

European Economic and Social Committee

ECO/102

**Place of supply - electricity and
gas (VAT rules)**

Brussels, 26 March 2003

OPINION

of the

European Economic and Social Committee

on the

**Proposal for a Council Directive amending Directive 77/388/EEC as regards the rules on the
place of supply of electricity and gas**

(COM(2002) 688 final – 2002/0286 (CNS))

On 16 December 2002 the Council decided to consult the Economic and Social Committee, under Article 262 of the Treaty establishing the European Community, on the

*Proposal for a Council Directive amending Directive 77/388/EEC as regards the rules on the
place of supply of electricity and gas*

(COM(2002) 688 final).

The Section for Economic and Monetary Union and Economic and Social Cohesion, which was responsible for preparing the Committee's work on the subject, adopted its opinion on 6 March 2003. The rapporteur was **Mr Pezzini**.

At its 398th plenary session of 26 and 27 March 2003 (meeting of 26 March), the Economic and Social Committee adopted the following opinion by 97 votes to one with four abstentions.

1. Introduction

1. Following the establishment of the EU internal market, the electricity and gas market in the Member States has been gradually liberalised in order to increase efficiency in this sector. The European Council meeting in Lisbon on 23-24 March 2000 called for "rapid work" to complete the internal market and asked *"the Commission ... to speed up liberalisation"* in areas such as gas and electricity. The Energy Council of 30 May 2000 invited the Commission *"to present timely proposals for further action"*.
2. The Energy Council of 25 November 2002 gave further impetus to the gas and electricity liberalisation process, laying down the following requirements for Member States:

- liberalisation of non-household markets for energy and gas by 1 July 2004;
- liberalisation of household markets by 1 July 2007;
- compulsory legal separation between network operating companies and energy production companies;
- public service obligations (including provision of energy at reasonable prices);
- rules on pricing of network transmission, and;
- rules for allocation of available interconnection capacities for cross-border exchanges in electricity.

1. The European Economic and Social Committee is fully aware that while most of the Member States support liberalisation within the deadlines set, the situation is at present far from uniform. Moreover, the variation in the degree of energy market liberalisation in the Member States gives rise to significant discrepancies in the level of single market completion.
2. The EESC therefore supports all efforts aimed at achieving a market which can operate effectively. Market liberalisation cannot by itself guarantee that the market will function in practice.
3. The liberalisation of these markets requires increasing deregulation and is resulting in an increase in cross-border trade between Member States. As a result of new EU and national measures a considerable change in the operation of these markets is taking place.
 1. In the traditional electricity market the major electricity generators, transmission system operators and national and local distribution companies in most Member States were almost completely state-owned. Generally speaking, the electricity market was mainly a national market limited to trade within each country's borders. The same was true of the gas market.

4. As a result of liberalisation, energy markets have ceased to be purely national and have started to operate on a European basis. This led to the arrival of new market players such as power exchanges, independent power producers, brokers and traders. The dominant position of the state-owned companies, such as the large generators, is changing through privatisation and mergers. In countries where liberalisation is in full process, changes in methods of doing business and in the market place itself have been seen.
5. This increasing liberalisation of the gas and electricity distribution sector has led to an urgent need for a review of the current VAT rules to ensure that they are compatible with the need for correct and simple taxation of such supplies. The new markets also bring new problems, such as the question of the taxation of transmission costs.

2. Problems encountered under the current rules

1. Place of supply

1. Under VAT the "place of supply" decides which Member State is entitled to tax a transaction. It therefore also decides the rate of VAT payable and (usually) the Member State in which the supplier must register. It is elaborately defined and is not necessarily the place where, in a physical sense, one might regard the supply as occurring.
2. Under Article 5(2) of the Sixth VAT Directive¹ electricity and gas are considered tangible property. The supply of them is therefore regarded as a supply of goods, and the place of supply has to be determined in accordance with Article 8 of the Directive. Until the liberalisation of the electricity and gas markets, the question as to whether the supply fell under Article 8(1)(a) or 8(1)(b) – supply with or supply without transport – was not raised, because in almost all EU Member States the generation, distribution and trade of electricity was a national matter and hence cross-border trade did not occur. The occasional cross-border transactions were no cause for problems and where a distributor did make a cross-border supply, he would register in the other Member State.
3. In the new liberalised market cross-border transactions are frequent. The characteristics of electricity and gas make it almost impossible to trace their physical flows. For example, if a generator in northern Europe sells electricity to a consumer in southern Europe, this does not mean that the electrons produced by the generator will in fact flow from north to south. Similarly one cannot apply the idea of transportation to electricity and gas and it does not make sense to ask someone making a cross-border supply of these commodities to provide documentary evidence that a consignment has departed or arrived.
4. The physical flows do not coincide with the contractual relationship between the seller and the buyer; this is particularly true if the buyer asks for delivery to go direct to his customer.

