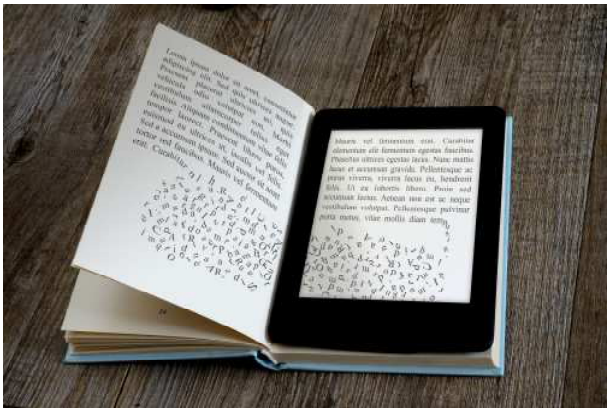
VAT ALERT

K Oy (C-219/13)

BACKGROUND

Under EU VAT law, EU Member States may, at their discretion, apply a reduced rate of VAT to books produced on "…all physical means of support". The term "all physical means of support" has generally been interpreted to include all printed books, but to exclude audio books and all digital and electronic books, commonly referred to as "e-books". There is also a prohibition under EU VAT law against applying a reduced rate of VAT to "electronically supplied services". Accordingly, in the UK, for example, printed books are currently zero-rated for VAT purposes (i.e. VAT is charged on their supply at the rate of 0%) whilst the supply of e-books is treated as a supply of electronic services which is subject to VAT at the standard rate (i.e. 20%).

The question this litigation raised was whether this apparently discrepant treatment of similar products complied with the EU principle of fiscal neutrality, according to which similar and competing products must be treated equally for VAT purposes?



THE DECISION

The Court of Justice of the European Union (the "**Court of Justice**") has addressed this question in its recent judgment in the case of *K Oy* (C-219/13), regarding the application of different rates of VAT in Finland to printed books and e-books. The case was referred to the Court of Justice by the Finnish Tax Administration, and is one of several cases brought before various courts regarding the application of reduced rates of VAT to e-books: infringement proceedings are currently pending against France and Luxembourg regarding their application of a reduced rate of VAT to e-books, in relation to which proceedings the EU Commission has stated, unequivocally, that, "*The provision of ebooks is an*

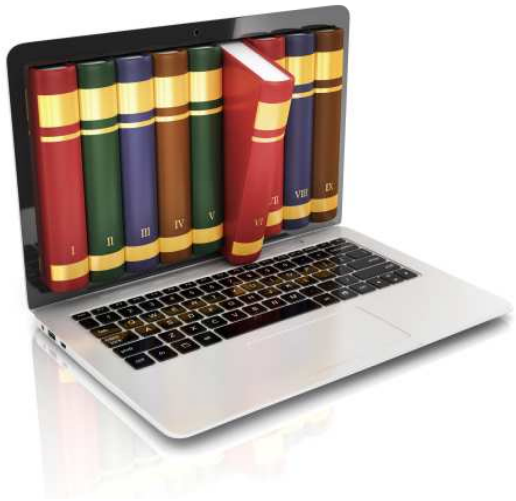
electronically provided service and as such cannot benefit from a reduced rate."

The present case was brought by K Oy, a publisher of e-books in Finland, arguing for the principle of fiscal neutrality, which has become a fundamental tenet of the common EU system of VAT, and which precludes treating similar goods or services, which are therefore in competition with each other, differently for VAT purposes. K Oy argued that printed books and e-books are similar goods with similar characteristics which are in competition with each other and as such treating them differently for VAT purposes, by allowing Finnish tax legislation to apply a reduced rate of VAT to one but not to the other, is a breach of this principle.

In its judgment, the Court of Justice has followed the Advocate-General's Opinion issued in April and confirmed that the Principal VAT Directive, which does not specifically deal with the VAT treatment of e-books, does not preclude national legislation which applies different rates of VAT to printed books and e-books, provided that such legislation complies with the principle of fiscal neutrality. In the Court of Justice's view, whether such domestic legislation is compliant with the principle of fiscal neutrality is a question of fact for national courts to determine on a case-by-case basis.

According to the judgment, to answer this question, national courts will have to consider the extent to which, from the perspective of an "average" consumer in the applicable Member State, the two kinds of book have similar characteristics and satisfy the same needs. In identifying who is an "average" consumer for these purposes, national courts must take into account the particular features of the market for the relevant goods in the applicable Member State e.g. market penetration in that Member State of e-books and the equipment needed to view them compared to printed books.

Notwithstanding the above, the Court of Justice's judgment appears to be clear that, "*…if what matters for that consumer is essentially the similar content of all books, regardless of their physical support or characteristics, the selective application of a reduced rate of VAT is not justified.*" In other words, if a national court concludes that printed books and e-books achieve substantially the same purpose from the perspective of an average consumer in that Member State, then the court will have no choice but to rule that the same VAT treatment must be applied to both.



COMMENT

Whilst the Court of Justice's decision does not bring the VAT treatment of e-books into line with printed books - and to that extent it maintains the status quo - in theory it invites the national courts of EU Member States to look again at the issue in the light of the principle of fiscal neutrality.

In the Court of Justice's view, it is up to national courts to decide whether, as a matter of fact, printed books and e-books are sufficiently different from each other to justify the selective application of a reduced rate of VAT to one but not the other. The requirement expressed in the judgment for national courts to assess the issue from the point of view of an "average consumer", who will likely differ depending on the nature of the e-product and the Member State concerned, means that the VAT treatment of e-books may conceivably vary between Member States and over time, as the market for new technologies develops. In the UK, we understand the First-tier tax tribunal will be given an early opportunity to consider the issue in a case currently being run before it on HMRC's application of the standard rate of VAT to e-books. In any event, the Court of Justice's judgment appears to be significantly softer than the EU Commission's view that VAT must be charged on e-books at the full rate.

Politically speaking, it is important to bear in mind that from 1 January 2015 EU-based businesses will need to charge VAT at the rate applicable in the Member State of the consumer on most cross-border e-commerce services including e-books. This will be consistent with the rule currently applicable for businesses based outside the EU. Currently, EU-based businesses charge VAT on cross-border e-commerce services supplied to consumers at the rate applicable in the Member State where the supplier is based, so Member States who have reduced

their rate of VAT on the supply of e-books have been able to obtain a competitive advantage by attracting businesses to their location. This potential advantage ends on 31 December 2014 and it seems unlikely that Member States will wish to go out of their way now to find reasons to lower the rate of VAT on e-books if they will gain no competitive advantage for their jurisdiction and merely reduce their tax revenues.

The judgment also fails to address the tricky issue of how the principle of fiscal neutrality interacts with the express prohibition under the Principal VAT Directive against the application of a reduced rate of VAT to electronically supplied services. It appears that this issue may yet have a long way to run.

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