

## WHITE PAPER

# New EU VAT Legislation Pertaining to the Sale of Ebooks

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## INTRODUCTION

Newly implemented VAT legislation in the EU means that if you sell ebooks your means of applying and accounting for VAT just got more complicated.

Like most consumer products ebooks sold in the EU are liable to VAT. So, if you are UK-based and registered for VAT you charge the consumer 20% VAT, whether they are in the UK or anywhere within the EU.

A significant number of ebook publishers, and of course most self-publishers, are micro-businesses that, due to their size, fall outside the scope of VAT so, until now, VAT has not been an issue for them. However, from 1<sup>st</sup> January 2015 this has changed and if you are not complying with the new legislative requirements you need to move very fast.

This White Paper focuses on the changed legislation as it applies to businesses based in the EU selling ebooks. For the examples it assumes that your business is located in the UK but, with some exceptions, the legislation applies equally across all 28 states.

If you are located outside the EU and if you want to know what products other than ebooks also fall within the changes, as the scope includes all digital services, you may want to jump straight to the other information and links at the end of this paper.

## PREVIOUS SITUATION

### Selling to a consumer

If you were a VAT-registered business selling ebooks last year the rate of VAT applied was determined by the place of supply i.e. where your business was located. A UK-based seller charged 20%, a Greek seller 23% and a Luxembourg seller 3%. You charged VAT to any consumer in the EU at your local rate. At regular, usually quarterly, intervals you completed a VAT return and paid the VAT received on your sales to HM Revenue & Customs (HMRC) or your country's equivalent.

### **Selling to a VAT-registered business**

If you were a VAT-registered business selling ebooks last year then, assuming your buyer, wherever they were in the EU, provided a valid VAT number, that was that. There was no need to apply VAT, as this was a straightforward business-to-business (B2B) transaction between two VAT-registered organisations.

### **WHAT HAS CHANGED?**

On 1<sup>st</sup> January 2015 the legislation applicable to digital services, which includes ebooks, was altered. The fundamental change is that the VAT applied is now determined by the place of the buyer not the location of the supplier. So, as a seller, you must identify the location of each consumer and apply the VAT appropriate to that EU state. If you are a UK-based business you now charge a Greek buyer of your ebook 23% VAT, a German 19% and a Luxembourger 3%.

As a seller you now need to know the country in which the buyer is located and the VAT rate applicable to ebooks in that country. Instead of one VAT rate you now have to know 28.

B2B transactions, as described above, continue unchanged with no VAT applicable.

### **WHY HAS IT CHANGED?**

The official reason for this change is two-fold.

Firstly, it is to provide a more level playing field for ebook sellers throughout the EU. Ebook sales in the EU are dominated by a few large businesses, principally Amazon and Apple. They chose to domicile their EU sales operations in Luxembourg because that country applies the lowest, currently 3%, rate of VAT to ebooks in the EU. Although this is good news for consumers, because it means VAT is as low as it can be, it does mean that the hundreds of competing sellers throughout the EU struggle against Amazon and the others because they are unable or unwilling to relocate from their place of origin and are compelled to charge higher rates of VAT. In the UK, for example, Amazon will now have to

charge 20% on any ebook sales, aligning them with other UK sellers from Waterstones to your one-woman self-publishing operation.

The second reason for change is to align the rate of VAT charged on ebooks with most other consumer products, where it is determined at the point of sale or consumption rather than at the place of manufacture. The situation is exacerbated because of the very nature of ebooks and digital services, which are not tangible items and can be made available almost instantly across national borders.

A further but less-publicised reason for change is that the overall EU VAT take will rise with consequent benefits to individual countries. With a large proportion of ebook sales generated out of Luxembourg, the VAT take was biased towards 3% but now it will reflect consumer purchasing across all countries and all rates. As all other rates are above 3% there is only way for the VAT revenue to go and that is up. Of course there is a presumption here that the increased prices resulting from higher rates of VAT will not put off consumers with a consequent drop in demand.

## IS THIS A PROBLEM?

The outcome of this change for businesses selling ebooks is that it requires additional work to set up and administer 28 VAT rates and confirm the location of each consumer. Also it means reporting and paying VAT to every state in the EU where a sale is made, but the VAT authorities have provided a solution for this, of which more later. These administration issues are not particularly complex and for a large, established publisher or seller, where such data capture is merely an extension of its existing CRM and accounting systems, they will be accommodated quite easily.

