



COMMISSION OF THE EUROPEAN COMMUNITIES

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2002/0286 (CNS)

Proposal for a

**COUNCIL DIRECTIVE**

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

(presented by the Commission)

## **EXPLANATORY MEMORANDUM**

### **1. INTRODUCTION**

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 legal instrument for liberalisation of the electricity market at EU level was Directive 96/92/EC, concerning common rules for the internal market in electricity<sup>1</sup>. The Directive 98/30/EC<sup>2</sup> providing an internal market for natural gas was adopted on 22 June 1998.

The European Council meeting in Lisbon on 23-24 March 2000 called for "rapid work" to complete the internal market and asked "the Commission, the Council and the Member States, each in accordance with their respective powers ... to speed up liberalisation in areas such as gas, electricity ... The aim is to achieve a fully functional operational internal market in these areas; the European Council will assess progress achieved when it meets next Spring on the basis of a Commission report and appropriate proposals".

The Energy Council of 30 May 2000 stressed "the importance and urgency of the conclusions reached at the Lisbon European Council" and invited the Commission "to present timely proposals for further action". In the Commission Communication "Completing the Internal Energy Market", the conclusion is reached that proposals aimed at completing the internal gas and electricity markets can now be made to the Parliament and Council, which would not only achieve this primary objective but also be compatible with, and contribute to, the Community's other relevant policies in this area. The proposal<sup>3</sup> to amend Directives 96/92/EC and 98/30/EC, which introduces a set of new measures to open up the gas and electricity markets fully by 2005 for the benefit of European consumers, therefore meets the request of the European Council and the Energy Council.

The liberalisation of these markets entails increasing deregulation as well as 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.

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 can be said for the gas market.

As a result of liberalisation, energy markets have ceased to be purely national and have started to operate on a European basis. This implied 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.

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

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<sup>1</sup> 96/92/EC, OJ L 27 of 30.01.97, p. 20

<sup>2</sup> 98/30/EC, OJ L 204 of 21.07.98, p.1

<sup>3</sup> COM(2001) 125 final of 13 March 2001

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**

### **2.1. Place of supply**

Under Article 5(2) of the Sixth VAT Directive<sup>4</sup> electric current, gas, heat, refrigeration and the like are considered tangible property. Consequently, as the supply of electricity and the like is a supply of goods, the place of supply has to be determined in accordance with Article 8 of the Sixth VAT 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 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 incidental cross-border transactions were no cause for problems. Where a distributor made an occasional cross-border supply, he would register in the other Member State.

In a liberalised market, the first question concerns the determination of the place of supply with respect to cross-border transactions. According to Article 8(1)(a), the place of supply, if electricity is dispatched or transported, is the place where electricity is at the time when dispatch or transport to the person to whom it is supplied begins. If Article 8(1)(a) is not applicable, the place of supply is where the goods are when the supply takes place.

However, the nature of electricity and gas makes it particularly difficult to determine the place of supply. The physical flows do not coincide with the contractual relationship between the seller and the buyer. 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. In practice it is almost impossible, considering the characteristics of electricity, to trace physically the flows of the electricity.

It might also be difficult to apply the rules for the place of supply because of differences in the civil law of the Member States, resulting in different rules for determining the time and place of supply, which could lead to differences of application.

If one assumes, however, that the supply of electricity and gas is a supply with dispatch, the rules for intra-Community supply of goods (Article 28c) are applicable when the seller and buyer are established in different Member States. This gives rise to another problem.

A taxable supply in the Member State of departure qualifies for an exemption when the following conditions are met:

- The supply is effected for another taxable person acting as such in a Member State other than the departure of the goods;
- The goods are dispatched or transported by or on behalf of the vendor or the purchaser outside the territory of the Member State of departure but within the Community.

The supplier has to provide sufficient proof of the transport in order to obtain an exemption. In general, it will be difficult to submit evidence of the dispatch or transport, from the traditional point of view (transport documents, supporting records), since electricity is not transported via traditional transport means (lorry, train, vessel).

