



Assessment of the application and impact of the VAT exemption for importation of small consignments

*Specific Contract No7 TAXUD/2013/DE/334
Based on Framework Contract No
Taxud/2012/CC/117*

*Executive Summary
EY – May 2015*





Disclaimer

The information and views set out in this report are those of the author(s) and do not necessarily reflect the official opinion of the Commission. The Commission does not guarantee the accuracy of the data included in this study. Neither the Commission nor any person acting on the Commission's behalf may be held responsible for the use which may be made of the information contained therein.

doi:10.2778/822083
ISBN: 978-92-79-47901-4
© European Union, 2015

Reproduction is authorised provided the source is acknowledged.



Executive summary

In general, imports in the EU are charged with customs duties and VAT unless they are specifically exempt. VAT Directives and Customs Regulations provide for an exemption for the importation of consignments with a negligible value.

The low value consignment relief for VAT (hereinafter 'LVCR') has been introduced in the EU in 1983. The relevant provisions in the EU Directive allowed Member States to relieve imports of goods of a negligible not exceeding 22 [ECU] from VAT and was intended as a method to facilitate cross-border trade by reducing the administrative burden and cost involved for business and Member States.

The LVCR has been subject to a lot of discussion over time, considering that so-called 'duty & VAT free imports' were adversely impacting domestic sales for which VAT must be charged in any case, but also considering the administrative burden (both for operators and for customs administrations) linked to the collection of VAT on an increasing number of consignments. The Commission has notably received several complains and submissions from industry stakeholders in this area.

Some product categories appear to be more affected than other by this type of trade. The Authorities in a number of Member States have therefore also looked into this particular exemption which has led to variety in interpretations and exclusions from the VAT exemption such as mail order.

The growth in the volume of imported consignments in the EU, which appears to be largely driven by a boom in e-commerce, has put pressure on the existing LVCR arrangement. The current VAT Directive obliges the Member States to exempt all commercial importations (business-to-consumer, hereafter "B2C") of consignments with a value not exceeding EUR 10 from import VAT. Member States are free to increase this threshold up to EUR 22. Member States are also allowed to exclude mail order shipments from this arrangement, which would legally almost remove the exemption for most of the consignments.

In addition to the above mentioned exemption, non-commercial consignments sent from a third country by a private person to another private person in the EU with a value not exceeding EUR 45 are also exempt from import VAT.

The Commission emphasized in its 2011 Communication on the future of VAT that *"a number of provisions in the VAT Directive are outdated and do not take the single market aspect sufficiently into account"*. Within this context, the Communication is clear that *"the treatment of small consignments and other internet sales is to be tackled"* to ensure a *"level playing field for non-EU and EU suppliers"*. On that basis, the Commission Expert Group made the specific recommendation in 2014 to *"abolish the small consignments exemption"* and that this should be pursued as *"a priority in tandem with the development of the broader One Stop Shop also applying to other small consignments for which no customs duties are due"*.

In order to feed the future debates, our study sets out the results of our assessment of the application and impact of the existing low value consignments relief in two separate parts: Part I presents a review of the legal framework and procedures in



place in the 28 EU Member States and Part II provides an economic analysis of the low value consignments market and its consequences.

Legislative review

The review has showed certain variations in the national applications of this exemption.

The Customs Regulations stipulate that all EU Member States apply a customs duty relief if the consignment has an intrinsic value below EUR 150. This relief does not apply to alcoholic products, perfumes, toilet waters and tobacco or tobacco products. The intrinsic value is the actual value of the product and does not include any other costs such as insurance and freight.

Analysis with regard to the VAT relief indicates that most EU Member States have implemented the maximum allowed threshold of EUR 22.

The review shows that Member States have a different approach towards the method for determining the value threshold either opting for the total value or that of the intrinsic value as a basis. This different approach has led to a mismatch of interpretation amongst practical operators over which 'valuation' method to apply.

Some Member States have excluded certain products from the LVCR on top of the general restrictions. Only the United Kingdom has excluded from the VAT exemption mail order goods coming from a specific geographic origin, i.e. the Channel Islands. Policy papers circulated suggest that the United Kingdom exclusion is based on the distortion of competition these import flows cause in the UK market. The treatment of mail orders differs across Member States, i.e. five Member States invoked the right to exclude mail orders from the application of LVCR in its entirety, or for specific product categories only. All indicated that the rationale was to prevent abuse, for instance routing shipments via non-EU territories to enjoy said exemption, or the fact that it constitutes a form of competition between the mail order market and the domestic market. Three Member States reversed their decision to exclude mail order in their national legislation, notably to avoid the relocation of economic operators to countries that do not apply such mail order exclusion and because the cost of collecting VAT from an import exceeded the actual tax revenue for that import.

