
by the Energy Community Secretariat

June, 2023
PURPOSE STATEMENT

Assessment of the draft Law of Ukraine “On Amending the Tax Code of Ukraine on Taxation of Accessing the Interconnectors and other Electricity Export and Import Transactions” provided by the Ministry of Energy of Ukraine.

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Introduction

The present assessment follows a request of the Ministry of Energy of Ukraine (hereinafter, the Ministry) to the Secretariat to provide a compliance assessment of the draft Law of Ukraine “On Amending the Tax Code of Ukraine on Taxation of Accessing the Interconnectors and other Electricity Export and Import Transactions”.

Background

In the past, the Secretariat has been organizing workshops and provided technical assistance to the national authorities identifying and explaining the key provisions of the EU’s common system of value added tax (hereinafter, VAT) for Contracting Parties to apply as a precondition for further energy market integration. The Secretariat also drafted a detailed overview of the provisions of national VAT rules which require amendments, and shared them with the national authorities, including Ukraine.

Following an initiative of the Ministry of Finance, a working group has been established consisting of designated representatives of the Ministry of Finance, the Ministry of Energy, the EU4PFM project and the Secretariat, and tasked to propose amendments to the Tax Code of Ukraine related to transactions in network energy. The specific tasks of the working group are:

- to review the proposed amendments and verify their compatibility with the provisions of the VAT Directive, in close cooperation with E4PFM experts and VAT experts recommended by the Commission and engaged by the Secretariat,
- the key stakeholders (transmission system and market operator) to prepare a description of cross-border transactions in network energy;
- based on this description of affected transactions, to estimate the impact of the amendments on the budget revenues from VAT.

The working group convened three times and agreed on the need to amend the Tax Code to enable the implementation of the Energy Community Treaty and to allow for interconnection capacity allocation in accordance with the Energy Community acquis.

In the meantime, the process of integration of the Ukrainian electricity market with the EU has started and the allocation of cross border capacity has been subject to recent amendments to the Electricity Market Law (see Observatory Assessments 4/23, 6/23 and 7/23)\(^1\). The lack of harmonized taxation emerged as an obstacle for the billing procedure for services between the Ukrainian transmission system operator and market participants, as well as in relation to the future allocation office for joined capacity allocations.

\(^1\) https://www.energy-community.org/Ukraine/observatory.html
Impact of the amendments on Tax Code

While the financial impact on budget revenues is yet to be determined, the amendments proposed by the Ministry of Energy are expected to remove obstacles for joint capacity allocation in accordance with Regulation 2015/1222 as incorporated in the Energy Community (hereinafter, CACM).

The harmonization of VAT regime will enable joint allocation of cross border capacities and in case of congestion, result in revenues for the national transmission system operator, Ukrenergo, from providing taxable services to market participants established in Ukraine.

Compliance assessment

Without prejudice to the findings and conclusions of the working group and recalling that the fiscal regime is out of the scope of the Energy Community Treaty, this compliance assessment is limited to network energy-based transactions and builds on the commitments under the Association and Accession Agreement with the EU, namely to gradually align Ukraine’s VAT regime with the EU’s.

The main concern in this respect is that the amendments proposed by the Ministry of Energy are not in line with the corresponding provisions of VAT Directive 2006/112/EC, which define the principles and procedure for taxation of the service of providing access to interconnectors.

Conclusions and recommendations

The Secretariat suggests to introduce amendments in the draft which allow for the approximation of the Tax Code of Ukraine with the VAT Directive, by transposing the provisions of the VAT Directive pertaining to cross border transactions in network energy.

It is recommended to introduce the following changes as a matter of priority:

- in a case in which the person to whom the services are provided is a business entity, define the place of provision of services (at least the services related to providing access to and use of natural gas and electricity networks) as the country in which the recipient is established, and otherwise as the country in which the supplier is established;
- to oblige the recipient of services to calculate, report and pay VAT on received services of access to network, and to deduct input VAT on received services supplied by a service provider established outside Ukraine.

