



POLICY GUIDELINES

by the Energy Community Secretariat

for treatment of Value Added Tax on transactions related to cross border trade of electricity in the Contracting Parties of the Energy Community

PG 01/2015 / 09 Jan 2015



1. Purpose

Recalling that there is no common system of value added tax (VAT) either within the Energy Community or in transactions between Energy Community Contracting Parties (EnC CPs) and the European Union Members States (EU MS), it is important to ensure that all taxes are charged on goods and services and that there is no double taxation of any good and service supplied in accordance with the Treaty establishing the Energy Community (the Treaty).

The EU tax legislation is not directly applicable in the Energy Community, but certain assumptions should be considered to ensure compatible markets without tax barriers.

The **Treaty** explicitly requires that “*Customs duties and quantitative restrictions on the import and export of Network Energy and all measures having equivalent effect shall be prohibited between the Parties. This prohibition shall also apply to customs duties of a fiscal nature.*” (Article 41 of the Treaty)

Whether this provision can be interpreted as a requirement to eliminate any existing taxes on the supply of electricity or gas is subject to a case-by-case analysis. Still, key stakeholders identified VAT as an obstacle to trade and the need to remove tax barriers to trade.

This document is prepared with the aim to present harmonized approach to overcome tax barriers to trade in electricity and to provide guidelines on how to handle tax related aspects of cross border trade relevant for the implementation of the Treaty.

In terms of value added tax (VAT), two aspects are relevant: transactions dealing with electricity as a product and transactions dealing with services related to transport of electricity, including hosting cross border flows.

The elaborated questions relate to taxation of the following transaction:

- supply of services related to cross border trade of electricity;
- import and export of electricity and retail supply of electricity by non-resident suppliers.

Taking account of the existing impediments of tax nature for an integrated electricity market in the Energy Community, respective EU rules related to certain tax aspects of the integrated energy market and applicability of these rules in the Energy Community, the document defines a harmonized approach to VAT in cross border trade based on the respective EU rules.

The scope of proposed adjustment is intended to keep this harmonized approach contained within the limits of objective needs of the Treaty and to maintain the sustainability of the Treaty. Nothing in this document aims at extending the Treaty beyond the identified objective needs to transpose and implement the rules on internal market in energy.

The establishment of the Coordinated Auction Office of South Eastern Europe (CAO) first faced and identified obstacles of fiscal nature for cross border transactions. The Montenegrin VAT Law defines the place of supply of service in general in the location where service was provided. The Interpretation of Montenegrin Ministry of Finance solved the issue related to VAT charged on the basis of the seat of CAO, making reference to the Rulebook on implementation of Law on VAT¹. The interpretation defined the treatment of the fees charged by SEE CAO for its operation and excluded from taxation the amounts charged, received or remitted by a taxpayer in the name and for the account of another person if recorded by the taxpayer.

¹ <http://www.poreskauprava.gov.me/en/library/pravilnici>

The taxation of services provided to founding members of SEE CAO remained different. In October 2014 the Coordinated Auction Office of South Eastern Europe called for the harmonization of VAT treatment in non EU states in South Eastern Europe.

In the same time, transmission system operators working on establishing the common auction of interconnecting capacities faced the problem of double taxation arising from the different definition of the place of taxable transaction. The Agreement on common allocation procedure between TSOs from Serbia and FYR Macedonia prepared in 2011 is still on hold due to non-harmonized VAT treatment of underlying transactions, namely different definition of the place of supply of service, giving rise to double taxation of the same transaction (fee on access to interconnection capacities).

The 18th Athens Forum in its Conclusions² related to promoting cross-border electricity trade invited the Contracting Parties to overcome the barriers to regionally coordinated capacity allocation and market coupling resulting from different VAT rules. The Forum invited the Secretariat and the European Commission to address the question in future communication with the relevant institutions in the Energy Community.

Finally, the market operators from the Energy Community at their meetings on 5th May 2014 and 28th June 2014 reiterated the need to harmonize applicable rules on value added tax as a precondition for smooth cross border trade and to avoid tax evasion or double taxation on services related to hosting cross border flows.

Implementation of the rules from the EU Third Legislative Package introduced a new obligation: to allow customers access to suppliers regardless of their seat of registration, subject to respecting national trading and balancing rules. Implementation of this requirement without proper tax scrutiny might lead to double taxation or non taxation, incite tax fraud and eventually impair the efforts towards market integration.

Different VAT rules and lack of coordination and harmonization in the pending process of market opening increase the risk of tax frauds in cross border trade, of double taxation or non taxation of cross border services and will likely prove detrimental for emerging competitive markets of the Energy Community.

2. The rules on value added tax in the Energy Community

The current legislation and practices in the Contracting Parties as regards VAT are different and not harmonized.

All domestic transactions related to supply of electricity are subject to VAT in all Contracting Parties, except Moldova where VAT rate is zero on electricity supplied to household.

The place of taxable transaction for all supplies of electricity is determined at the place where electricity is supplied to customer.