Review of practical procedures and costs for stakeholders

Dependent on the Member State as well as the value of the consignment, it has been identified that significant differences exist in the applicable customs clearance procedures. In addition, our observation points out that the practice may differ from the theoretical framework and is consistently less strict in terms of requirements.

Indicative calculations based on clearance costs received from courier firms demonstrate a direct correlation between these costs and the increase in customs requirements, following the applicable exemptions, as presented in Table 1 below.



Table 1: Correlation between customs clearance procedures in practice and the cost related to the processing of an import, per consignment category

Value	Import duties	Courier firms customs declaration	Approximated average cost for processing an import (courier firms)
Below EUR 10-22	<ul style="list-style-type: none"> ▪ No VAT ▪ No customs duties 	Declaration by any other act, oral declaration, paper based or electronic manifest, simplified SAD	EUR 2.34
Above EUR 10-22, but below EUR 150	<ul style="list-style-type: none"> ▪ VAT payable ▪ No customs duties 	Simplified electronic declaration or SAD	EUR 8.96
Above EUR 150	<ul style="list-style-type: none"> ▪ VAT payable ▪ Customs duties payable 	Full or simplified SAD	EUR 9.21

Source: Postal operators and courier firms contacted, EY calculation

All consignments generate costs for their processing by operators. It is clear however from the results shown in Table 1 that there is a major increase in costs when the VAT exemption threshold is reached, and only a small increase when the customs threshold is reached. This is due to the specific obligations linked the customs clearance of goods when taxes or duties are to be collected. This appears to be also true for public postal operators which in most cases will not charge a clearance fee if the consignments is below the VAT threshold, however they will charge a clearance fee for the consignments where VAT and/or customs duties are payable.

Based on the limited information available to the relevant Member States' administrations, no reliable conclusions can be made in relation to the cost of collecting VAT or the cost for the processing of a customs declaration.

A few Member States have also implemented simplified procedures for the importation of B2C consignments. The UK provides here the most developed methodology by means of a prepayment arrangement whereby overseas traders are allowed to charge, collect and pay upfront the import VAT for mail order goods. The main benefit is that this system avoids unnecessary requirements upon arrival of the goods making clearance less time-consuming and costly for all parties. This is reflected in the average cost reported for the United Kingdom (EUR 1.80 – 5.77) which appears to be far below the estimated EU average of EUR 8.96.

Increasing concerns on the economic impact

The European Commission has received various indications including complaints and submissions from industry associations and tax authorities that the current provisions for the application of the VAT relief for imports of consignments with a low value allow for a distortion of competition.

These complaints should be seen in the context of the very rapid growth in the share of total retail sales accounted for by e-commerce in EU Member States. This has increased the potential opportunity for abuse of the LVCR, as online retailers can



locate their operations outside of the EU to service consumers in the EU and so benefit from the LVCR.

At the time this exemption was introduced, e-commerce did not exist and only traditional mail order was available to customers, although the Directive specifically provided for a possibility to exclude mail order, notably to avoid distortions of competition.

The objective of this report is also to provide a quantitative overview of the imports covered by the exemption, as well as a qualitative assessment of the impact on the distortion of competition.

Quantitative assessment of the historic volume and growth of small consignments

Providing a quantitative assessment of the goods covered by the LVCR requires the identification and collection of data on the volumes of small consignments imported into EU Member States from outside the EU.

A number of data sources were explored including Eurostat, and the Member States' national statistics offices. Whilst there is evidence that the LVCR is applied in various product categories for B2C shipments, in practice there appears to be no comprehensive, public and readily available sources of information on the volumes, source and value of such consignments. This is notably due to the fact that they are excluded from the Eurostat data.

The Universal Postal Union (UPU) however collates information on the volumes of international postal mail receipts for EU Member States, although this dataset does not record the country of origin nor the value of the mail item received.

To estimate the size and development of the LVCR market a number of assumptions and proxies have been used to refine the UPU data set. In order to analyse how sensitive the results are, a number of different assumptions have been tested. Maximum, base and minimum scenarios were developed through running sensitivity analysis on key parameters, with the base case representing the most reasonable set of estimates for the LVCR market development between 1999 and 2013. The results are shown in Table 2. It should be noted that this is the first attempt to estimate data on importation of small consignments for all EU member states in a consistent manner.



Table 2: Public and Private Operators: Total international receipts of small consignments originating from outside the EU in millions (items)

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	1999-2013 growth
Min	10.48	9.07	9.26	15.19	23.12	30.58	41.27	44.88	52.53	60.42	66.77	73.79	78.98	85.35	93.14	789%
Base	29.78	25.70	26.24	30.57	40.83	49.62	67.39	65.20	74.47	84.48	89.84	97.39	99.47	105.15	114.85	286%
Max	53.61	46.16	47.19	49.52	62.66	73.14	99.70	90.28	101.52	114.09	118.19	126.32	124.58	129.44	141.56	164%

Source: UPU, private and designated postal operators’ data and EY analysis

All three scenarios presented in Table 2 and in Figure 1 point towards a significant increase in imports of small consignments originating from outside the EU. The growth trend from 1999 to 2013 in the base case is 286%.