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<sup>4</sup> 77/388/EEC, OJ L 145 of 13.6.1977, p. 1

These problems become even more complex if electricity or gas is sold in triangular transactions.

## **2.2. Transmission costs**

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.

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 (established and non-established traders) 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 non-established traders, 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 identified for VAT purposes. 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 systems operator 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. GENERAL OUTLINE OF THE PROPOSED SOLUTION**

The Commission concludes that applying the provisions of the current VAT system, in particular the exemption for intra-Community supplies and the taxation of intra-Community acquisitions to supplies of gas and electricity gives rise to unnecessary problems. The Commission therefore proposes to amend the rules on the place of taxation in order to facilitate the functioning of the internal market for energy. These new rules take into account the specific nature of the goods involved, since this is the main reason why the current arrangements for the taxation of supplies between traders established in different Member States can not be applied properly. One basic principle for the VAT treatment of goods, taxation following the place where the goods are physically located, is abandoned for these supplies. Derogation from this principle is justified by the simple fact that it is in most cases impossible to establish a link between the transaction and the physical flow of the goods.

The proposed solution results in the taxation of all supplies, before the final stage, at the place where the customer has established his business or has a fixed establishment to which the gas and electricity are supplied. To simplify taxation, this taxation principle will be combined with a reverse charge mechanism if the supplier and the buyer are not established in the same territory.

On the other hand, the proposed rules seek to ensure that the supply of gas and electricity at the final stage, mainly from distributor to final consumers, will be taxed at the place where the actual consumption takes place. This is necessary, because the consumption of energy does not always take place where the final consumer is established or has his permanent address, whereas the objective of the VAT system is to try to ensure that tax accrues to the Member

State of final consumption. In practice, the place of use and enjoyment will be the place where the gas and electricity are metered, which coincides often with the place where the final consumer is established, has his permanent address or where he usually resides.

The result of these changes will be that all supplies of gas and electricity with a view to resale (from the generator to the distributor) will be taxable in the country where the buyer is located. The need for suppliers to register in other Member States will be avoided by an obligatory reverse charge. On the other hand, for supplies directly to final consumers in another Member State, whether or not they are taxable persons, generators and/or traders will, in principle, have to register in the country where their customer is established. However, for supplies to taxable persons, the Member State of consumption can opt, under the current Article 21(1)(a) second subparagraph for the application of a reverse charge mechanism.

This proposal only seeks to cover the supply of electricity by cable and natural gas, including liquefied natural gas (LNG), in pipelines. Gas traded in bottles will be subject to the existing rules for taxation. The other intangible goods mentioned in Article 5(2) of the Sixth VAT Directive, heat, refrigeration and the like are very unlikely to be traded between Member States to any significant degree and are certainly not subject to intracommunity supplies. Therefore they are not included in Article 8(1)(d) and (e).

As a consequence of the change to the rules for the place of supply, an exemption for importation is introduced. Finally, the place of supply of some services directly connected to the supply of gas and electricity is changed. The provision of access to and the provision of transport or transmission by electricity and gas channels is included in Article 9(2)(e).

#### **4. PROPOSED CHANGES SET OUT IN ARTICLE 1**

##### **4.1. Article 1.1.: changes to Article 5**

As mentioned above, this proposal seeks to cover the supply of electricity by cable and natural gas, including liquefied natural gas (LNG), in pipelines. The rules established by this Directive for natural gas are also intended to apply to biogas and gas from biomass or other types of gas in so far as such gases can technically and safely be injected into, and transported through the natural gas distribution system<sup>5</sup>. A definition of natural gas is included in Article 5(2).

##### **4.2. Article 1.2.: changes to Article 8**

Article 5(1) provides that the supply of a good shall mean the transfer of a right to dispose of tangible property as an owner. Article 5(2) provides that electric current and gas are considered as tangible property. Consequently, any change of the rules on the place of taxation, requires an amendment of Article 8, the article governing the rules on the place of taxation of supply of goods.

