

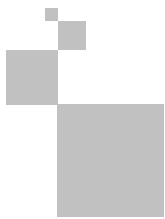


Draft Final Report

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

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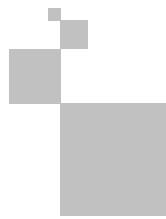
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A. INTRODUCTION

One of the Energy Community's objectives is to create an integrated energy market allowing for cross-border energy trade and integration with the EU energy market. As the efforts to integrate national markets into Energy Community intensified, obstacles to market integration arising from non-harmonized VAT legislation started to emerge.

The goal of the study was to assess value added tax (VAT) legislation in the Energy Community Contracting Parties¹ in order to identify obstacles to market competition and market integration stemming from non-harmonized rules governing the VAT on goods and services in the network energy businesses, and to propose measures for their harmonization.

Harmonized VAT rules are meant to ensure a level playing field with regards to the supply and demand of gas and electricity, both between Energy Community Contracting Parties on one side and EU Member States on the other, as well as among Energy Community Contracting parties.

Furthermore, the document aims to identify instances of non-harmonized VAT legislation across Energy Community CPs, and to propose steps for their harmonization in line with the EU legislation.

A.1 Document structure

In Section B we outline the basic principles of VAT legislation in the EU, with a particular focus on provisions related to trade in energy and access to energy infrastructure. We also outline existing mechanisms in the EU aimed at addressing tax fraud. Following, we identify the main principles of EU VAT legislation that should be incorporated in legislation of CPs.

In Section C we outline current state of play in the Contracting Parties (CPs) regarding VAT legislation, from two angles: first, we analyze the current legislative framework in each CP and evaluate the degree to which national legislation is aligned with EU legislation. Detailed analysis of VAT legislation in each CP is given in *Appendix I – Gap analysis*. Second, by contacting relevant stakeholders (TSOs, energy traders, regulators, ministries, interest groups, local experts) we investigate the possible practical barriers related to trade in energy and access to energy infrastructure stemming from VAT legislation. Furthermore, in Section D we summarize main principles of VAT taxation in CPs in relation to import, export and transit of energy and access to energy infrastructure. In section E we analyze the issue of double and no taxation, and identify CPs where this might be an issue.

¹ Contracting Parties to the Energy Community include Albania, Bosnia and Herzegovina, Kosovo*, Former Yugoslav Republic of Macedonia, Moldova, Montenegro, Serbia, Ukraine and Georgia (in accordance with the MC Decision 2016 D/2016/18/MC-EnC of 14 October on the accession of Georgia to the Energy Community Treaty).

In Sections F we analyze possible scenarios of harmonization of national legislation and propose optimal course of action. Based on the analysis of current legislative framework and practical issues related to VAT taxation in CPs, and taking into account principles of VAT taxation in the EU that should be incorporated into national legislation of CPs, in Section G we give a list of proposed optimal changes to national legislation in order to accommodate the observed shortcomings of current legislative framework in CPs.

In Section H we assess some of the specific issue in energy sector, such as cross border supply of customers, net metering and backhaul capacity, and analyze the situation in CPs in respect to these issues, and in the context of VAT legislation.

Finally, in Section I we assess the costs and benefits arising from proposed legislation changes for economic operators, consumers and state budgets.

B. REVIEW OF EU REGULATION RELATED TO VALUE ADDED TAXATION

The primary legislative act on the EU level defining the issue of VAT taxation is *Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax OJ L 347, 11.12.2006, p. 1–118* (Directive 2006/112/EC - “VAT Directive”) and its amendments² as well as supporting *Council Implementing Regulation (EU) No 282/2011 of 15 March 2011 laying down implementing measures for Directive 2006/112/EC on the common system of value added tax OJ L 77, 23.3.2011, p. 1–22* (Regulation 282/2011).

In the remainder of this chapter we elaborate on the main principles of VAT taxation in the EU and identify main elements that should be transposed to VAT legislation of Contracting Parties (CPs). Consequently, a more harmonized system of VAT taxation could be created in the Energy Community CPs.

B.1 Summary of Directive 2006/112/EC (“VAT Directive”) and Regulation 282/2011

B.1.1 General principles of VAT Directive

The VAT Directive 2006/112 codifies the provisions governing the introduction of the common system of VAT in the European Union. The common system of VAT applies to goods and services bought and sold for consumption within the EU. The VAT tax is calculated on the basis of the value added to goods and services at each stage of production and of the distribution chain.