It is further recommended to:

- introduce the notion of taxable dealer in network energy who is obliged to calculate and pay VAT on purchased energy, and entitled to deduct input VAT;
- define the place of supply of energy as the location of the customer, when the customer is a taxable dealer. If the customer is a final consumer, the place of supply should be defined as the place where the customer effectively uses and consumes the energy.
- align the Tax Code with the VAT Directive by exempting energy from VAT at importation.
For these purposes, the provisions related to access to the network and cross border trade in electricity should be equally applicable for transactions related to access to the network and trade in natural gas transported and distributed through natural gas networks, as well as heating and cooling energy networks.
# Annex

**Detailed assessment of proposed draft Law of Ukraine “On Amending the Tax Code of Ukraine on Taxation of Accessing the Interconnectors and other Electricity Export and Import Transactions”**

<table>
<thead>
<tr>
<th>Provision (Norm) of the Current Piece of Legislation</th>
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<th>Energy Community Secretariat’s comments and recommendations</th>
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</table>
...  
186.3. The place of supply of services as specified in this item shall be considered the place where the recipient of the services is registered as a business entity or – if there is no such a place – place of its permanent or preferred residence. Such services shall include:  
...  
j) provision of services for producing and arranging video films, movies, animated cartoons, TV programs, promotional films, photo advertising materials, and computer graphics.  
Para is absent | Amendment in point (k) is intended to remove VAT related barriers for joint capacity allocation.  
In Article 186.2,3 it is advisable to specify the services, as well as to include services of access to natural gas network, since the same rules apply for natural gas.  
Suggested amendment should read:  
A supply of services is to be treated as made—  
(a) in a case in which the person to whom the services are supplied is a relevant business person, in the country in which the recipient belongs, and  
(b) otherwise, in the country in which the supplier belongs. |
| Article 186. Place of Supply of Goods and Services  
...  
186.3. The place of supply of services as specified in this item shall be considered the place where the recipient of the services is registered as a business entity or – if there is no such a place – place of its permanent or preferred residence. Such services shall include:  
...  
j) provision of services on the production and arrangement of video films, movies, animated cartoons, TV programs, promotional films, photo advertising materials, and computer graphics;  
k) services provided according to the Law of Ukraine “On Electricity Market”. |
For the purposes of this Act a person is a relevant business person in relation to a supply of services if:
(a) the person carries on a business, and
(b) the services are not received by the person wholly for private purposes, whether or not the services are received in the course of business.

OR
“k) the provision of access to a natural gas system situated within the territory of Ukraine or to any network connected to such a system, to the electricity system or to heating or cooling networks, or the transmission or distribution through these systems or networks, and the provision of other services directly linked thereto”

OR:
k) services provided according to the Law of Ukraine “On Electricity Market” such as but not limited to provision of access to the electricity system situated within the territory of Ukraine or to any network connected to such a system, to a natural gas system or to heating or cooling networks, or the transmission or distribution through these systems or networks, and the provision of other services directly linked thereto
In addition, it is suggested to amend the Law with the provision of Article 38 and 39 of the VAT Directive related to cross border trade in electricity and natural gas:

Article 186.1 (Place of supplying goods) shall be amended with paragraph 1a)

186.1 a
In the case of supply of gas through a natural gas distribution system, or of electricity, to a taxable dealer, the place of supply shall be deemed to be the place where that taxable dealer has established his business for which the goods are supplied, or, in the absence of such a place of business, the place where he has his permanent address or usually resides.

In the case of supply of gas through a natural gas distribution system, or of electricity, where such a supply is not covered by Article 186.1a [in VAT Directive art 38 - case of supply to taxable dealer], the place of supply shall be deemed to be the place where the customer effectively uses and consumes the goods.

Where all or part of the gas or electricity is not effectively consumed by the customer, those non-consumed goods shall be deemed to have been used and consumed at the place where the customer has established his business. In the absence of such a place of business, the customer shall be deemed to have used and consumed the
<table>
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<tr>
<th>Article 188. Procedure for Determination of Taxation Base in Case the Goods/Services are Supplied</th>
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<td>188.1. The tax base for goods/ services supply transactions shall be determined based on their contractual value considering the national taxes and fees (except the excise duty that is charged following sub-items 213.1.9 and 213.1.14 item 213.1 Article 213 of this Code, compulsory state pension insurance fee that is charged from the cost of cellular communications services, value added tax and excise duty for ethanol that is used by</td>
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This amendment is not clear, namely what goods and services are considered as “reimbursed under ECT”.

If an amendment is needed, the specification of the supply in question must be provided, which transactions are exempted and how would be determined the tax base in these cases (eg supply of goods and services pursuant to the amendments of Article 186 of this Law.

Note:
Manufacturers – business entities to produce medications, including the components of blood and drugs produced from them (except the medications in the form of balsams and elixirs).

