



CHARITY FINANCE DIRECTORS' GROUP

A Review of Royal Mail's Special Privileges: A consultation document

CFDG Response **April 2004**

Postcomm welcomes comments on the provisional view that Royal Mail's VAT exemption is not necessary for the provision of a universal postal service and that the VAT exemption distorts competition in a significant part of the UK postal services market.

Postcomm also welcomes comments on the provisional view that there appears to be no justification for Parcelforce to continue to benefit from the VAT exemption.

The Charity Finance Directors' Group would like to express our concern that the Postcomm consultation document does not consider the affect that the removal of Royal Mail's VAT exemption will have on charities. Although in the long-term, a level playing field in the VAT treatment of all postal operators could lead to increased competition and eventually allow increased choice and innovative services, in the short term at least, the proposed changes could leave most charities at a significant financial disadvantage.

The Postcomm document does not fully consider the unique position of charities in relation to VAT, and the financial cost of this tax on the charity sector. The nature of Value Added Tax is underpinned by the assumption that the cost of a service or product is ultimately borne by the final consumer. Needless to say as charities usually operate outside of this assumption in that they do not pass on their costs to a final customer, they are responsible for meeting this cost and are therefore financially penalised.

In addition, when charities do charge for a service, they often engage in activities that are categorised as exempt supplies. This means that unlike zero-rated supplies, which are technically taxable in the same way as standard supplies, despite no tax being paid on them, exempt supplies are considered outside of the tax system. Consequently there exists no mechanism by which to secure reimbursement. The provision of education, care for the sick, disabled, or elderly, as well as goods and services connected with a fundraising event are all examples of activities which constitute exempt supplies and therefore on which there can be no VAT rebate.

Subsequently the proposal to remove Royal Mail's VAT exemption will further penalise charities, particularly as postal costs often represent a significant proportion of their overheads. The Royal Mail estimates that the charity sector spends around £100 million per year on their services. A number of organisations have contacted us expressing their dismay at the extra costs. One small membership organisation stated that their postal costs represent 10% of their overheads. A medium sized care charity with a turnover of approximately £5 million that is exempt from charging any

VAT on its services wrote expressing concern because they could forfeit up to £18,000 per year. Another super-large care charity that is also exempt from charging VAT estimated that it would annually cost them £110,000.

VAT on postage would also affect a key charity fundraising activity in the form of direct mail. According to the Institute of Fundraising direct mail accounted for 4.7% of new voluntary income in 2002/2003; however, a very large percentage of on-going committed support to charities is initiated through this method. The Institute's members have told them that they would rethink the use of direct mail as a fundraising technique due to increased costs.

It is not simply the absolute cost of irrecoverable VAT that we are concerned about but the fact that it often results in sub-optimal investment or efficiency allocation as it skews capital investment decisions. VAT is imposed on some types of projects but not others; it penalizes use of temporary staff, shared services, secondments and partnership working, and frequently delays investment due to the additional tax payable on the basic capital cost. If the proposal goes ahead then this could very well bias charities choice of communications away from post and towards other mediums. Charities could make more use of email with their donors, or begin to originate post at an overseas source with a lower cost.

Vat on postage could have a sever effect on direct mail, which is a key fundraising activity for many charities. According to the Institute of Fundraising direct mail accounted for 4.7% of new voluntary income in 2002/2003; however, a very large percentage of on-going committed support to charities is initiated through this method. The Institute's members have told them that they would rethink the use of direct mail as a fundraising technique due to increased costs.

If the proposal goes ahead then the British government should ensure that the price of stamps in the UK does not increase; the cost of VAT should be absorbed. The government should not benefit from this proposal at the expense of charities. If Royal Mail loses its exempt status then we urge the government to recompense charities in some way for their financial loss. The European Parliament recently voted to accept the Schmidt report that proposed the application of VAT on all postal services, however they also voted to carry a key amendment for charities, which stated:

RECITAL 5b (new)

(5b) The Member States should take the measures necessary to ensure that charitable associations and organisations are not faced with additional financial charges as a result of this Directive, for example, by adopting special provisions such as reimbursement mechanisms.

Justification: Apart from the fact that communications activities by charitable associations and organisations would be more expensive, it should be noted that these bodies produce substantial volumes of mail which would be likely to decline if they had to bear the costs of VAT.

Summary: Postcomm's consultation document fails to mention the unique position of charities in relation to VAT, and the sectors heavy use of postage. We advise Postcomm to consider the heavy financial cost of VAT on postal services when making their recommendations to Government. If the proposal goes ahead then we would urge the Government to monitor the effect on charities and create a system of reimbursement for any financial losses.