Figure 1: Low value Extra-EU international parcel receipts in million (items)



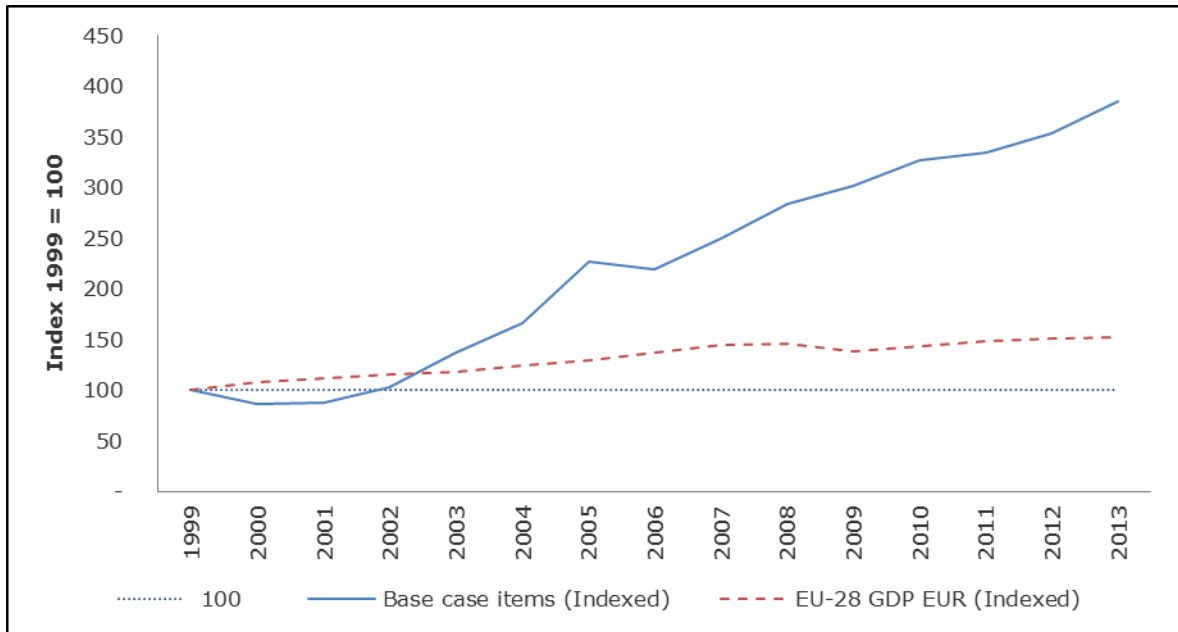
Source: EY analysis

This substantial increase in parcel volumes – especially when compared to the evolution of GDP at the same time – has been most likely influenced by the emergence and growing importance of e-commerce trade and the liberalization of the postal markets and the introduction of new players on the parcel deliveries.

Figure 2 shows the growth in the base case postal market volumes compared to the GDP growth in the EU. It is worth noting that the postal market volumes have significantly outpaced the GDP growth across the EU in the period 1999 to 2013.



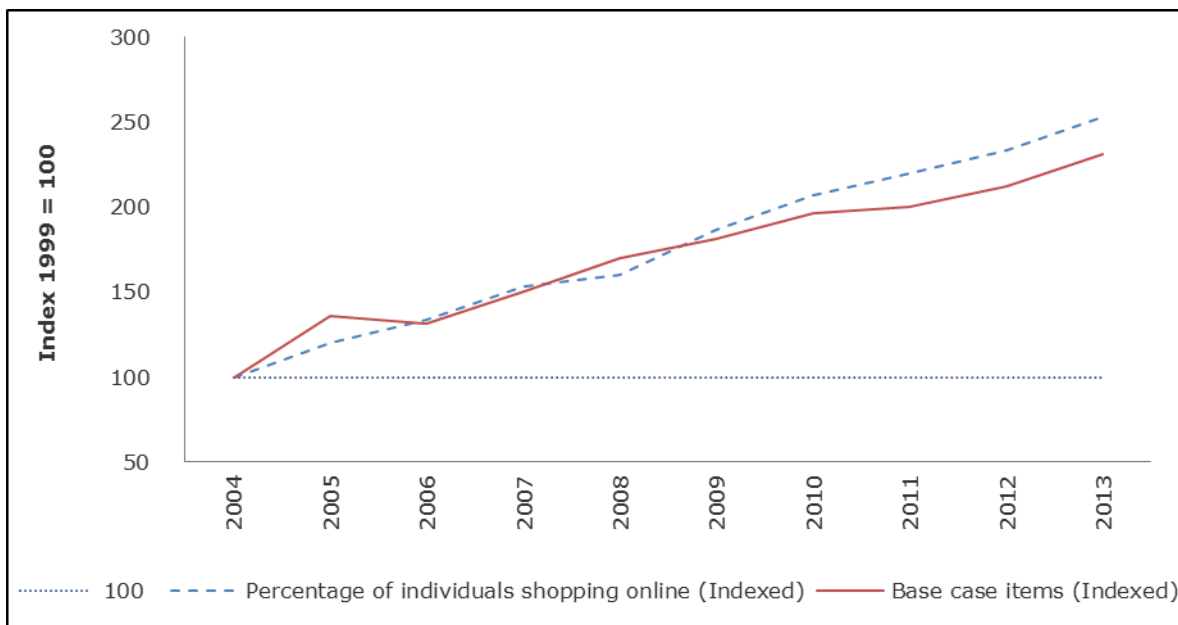
Figure 2: Low value Extra-EU international parcel receipts growth vs GDP growth from 1999 to 2013