The main principles that underpin the VAT Directive are:

1. **Harmonization of VAT legislation.** In order to create a truly common internal market on the EU level, it is essential to establish legislation on turnover taxes that does not distort competition or hinder the free movement of goods and services.
2. **Simplicity and neutrality in taxation.** A VAT system achieves the highest degree of simplicity and neutrality when the tax is levied in as general a manner as possible and when its scope covers all stages of production and distribution, as well as the supply of services.
3. **Neutrality in competition.** The common system of VAT should, even if rates and exemptions are not fully harmonized, result in neutrality in competition, such that within the territory of each Member State similar goods and services bear the same tax burden, whatever the length of the production and distribution chain.

The VAT Directive also defines the minimum VAT rate, i.e. **standard minimum rate**, of 15% (Article 97 of VAT Directive). In addition to the standard minimum rate, the

² Council Directive (VAT Directive) 2006/112 was amended by the following Council Directives: 2006/138/EC of 19 December 2006, 2007/75/EC of 20 December 2007, 2008/8/EC of 12 February 2008, 2008/117/EC of 16 December 2008, 2009/47/EC of 5 May 2009, 2009/69/EC of 25 June 2009, 2009/162/EU of 22 December 2009, 2010/23/EU of 16 March 2010, 2010/45/EU of 13 July 2010, 2010/88/EU of 7 December 2010, 2013/42/EU of 22 July 2013, 2013/43/EU of 22 July 2013, and 2013/61/EU of 17 December 2013.

Directive allows for application of maximum of two reduced rates of not less than 5%. The reduced rates may apply only to supplies of goods and services in the categories listed in Annex III to the VAT Directive (as last amended by *Council Directive 2009/47/EC of 5 May 2009 amending Directive 2006/112/EC as regards reduced rates of value added tax OJ L 116, 9.5.2009, p. 18–20*).

B.1.2 Definition of key principles of VAT taxation of energy and energy related network services

The main principles of the Directive 2006/112/EC and its amendments relevant for supply of electricity and gas as goods, and access to electricity and gas infrastructure are as follows:

1. Electricity and gas are treated as goods for VAT purposes.
2. In order to avoid possible double or no taxation of electricity and gas, and taking into account difficulty of determining the place of supply of electricity and gas, as well as to foster true internal market free of barriers linked to VAT regime, the following principles are applied in relation to the supply of electricity and gas:
 - In case of the supply of gas through the natural gas distribution system³, or of electricity to a **taxable dealer**⁴, 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 (in the absence of such a place of business or fixed establishment, the place where he has his permanent address or usually resides) (BUSINESS TO BUSINESS or B2B) (*Article 38 of VAT Directive*).
 - In the case of the supply of gas through the natural gas distribution system or of electricity to the **end customer**, the place of supply shall be deemed to be the place where the end customer effectively uses and consumes the goods. (BUSINESS TO CUSTOMER or B2C) (*Article 39 of VAT Directive*).
3. In order to avoid double taxation, importation of gas and electricity is exempted from VAT (*Article 143 of VAT Directive*).
4. Supply of services related to the access to the natural gas or electricity distributions system.
 - For provision of access to the natural gas or electricity distributions system 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 (permanent address or usual residence), rather than where the supplier is established⁵ (*Article 44 and 195 of VAT Directive*).
 - The place of supply of services related to 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 **customers** established **outside the European Union**, or to **taxable persons** established in the EU 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 (Article 59h and Article 39).

³ Term “distribution system” implies the entire gas and electricity network to which the final consumers are connected.

⁴ Taxable dealer is a taxable person whose principal activity in respect to purchases of gas and electricity is reselling those products and whose own consumption of those products is negligible.

⁵ Only taxable persons have access to gas and electricity networks, hence non-taxable person have not been addressed.

