

# Study on Examining the Implementation of the EU Acquis on Value Added Tax in the Energy Community Legal order

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# Agenda

- o Introduction
- o Overview of EU VAT related legislation
- o Energy Sector related VAT Principles
- o Analysis of VAT legislation in CPs
- o Double, no taxation or tax fraud
- o Analysis of Energy Related Issues
- o Proposal of Changes of National Legislation
- o Next Steps

## o Introduction

- o Overview of EU VAT related legislation
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# Motivation for the study

- o Why harmonization of VAT legislation in CPs?
  - National legislation appropriate for energy related transactions taking place within national borders
  - Similar to saturation in the EU prior to liberalization energy markets
  - Necessary to amend national legislation to allow for cross border trade and access to energy infrastructure
- o Deliverables:
  - The Contract was signed on June 28, 2016
  - Inception report approved on August 23, 2016; Interim report approved on November 28, 2016; draft Final report submitted on December 23, 2016

# What is this study (not) about?

- o In the study we:
  - Analyze EU VAT legislation
  - Identify key elements pertinent to energy markets (goods and services) that foster development of common market
  - Analyze VAT legislation in all Contracting parties
    - Legislative acts provided by CP
  - Identify gaps between legislation in EU and each CP
  - Propose legislative changes to each CP
- o In essence we focus on **VAT related obstacles to access to network infrastructure and trade in energy**

# How was the study carried out?

- o In order to performed the study we:
  1. Analyzed the EU VAT legislation
  2. Analyzed the VAT legislation in CPs
  3. Contacted relevant authorities in each CP to seek their views on VAT related obstacles
- 1. Team consisted of:
  1. Lega experts
  2. Economist
  3. Network engineers
  4. Local experts (Ukraine, Georgia, Moldova, FYRM)

# We appreciate cooperation from:



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# Directive 2006/112/EC – VAT Directive

- o VAT Directive and its amendments define common system of VAT in the EU
  - Applies to both **goods** and **services**
- o Main principles:
  - **Harmonization of VAT legislation**: establishment of legislation on turnover tax that does not distort competition
  - **Simplicity and neutrality in taxation**: covers all stages of production and distribution
  - **Neutrality in competition**: similar goods and services bear similar tax burden
- o Directive defines the **minimum rate** (15%) and allows for two reduced rates not less than 5%

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# Key principles related to energy markets

- o Electricity and gas are treated as goods for VAT purposes
- o Principles of supply of gas and electricity as goods (with the aim to avoid double or no taxation):
  - Supply to **taxable dealer (B2B)**: place of supply where dealer has establishment (Art. 38)
  - Supply to **end customer (B2C)**: the place of supply where end customer efficiently consumes the good (Art. 39)
  - Importation of gas and electricity is exempted from VAT (Art. 143)

# Key principles related to energy markets

- o Supply of services related to access to gas and electricity network:
  - To **taxable dealers**, the place of supply of services (e.g. interconnection capacity) will be where taxable dealer has his establishment (Art. 44 and Art. 195)
  - To end **customers** established outside the EU or in the EU but in different country from the supplier, is the place where the customer is established or has permanent address (Art. 59h and Art. 39) |
  - **Concept of permanent address** defined in Regulation 282/2011/EU

# Principles related to fraud prevention

- o General principle: person supplying goods and services pays for the VAT (Art. 193)
- o As a derogation (to simplify the procedure and to fight tax evasion) tax dealer to whom the supplies of gas and electricity are made is liable for VAT (Art. 199, Art. 199a) – known as **reverse charge mechanism** (RCM)
- o RCM subject to reporting of taxable dealer who supply goods or services to which RCM applies

# Key principles of the VAT Directive that should be transposed to VAT regulation of CPs

- o Emphasis on:
- o Taxable Persons (B2B):
  - Allow access to non domestic firms to participate in domestic energy market
  - Simplify VAT related procedures
  - Avoid issue of double (no) taxation
  - In essence only taxable persons (e.g. traders) can participate in cross border transactions
- o Non Taxable persons (B2C)
  - Supply of energy to end customers by foreign based firms

# Key principles of the VAT Directive that should be transposed to VAT regulation of CPs

- o Taxable person (Art. 9)
  - Exemption related to state and government bodies (not considered taxable persons) (Art. 13)
- o Treatment of gas and electricity as goods (Art. 15)
- o Place of transaction:
  - For goods (Art. 31-36): the place where customer is located (gas and electricity)
  - For services (Art. 44): to taxable person where he is established: to non taxable person where supplier is established

