

KEY ISSUES

Bomb disposal within the VAT minefield: An attempt at clarifying the rules

Keith Renwick with Geoff Gilbert and Paul Harwood

An article in the Guardian on 31st July 2001, headlined "Freeserve threat over VAT", quoted a Customs & Excise official, who described VAT rules relating to the supply of electronic services as a "minefield". It is obvious from a number of recent e-mails on mailing lists that a some VAT rules and regulations are either ambiguous or are being incorrectly applied.

Issues raised include the following:

- Should goods supplied from outside the EC be subject to VAT as a reverse charge?
- Publishers apportion combined print/electronic subscriptions in different proportions and charge VAT on the electronic part of the subscription;
- Inconsistencies in EC regulations relating to electronic services supplied on an international basis.

This Key Issues feature attempts to clarify some of these issues, in order to ensure that VAT regulations are understood and correctly applied, although many are open to different interpretation by suppliers, customers, Customs & Excise officials and accountants.

In the first section, Geoff Gilbert outlines the VAT position relating to VAT on materials from non-EC countries.

In the second section, I have outlined the regulations on mixed supplies of print and other materials and attempt to clarify the rules relating to whether VAT is imposed at the rate of country of supply or use.

Finally, Paul Harwood describes the activities of the Frankfurt Group in lobbying for uniformity throughout the EC in applying rules relating to electronic information services.

VAT and electronically published information resources from non-EC countries

One of the fundamental issues to arise from the consideration of deals, made by publishers with the UK HEI community through

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NESLI, was the recognition that there could be an added burden of cost because VAT is applicable to electronically published materials (EPM's). This has brought into question the principle of whether or not VAT should be applicable to information resources designed to further research and teaching and learning. This discussion in itself is a delicate issue, which has many pitfalls for the academic and research community. There is also the question of whether VAT is applicable on EPM's purchased or supplied from non-EC countries. For instance, if institutions enter into a licence to purchase access to Academic Press's APPEAL database, is VAT payable on the cost of that service, when the company is not based in an EC country and the service itself is not delivered from an EC country? This matter has been raised because in the EC, electronically published materials are liable to VAT and NESLI, of course, is charged with the delivery of deals for electronic journals.

For some considerable time, inconsistency in the advice given and practice undertaken has been a concern within higher education institutions, especially, as to whether, in this instance, VAT should be self-imposed using the 'reverse charge' procedure. So, as well as looking at some of the arguments about whether VAT should be applicable to electronic publications, it may be useful to describe the legislation that is currently in force and what is being proposed both by the UK Government and by the EC.

The relevant current legislation on this question is the Value Added Tax Act 1994. Section 8 of this Act delineates the principle of a 'reverse charge on supplies received from abroad'. A reverse charge is applicable to any of the services in paragraphs 1-8 of Schedule 5 (Services supplied to where received) of the Act. Paragraph 3 states "Services of consultants, engineers, consultancy, bureaux, lawyers, accountants, and other similar services; data processing and provision of information....". What is a reverse charge? According to legislation, the supplier of a service usually has the responsibility for any VAT due on supply. However, if the recipient is situated in an EC member state but their supplier is located in a non-EC country, then it is the recipient, who has the responsibility for acknowledging that VAT due and arranging payment of that VAT.

This legislation appears to be clear and

unequivocal, yet not all higher education institutions have followed it to the letter, presumably, because local Customs & Excise offices have allowed some degree of local interpretation of the necessity to apply it. However, the greater awareness of EPM's and the use of the Internet as a delivery tool of information, has led to a tightening up of the situation. University finance offices as well as Customs and Excise have been alerted to this lack of diligence in enforcing what is laid out in the legislation.

In addition, the EC has announced proposed amendments to the VAT treatment of electronically delivered services, which will update VAT legislation to take into account the supply of services delivered online by digital means, especially when such services are traded between EC and non-EC countries. The full text of the proposal - (COM2000) 349 Final) is available from: http://europa.eu.int/comm/taxation_customs/proposals/taxation/tax_prop.htm. The basic aim of the proposal is to amend the EC Vat system to take account of the emergence of the Internet as a means of global e-commerce. It argues that the current VAT rules do not sufficiently address the supply of services delivered online by digital means via the Internet and most especially in terms of services traded between EC and non-EC countries.