At the same time, the tax base of goods/services supply transactions cannot be lower than the price of purchase of such goods/services, and the tax base of transactions related to the supply of independently manufactured goods/services cannot be lower than the regular prices, while the tax base of transactions related to the supply of non-current assets cannot be lower than the book (residual) value according to the accounting data that prevailed as of the start of the reporting (tax) period, during which such transactions are conducted (in case there is no accounting of non-current assets – based on a regular price), except:

- goods/services, the prices for which are subject to state regulation;
- gas to be supplied for the needs of households;
- electricity, the price for which prevails in the electricity market.

If the proposed amendment were adopted, i.e. to exempt cross border services related to access to the network from taxation, the amendment to the provision of Article 188.1 still does not define the tax base.

The provision “At the same time, the tax base of goods/services supply transactions cannot be lower than the price of purchase of such goods/services, and the tax base of transactions related to the supply of independently manufactured goods/services cannot be lower than the regular prices, while the tax base of transactions related to the supply of non-current assets cannot be lower than the book (residual) value according to the accounting data that prevailed as of the start of the reporting (tax) period, during which such transactions are conducted (in case there is no accounting of non-current assets – based on a regular price), except:” is not in line with VAT Directive.

At least, for the purpose of determining the taxable amount of supplies of energy, gas, heat or cooling energy and the provision of access to systems/distribution and transmission through a system as well as any closely linked services, the taxable amount shall include everything which constitutes consideration obtained or to be obtained by the supplier, in return for the
supply, from the customer or a third party, including subsidies directly linked to the price of the supply. The taxable amount shall also include the following factors:

(a) taxes, duties, levies and charges, excluding the VAT itself;
(b) incidental expenses, such as commission, packing, transport and insurance costs, charged by the supplier to the customer. Expenses covered by a separate agreement may be regarded as incidental expenses

The taxable amount shall not include the following factors:

(a) price reductions by way of discount for early payment;
(b) price discounts and rebates granted to the customer and obtained by him at the time of the supply;
(c) amounts received by a taxable person from the customer, as repayment of expenditure incurred in the name and on behalf of the customer, and entered in his books in a suspense account. The taxable person must furnish proof of the actual amount of the expenditure referred to in point (c) and may not deduct any VAT which may have been charged.
With regards to zero/negative prices, if UA MoF decides to provide for express provisions in this case, they can use the EU MS examples on the subject as basis. In Bulgaria, for example, it is done in instructions/orders and not in the VAT primary law.

Other than in the case of supplies between related parties (and this is done for anti-evasion and avoidance purposes), the EU Directive does not in any way regulate the pricing of the goods/services.

Reference to Art. 73, 78, 79 and 80 of the EU VAT Directive.

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<tr>
<th>Article 197. Transactions Exempted from Taxation</th>
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<td>197.29. Transactions on granting access to interconnectors shall be exempted from taxation. The transactions on granting access to interconnectors shall include granting, use, transfer, termination, non-nomination, decrease, and restriction of distributed physical rights for transfer using the mechanisms as specified by regulations of the National Energy and Utilities Regulatory Commission.</td>
<td>The exemption from VAT for the access to interconnectors is not in line with VAT Directive and could lead to legal uncertainty for businesses. If the rules for place of supply of services will be amended, the exemption is not necessary. It shall be subject to VAT depending on the seat of service recipient. In case of foreign service provider, service recipient shall apply reverse charging, calculate and report due VAT (and deduct input tax subsequently) as described in Article 186.3</td>
</tr>
</tbody>
</table>

Instead, the following amendments should be introduced:
Transactions exempted from VAT shall be:
- importation of gas through a natural gas system or any network connected to such a system or fed in from a vessel transporting gas into a natural gas system or any upstream pipeline network, and of electricity.
(Note: Taking into consideration the concerns of the Ministry of Finance, this amendment could be postponed.).

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<th>Article 198. Tax Credit</th>
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<tr>
<td>198.5. The taxpayer should calculate tax liabilities based on the tax base as specified following item 189.1 Article 189 of this Code and compile, not later than the last day of the reporting (tax) period, and register in the Unified Register of Tax Invoices within the period as established by this Code for such registration, the consolidated tax invoice for goods/services, non-current assets purchased/manufactured with value added tax (for goods/services, non-current assets acquired or manufactured before 1 July 2015 – if during such acquisition or manufacturing the amounts of tax have been included in the tax base).</td>
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</tbody>
</table>

Amend with the following:

VAT shall be payable by any person who is identified for VAT purposes in Ukraine to whom goods are supplied in the circumstances specified in Articles 186.1a (which define supply of goods (gas and electricity) to a taxable dealer or to the customer), if the supplies are carried out by a taxable person not established within Ukraine.