The proposed amendments of Article 8 make a distinction between those supplies of gas or electricity which are made with a view to resale, and those which are or not. In the latter case, the gas and electricity are considered to be purchased for consumption.

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<sup>5</sup> This definition is in accordance with Article 1 of the amended proposal for a Directive amending Directive 98/30/EC

In Article 8(1), a new subparagraph (d) is inserted, according to which the place of supply of electricity and natural gas is deemed to be the place where the customer (EU or non-EU business customer) has established his business or has a fixed establishment to which the gas or electricity is supplied.

The scope of this provision is limited to taxable persons who, in the course of their economic activity, purchase or import electricity or natural gas with a view to resale. This limits the application to generators and general traders, who do not sell gas and electricity to final private consumers. In order to use this provision the supplier has to have some proof of the intention to resell the goods. As there are only a limited number of players in this field, the evidence as to the use of the gas and electricity by these businesses is not expected to cause problems.

When an EU generator sells electricity to a customer outside the EU, the place of supply is outside the Community. This transaction is not subject to taxation in the EU. However, a subsequent sale to another trader established in the EU will be subject to VAT in the Member State where the buyer is registered.

For these transactions, in contrast with an export under Article 15 of the Sixth VAT Directive, no additional conditions other than the proof that the buyer has established his business outside the EU can be requested. For these cases, the same elements accepted by the national administrations to prove that a service mentioned in Article 9(2)(e) takes place outside the Community, should be sufficient. The same reasoning applies to supplies that are taxable in another Member State. Because the place of supply will be the place where the customer is established, those transactions are not to be mentioned in the recapitulative statements, covered by Article 22(6)(b).

Finally, a new subparagraph (e) is inserted in Article 8(1) to cover the supply of electricity and natural gas, which does not fall under the scope of Article 8(1)(d).

According to this provision, the supply of natural gas and electricity in the final stage, that is from distributor to final consumer, will be taxed at the place where the customer has the effective use and enjoyment of the natural gas and electricity. This provision ensures that the supply is taxed at the place where the actual consumption takes place.

For distributors that are not established in the country where their customers consume the gas and electricity, registration could be necessary. Where the customers are solely taxable persons no registration will be required, if the Member State in which the customer is established designates the person to whom the taxable supply is made as the person liable to pay tax.

#### **4.3. Article 1.3.: changes to Article 9(2)(e)**

Formerly, the cost of transport or transmission was included in the price of the electricity supplied. The amount invoiced to the customer was deemed to correspond in full to the delivery made and followed the system applicable to purchases and sales. Since the provision of transport or transmission services in the EU can be and is separated from the delivery of energy, this service is increasingly being invoiced separately from the supply of the goods.

To date Member States have taken different positions on the tax treatment of such separate supplies. In some Member States payments for the (cross-border) transmission of electricity through a cable are considered to be made for the use of the cable and are considered to

constitute compensation for services connected with immovable property. These services are consequently taxed at the place where the cable is located. Others defend the position that these costs are transport costs and should be taxed according to Article 9(2)(b) and Article 28b(C).

In order to harmonise and simplify the taxation of the costs of access and use of the distribution networks, the Commission proposes to include the provision of access to and the provision of transport or transmission by electricity and gas channels under the scope of Article 9(2)(e). When these services are performed for customers outside the Community and for taxable persons established in the Community, but not in the same country as the supplier, the place of supply of these services is the place of establishment of the customer.

#### **4.4. Article 1.4.: changes to Article 14**

In meshed networks, such as the interconnected transmission system on the European continent, a cross-border power exchange between two countries (that originates from additional power in country A and correspondingly reduced power in country B) does not only result in power flows between these two countries. According to the physical laws governing the flow of electricity (the electrical flow prefers the way of 'least resistance'), some of the additional power flows through other countries, including countries that are not part of the European Community. Since the flows of electricity are measured at the borders, these flows should result in an import under Article 7, even though there is not necessarily a link between this import and the supply which originated the flow of electricity.