The concepts of **permanent address** and **usual residence** which are relevant in many instances when determining the place of supply, are defined in **the Regulation 282/2011/EU**. According to the Regulation, the customer established within the Community is a taxable person in case:

- The customer has communicated his individual VAT identification number to the supplier, and the supplier obtains confirmation of the validity of that identification number and the associated name and address in accordance with Article 31 of *Council Regulation (EU) No 904/2010 of 7 October 2010 on administrative cooperation and combating fraud in the field of value added tax OJ L 268, 12.10.2010, p. 1–18 (Regulation 904/2010)*.
- Where the customer has not yet received an individual VAT identification number, but informs the supplier that he has applied for it and the supplier obtains any other proof which demonstrates that the customer is a taxable person or a non-taxable legal person required to be identified for VAT purposes and carries out a reasonable level of verification of the accuracy of the information provided by the customer, by normal commercial security measures such as those relating to identity or payment checks.

Unless the supplier has information to the contrary, the supplier may regard a customer established within the Community as a non-taxable person when he can demonstrate that the customer has not communicated his individual VAT identification number to him.⁶

⁶ Under Article 25 of Implementing Regulation 282/2011, for the application of the rules governing the place of supply of services, only the circumstances existing at the time of the chargeable event shall be taken into account. Any subsequent changes to the use of the service received shall not affect the determination of the place of supply, provided there is no abusive practice.

B.2 Summary of key regulations on preventing VAT fraud and definition of principles that should be transposed to VAT legislation of CP's

B.2.1 Reverse charge mechanism (RCM)

As a general rule, the Directive 2006/112/EC requires the person who makes supplies of goods or services to account for and pay the VAT on those supplies (Article 193). However, as a derogation to Article 193, and in order to simplify the procedure for collecting VAT and to prevent tax evasion or avoidance, the VAT Directive stipulates that Member States may provide that the person liable for payment of VAT is the **taxable dealer** to whom the supplies of gas and electricity are made, as defined in Article 38(2) (Article 199 and Article 199a): the provision also known as reverse charge mechanism.

The application of the reverse charge mechanism is subject to the introduction of appropriate and effective reporting obligations on taxable persons who supply the goods or services to which the RCM applies.

The Member States have to inform the European Commission when introducing reverse charge measure and provide the latter with information mainly on the scope of the measure, its impact in terms of reporting and control, as well as with regard to its effectiveness to tackle fraud including the potential consequences due to a shift of the risk of fraud to other activities. The Member States shall also inform the European Commission on date of introduction and the period covered.

B.2.2 Quick reaction mechanism

As indicated in Directive 2013/42/EU⁷ *“experience has also shown that the designation of the recipient as the person liable for the payment of the VAT (reverse charge) is, in certain cases, an effective measure to stop VAT fraud in specific sectors. Under the reverse charge provisions in Articles 199 and 199a of Directive 2006/112/EC, Member States do not have the flexibility to respond quickly to sudden and massive fraud in categories of goods and services falling outside the scope of those Articles. Specific arrangements therefore need to be made to address these circumstances”*.

To overcome the above problem *Directive 2013/42/EU* regulates the implementation of immediate measures to be taken in cases of sudden and massive VAT fraud (“quick reaction mechanism” or “**QRM**”). This mechanism allows Member States, in cases of imperative urgency to designate the recipient as the person liable to pay VAT (reverse charge mechanism), on specific supplies of goods. The measures can be applied only for a short period of time.

The Member State which aims to introduce the special and temporary measure regulated by QRM, sends the notification to the European Commission and to other Member States reporting information about the type and characteristics of the committed fraud, reasons for urgency, financial consequences and some other standardized data related to the VAT fraud.

⁷ COUNCIL DIRECTIVE 2013/42/EU of 22 July 2013 amending Directive 2006/112/EC on the common system of value added tax, as regards a Quick Reaction Mechanism against VAT fraud.

In order to ensure the exercising of the option is proportionate to the problem, the Commission, once it is in possession of the relevant information, has a short period in which to appraise the notification and confirm whether it objects to the QRM special measure.

The European Commission can approve the implementation of the temporary measure. In this case, European Commission issues the written decision to VAT Committee of EU and to the Member State. If the measure is considered as unnecessary, the European Commission issues the negative opinion.

B.3 Definition of key principles that should be transposed to VAT legislation of CPs

One of the goals of the Energy Community is to create a common energy market among its CPs. To this end, it is necessary to harmonize VAT legislation in CPs in order to remove VAT related barriers that hamper development of energy market among CPs, and to eliminate instances leading to double or no taxation.

