

3 September 2010

bob.morrison@hmc.gsi.gov.uk

Dear Bob,

HMRC consultation on postal services VAT

Consumer Focus is the independent champion for consumers across England, Wales, Scotland, and for postal consumers in Northern Ireland. We operate across the whole of the economy, persuading businesses and public services to put consumers at the heart of what they do.

Our comments on HMRC's proposals are made from the perspective of our experience of championing consumers' interests in private and public sectors. We have a particular focus on the interests of consumers in markets such as post that are 'designated' by Government as requiring additional consumer advocacy. We work to secure fairer markets, greater value for money, and improved customer service, and have a commitment to work on behalf of vulnerable and disadvantaged consumers, and a duty to work on issues of sustainable development.

Consumer Focus is concerned that HMRC's proposed changes to the application of VAT for postal services will not solve the problem caused by the VAT exemption which Royal Mail enjoys for certain postal services; namely the barrier to end to end (E2E) competition in the postal market. It is widely acknowledged that Royal Mail's ability to exempt certain postal services from the levying of VAT is perpetuating a competitive distortion in the postal market and is one of the main barriers to entry to alternative E2E operators¹.

We do not believe that HMRC's proposals will eradicate the competitive distortion created by the VAT exemption because Royal Mail will still be able to exempt products which are similar to those which its potential competitors would be looking to bring to market (for example products similar to Mailsort). It is our view that the decision that only "public postal services" provided by a universal service provider, and the supply of related incidental goods, will qualify for exemption is logically flawed. If the principle is to ensure that only "public postal services" shall be exempt from VAT it should not matter which company or entity provides it be it the Universal Service Provider (USP) or its competitors. There should be a level playing field.

We believe that it is important to remove this barrier to entry because increased postal market competition provides benefits for postal consumers, for large mailers in terms of lower prices, and also small users. This is because it provides the competitive constraint on Royal Mail to become more efficient, thus keeping postal prices for consumers lower than they would otherwise be in the absence of competition.

There are a number of possible solutions which we are aware of that could end this barrier to entry although each has its own drawbacks.

¹ See for example Frontier Economics, Scope of the price control 2011 – Assessment of competitive constraints on Royal Mail's pricing behaviour, May 2010 p34-6

In 2006 Postcomm² recommended to the Treasury that a solution to the competitive distortion should meet two principles. Consumer Focus believes that these principles are still sound today. These are:

1. There is a level playing field for postal operators
2. There is no significant price rises for customers

Below we list five main ways that the problem could be solved. A mixture of these solutions could also be compatible with solving the problem. We do not have a definitive view as to what solution should be implemented.

1. The VAT exemption could be extended to other operators. This would provide benefits to certain mail customers and end the distortion. However, we concede that it would deprive the Treasury of much needed revenue
2. The full rate of VAT could be applied to all postal operators. This would eliminate the competitive distortion. However, this would involve significant price rises for customers which could overly disrupt the postal market and disadvantage customers. This could have a significant effect on an already dwindling letter market that could undermine the provision of the USO
3. Introduce a reduced rate of VAT applied to all postal operators. This represents a compromise between the first two solutions and would meet the two principles above. However, it could prove very difficult to implement as it would require changes to EU legislation requiring unanimous approval from all 27 member states. We would also note that the European Court of Justice interpretation of postal VAT is unclear
4. Allow the USP to exempt VAT from Universal Service Obligation (USO) postal products only. This would go some way to removing the current competitive distortion but would not remove it completely as some bulk mail products (such as Cleanmail), which would compete with competitors' products and services, are still part of the USO, and thus would be covered by the VAT exemption
5. Only allow the USP to exempt postal products from VAT in markets where competition is unlikely to develop. Of course this would require a large degree of regulatory oversight and resulting cost

In conclusion, there is no easy solution which will end the current competitive distortion caused by Royal Mail's ability to exempt certain postal products from VAT. However, we are clear that HMRC's proposals as they stand will do little to end this barrier to entry.

I hope these comments are helpful. My colleague, Cem Suleyman, would be pleased to follow them up with you either in person or via telephone/email (cem.suleyman@consumerfocus.org.uk, 0207 799 7932).

Yours Sincerely,



Robert Hammond
Head of Regulated Industries

² Postcomm, Competitive Market Review: Tackling barriers to entry in postal services, Final decisions and recommendations (April 2006) p.iii