As the rules for the place of supply of electricity and gas are changed, the supply by third country generators and traders to distributors and final consumers in the EU will under all circumstances be taxable in the EU. Without changes to Article 14 of the Sixth VAT Directive in cases of actual import, there is also the risk of double taxation (at import and on the supply).

To avoid these problems, the import of gas and electricity should be exempted with a right of deduction. A new Article 14(1)(k) is inserted that exempts the final importation of electricity and natural gas in pipelines.

#### **4.5. Article 1.5.: changes to Article 21**

The change to the place of supply is of no value if it is not combined with an obligatory reverse charge. Otherwise every supplier who deals with traders in another Member State would still be obliged to register in up to 15 Member States.

A new Article 21(1)(f) is therefore inserted which makes the following persons liable to pay VAT: the persons who are identified for value added tax purposes within the territory of the country to whom goods covered by (new) Article 8(1)(d) are supplied, if the supplies are carried out by a taxable person established in another country. This provision covers all supplies that take place under Article 8(1)(d), both supplied by taxable persons in other Member States and by taxable persons in third countries. However, this proposed provision only applies to supplies covered by Article 8(1)(d), namely the supplies of electricity and natural gas in pipelines with a view to resale.

On the contrary, the current rules of Article 21(1)(a) are applicable to supplies of electricity and natural gas in pipelines covered by (new) Article 8(1)(e). This concerns supplies made for consumption and not with a view to resale. Under Article 21(1)(a), the taxable person

carrying out the supply is the person liable to pay the tax. However, for supplies made by a taxable person not established within the territory of the country, the Member State where the supply takes place can designate the person to whom the taxable supply is carried out, as the person liable to pay the tax.

Proposal for a

**COUNCIL DIRECTIVE**

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

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community, and in particular Article 93 thereof,

Having regard to the proposal from the Commission<sup>6</sup>,

Having regard to the opinion of the European Parliament<sup>7</sup>,

Having regard to the opinion of the European Economic and Social Committee<sup>8</sup>,

Whereas:

- (1) Increasing liberalisation of the gas and electricity sector, aimed at completing the internal market for electricity and natural gas, has revealed a need to review the current VAT rules on the place of supply of those goods, set out in Council Directive 77/388/EEC of 17 May 1977 on the harmonisation of the laws of the Member States relating to turnover taxes - Common system of value added tax: uniform basis of assessment<sup>9</sup>, in order to modernise and simplify the operation of the VAT system within the context of the internal market, a strategy to which the Commission is committed<sup>10</sup>.
- (2) Electricity and gas are treated as goods for VAT purposes, and, accordingly, the place of their supply with respect to cross-border transactions has to be determined in accordance with Article 8 of Directive 77/388/EEC. However, since electricity and gas are difficult to track physically it is particularly difficult to determine the place of supply under the current rules.
- (3) In order to attain a real internal market for electricity and gas without VAT obstacles, the place of supply of electricity and of natural gas in pipelines, before the goods reach the final stage of consumption, should be determined to be the place where the customer has established his business.

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<sup>6</sup> OJ C , , p. .

<sup>7</sup> OJ C , , p. .

<sup>8</sup> OJ C , , p. .

<sup>9</sup> OJ L145,13.6.1977,p.1.Directive as last amended by Directive 2002/38/EC ( OJ L 128, 15.5.2002,p.41)

<sup>10</sup> Com(2000)348 final

- (4) The supply of electricity and gas in the final stage, from traders and distributors to final consumer, should be taxed at the place where the customer has effective use and enjoyment of the goods, in order to ensure that taxation takes place in the country where actual consumption takes place.
- (5) Electricity and gas are supplied through distribution networks, to which network operators provide access. In order to avoid double or non-taxation, it is necessary to harmonise the rules governing the place of supply of the transmission and transportation services. Access to and use of the distribution networks should therefore be added to the list of specific instances set out in Article 9, paragraph 2 of Directive 77/388/EEC.
- (6) The final importation of electricity and of natural gas in pipelines should be exempted in order to avoid double taxation.
- (7) Those changes in the rules governing the place of supply for electricity and for natural gas in pipelines, where the goods are intended for resale, need to be combined with a compulsory reverse charge.
- (8) Directive 77/388/EEC should therefore be amended accordingly,

HAS ADOPTED THIS DIRECTIVE:

#### *Article 1*

Directive 77/388/EEC is hereby amended as follows:

- (1) In Article 5(2), the following subparagraph is added:

"For the purposes of this Directive natural gas shall include liquefied natural gas and biogas and gas from biomass or other types of gas in so far as such gases can technically and safely be injected into, and transported through, the natural gas distribution system."