# Key principles of the VAT Directive that should be transposed to VAT regulation of CPs

- o Supply of goods to taxable dealer (B2B) (Art. 38)
  - For supply of gas and electricity to taxable dealer place of supply will be where he has his establishment
- o Supply of goods to customer (B2C) (Art. 39)
  - For supply of gas and electricity to end customer, place of supply will be where that customer effectively consumes the good
- o Access to gas and electricity network to non taxable person established outside Community (Art. 59h)
  - The place of transaction will be where the person is established



# Key principles of the VAT Directive that should be transposed to VAT regulation of CPs

- o Chargeable event (Art. 63):
  - The VAT will be due when the goods or services are supplied
- o Reduced VAT rate for supply of goods (Art. 99 and 102)
  - Max. 2 reduced rate of not less than 5%
- o Exemption of importation of gas and electricity (Art. 143)
- o Exemption of exportation (Art. 146)
- o Reverse charge (Art. 199a)
  - Taxable person to whom supplies of gas and electricity are made is liable for VAT
- o Refund to taxable persons not established in Community

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# Albania

- o Largely in line with VAT Directive
- o What needs to be implemented:
  - Regulation for avoidance of double taxation, non-taxation or distortion of competition
  - Regulation for general VAT exemption
  - Regulation for reporting mechanism on fraudulent activities
- o No VAT related obstacles identified by the stakeholders

# Bosnia and Herzegovina

- o What needs to be implemented:
  - Basic definitions of VAT Directive
  - Electricity and gas should be included in the exception of VAT for state bodies
  - Place of supply of services should be based on the place where the recipient is established
  - Key principles of VAT regarding supply of gas and electricity to taxable dealers and customers should be implemented

# Bosnia and Herzegovina cont.

- Introduction of possibility of different, lower VAT rates for electricity and gas
  - Introduction of exemption of VAT for the importation of gas and energy
  - Implementation of the reverse charge mechanism
  - Introduction of VAT refund to taxable persons who are not established in BiH
  - Alignment of definitions of persons liable for payment of VAT with VAT Directive
- o Stakeholders identified the issue of double taxation

# Georgia

- o What needs to be implemented:
  - Broad amendment of VAT legislation
  - Definition of the role of State Bodies regarding gas and electricity
  - Introduction of the definition of the place of supply
  - Definition of the place of supply of gas and electricity
  - Introduction of a reduced tariff for gas and electricity
  - Exemption from VAT for the importation of gas and electricity
  - Reverse charge related to gas and electricity should be implemented
  - Allow for VAT refund
  - Allow a definition of the persons liable to pay VAT
- o No VAT related obstacles identified by stakeholders

# FYR of Macedonia

- o Partly in line with the VAT Directive
- o What needs to be implemented:
  - Reduced VAT rates for electricity and gas
  - Rules regarding supply of electricity and gas to taxable dealers (B2B) and customers (B2C)
  - Reverse charge mechanism and fraudulent activities
- o No VAT related obstacles identified by stakeholders

# Kosovo\*

- o Law on Value Added Tax of Kosovo\* is mostly in line with the VAT directive
- o Still the following should be implemented:
  - Introduce a reduced VAT rate for electricity and gas
  - Introduce a mechanism for reporting fraudulent activities
- o No VAT related obstacles identified by stakeholders



# Moldova

- o The Fiscal Code of Moldavia is partially in line with the VAT Directive
- o What needs to be implemented:
  - Introduction of a provision of certain services according to where the services have actually been used and consumed
  - Differ supply to a customer from supply to a taxable dealer
  - Introduction of reverse charge
  - Reporting of fraudulent activities
- o No VAT related obstacles identified by stakeholders

# Montenegro

- o Law on Value Added Tax of Montenegro is partly in line with the VAT Directive
- o What needs to be implemented:
  - Introduction of articles 38 and 39 of the VAT Directive
  - Introduction of possibility for reduced VAT rates for electricity and gas
  - Exemption the import of gas and electricity from VAT
  - Reverse charge should be implemented
- o No VAT related obstacles identified by stakeholders

# Republic of Serbia

- o VAT Law largely in line with the VAT Directive.
- o What needs to be implemented:
  - Adaptation of a more general definition of a chargeable event
  - Differentiation of the place of transaction regarding whether the person is taxable or non-taxable
  - Introduction of reduced VAT rates for electricity and gas
  - Define conditions for producing a report on fraudulent activities in territory of Serbia in relation to supplies of gas and electricity
- o No VAT related obstacles identified by stakeholders

