



Survey reveals VAT anomalies

Incumbent postal operators given preferential treatment in 18 EU countries

The liberalisation of the European postal market promises the benefits of open and fair competition to all users of mail services. Yet that competition is being distorted in no less than 18 of the 25 EU member states due to anomalies in the way they apply VAT to postal services. This was the conclusion of a recent survey undertaken by the tax practice of international law firm Baker & McKenzie.

When the value-added tax system was introduced throughout the European Union in the 1970s, it was agreed that postal services could be exempted from VAT. At the time they were regarded as a state-funded activity in the public interest, and the postal sector was characterised by monopolies providing a limited range of services that were not subject to any competition. As each country had only one national postal operator, no one was disadvantaged by the VAT exemption.

Competitive disadvantage

But now the situation has changed. Gradual liberalisation of the European postal market is allowing other postal operators to compete with the incumbent for mail services. Yet VAT legislation has not been adapted to the new situation. VAT exemptions are typically only granted for the 'universal service' that the incumbent national postal operators are obliged to provide, and

are therefore usually available exclusively to them. This represents a significant competitive disadvantage for other operators – the national playing fields on which they are now allowed to compete are anything but level.

Three countries

The objective of the Baker & McKenzie survey that was commissioned by TNT, was to provide an overview of the way VAT was applied to postal services in all 25 EU countries. Experts in local offices provided the research team with current national VAT legislation with respect to postal services, along with any applicable administrative guidelines. They also received descriptions of which players and what services were exempt from VAT, local discussions and court cases on the subject, and examples of competition being distorted as a result. The survey

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revealed that only three countries have no VAT exemption: Finland, Sweden and Slovenia.

Limited exemption

In four countries – the Czech Republic, Estonia, the Netherlands and Spain – some degree of VAT exemption is still granted to the incumbent operator but appeared not to interfere significantly with open competition. While only the national licence holders are exempted from VAT on the universal services they must provide, those services are very narrowly defined. In the Netherlands, for example, licence holder TNT NV is only VAT exempt on services that fall under the USO, including the reserved area of letters of 50 grams or less. The exemption does not apply to printed matter and bulk mail outside the limited USO area. In practice this means that the exemption is largely limited to private individuals, representing only around the 6% of the market that is least attractive to competitors. Meanwhile none of the mail in the highly competitive sector of the market, such as bulk mail printed matter and direct mail, is exempted from VAT.

Brussels takes action against UK and Germany

The European Commission started an infringement proceeding on April 10th that could lead to legal action against the UK and Germany for giving unfair tax advantages to Royal Mail and Deutsche Post over their competitors.

The UK and Germany have two months to explain why only their former postal monopolies are exempted from VAT. If the European Commission remains unconvinced, they will need to argue their case before the European Court of Justice in Luxembourg.

The Council has still not adopted the European Commission's 2003 proposal to harmonise how VAT is applied to postal services.

Substantial distortion

VAT regulations in all the other 18 EU countries were found to result in a substantial distortion of the competitive landscape of the national postal market. But even here the Baker & McKenzie study revealed that two groups could be distinguished. While not all-inclusive, the interpretation and scope of what is included within 'universal services' was broader in six of the 18. In one of these countries for example a practical consequence of the applicable postal legislation means that bulk mail printed matter of 2kg or less per item is considered to be part of universal services. While other players must charge VAT to

their customers for this service in a competitive area of the postal market, the incumbent does not.

In the remaining 12 countries, VAT exemption covers all post-related activities of the incumbent operator appointed under national legislation. In the United Kingdom, for example, any services in connection with the delivery of post by Royal Mail are VAT exempt. Even though the UK postal market has been fully liberalised since the beginning of the year, only Royal Mail's competitors are required to charge VAT on all the postal services they provide.

Dutch government sets date for full liberalisation

On April 13th the Dutch government announced that the postal market in the Netherlands would be made fully open to free competition as from January 1st, 2008. That date would only be confirmed if current inequalities in the application of VAT in the UK and Germany were addressed.

TNT now only has a statutory monopoly on items weighing 50 grams or less, and this would be removed with the introduction of the legislation announced by the government. The VAT exemption currently enjoyed by the incumbent operators in the UK and Germany is key among a number of issues that the

Dutch government would like to see resolved before the postal market is further opened to competition.

Commenting on the announcement, TNT CEO Peter Bakker said he was pleased that the government had acknowledged the current lack of level playing field,



and that this had been made a precondition for the further opening up of his company's home market. "We hope that the Cabinet can contribute to the removal of these obstacles in other countries," he said. "A level playing field will offer TNT substantial growth potential outside the Netherlands."

Ferber Report adopted by European Parliament

Postal market to be fully open by 2009

The European Parliament agreed by a large majority to accept the Ferber Report on the application of the European Directive for postal services during a plenary debate on February 1st. In anticipation of the European Commission's final proposals expected later this year, the Report recommends that 2009 should remain the deadline for the full opening up of the market for postal services.