Thus, it is argued that any proposed modifications to VAT in the EC should be guided by three principles: no new or additional taxes are necessary but existing taxes, such as VAT, should be adapted so that they can relate to e-commerce. In the case of the EC tax system, electronic deliveries should be treated as supplies of services. Finally only supplies of such services consumed in Europe should be taxed in Europe (i.e. taxation should take place in the jurisdiction where consumption takes place).

There have, apparently, been objections to this proposal from member states, such as France, as well as from the United States. These objections revolve around the added bureaucracy that would need to be created, in order establish taxation at source in a non-EC country. Such is the strength of these objections that implementation of the proposal has now been delayed, if not abandoned completely. The recent

think of light that some colleagues have detected in the AOL/Freeserve (see <http://www.guardian.co.uk/Archive/Article/0,4273,4230942,00.html>) dispute may be a red herring, because current legislation is quite clear. If the service is consumed in the UK, then at some point, VAT should be paid by the reverse charge mechanism. Only the supplier, AOL and/or Freeserve, can gain in this dispute, the receiver of the service cannot.

In the meantime, where does this leave Library and Information Services, who are trying to assess where they stand when calculating the cost of NESLI deals with publishers based in non-EC countries, or, indeed, purchasing any electronic publications from these countries? Much has depended, and still does, on the policy of each institution's Finance Office on VAT and with their relationship to the local Customs and Excise Office. In terms of principles that can be raised on the question of VAT on EPM's, discussions need to take place to establish the ramifications of the present situation:

1. VAT is applicable to electronically published.
2. VAT on EPM's supplied from non-EC countries are liable to VAT and this must be paid by the reverse charge mechanism.
3. Is it arguable to distinguish between the content of a journal or database and the delivery mechanism and access method to that content?
4. If a publisher supplies an information resource, as a 'bundle' of print and electronic, how should VAT be applied?

The argument of the Customs & Excise Office is concerned with the fact that EPM's may contain the same information content as their printed equivalents but that content is added to by the inclusion of functionality, such as search facilities and hypertext links. This, they would argue, alters the character of the product from the supply of goods to the supply of a service. Once this transformation to a service from a good is established, then the ability to zero rate EPM's is lost, as they no longer fit 'ordinary and everyday meaning' of books, journals and periodicals under the VAT Act 1994. A further difficulty is that under European agreements, the UK cannot either extend the scope of existing reliefs on VAT or create new ones.

VAT applied to print/electronic mixed supplies and the package test

Recent correspondence on e-lists has discussed the rate at which VAT is charged on combined or "mixed" supplies of print and electronic subscriptions, particularly where they are provided at no additional cost. In cases where the electronic subscription is provided at additional cost to print, the VAT element is obviously charged only on the additional subscription.

The primary concern of librarians has been over the apportionment of the print and electronic subscriptions, which is entirely at the discretion of publishers. What has become obvious from my research into this area is that most publishers have been applying the rules incorrectly in charging any VAT on any part of the combined print/electronic package.

The principal Customs & Excise document related to printed publications is Notice 701/10, dated October 1999. Section 2.8 of this document relates to mixed supplies and the package test, which states, "...if you supply standard and zero-rated goods together for a single price, for example a book and audio cassette tape, you must normally apportion that price between them and account for VAT on the standard-rated items". It would appear at first glance that the rules are presently being correctly applied in apportioning VAT between the print and electronic subscriptions. However, the document goes onto to define the "package test" in order to assess the VAT liability for mixed supplies as follows, "...where there is a multiple supply, which is items of equal or similar significance with no single item predominating, you have a choice. You can account for VAT by apportionment between the standard rated and zero-rated elements or you can apply the package test. *It may reduce your tax burden and be simpler to operate* (my italics) as follows:

- If the package contains more zero-rated than standard-rated items, the package as a whole can be zero-rated;
- If there are more standard-rated items, the package as a whole is standard-rated; and
- Where there are equal numbers of zero-rated and standard-rated items, the liability of the package is decided by the costs of the goods. If the zero-rated elements of the package cost

more, the whole package is zero-rated and vice versa."