# Ukraine

- o What needs to be implemented:
  - Exemption of state bodies from VAT
  - Determination of the place of provision of certain services according to where the services has actually been used and consumed
  - Full implementation of articles 38 & 39
  - Possibility to introduce reduced VAT rates for electricity and gas
  - General exemption on importation of gas and electricity
  - General exemption on exportation of gas and electricity
  - Implementation of reverse charge and reporting on the same.
- o Stakeholders identified VAT refund as an important obstacle to cross border trade

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# Double, no taxation instances, tax fraud

- o With cross border trade and access to energy infrastructure, there are three potential issues that might occur as a result of non-harmonized VAT legislation:
  - No taxation
    - Taxpayer does not pay the VAT he owes, or claims a debt to the administration that is actually not due.
  - Double taxation
    - Occurs when a business entity pays VAT on goods and services acquired in a foreign country and later pays VAT in its home country, without being able to obtain a VAT refund in a foreign country.
  - Tax fraud
    - Carousel or “missing trader” fraud

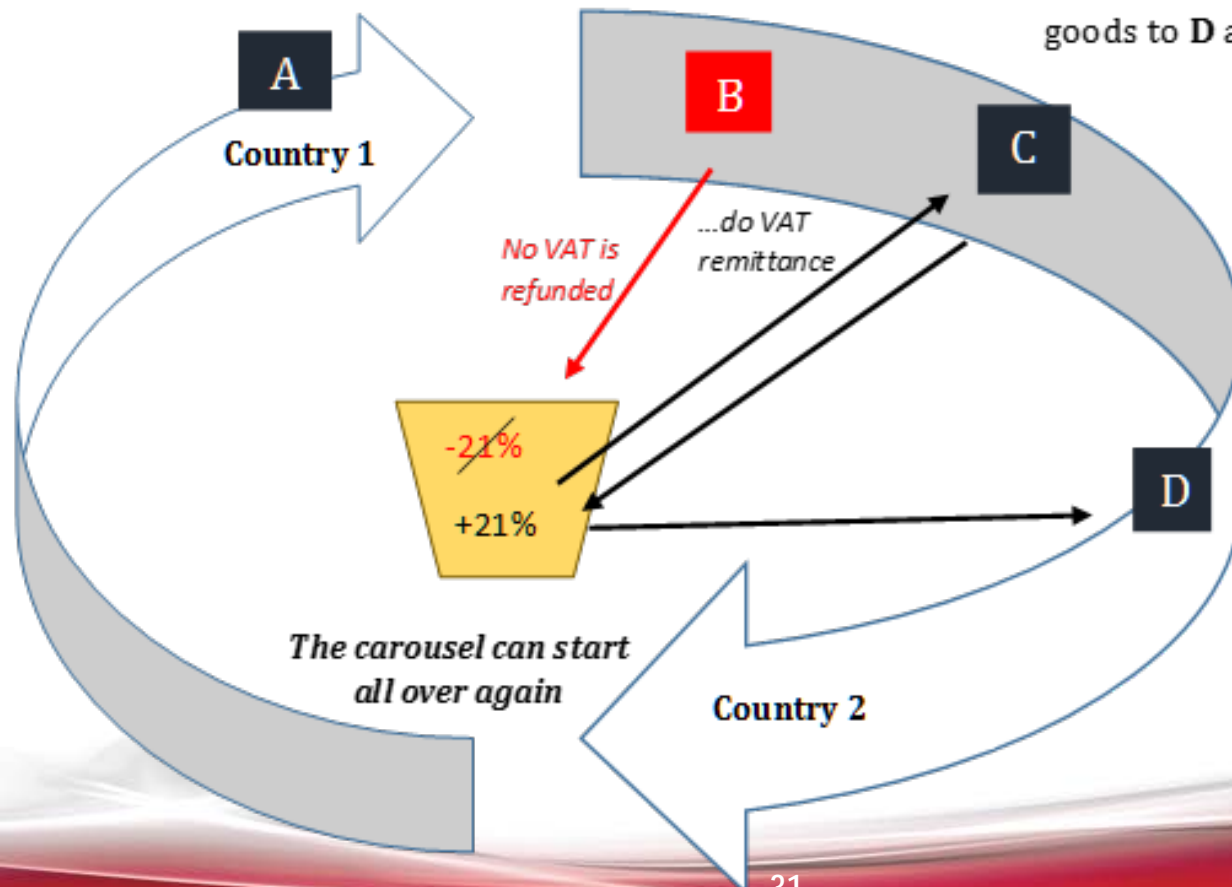
# Tax fraud

**Business A** delivers goods to **B** in Country 1. Because this is a cross-border sale, A does **not** charge B any VAT.

**B** sells the goods to **C** and charges 21% VAT. B has to remit this to the taxing authority, but **fails** to do so. He commits **fraud**.