5. The present rules sometimes require a supplier to register for VAT in a Member State other than his own; this causes trouble and expense and can hinder the development of the single market.
6. There might also be difficulties because of differences in the civil law of the Member States as regards determining the time and place of supply.

2. Transmission costs

1. According to Article 7 of Directive 96/92/EC Member States must designate a system operator to be responsible for operating, ensuring the maintenance of, and, if necessary, developing the transmission system in a given area and its interconnectors with other systems, in order to guarantee security of supply. The system operator is responsible for managing energy flows on the system, taking into account exchanges with other interconnected systems. In case of import of electricity, the system operator allocates the available capacity.
2. The national system operator carries the cost of the network. This network is used for national and international transport of electricity. Within the overall costs incurred by a Transmission Systems Operator, an allocation is made of costs related to national transmission services and to cross-border exchanges. Market participants who export electricity pay a fee covering the total network costs. This fee is in VAT terms the consideration for a service. If the fee is charged to a trader established in a different Member State from the TSO, the place of supply of these services becomes important. If this fee is considered as the payment for an intra-community transport service, the VAT would be due in the Member State where the trader is registered for VAT. If, on the other hand, it is considered that the fee is charged to provide access to the electricity distribution network, the place of taxation would be determined according to Article 9(1), namely the country where the TSO is established. Uncertainty as to which paragraph of Article 9 is applicable could lead to differences in interpretation, resulting in double or non-taxation.

3. The proposed solution

1. General approach

1. The current VAT system, in particular the rules on supplies between Member States, gives rise to unnecessary problems when applied to gas and electricity. New rules on the place of supply will take into account the specific nature of these commodities and facilitate the functioning of the internal market for them. A basic principle of the normal VAT system – taxation where the goods are physically located – is abandoned for these supplies since in most cases it is impossible to establish a link between the transaction and any physical flow of goods.

2. The new rules

1. The "rules" set out below are an attempt to state the matter in informal language but with sufficient accuracy.

2. **First rule**

1. A supply of electricity or gas to a person in the same Member State as the seller will be taxable in that Member State and the person liable for the tax will be the seller. A sale to a person outside the EU will not be liable to EU VAT. In both respects this is a continuation of the present state of affairs.

3. **Second rule**

1. A supply of electricity or gas to a person in a different Member State from the seller will, if the purchaser is engaged in the business of re-selling that commodity, be taxable in the purchaser's Member State. The person liable for the tax will be the purchaser. The seller will not have to register in the purchaser's Member State.

4. **Third rule**

1. A supply of electricity or gas to a person in a different Member State from the seller will, if the purchaser is NOT engaged in the business of re-selling that commodity, be taxable in the Member State where the energy is consumed. The person liable for the tax will be the seller, who will have to register in that Member State.
2. However, if the purchaser of the energy is registered for VAT in the Member State where the energy is consumed, the government of that Member State can opt to shift the liability from the seller to the purchaser, in which event the seller would not have to register in that Member State.
3. On a practical point, the place where the energy is consumed is the place where the meter is located.

5. **Fourth rule**

1. Purchases of electricity or gas from someone outside the EU are not explicitly dealt with. The position seems to be:
- If the purchaser is engaged in the business of re-selling that commodity, the purchase will be taxable in the purchaser's Member State and the person liable for the tax will be the purchaser.

- If the purchaser is not engaged in the business of re-selling that commodity, the purchase will be taxable in the Member State where the energy is consumed. The person primarily liable for the tax would be the seller, but if he did not register in that Member State, the government could use its right to shift the liability to the purchaser if he is registered there.