Source: EY analysis

Figure 3 shows the growth in the base case postal market volumes compared to the trend of individuals shopping online. It appears that the postal market volumes have increased in line with growth of e-commerce in the EU in the period 2004 to 2013.

Figure 3 Low value Extra-EU international parcel receipts growth vs percentage of individuals shopping online growth from 2004 to 2013



Source: EY analysis



This significant growth in volumes of small consignments sent from outside the EU illustrates a competitive distortion arising from the LVCR. Businesses are indeed incentivised to locate their operations outside the EU and hence benefit from the VAT exemption.

Estimating the VAT foregone as a consequence of the LVCR

The purpose of calculating the VAT foregone as a consequence of the LVCR is to assist in understanding the magnitude of the issue from a policy makers' perspective, in particular how the magnitude can evolve if no measures are taken to correct the situation.

The VAT foregone for each Member State is calculated by multiplying the total volume of international receipts of small consignments originating from outside the EU by the value of the small consignment (including transport cost), and then applying the applicable VAT rate per Member State.

According to the estimates, **VAT foregone in the EU in the base scenario was EUR 118 million in 1999**, peaking at just under **EUR 640 million in 2011**. Despite the economic crisis and interventions by certain Member States (e.g. the United Kingdom and Denmark) to change the law relating to the LVCR, the estimates still show a VAT foregone of approximately **EUR 535 million in 2013**. These results are shown in Table 3. **At its maximum, the VAT foregone within the EU could have reached just under EUR 900 million in 2011**. This is equivalent to a **business turnover of EUR 4.5 billion**.

This does not mean however that the removal of the said exemption would bring additional resources to the Treasury to the same extent. All this would depend on the simplifications which could be introduced to decrease the collection costs by customs authorities.

Table 3: VAT foregone in millions (EUR) in the EU-28 Member States

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	1999-2013 growth
Min	20.75	18.12	18.43	29.70	128.30	162.06	189.39	202.60	232.24	285.03	306.41	313.52	356.06	235.13	203.98	883%
Base	117.63	103.73	104.83	122.18	247.93	304.04	384.95	387.55	446.94	528.17	556.30	588.43	638.21	533.87	534.78	355%
Max	268.27	235.67	238.74	249.06	400.65	474.69	621.80	589.97	675.71	783.25	806.87	856.50	894.28	795.48	825.14	208%

Source: EY analysis

Qualitative assessment of competition distortions as a consequence of the LVCR

In addition to the quantitative analysis presented in previous sections, a qualitative assessment has also been undertaken to identify examples of competitive distortions arising as a consequence of the LVCR. This analysis has been used to develop a number of case studies of competitive distortion for specific countries and/or for specific goods. These included:

- The emergence and decline of the fulfilment industry in the Channel Island, which according to HMRC had resulted in **EUR 170 million (GBP 140 million) of VAT foregone at its peak in 2009**.



- The LVCR abuse in the magazines industry in Denmark and Finland, which has been scrutinized by the Danish Government and is estimated to have resulted in **EUR 8 million (DKK 60 million) of VAT foregone in Denmark per year since 2004.**
- Information from contacted business organizations suggests that imports of LVCR goods from Gibraltar and Switzerland have been growing in recent years. A number of Chinese companies are also reported in the media to have been avoiding paying the applicable VAT to gain competitive advantage over local businesses as a result of LVCR.

These cases highlight clear competitive distortions that can be directly attributable to the LVCR.

Conclusions

In conclusion, based on the available information, there is evidence to demonstrate major competitive distortions resulting from the LVCR. The impacts of such distortions include the considerable loss of VAT revenues to Member States as well as reports of business closures, business relocations and booming fulfilment industries outside the EU.



KP-01-15-344-EN-N

doi:10.2778/822083
ISBN: 978-92-79-47901-4