The process that Energy Community is undergoing is very similar to the process that EU Member States underwent at the end of the previous and the beginning of current decade, when EU introduced electricity (Directive 96/92/EC) and gas Directives (Directive 98/30/EC) with the goal of creating a common internal energy market. At that time, the EU Member States faced similar challenges as EnC CPs in relation to the VAT issues. In particular, VAT legislation at the time was appropriate for transactions taking place within national borders, but not for intra community trade. Therefore, the Commission introduced the VAT Directive which defined number of general and energy market specific provisions that needed to be transposed into VAT legislation of Member States in order to foster development of internal (energy) market and to eliminate instances of double or no taxation.

Despite contextual as well as institutional differences that exist between the current situation in EnC CPs and situation that prevailed among Member States prior to introduction of VAT Directive, some of the provisions of VAT Directive can be integrated into VAT legislation of CPs. Integration of selected provisions would serve to harmonize the approach to taxation of energy goods and services in EnC and to foster development of EnC wide energy market.

In the remaining of this section we identify the key definitions and principles from VAT Directive that have a positive effect on fostering common market and reducing instances leading to double and no taxation. We highly suggest these principles be incorporated in the VAT legislation of CPs.

Term	Act defining the term and definition
DEFINITION - Taxable person	Art. 9 VAT DIRECTIVE Any person who, independently, carries out in any place any economic activity, whatever the purpose or results of that activity.
Taxable person (exemption related to the State and <u>governmental bodies</u>)	Art. 13 VAT DIRECTIVE and Annex 1 states, regional and local government authorities and other bodies governed by public law shall not be regarded as taxable persons in respect of the activities or transactions in which they engage as public authorities, even where they collect dues, fees, contributions or payments in connection with those activities or transactions. When they engage in such activities or transactions, they shall be regarded as taxable persons in respect of those activities or transactions where their treatment as non-taxable persons would lead to significant distortions of competition.

	Annex I of Directive provides the supply of gas and electricity as one of these activities.
DEFINITION - Place of transaction (General rule)	<p>Art. 31-36 VAT DIRECTIVE The place of a supply of goods is: the location of the goods at the time of supply (where the goods are not dispatched or transported); the location of the goods at the time when dispatch or transport to the customer begins (where the goods are dispatched or transported); the place of departure of the passenger transport operation (where the goods are sold on board ships, aircraft or trains); the place where the customer is located (in the case of gas through the natural gas distribution system, or electricity).</p> <p>Art. 44 VAT DIRECTIVE The place of supply of services to a taxable person acting as such shall be the place where that person <i>has established his business</i>. If those services are provided to a fixed establishment of the taxable person located in a place other than the place where he has established his business, the place of supply of those services shall be the place where that fixed establishment is located. In the absence of such place of establishment or fixed establishment, the place of supply of services shall be the place where the taxable person who receives such services has his permanent address or usually resides. The place of supply of services to a non-taxable person shall be the place where the supplier has established his business.</p>
Avoidance of double taxation	<p>Art. 59a) VAT DIRECTIVE In order to prevent double taxation, non-taxation or distortion of competition, Member States may, with regard to services the place of supply of which is governed by Articles 44, 45, 56, 58 and 59:</p> <p>a) consider the place of supply of any or all of those services, if situated within their territory, as being situated outside the Community if the effective use and enjoyment of the services takes place outside the Community;</p> <p>b) consider the place of supply of any or all of those services, if situated outside the Community, as being situated within their territory if the effective use and enjoyment of the services takes place within their territory.</p>
Treatment of electricity and gas as goods	Art. 15 VAT DIRECTIVE Electricity and gas shall be treated as tangible property.
The provision of access to a natural gas or to the electricity distribution system	<p>Art. 59h VAT DIRECTIVE Supply of services to non-taxable persons outside the Community.</p> <p>The place of supply <i>of the provision of access to a natural gas or to the electricity system</i> situated within the territory of the Community, or the transmission or distribution through these systems or networks, and the provision of</p>

