clarify that we are well aware of how the political sensitiveness of the debate might affect the final decision on the definition.