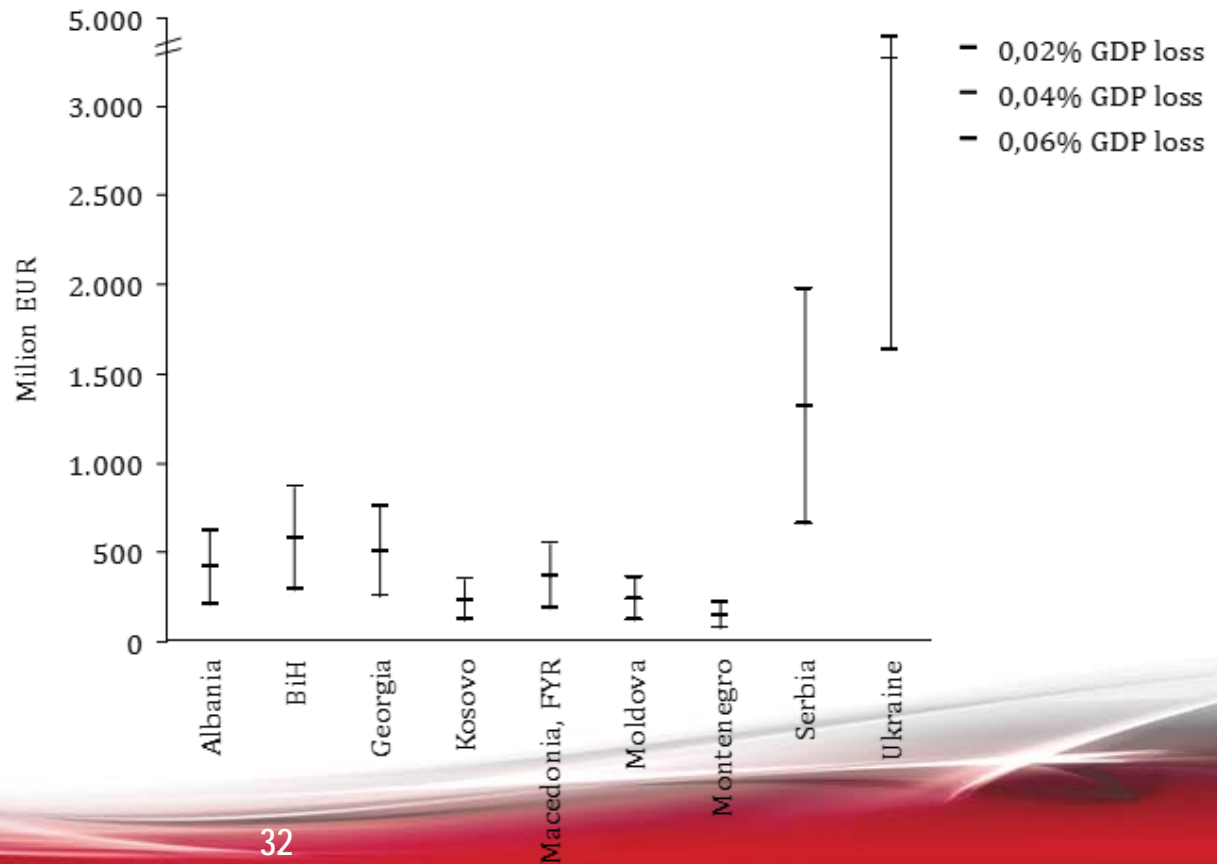
**C** has paid 21% worth of VAT to **B**, which he can deduct on his VAT return. **C** delivers the goods to **D** and charges VAT.

**D** can sell the goods back to **A**. Because this is a cross-border sale, D charges 0% VAT.



# Tax fraud

- o No estimates for EnC: but data for EU indicate €50 billion annually (0.4% of GDP)
- o Assuming the same share of VAT fraud in CPs and assuming the value of GDP at current prices for all CPs of 176.3 billion EUR → loss of 705 million EUR in total for all CPs .
- o Effective tool to fight tax fraud is RCM:
  - Final buyer pays the VAT





# Double / no taxation – CPs

## o Bosnia and Herzegovina

- Foreign based companies not invoiced VAT for use of interconnecting capacity (daily) in BiH
- But Elektroprijenos BiH pays the corresponding VAT
- Instance of double taxation

## o Georgia

- Use of interconnection capacity subject to VAT
- Pursuant to article 181 foreign based firms cannot receive VAT refund for use of interconnection capacity: VAT refund possible only in case of goods

## o Ukraine

- Stakeholders indicated VAT refund is perfume in unsystematic manner

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# Supply by non resident suppliers