	<p>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 taxable at the place where that person is established, has his permanent address or usually resides.</p>
<p>Supply of goods (gas and electricity) to taxable dealer (Business to Business)</p>	<p>Art. 38 VAT DIRECTIVE 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.</p> <p>Taxable dealer shall mean a taxable person whose principal activity in respect of purchases of gas or electricity is reselling those products and whose own consumption of those products is negligible.</p>
<p>Supply of goods (gas and electricity) to the customer (Business to Customer)</p>	<p>Art. 39 VAT DIRECTIVE 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, and the place of supply shall be deemed to be the place where the customer effectively uses and consumes the goods.</p> <p>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.</p>
<p>Chargeable event</p>	<p>Art. 63 VAT DIRECTIVE The chargeable event shall occur and VAT shall become chargeable when the goods or the services are supplied.</p>
<p>VAT rate for supply of goods (energy and gas) – possibility of reduction</p>	<p>Art. 102 AND 99 VAT DIRECTIVE After consultation of the VAT Committee, each Member State may apply a reduced rate to the supply of natural gas and electricity. The reduced rates shall be fixed as a percentage of the taxable amount, which may not be less than 5%.</p>
<p>Import of gas and energy (Exemptions on importation)</p>	<p>Art. 143 VAT DIRECTIVE Member States shall exempt the 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, of electricity or of heat or cooling energy through heating or cooling networks.</p>
<p>Export (Exemption of</p>	<p>Art. 146 VAT DIRECTIVE Member States shall exempt the</p>

<p>exportation)</p>	<p>following transactions:</p> <p>a) the supply of goods dispatched or transported to a destination outside the Community by or on behalf of the vendor;</p> <p>b.) the supply of goods dispatched or transported to a destination outside the Community by or on behalf of a customer not established within their respective territory, with the exception of goods transported by the customer himself for the equipping, fuelling and provisioning of pleasure boats and private aircraft or any other means of transport for private use.</p>
<p>Reverse charge</p>	<p>Art. 199a Paragraph 1 VAT DIRECTIVE 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 the following supplies are made: (e) supplies of gas and electricity to a taxable dealer.</p>
<p>Reporting of fraudulent activities</p>	<p>Art. 199a Paragraph 4 VAT DIRECTIVE Each Member State that has detected a shift in trends of fraudulent activities in its territory in relation to the goods or services listed in paragraph 1 from the date of entry into force of this Article with respect to such goods or services, shall submit a report to the Commission in that respect no later than 30 June 2017.</p>
<p>Deductions (refunds) to persons not established in the Member State</p>	<p>Art. 171 VAT DIRECTIVE VAT shall be refunded to taxable persons who are not established in the Member State in which they purchase goods and services or import goods subject to VAT but who are established in another Member State, in accordance with the detailed rules laid down in Directive 2008/9/EC.</p> <p>VAT shall be refunded to taxable persons who are not established within the territory of the Community in accordance with the detailed implementing rules laid down in Directive 86/560/EEC.</p> <p>The taxable persons referred to in Article 1 of Directive 86/560/EEC shall also, for the purposes of applying that Directive, be regarded as taxable persons who are not established in the Community where, in the Member State in which they purchase goods and services or import goods subject to VAT, they have only carried out the supply of goods or services to a person designated in accordance with Articles 194 to 197 or Article 199 as liable for payment of VAT.</p>

C. AN OVERVIEW OF DIFFERENCES IN THE APPLICABLE VAT REGIMES ON NETWORK ENERGY RELATED TRANSACTIONS AMONG THE CONTRACTING PARTIES, AS WELL AS A COMPARISON AGAINST THE RELEVANT ELEMENTS OF THE EU ACQUIS ON VAT, FOR EACH CONTRACTING PARTY

In this section we analyze VAT legislation in each CP and assess to what degree the national legislation is compliant with provisions identified in Section B.3. The review presented in this chapter represents a succinct analysis of national VAT legislation: detailed analysis of each CP is given in separate document, **Appendix I – Gap Analysis**, which is a part of this report.

C.1 Albania

C.1.1 Overview of the VAT legislation

On January 30, 2015, The Ministry of Finance of Albania published the Instruction “*On VAT*” (Official Gazette no. 12, dated 06.02.2015, effective as of 01.01.2015⁸). The new law and its instructions aim at harmonizing Albania’s VAT law with the European VAT rules incorporated in the EU VAT Directive.