The problems arise for small businesses that sell ebooks. These are what HMRC define as micro-businesses and they include publishers, distributors and self-publishers who represent the great majority of publishing businesses in the EU. Most of these businesses are unfamiliar with VAT because they do not exceed the threshold for turnover above which it is compulsory to register for VAT. This is particularly so in the UK which has the highest threshold, £81,000, in the EU.

So here are the challenges for micro-businesses:

1. Under the new legislation the VAT threshold across the EU has been reduced to zero. This means that if you are selling ebooks in the EU you will have to register for VAT no matter what size of business you are. If you sell only one ebook you have to register, charge, and account for VAT.
2. You must ensure you apply the correct rate of VAT, from the 28 different rates, according to the location of the buyer in the EU.

3. You have to identify the location of each buyer of your ebooks and corroborate that location with two separate pieces of information. These could be the billing address of the buyer and the location of their bank, for example. This is required to prove that the buyer is located for purposes of tax domicile in the country they say they are located in and to ensure that, eventually, the VAT charged finds its way to that country.
4. You have to register for VAT in every EU state and ensure that the VAT you collect on sales is remitted to that country – the VAT administrators across the EU have addressed this particular challenge and provided a solution that will be explained in the next section.

On top of these four challenges you have also to:

- i. retain all records for at least ten years;
- ii. submit, if so required, to a VAT audit by any one of the 28 states of the EU.

There is an ongoing debate as to whether or not the collection of customer data will render a micro-business liable to register as a Data Controller under the Data Protection Act (1998). Initial enquiries suggest this is unlikely unless that data is used for purposes other than simply meeting the VAT legislation requirements but clarification is required.

All of this is within the normal capabilities of a large organization but for a micro-business it ushers in a new dimension in administration!

## WHAT ARE THE OPTIONS?

If you are a micro-business with no previous experience of VAT there are a number of ways in which you can ensure you comply with the new legislation.

1. You can handle the process yourself. If you already have some good accounting software and are prepared to go through the set-up process then this is a reasonable option, particularly if your existing or planned sales of ebooks into other EU states are high. There is plenty of advice available from HMRC and others on what to do. You may wish to speak with your accountant or tax advisor too.

You can choose between registering for VAT in each EU state and dealing with it on a country-by-country basis or using the HMRC facility known as VAT Mini One-Stop Shop (VATMOSS). Once registered with VATMOSS the need to register and account for VAT to each EU state is effectively removed. Instead, you provide your sales information to VATMOSS, pay them the total VAT due across all your sales and they then deal with the distribution of the VAT payments to the other EU countries. Each EU

country is setting up its own VATMOSS in order to simplify this aspect of the legislation for businesses. Many large businesses may already be registered for VAT in multiple countries but for the micro-business VATMOSS simplifies much administration and means it is necessary only to register for VAT in the country in which you are domiciled.

Also, for UK-based businesses, HMRC has confirmed that, although they will need to account to VATMOSS for all EU sales outside the UK, the registration threshold for UK annual sales of £81,000 will remain. Consequently ebook sales within the UK can be VAT-free until your turnover reaches £81,000.

One potential benefit is that, by registering for VAT, you will be able to reclaim any input tax you incur in respect of ebooks, although this will have to be aligned against the VAT on your sales.

The other aspect that will require some thought is ensuring you are able to capture the necessary information to prove the location of the buyer. It was mentioned earlier that two corroborating items of data are needed. Consequently your sales and check out process will need to enable this data capture. However, due to effective lobbying, HMRC announced that a concession will be introduced so that UK businesses do not need to provide corroboration of the location until July 2015.

In summary, for a one-man business, handling the process yourself is quite possible but it is not a solution to follow without careful consideration of the additional time and effort that will be necessary to set up and thereafter administer VAT.

2. Use an intermediary or third-party to sell your ebooks. There are many companies that offer this service including Amazon's Kindle Store, Apple iStore and eBookPartnership. If you consign your ebook sales to them they are responsible for all VAT matters. It is necessary only to confirm that your chosen third-party seller is set-up to manage VAT under the new legislative process.