The transactions from art. 197.29 should not be exempted according to the VAT Directive.
credit), if such goods/services, non-current assets are assigned to be used or start to be used:

a) in transactions, which are not an object of taxation, following Article 196 of this Code (except the cases of transactions as specified by sub-item 196.1.7 item 196.1 Article 196 of this Code) or the place of supply of which is located outside the customs territory of Ukraine;

b) in transactions exempted from taxation following Article 197, sub-section 2 section XX of this Code, international agreements (treaties) (except the cases of transactions as specified by subitem 197.1.28 item 197.1 Article 197 of this Code and the transactions as specified by item 197.11 Article 197 of this Code);

…

tax credit), if such goods/services, non-current assets are assigned to be used or start to be used:

a) in transactions, which are not an object of taxation, following Article 196 of this Code (except the cases of transactions as specified by sub-item 196.1.7 item 196.1 Article 196 of this Code) or the place of supply of which is located outside the customs territory of Ukraine;

b) in transactions exempted from taxation following Article 197, sub-section 2 section XX of this Code, international agreements (treaties) (except the cases of transactions as specified by subitem 197.1.28 item 197.1 Article 197 of this Code and the transactions as specified by items 197.11 and 197.29 Article 197 of this Code);

…

Alternatively:

The tax shall be payable by a person registered under this Act who is a supplier of a taxable supply.

(2) Where the supplier is a taxable person who is not established within the territory of the Ukraine and the place of supply is the territory of the Ukraine and the supply is taxable, the tax shall be chargeable from the recipient of the supply upon:

1. supply of natural gas through a natural gas system situated on the territory of Ukraine or through a network connected to such a system, supply of electricity or of heating or cooling energy through district heating or cooling networks, to a taxable dealer under the circumstances of Art. 186.1 a registered under this Act;

2. supply of services, where the recipient is an entity - tax payer.

The provision on tax liability stating that it is the entity – recipient who is liable for VAT under reverse charge should encompass importations of electricity/gas/energy and purchase of energy trade related services.
<table>
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<tr>
<th>Article 199. Proportional Allocation of Tax Amounts to Tax Credit</th>
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<th>The transactions from art. 197.29 should not be exempted according to the VAT Directive.</th>
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<tbody>
<tr>
<td>... 199.6. Rules of this Article shall not be used in case of: transactions as specified by sub-item 196.1.7 item 196.1 Article 196 of this Code; transactions as specified by sub-item 197.1.28 item 197.1, items 197.11 and 197.24 Article 197 of this Code.</td>
<td>... 199.6. Rules of this Article shall not be used in case of: transactions as specified by sub-item 196.1.7 item 196.1 Article 196 of this Code; transactions as specified by sub-item 197.1.28 item 197.1, items 197.11, 197.24, and 197.29 Article 197 of this Code.</td>
<td>This proposal could lead to legal uncertainty.</td>
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<td><strong>213.3. Transactions with excisable goods, which shall be exempted from taxation:</strong></td>
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<td>This amendment is not needed, as it will be already covered with amendments to Article 186 and 197 or they can simply refer to these articles if this is part of the structure of their law.</td>
</tr>
<tr>
<td>213.3.14. import into the customs territory of Ukraine and sale in the customs territory of Ukraine the bodies to automobiles subject to use them to manufacture the automobiles as specified in commodity item 8703 under the UCT ZED (Ukrainian Classification of Goods for Foreign Economic Activity).</td>
<td>213.3.14. import into the customs territory of Ukraine and sale in the customs territory of Ukraine the bodies to automobiles subject to use them to manufacture the automobiles as specified in commodity item 8703 under the UCT ZED (Ukrainian Classification of Goods for Foreign Economic Activity); 213.3.15. electricity imports by the trade agent specified under the Law of Ukraine “On Electricity Market” during the coupling of the day-ahead market and intraday market with day-ahead and intraday markets of neighboring countries to sell such electricity in the future under the procedure as established by the day-ahead market and intraday market.</td>
<td>The same transaction (imports) could be treated different (if it is made or not by a trade agent) and could lead to legal uncertainty. Ukraine should decide if will exempt the import of electricity or not. According to the VAT Directive, the import of electricity should be exempted. Alternatively:</td>
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<tr>
<td><em>Para is absent</em></td>
<td></td>
<td>213.3.15. the importation of electricity;</td>
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