The well written Report briefly addresses all the well written key issues concerned with the liberalisation of the European postal market. It welcomes the progress made to date in the application of the Postal Directive in general, but also highlights a number of deficiencies and unresolved problems.

Risk of imbalance

One of the key issues on which the Report calls on the Commission to take action is that a number of countries are "seriously late" in opening up their markets (see "Equal timing is vital"). This creates a risk of imbalance in the European postal market, with some entrants being disadvantaged. Another concern is the unequal competitive advantage given to some incumbent operators by the way VAT is applied.

Strategic role

The Report agrees with the Commission that postal services have a strategic role to play within a wider communications and distribution market. Key activities such as e-commerce, home shopping, publishing and banking rely on the postal infrastructure. It currently leaves as an open question how consumer access to postal services can best be guaranteed. Nevertheless, proposals by a few MEPs that monopolies should be maintained in their countries have now been definitively rejected.

Resisting unnecessary regulation

By adopting the Ferber Report, the European Parliament has emphasised that any attempts by member states to introduce too many new and unnecessary regulations should be resisted.

Regulating downstream access or licensing, for example, could impede the free market activity that liberalisation is intended to promote. While the opening of the market requires independent and effective regulation, the new regulatory bodies should grow into their role as competition authorities.

Ferber sums up the Report by saying that the results of the Postal Directive to date have been encouraging. Although the concerns it describes need to be addressed and the Commission's last reports were still awaited, he considers that the 2009 deadline should be retained.



"Equal timing is vital", notes Dutch MEP

Later this year the Commission is to publish detailed studies for each member state. In addition to indicating whether the 2009 deadline is achievable, the studies will examine the impact of a fully liberalised postal market on the universal service.

Dutch MEP Jeanine Hennis-Plasschaert welcomed the implementation of the directive, but argued the importance for companies such as TNT of it being applied uniformly in all member states. "It is vital that member states keep to an equal timing in the further opening of their postal markets," she said, "and that the directive is applied in the same way."

Dutch MEP Jeanine Hennis-Plasschaert

Boston Consulting Group develops new index

Level playing field concept quantified

How can an objective comparison of the degree of liberalisation in the addressed mail markets in different EU countries be made? To answer this question, TPG Post recently commissioned the Boston Consulting Group (BCG) to develop an analytical tool that would do just that. The goal was to enable the 'level playing field' concept to be quantified for the first time.

The model allows the fairness of competition in various markets to be objectively measured. As the model can be recalculated and updated at any time, it can provide an accurate snapshot of the impact of regulatory changes and conditions. The next step will be to apply the new model to all EU countries.

"National regulators will have a significant influence on the conditions for the players in the transition to an open market," says Bas van Heel, the BCG senior manager who led the research. "Interested parties will need a model that can predict the changes that will be introduced when regulators choose a particular course of action."

Objective measure

The model that BCG has developed calculates a so-called 'Level Playing Field Index', which is a figure that indicates how attractive the market for addressed post is in a certain country for a new entrant or investor. Where the index is the same in different countries, it can be said that a level playing field exists. "Until now the discussions about liberalisation have principally been qualitative," explains Van Heel. "That has made the discussion difficult. Our model provides an objective measure of the extent to which a level playing field exists between different countries." As the LPF index can be recalculated and updated at any time, it can provide an accurate snapshot of the impact of



BCG Senior Manager Bas van Heel

regulatory changes and conditions. The development of new players in the market over a period of ten years is modelled in the analysis. It is assumed that new entrants begin without their own network. Mail from their large volume customers is passed on the national postal operator for final delivery. For the longer term, when it is assumed that new entrants will gradually be able to serve smaller business customers, an end-to-end model is used for the calculations, in which the entrant is able to provide services over the 'last mile'.

Net present value

To create a point of reference, the model first calculates the net present value a new entrant could create in an ideal situation. This would be a completely level playing field on which the

entrant faces the same conditions as the incumbent postal operator. This ideal LPF index would be 100%. The model then calculates the value they could create taking the effects of the actual regulatory conditions into account. The LPF index compares this with the outcome in the ideal situation. The resulting figure, a percentage between 0 and 100, indicates the attractiveness of a particular postal market for new entrants or investors.