As regards cross border transactions, in all Contracting Parties a license to supply electricity must be obtained. This extends to wholesale supply (referred to as “trade” in some jurisdictions), except in Montenegro. Therefore foreign suppliers still do not have access to retail customers. In Montenegro wholesale supplier does not need license, but must register as a market participant, eligible to supply other registered market participants. Import of electricity is subject to VAT, except in Kosovo* and Moldova. Export of electricity is tax exempted.

When services of network operators are considered, the rule is that access and use of network are subject to VAT in all jurisdictions.

² <http://www.energy-community.org/pls/portal/docs/2104179.PDF>

* This designation is without prejudice to position on status and is in line with UNSCR 1244 and ICJ Opinion on Kosovo Declaration on Independence

The place of taxable transaction for services related to access to and use of power network in Albania, Kosovo* and Serbia is defined in the place of customer, i.e. the recipient of the service.

In Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia and Montenegro, the place of taxable transaction for network related services is determined in the place of service provider or at the place where service is provided. In Moldova and Ukraine, in the absence of an explicit designation, network related service is assumed to be taxed at the place of service provider.

When access to interconnectors is considered, the place where service is provided is subject to interpretation and in general the interpretation is that service is provided on the national territory and subject to VAT, presented in the invoice of service provider, to domestic and foreign entities.

Market participants and market operators in the Energy Community rightly claim that different VAT rules do not contribute to simple and efficient procedure for capacity allocation, often present obstacle to trade and in general do not facilitate market integration.

3. VAT in the European Union

The most important act in this matter is Directive 2006/112/EC on common system of value added tax which defines principle for treatments of electricity and gas and related services for taxation. Since then, tax dimension has been monitored and instruments made available to foster single electricity and gas market by removing fiscal obstacles.

This Directive was amended in 2008 with the Directive 2008/8/EC as regards the place of supply of services,⁴ and further clarified with the Implementing Regulation (EU) No 282/2011 laying down implementing measures for Directive 2006/112/EC⁵.

The main principles of the Directive 2006/112/EC on common system of value added tax relevant for supply of electricity and gas, as well as supply of services related to transactions in electricity and gas are the following:

Recital (19) *Electricity and gas are treated as goods for VAT purposes. It is, however, particularly difficult to determine the place of supply. In order to avoid double taxation or non taxation and to attain a genuine internal market free of barriers linked to the VAT regime, the place of supply of gas through the natural gas distribution system, or of electricity, before the goods reach the final stage of consumption, should therefore **be the place where the customer has established his business**. The supply of electricity and gas at the final stage, that is to say, from traders and distributors to the final consumer, should be taxed at **the place where the customer actually uses** and consumes the goods.*

Recital (37) *The supply of gas through the natural gas distribution system, and of electricity is taxed at the **place of the customer**. In order to avoid double taxation, the importation of such products should therefore be exempted from VAT.*

Article 38: (1) *In the case of the supply of gas through the 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** or has a fixed establishment for which the goods are supplied, or, in the absence of such a place of business or fixed establishment, the place where he has his permanent address or usually resides.*

Article 38(2) of the VAT Directive defines that “taxable dealer shall mean a taxable person whose principal activity in respect of purchases of gas, electricity, heat or cooling energy is

⁴OJ L 44/11 20.2.2008 <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2008:044:0011:0022:EN:PDF>

⁵OJ L 77/1 23.3.2011 <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2011:077:0001:0022:EN:PDF>

reselling those products and whose own consumption of those products is negligible.”

Article 39: *In the case of the supply of gas through the natural gas distribution system, or of electricity, where such a supply is not covered by Article 38, 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 or has a fixed establishment for which the goods are supplied. In the absence of such a place of business or fixed establishment, the customer shall be deemed to have used and consumed the goods at the place where he has his permanent address or usually resides.*

Article 56: *The place of supply of the following services to customers established outside the Community⁶, or to taxable persons established in the Community but not in the same country as the supplier, shall be the place where **the customer has established his business** or has a fixed establishment for which the service is supplied, or, in the absence of such a place, the place where he has his permanent address or usually resides: (h) the provision of access to, and of transport or transmission through, natural gas and electricity distribution systems and the provision of other services directly linked thereto;*

Article 143: *Member States shall exempt the following transactions:*

(l) the importation of gas through the natural gas distribution system, or of electricity.

The Directive 2008/8/EC additionally clarified that “*For supplies of services to taxable persons, the general rule with respect to the place of supply of services should be based on the place where the recipient is established, rather than where the supplier is established*” and “*Where services are supplied to non-taxable persons, the general rule should continue to be that the place of supply of services is the place where the supplier has established his business.*” The Regulation 282/2011 further specifies the place of supply of services if the determination of place depends on whether the customer is taxable person or non-taxable person. For services supplied to a non-taxable person, the place of supply shall be deemed the place where service provider is established. Further, the supplier may regard the customer as a taxable person if the customer has communicated his individual VAT identification number.

However, supply of services to a non-taxable person outside the Community (i.e. European Union) is further clarified in Article 2 of Directive 2008/8/EC as regards the place of supply of services to non taxable person who is established or has permanent address outside the Community.