6. **Fifth rule**

1. The present uncertainty regarding charges for the transmission of electricity will be removed by providing that:

- As now, if the person providing the service and his customer are in the same Member State, the service is taxable in that Member State and the person liable is the person providing the service.
- If the two persons are in different Member States, the customer owes VAT to his Member State.
- If the supplier is outside the EU, the customer owes VAT to his Member State.

4. **Comments**

1. **General**

1. This proposal by the Commission to amend the VAT rules to take account of the liberalisation of the energy market will play a valuable part in liberalising it still further by removing constraints on the industry which were not foreseen when electricity and gas were largely state monopolies that did not operate beyond the state's borders. Such changes have been requested by the industry, which broadly supports the present proposals. At present there are about 200 firms making supplies of electricity or gas into another Member State; the number is expected to increase, perhaps tenfold, over the coming years.
2. Our welcome for the proposal is, however, subject to two reservations and a suggestion, which are set out in the next three paragraphs.

2. **First reservation**

1. The provisions which we have described above as the "Third rule" introduce uncertainty into the scheme. A supplier in one Member State may have many customers in another Member State who do not sell energy but use it. The government of the customers' Member State may exercise its option as regards one customer and not another; moreover, as regards any one customer it may change its mind and take the

opposite decision for later supplies and even change yet again. The supplier may have customers in other Member States and face the same uncertainties there.

2. The Commission's paper does not say why it chose this arrangement, which conflicts with the principle that taxation should be certain and above all not be discretionary, especially on such a vital matter as who has to pay.
3. The Commission has provided two answers to our concerns:
 - A supplier with several customers in another Member State would probably be registered there for VAT purposes, in which case no problem would arise.
 - A Member State wishing to shift VAT liability should apply it to all suppliers and all supplies.
 1. As for the Commission's first answer, the EESC maintains that it is quite possible for suppliers to have more than one customer in a another country without being registered there themselves.
 2. As regards the Commission's second answer, the EESC, in line with the provisions of the Directive, maintains the view that a Member State has the option of shifting the liability for some supplies only. It would be desirable if the Commission could assure us, in writing, that all the Member States accept this interpretation.
4. The provision which appears to take precedence, i.e. which applies if the option is not exercised, requires the supplier to register outside his own Member State, a burden which the new Directive should aim to reduce.
5. We suggest that the "Third rule" should be refashioned on the following lines:
 1. The Third rule, a suggested new version.
 2. A supply of electricity or gas to a person in a different Member State from the seller should, if the purchaser is NOT engaged in the business of re-selling that commodity, be taxable in the Member State where the energy is consumed. The person liable for the tax should be the purchaser if he is registered for VAT in that Member State. If he is not registered there the person liable should be the seller, who would have to register there.

3. Second reservation

1. The new rules depend on whether or not the purchaser is engaged in the business of re-selling electricity or gas. In response to the EESC's question concerning the case of a municipality, which buys electricity and sells some of it to the people in its area and uses some of it in its own offices and for lighting the streets, the Commission states that it is necessary to know the intention of the purchaser at the time of purchase. If the intention is to re-sell most of the electricity, the purchase will be subject to the second rule, according to which the transaction is taxable in the Member State where the purchaser is located and the purchaser is the person liable to pay the tax. If not, the third rule is applicable.
2. The EESC considers that "intention" is a difficult criterion to verify and is not appropriate for taxation purposes; similarly, the word "most" is too vague. Clarification of this provision would prevent difficulties in applying the proposed Directive.

4. Suggestion

1. If, by way of an example, an Italian company buys gas from a French producer and uses it entirely for the generation and sale of electricity, the purchase of gas would at present, according to the Commission's proposed Directive, be subject to the third rule. However, the EESC believes it would be more in keeping with the principles of the Directive to apply the second rule in such cases.

5. Conclusion

1. The Committee agrees with the aims of the proposal and some of its provisions, but withholds its approval until satisfactory replies are received to the reservations in paragraphs 4.2 and 4.3 above.

Brussels, 26 March 2003.

The President

of the

European Economic and Social
Committee

The Secretary-
General

of the

European Economic and Social Committee

Roger Briesch

Patrick Venturini

¹ OJ L 145 of 13.6.1977, p. 1.

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