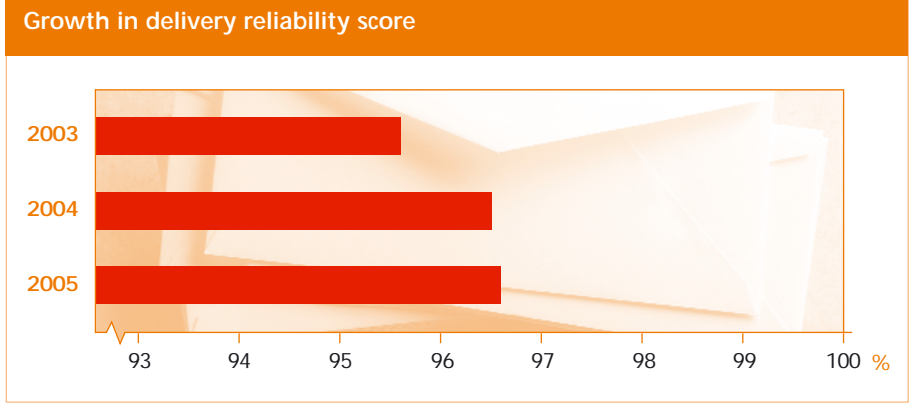
Clear conclusion

The tool was first applied to a comparison of the UK, German and Dutch postal markets. The Netherlands scored 74%, Germany 30% and the UK only scored 11%. "There's a clear conclusion that must be drawn from our calculations", states Van Heel. "The liberalisation measures that these countries have announced will definitely not lead to a level playing field. That is certainly not yet on the horizon. The factor that has the greatest influence is the way VAT regulations are applied. Both in Germany and the United Kingdom, the VAT regulations put new competitors at a significant disadvantage compared to their own national postal operators." The next step will be to apply the new model to all EU countries.

Mail delivery quality even higher in the Netherlands

TPG Post achieved its highest delivery reliability score ever in 2005. Of all the domestic letters posted in the Netherlands last year, 96.6% were delivered on the following working day.

The overall score for mail reliability is calculated by combining the delivery statistics for two categories of letter post, and is verified by accountants PricewaterhouseCoopers. Two-thirds of the total concerned bulk mail up to 100 grams sent by TPG Post's business customers, 97.2% of which was delivered the next day. The remainder were letters stamped and sent via post boxes, for which the figure was 95.6%.



Product range expansion almost complete

All TPG Post Service Points will begin providing the company's full product assortment from next month onwards. The expanded product and service offering marks a significant step in the postal operator's outlet policy.

Some years ago TPG Post began closing many of its traditional post offices due to a decline in the number of transactions being performed in them. To ensure that the public would continue

to have access to postal services in their neighbourhood, 'TPG Post Service Points' were established within shops. There are now about 800 post offices and 1,300 of the new Service Points in

the Netherlands. While the total number of outlets is the same as in the past, the location in shops means that they are often better accessible to the public.

Consistent, high quality offering
Initially only the most popular mail products were offered in the Service Points. In response to requests from customers and operators and to provide a consistent, high quality offering across all outlets, it was decided that all consumer mail services provided by post offices should also be provided in the Service Points. These additional services include registered international mail and the collection of packages with additional services. The extension of these to the remaining 1,000 Service Points will be completed next month. To achieve this, operators and employees have received intensive training.



Focus on core competency

TNT to exit logistics business

TNT recently announced a number of initiatives to sharpen its strategic focus on providing delivery services by managing transport networks. They include exiting its logistics business and a € 1 billion share repurchase.

The decision to sell their logistics business is a key result of a thorough strategic review. "It is clear that we are successful at designing, implementing and running delivery network businesses," TNT's CEO Peter Bakker explains. "This is our core competency, lies at the heart of our business going forward, and offers us a sustainable competitive advantage and very compelling growth opportunities." The new strategy is in stark contrast to that of its major competitors. Last December Deutsche Post completed the € 5.5 billion acquisition of UK logistics giant Exel. It is clear that TNT is charting a course that will differentiate it from its rivals.

Creating value

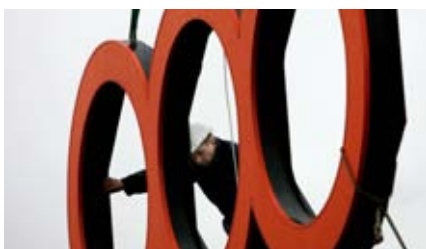
High quality networks have proven to be intrinsically more attractive to TNT than customer dedicated supply chains. "We have very strong network platforms to build on," says Bakker, "particularly our fast growing Express and European Mail Networks businesses and our profitable Mail Netherlands business." And driving increased volumes across these networks will allow TNT to improve efficiency and operating leverage. Bakker explains this is also expected to generate a higher return on capital. "We have taken the initiative to optimise our capital structure," he says, "and we intend to return capital to our share-

holders, as we are focused on creating value for our shareholders both in the short and in the long term."

The acquisition of TG+, a leading Express operator in Spain and Portugal, together with the purchase of Hoau, China's leading domestic freight and parcel operator, make a good fit with TNT's network focus. Meanwhile the Asia Road network, China domestic Express network and China/Europe air lane initiatives will strengthen TNT's position as the leading integrated transport provider in the region.

New name and colour for Dutch postal operator

The TPG Group changed its name to TNT in 2005. Preparations for its Netherlands mail subsidiary to follow suit are already underway. On October 16th this year its name will officially be changed from TPG Post to TNT Post.



TNT Post will be given a new look as well as it adopts the colour of the TNT brand. Everything that carries the company name, such as the red vans and post boxes, will become orange. An

employee uniform in the new TNT Post house style will also be introduced. To limit the costs of such a large-scale operation, the changes will be spread over the next few years, introducing rebranded items as far as possible when they would otherwise need to be replaced.

The name change reflects the growing internationalisation of the postal market and the company's business operations. Outside the Netherlands TPG Post has always been better known as TNT.

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