EU Takes on VAT Treatment of E-Book Sales

by David D. Stewart

The European Commission has launched an infringement proceeding against France and Luxembourg over the two countries' decisions to apply their reduced VAT rates for physical books to the sale of electronic books.

In a July 3 statement the European Commission said that it was taking action ''because the VAT rates they are applying to digital books are potentially incompatible with EU law.''

The EU VAT rules operate differently for physical and electronic books. Under the EU's interpretation, e-books are electronic services, taxable in the country of the seller as business-to-consumer sales, while physical books are goods, taxable in the country of the customer in the case of cross-border online sales. However, beginning in 2015, the rules are scheduled to change with business-to-consumer sales of electronic services taxable in the member state of the customer.

Luxembourg has been the country of choice for multinationals seeking entry into the European market because it has the EU's lowest general VAT rate (15 percent), which can be applied to all business-to-consumer sales of electronic services.

However, while the EU VAT directive allows member states to apply reduced VAT rates to a restricted list of goods and services, including books, it limits the reduced rates to books that are printed on a ''physical means of support.''

This doesn't apply to digital content, which is considered a supply of services — not listed in the Annex. Because digital content provides ''the same books and newspapers as [print], for many years there is a cry for identical treatment — which isn't allowed according to the current directive,'' said Raymond Feen, a VAT consultant and founder of ALLVAT.

The distinction creates an unusual situation in book sales. For example, a customer in the United Kingdom would pay no VAT on a physical book from any source, but would pay a 20 percent VAT rate on an e-book sold by a U.K. entity.

''The commission intends to change this and is seeking solutions,'' noted Feen. ''Luxembourg and France by themselves decided at the beginning of this year not to wait and changed the rate for digital content already in line with printed material.''

In 2011 France and Luxembourg moved to align the tax rates on books delivered through electronic media with the reduced rates applicable to books sold in physical form. (France's reduced rate is 7 percent and Luxembourg's is 3 percent.)

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The European Commission is addressing the different VAT rates in the EU for physical and electronic books, which has created serious competitive distortions.

The move created a potential windfall for e-book retailers, including Amazon, Apple, and Sony, all of which have established electronic sales companies in the grand duchy.

''This situation is creating serious distortions of competition that are damaging to economic operators in the other 25 Member States, since digital books can easily be purchased in a State other than the one where the consumer resides and, under the current rules, the VAT rate [that] applies is that of the provider's, not the customer's, Member State,'' the European Commission statement said.

According to the commission, local e-book merchants have complained that the sales structures of the large retailers that have taken advantage of the reduced rates have hurt local sales figures in other member states for both e-books and physical books during the first quarter of 2012.

The commission acknowledged that it is considering a plan to harmonize e-book and physical book rates as part of its VAT modernization project. However, it said that any proposals to that effect will not be made until 2013 and that such a change could be accomplished only through an amendment to the VAT directive.

Tom Borec, a Zurich-based senior tax manager with PwC, said that he was surprised by the timing of the European Commission's action.

''It is an interesting timing. I thought that the commission would either act faster or slower than it did,'' said Borec.

Borec said the commission likely monitored the effects of the rate reductions to books and e-book sales in other EU countries and was compelled to enforce the current policy under the VAT directive regardless of any future changes that may be adopted.

In both cases it was essentially claimed that e-books should be taxed as paper books. He sees differences between the two cases as well, noting that comments from French officials at the time the rate was reduced indicated the acknowledgment that the reduced rate was counter to the VAT directive and that the government was prepared to pay fines from the EU. Luxembourg's approach, however, was to claim that the rate reduction was an implementation of the EU's discussion of future changes to the VAT directive.

Borec views VAT as an area for competition but says that in the short term Luxembourg holds the advantage of having the second-lowest VAT rates in the EU on books. The VAT directive prevents other member states from adopting new reduced rates lower than 5 percent. He noted that only the United Kingdom has a lower book rate (0 percent), but that the U.K. government has said that it would not apply that rate to e-books.

''I really think that if any other country wanted to introduce a reduced rate, they would have most probably done it by now,'' said Borec. ''As it is, everyone is waiting for the outcome of the infringement procedure.''

''In 2015 the new VAT rules for e-services will be introduced so e-books will have to be taxed, not at the rate in Luxembourg or France, but at the rate of the country where the consumer is resident. For Luxembourg and France they will be able to use this VAT rate until the end of 2014, and afterwards it doesn't matter how Luxembourg or France want to tax them, it is a question of how different countries will decide how to tax them for their own residents,'' explained Borec.

Beginning in 2015, according to Borec, the competition will be between the sellers of physical and e-books rather than between member states.

''It will be a different format of competition,'' said Borec. ''One of the issues the industry will be facing is how to define the e-book. Is it only text or can it also include movies, songs, other data, and advertisements? All of these things are defined for traditional media and are crucial to determine the correct VAT rate.''

In its statement, the commission said it is sending letters of formal notice to France and Luxembourg and that the two countries will have one month to submit comments. The next step for the commission will be to issue a reasoned opinion directing the two countries to change their VAT rates. At that point, the case could be brought before the European Court of Justice.

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