Of course there is a cost to this solution, as the intermediary will impose a charge usually in the form of a percentage commission applied to your sales. You will receive the balance by way of a royalty. Also, you will have to sell all your ebooks through the third-party or parties and you will not be able to sell any ebooks directly from your own website. If you persist in selling some ebooks from your site then you are back to option one as you will be responsible for all VAT associated with those sales.

Despite the additional cost, the advantage of this solution is that all selling and VAT matters are the responsibility of the intermediary. You are absolved of all the administration and reporting.

There is a disadvantage using this approach if your ebook sales are largely or exclusively to UK buyers. A third-party will charge the consumer VAT of 20% on top of the basic price. However, as a micro-business, under the £81,000 VAT threshold, you need not charge VAT and can keep your prices lower.

3. Block sales of ebooks to other EU countries and sell only to your country of domicile and to non-EU countries. This will be feasible if your sales to consumers in other EU countries are zero or low and you are prepared to forgo such sales for the sake of avoiding VAT registration.

However, there is debate concerning the legality of this option. A fundamental principle of the EU is that products and services are available in all member states and deliberately blocking sales is discriminatory. If you consider going down this route then further research is needed to obtain a definitive answer.

These three options each provide a solution to the new VAT regime and your choice will be determined by balancing cost, time, experience and your confidence in handling VAT and administration.

The standout recommendation for most micro-businesses will be using a third-party seller. This removes all the administrative hassle for a small loss of earnings and enables you to carry on largely as you are now, while accepting that you will no longer be able to sell direct to the consumer.

## ANYTHING ELSE?

One concern that has arisen in the run up to the VAT change is the impact it will have upon the price of ebooks.

Considering this from a consumer's perspective, if you are buying ebooks from a seller in your own country there will be no change in the price. The VAT element of the price remains the same at whatever rate is applicable in that country. However, because the biggest sellers are all based in Luxembourg it is likely you bought an ebook from there. Until December a UK-based buyer paid just 3% VAT as part of the total price when they purchased an ebook from Amazon, for example. Now, although the sale is conducted through Luxembourg, you will be charged 20% VAT, a hefty increase.

The seller has a choice with the ebook price: increase it to reflect the higher rate of VAT or do nothing and absorb it? The former may reduce sales volumes and the latter will reduce profits. The first few weeks of 2015 suggest a mixture of approaches have been adopted by sellers but it is likely that, over time, prices will move to ensure VAT is recouped in full. Amazon has increased prices so that they reflect the increased VAT as applicable throughout its EU sites. The author or publisher has the option to reduce the price but at the expense of a lower

royalty from Amazon. Apple has not increased prices but margins have reduced accordingly. The pain of absorbing the extra VAT will more likely be felt by the publishers and authors who will find the retailers squeeze them in order to preserve their margins. Time will tell.

Perhaps there will be a turn towards print books, which in almost all EU states attract a lower rate of VAT than ebooks. Until recently only Denmark and Bulgaria applied the same rate of 25% and 20% respectively. Interestingly, Italy and Malta have just reduced their VAT rate on ebooks to bring it in line with printed books at 4% and 5% respectively. Despite the changes in VAT applicable to ebooks print books tend to be more expensive anyway so any shift may be marginal. The actions by Italy and Malta do underscore the feeling of many in the publishing world that the VAT rate on ebooks should be identical to that on printed books. After all, apart from the means of delivery, there is no difference between the two products and their purpose; the content is exactly the same. There exists within EU legislature the notion of *fiscal neutrality* whereby similar products and services should attract VAT at the same rate so this supports the move towards equalizing VAT on digital and print books. However, experience suggests that as the EU rarely reduces VAT rates this is unlikely.

The UK position in this scenario is particularly interesting because, with print books zero-rated, the desire would be to similarly reduce VAT on ebooks to 0%. According to their legal advice the UK government would not be allowed to do this and instead would have to look at a compromise rate of, say, 5% for both. Again, for now this remains conjecture.