- o Directive 2009/72/EC (electricity Directive) in Article 3(4) and Directive 2009/73/EC (gas Directive) in Article 3(5) require Member States to ensure that *"all customers are entitled to have their electricity and/or gas respectively provided by a supplier, subject to the supplier's agreement, regardless of the Member State in which the supplier is registered, as long as the supplier follows the applicable trading and balancing rules."*
  - Are there any VAT related obstacles?
  - We analyze B2B and B2C

# Supply by non resident supplier-EU

- o B2B (country A to country B)
  - If country B is EU, the supplier does not account for VAT due to RCM
  - If country B is outside EU, it will be charged where customer resides
- o B2C (country A to country B)
  - If country B is EU, the place of supply is where customer resides. Company will need to VAT register in country B
  - If country B is outside EU, no VAT charged as outside EU

# Supply by non resident supplier-CPs

- o Supply B2B in generally governed by RCM
- o Supply B2C requires establishing a branch or tax representative

# Supply by non resident supplier-CPs

CP	B2B	B2C
Albania	RCM	FR
BiH	FR	FR
Georgia	PE	PE
Kosovo*	RCM	FR
FYRM	RCM	PE
Moldova	PE	PE
Montenegro	FR	FR
Serbia	RCM	FR
Ukraine	PE	PE

\*PE - Permanent establishment (Branch or Company)

\*FR - Fiscal representative

\*RCM - reverse charge mechanism

# Supply by non resident supplier-CPs

- o Energy market regulation: supply of domestic consumers by foreign based firms
  - Approval by the NRA (supplier license)
  - Registration with TSO as market participating party (nominating power flows, balancing..)
- o Requires harmonization of energy legislation
- o Possible options:
  1. Mutual recognition of supply licenses
  2. Reciprocity principle
  3. Conditioned licensing
  4. Streamlined procedure

# Backhaul capacity

- o Backhaul (reverse flow) capacity enables the non-physical delivery of natural gas, whereby the performance of the delivery task is completed by netting the physical delivery and the reverse flow delivery task, carried out by the Transmission System Operator (TSO).
- o EU TSOs treat backhaul as a service, hence apply VAT rules as for other services
- o **Recommendation:** apply service based VAT rules



# Net metering

- o Problem: consumer is at the same time producer and consumer of electricity
  - Difficulty arises with households who are not taxable persons
- o Question: how to treat electricity supplied to the grid by the households?
- o Selling electricity to the grid implies commercial activity
  - Depending on jurisdiction, households have varying costs
- o Slovenian case: netting of energy done on annual basis
  - Extra produced energy given for free to the MO

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# Options for harmonization

- o **Scenario 1: do nothing**
  - Business entities have difficulties engaging in commercial relationships
  - Hampers development of common market
- o **Scenario 2: implement minimum changes necessary for harmonization**
  - Allow for better functioning of the market
  - 2 sub options: (1) implement particular principles; (2) **implement exact provisions**
- o **Scenario 3: full implementation**
  - Not realistic (e.g. reporting and monitoring instruments reserved for EU MS – they are derived from other EU institutions)

# Optimum harmonization

- o The definition of art. 9 VAT Directive regarding taxable persons: the exact definition to be used
- o Governmental bodies (Art. 13): in EnC many state owned bodies / companies actively participate in the market and might affect competition – need to clarify their position
- o Place of supply of goods and services: in order to unify the place of taxation (Art. 31-36, 44)
- o Treatment of electricity and gas as goods (Art. 15)
- o Supply of services (gas and electricity) to non taxable person (Art. 59h)
  - Taxable where that person resides

# Optimum harmonization

- o Supply of goods (gas and electricity) to taxable dealer (B2B) (Art. 38)
  - Taxable where dealer is established
- o Supply of goods (gas and electricity) to non taxable person (B2C)
  - Taxable where customer effectively consumes the good
- o Possibility for reduced rates for gas and electricity (Art. 99 and 102)
- o Importation exemption (Art. 143)
- o Export exemption (Art. 146)
- o Reverse charge (Art. 199a)
  - Person liable for VAT is the person to whom supplies of gas and electricity are made

# Optimum harmonization

- o Reporting of fraudulent activities (Art. 199a)
  - CP report to EnC on fraudulent activities
- o Tax refund (Art. 171)

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# Next steps

- o Receive feedback from the stakeholders
  - Comment on the use of appropriate legislative acts
  - Provide additional acts if necessary (e.g. rulebook)
  - Provide practical experience
- o Once the feedback is received the Consultant will update the Study



# We appreciate your attention

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