It is obvious from the package test that where electronic access is provided at no additional cost to print subscription, then the package as a whole can be zero-rated, therefore publishers should not charge VAT on any part of the combined subscription.

Confirmation of this rule can be gained from the recently published VAT Information Sheet 03/01, dated April 2001, entitled *VAT: Digitised publications*. This gives an example of a journal subscription in one format with the other format offered at no additional cost, where "...the VAT treatment will depend on the exact nature of the supply". This is often apparent from the contract, agreement or advertising material. So:-

- Where the paper journal is included at no additional cost to a subscription for the digitised version, the paper journal is ancillary to the digitised journal. This is a standard rated supply when made in the UK; or
- Where the supply is clearly for a paper journal and the customer happens to receive access to the digitised version for no additional cost, the digitised version is ancillary to the paper journal. This is zero-rated for supply of goods when made in the UK."

This clearly states the position that the provision of the electronic version at no additional cost to the printed version should be zero-rated. This rule applies to all forms of mixed supplies publications. Therefore, it should also apply in cases where the book forms the substantial part of the package, such as books with a CD-ROM.

The position is less clear in relation to arrangements for access to a wide range of electronic titles at a price based upon existing print subscriptions, e.g. Ideal, Emerald, Science Direct, etc. This is further complicated by the fact that electronic access is often arranged directly with the publisher, whereas the print subscriptions are handled by an agent. In these cases, treatment for VAT purposes should be identified from the contract or agreement with the publisher, but it must be clearly stated, so that the position is clear to all parties. It is perhaps worth noting that it is to the advantage of both publisher and customer, if contracts state that the subscription cost is based on print subscriptions

forming the substantial part, thereby allowing the zero-rate to apply.

For information, it should be noted that, where electronic subscriptions are provided to UK VAT-registered customers from other EC countries, and where the supplier is aware of their VAT registration number, VAT should not be charged by the supplier, but should be paid by the customer at the UK rate. Publishers in other EC countries do not charge VAT for print subscriptions, even where VAT is applicable to printed material within that country, therefore there is no reason why they should charge VAT on electronic subscriptions at their domestic rate.

The work of the Frankfurt Group:

The Frankfurt Group represents the interests of authors, publishers, libraries, research centres, subscription agents and rights organisations, and in July this year, issued a statement on European Commission proposals to modify the rules on the application of VAT to electronic services.

Stressing how education and research underpin the economic and cultural well-being of European Community member states, this group has lobbied hard to point out inconsistencies in current practice and a way forward for all parties. Their starting point has been that thirteen of the fifteen European Community members apply a reduced VAT rate to printed information, whilst VAT rates on electronic information are applied at the higher rate. They argue for an end to the inconsistent application and enforcement of VAT regulations within the EC and for scientific and educational information in electronic format to be taxed at the same rate as information in printed format. By way of contrast, the United States has agreed not to levy sales tax on electronic commerce, which includes electronic information, until at least 2006.

The Frankfurt Group, whilst recognising the complexity of the issues involved, has made it clear that it totally opposes plans that include different VAT rates for the same information available in printed and electronic form. It has asked all EC governments to apply VAT at either reduced or zero rates in the case of scientific, research and educational information. In the

absence of an enforceable VAT regime throughout Europe at this stage, the Group's goals are quite clear:

- application of the lowest equal rate for both printed and electronic information
- a level playing field for suppliers from within and outside the EC
- clear and consistent EC guidelines on this subject.

In conclusion

There are many issues that pose problems for

librarians, not least the inconsistencies between VAT rules applied to different formats of information dissemination and storage. It is likely that any major change in VAT regulations relating to the rate charged on printed information will occur as part of the harmonisation of VAT rates within the EC. It is important that all those, involved in information production and dissemination, highlight the fundamental issue – the format used for distributing information is irrelevant, what is important is content.