## SUMMARY

This change is not sudden although most micro-businesses have only become aware of its implications quite recently. The EU began a review of VAT on digital services back in 2008 and there was plenty of publicity from 2013 onwards by the likes of HMRC. Commentary from the publishing industry dates back at least to 2011. Unfortunately the consultation process leading up to the change did not involve small businesses and, of course, any businesses not registered for VAT were not going to receive any communication from the VAT authorities, then or now. Consequently it has caught many or most micro-businesses by surprise.

As outlined in the explanation of why this change has happened, the EU has inadvertently placed a huge additional burden upon fledgling and start-up enterprises in its effort to increase its VAT revenues from Amazon, Apple and other major players. These large organisations have been criticised heavily in recent years for their tax avoidance schemes. If this legislation is an attempt to hit back it is somewhat misguided.

The real losers are the EU consumers – who will have to pay higher prices; the micro-businesses – faced with major administrative demands; and the authors and independent publishers – who may see their income reduced as margins are

squeezed. Luxembourg might be thought a loser too as their VAT revenue is estimated to fall by over €800m but, thankfully for them, the EU has agreed a one-off compensation payment of €1bn!

Are there any winners? EU VAT revenue as a whole should increase, on the presumption of course that higher prices do not drive sales volumes down too far. Individual countries will benefit too as their share of total VAT revenue increases. The UK and Germany are each expecting VAT revenues to increase by over €300m as ebook sales are designated to them rather than to Luxembourg. National publishers should benefit as their ebooks will no longer be undercut by the lower prices offered by Amazon and others arising from their lower VAT charge – the playing field is more level. Finally, third-party sellers like eBook Partnership and Amazon Kindle should benefit from increased numbers of micro-businesses outsourcing their ebooks sales to avoid the VAT administration.

The bulk of the impact falls upon micro-businesses and a number of groups have recognized this and started lobbying for a rethink. Thanks to their efforts the digital services VATMOSS topic is receiving greater publicity and, in the UK, some concessions have been obtained. These include, as mentioned earlier, the ability for UK-based sellers to continue selling ebooks in the UK without imposing VAT and the six-month concession before full reporting of buyer's location details are required.

On reflection it seems that setting a sales threshold as part of these VAT changes would have been sensible as it would have kept most of the micro-businesses out of the process at a negligible loss of VAT revenue. It would enable them to focus upon their key challenges of development and growth while enforcement efforts could be focused upon the large businesses that account for the significant majority of all ebook sales and VAT. What really will be sad is to see micro-businesses shut down as a result of measures brought in to level the playing field for the ebook market.

## FURTHER INFORMATION

HMRC VAT – Digital Services: <https://www.gov.uk/government/publications/vat-supplying-digital-services-to-private-consumers/vat-businesses-supplying-digital-services-to-private-consumers>

HMRC Brief 46: VATMOSS additional guidance

EU VAT rates:

[http://ec.europa.eu/taxation\\_customs/resources/documents/taxation/vat/how\\_vat\\_works/rates/vat\\_rates\\_en.pdf](http://ec.europa.eu/taxation_customs/resources/documents/taxation/vat/how_vat_works/rates/vat_rates_en.pdf)

Information, news and views:

[www.thebookseller.com](http://www.thebookseller.com)

<http://euvataction.org>

<http://hannahkate.net/hannahs-bananas-a-vatmoss-analogy/>

[www.prowess.org.uk/euvat-vatmoss-news-resources](http://www.prowess.org.uk/euvat-vatmoss-news-resources)

[rachelandrew.github.io/eu-vat/third-parties.html](http://rachelandrew.github.io/eu-vat/third-parties.html)

Twitter – #VATMOSS

## Digital Services

In addition to ebooks the VAT changes apply to other electronically supplied services. The EU Commission definition is:

*Electronically supplied services shall include services which are delivered over the Internet or an electronic network and the nature of which renders their supply essentially automated and involving minimal human intervention, and impossible to ensure in the absence of information technology.*

HMRC provide some examples of electronic services:

- *Supplies of images or text, such as photos, screensavers, e-books and other digitised documents e.g. pdf files*
- *Supplies of music, films and games, including games of chance and gambling games, and of programmes on demand*
- *Online magazines*
- *Website supply or web hosting services*
- *Distance maintenance of programmes and equipment*
- *Supplies of software and software updates, advertising space on a website*

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