- (2) In Article 8(1), the following points (d) and (e) are added:

"d. in the case of the supply of electricity or of natural gas in pipelines to a taxable person who, in the course of his economic activity, purchases or imports electricity or natural gas with a view to resale: the place where the customer has established his business or has a fixed establishment to which the goods are supplied.

e. in the case of the supply of electricity or of natural gas in pipelines, where such a supply is not covered by point (d): the place where the customer has effective use and enjoyment of the goods."

- (3) In Article 9(2)(e), the following indent is inserted after the eighth indent:

"- the provision of access to, and of transport or transmission through, electricity and gas distribution networks."

- (4) In Article 14(1), the following point (k) is added:

“k. final importation of electricity and of natural gas in pipelines.”

(5) In Article 21(1), in the version set out in Article 28g, the following point (f) is added:

“f. persons who are identified for value added tax purposes within the territory of the country to whom goods covered by Article 8(1)(d) are supplied, if the supplies are carried out by a taxable person established in another Member State or in a third country.”

#### *Article 2*

Member States shall bring into force the laws, regulations and administrative provisions necessary to comply with this Directive by at the latest. They shall forthwith inform the Commission thereof.

When Member States adopt those provisions, they shall contain a reference to this Directive or be accompanied by such a reference on the occasion of their official publication. Member States shall determine how such reference is to be made.

#### *Article 3*

This Directive shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Communities*.

#### *Article 4*

This Directive is addressed to the Member States.

Done at Brussels,

*For the Council*  
*The President*

## **IMPACT ASSESSMENT FORM**

### **THE IMPACT OF THE PROPOSAL ON BUSINESS WITH SPECIAL REFERENCE TO SMALL AND MEDIUM-SIZED ENTERPRISES( SMEs)**

#### **TITLE OF PROPOSAL**

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

#### **DOCUMENT REFERENCE NUMBER**

#### **THE PROPOSAL**

1. Taking account of the principle of subsidiarity, why is Community legislation necessary in this area and what are its main aims?

To obtain a real internal market for gas and electricity, it is necessary to adjust the VAT rules on the place of taxation. This legislation simplifies taxation as all supplies of electricity and natural gas, before the final stage, will be taxable at the place where the customer has established his business.

#### **THE IMPACT ON BUSINESS**

2. Who will be affected by the proposal?

– which sectors of business

The gas and electricity generators, distributors and traders.

– which sizes of business (what is the concentration of small and medium-sized firms)

In general, these changes will only affect large enterprises.

– are there particular geographical areas of the Community where these businesses are found

No. However, these changes will particularly affect those Member States where the liberalisation of the gas and electricity markets is further developed.

3. What will business have to do to comply with the proposal?

Business will have no additional obligations. This legislation will create more certainty on the place of taxation and therefore simplify the application of the rules.

4. What economic effects is the proposal likely to have?

– on employment

- on investment and the creation of new businesses
- on the competitiveness of businesses.

The main effect of the proposal is the simplification of the VAT rules for the gas and electricity trade. By removing existing obstacles, such as the need to register for VAT purposes in other Member States, the competitiveness of European business will improve.

5. Does the proposal contain measures to take account of the specific situation of small and medium-sized firms (reduced or different requirements etc.)?

No.

#### **CONSULTATION**

6. List the organisations which have been consulted about the proposal and outline their main views.

Eurelectric.

European Federation of Electricity Traders.

Energy Participants Indirect Tax Forum.

The solution presented by the Commission was welcomed by the gas and electricity traders.