“The place of supply of the (provision of access to, and of transport or transmission through, natural gas and electricity distribution systems and the provision of other services directly linked thereto) to a non taxable person who is established or has his permanent address or usually resides outside the Community, shall be the place where that person is established, has his permanent address or usually reside.”

In addition, to combat tax fraud, EU adopted the Regulation (EU) No 904/2010 on administrative cooperation and combating fraud in the field of value added tax. In 2013 EU amended the Directive 2006/112/EC with Directive 2013/42/EU⁷ which introduced a Quick Reaction Mechanism against VAT fraud and Directive 2013/43/EU⁸ which introduced a

⁶ “Community” referred to in this Directive 2006/112/EC is the European Union

⁷ OJ L 201/1

<http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2013:201:0001:0003:EN:PDF>

⁸ <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2013:201:0004:0006:en:PDF>

reverse charge mechanism as a temporary measure. The reverse charge mechanism allows shifting of VAT liability from supplier to customers in certain sectors, including supply of gas and electricity, for a limited period of time.

The Directive 2013/43/EU defines that *“Member States may, until 31 December 2018 and for a minimum period of two years, provide that the person liable for payment of VAT is the taxable person to whom any of the following supplies are made: e) supplies of gas and electricity to a taxable dealer as defined in Article 38(2)”*

4. Policy Guidelines

In order to avoid double taxation or non taxation on supply of services by transmission system, it is recommended to apply EU rules as regards the place of supply of services, namely for *supplies of services to taxable persons*.

As regards other transactions related to cross border trade, Article 3.4 of Directive 2009/72/EU requires Contracting Parties to *“ensure that all customers are entitled to have their electricity provided by a supplier, subject to the supplier’s agreement, regardless of the Contracting Party in which the supplier is registered, as long as the supplier follows the applicable trading and balancing rules. In this regard, Contracting Party shall take all measures necessary to ensure that administrative procedures do not discriminate against supply undertakings already registered in another Contracting Party”*.

Recalling that Energy Community does not make a single customs or VAT area, to implement the Article 3.4 of the Directive 2009/72/EC, Contracting Parties should look for a feasible solution with a common and harmonized approach to transposition. Therefore, in addition to stipulated conditions on trading and balancing rules, access to national customers for suppliers registered in another Contracting Party should be ensured to the extent compliant with the tax legislation.

Harmonization of rules within the Energy Community using EU experience and practice to remove barriers and fight tax evasion will contribute to successful integration of internal market within Energy Community.

4.1. Access to interconnection capacities

In case of hosting cross border flows of electricity, the transmission system operators are obliged to allocate the available interconnection capacities in a competitive procedure. If the available capacities are not sufficient to meet the demand, i.e. in case of congestion, the user will be charged for supplied service of access to interconnection capacity in accordance with the allocation rules.

Recalling that *“the general rule with respect to the place of supply of services should be based on the place where the recipient is established, rather than where the supplier is established”*, the VAT will be calculated and paid at the place where recipient of service is established.

1. Contracting Parties shall ensure that for the provision of access to, and of transport or transmission through electricity distribution systems and the provision of other services directly linked thereto, the place of supply of the services shall be the place where the customer has established his business or has a fixed establishment for which the service is supplied, or, in the absence of such a place, the place where he has his permanent address or usually resides.
2. Value added tax will be charged only to customers who has established his business or has a fixed establishment for which the service is supplied, or, in the absence of such a place, the place where he has his permanent address or usually resides in the same country as the TSO.

3. Access to interconnection capacity in principle is not allocated to a non-taxable person.

The relevance of the change for national public revenues may be measured only by comparing information about the actual amount of congestion revenues and separately revenues collected from market participants who do not have seat or established business in the Contracting Party concerned.

4.2. Retail supply by foreign supplier

Considering the associated risks and complexity of legislative change, a general VAT exemption on import of electricity, as defined in the EU legislation may be difficult to implement.

If tax legislation is obstacle for customers to be supplied from suppliers registered abroad, Contracting Parties shall take all measures necessary to ensure that administrative procedures are not disproportionate and do not discriminate against supply undertakings already registered in another Contracting Party. In particular, seat requirements imposed on suppliers and traders must be justified for objective reasons and not go beyond what is necessary to attain them.

1. The place of supply of electricity through the distribution system, before the goods reach the final stage of consumption, should therefore be the place where the customer has established his business.
2. The supply of electricity at the final stage, that is to say, from traders and distributors to the final consumer, should be taxed at the place where the customer actually uses and consumes the goods.
3. Supplier established and registered outside the Contracting Party is authorized to supply domestic customers, as long as these customers may be considered as taxable persons, i.e. holding relevant VAT identification.
4. The possibility that non-taxable persons be supplied by suppliers established outside the Contracting Party shall be permitted only after explicit appointment of taxable person in that transaction, such as tax representative.

As regards effects on public revenues, the amount of due VAT on sale to final customers who are taxable persons shall be the same, regardless of the seat of supplier. If final customer is a non taxable person, then access of a foreign supplier should not be permitted to the customer without local VAT identification.

Vienna, 9 January 2015



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