The new VAT law changes the rules in respect of the *place of supply of services* in such a way that it harmonizes them with the relevant rules of the VAT Directive. As a general rule, the VAT Law defines that *services supplied to taxable persons* will be taxable in the place where the service recipient is established. Consequently, services provided to an entity established and registered for VAT purposes outside Albania will be subject to VAT in the jurisdiction of the service recipient and there will be no obligation to charge Albanian VAT, nor will there be a limitation on the right to deduct input VAT.

If the service is supplied to a **non-taxable person**, the place of supply will be considered to be the place where the service provider is established. As a consequence, a foreign service supplier providing services to a non-taxable (B2C) person in Albania **should register for VAT purposes in Albania** by appointing a **fiscal representative** to account for and pay the VAT liability.

Nevertheless, there is an exception to this general rule. Specifically, the place of supply will be the place where the non-taxable person is established or where he has his permanent address or usually resides in the case, *inter alia*, of **the provision of access to a natural gas system or other utility distribution systems**.

⁸ Instruction “on VAT” no.6, Official Gazette no. 12, dated 06.02.2015; Decision “On the implementing provisions of the Law on VAT” no. 953, dated 29.12.2014; LAW No. 92/2014 dated 24.07.2014 ON THE VALUE ADDED TAX IN THE REPUBLIC OF ALBANIA

Pursuant to the new VAT Law, a VAT reverse charge mechanism may be applied by an Albanian recipient who is a taxable person or a person identified for VAT purposes (B2C) if the foreign supplier of the services is not established in Albania. As a consequence, the foreign supplier does not need to register for VAT in Albania when supplying the services whose place of supply is Albania unless it creates a permanent establishment in Albania.

The new VAT law changes the rules on the place of **supply of natural gas and electricity** through a transmission and/or distribution system. The new rules make a distinction between those supplies which are made with a *view to resale and those purchased for consumption*. The place of supply of gas, and electricity supplied through distribution systems will be where the taxable dealer is established or has a permanent place through which the goods are supplied or, in the absence of such a place, the place where he usually resides (B2B). Further, the supply of natural gas, and electricity in the final stage from the taxable dealer to the end customer will be taxed at the place where the end customer consumes such goods (B2C).

As a consequence, suppliers that are not established in Albania where the consumption of the above mentioned goods occurs will have to appoint a VAT representative in order to account for and pay the VAT due.

Conclusion

The Albanian legislation has implemented main rules and definitions in order to be harmonized with the EU VAT Directive, though some differences remain. In particular, the Albanian VAT law uses the zero VAT rate (export), where the EU VAT Directive applies VAT exemptions. The reverse charge mechanism is applicable and mentioned in the invoicing rules of VAT law, though the reverse charge mechanism is not implemented as temporary measure for prevention of fraudulent activities. Overall, based on the analysis of current VAT legislation, Albanian VAT legislation has achieved high level of harmonization with EU Directive.

C.1.2 Obstacles identified by stakeholders

Albania does not have a gas transmission network, thus the responses provided by the stakeholders refer to transmission of electricity only. Allocation of interconnection capacity between Albania on one side and Montenegro and Greece on the other side is performed by *Coordinated Auction Office in South East Europe* (SEE CAO), according to its auction rules and procedures. At the border with Kosovo⁹ the interconnection capacity is allocated by Serbian Transmission System Operator (JP Elektromreža Srbije - EMS).

⁹ This designation is without prejudice to positions on status, and is in line with UNSCR 1244 and the ICJ Opinion on the Kosovo declaration of independence.



Figure 1: Interconnection booking mechanism between Albania and neighboring systems

According to the explanations provided by Albanian electricity Transmission System Operator (OST sh.a.), foreign based companies can participate in Albanian wholesale energy market based on the principle of reciprocity (Art .97. of the Power Sector Law).

Given that according to the current VAT legislation, supply of services supplied to taxable persons will be taxable in the place where the service recipient is established and that Albanian legislation allows for the use of reverse charge mechanism, OST sh.a. has not identified any VAT related obstacles.

C.2 Bosnia and Herzegovina

C.2.1 Overview of the VAT legislation

Bosnia and Herzegovina's VAT regime is regulated by the Law on the value added tax dated 2005 (hereinafter: VAT law)¹⁰.

Governmental bodies are generally not considered taxable persons except if they perform economic activities that lead to competition with private companies. Such regulation is partially in line with the VAT Directive: in Annex I, VAT Directive explicitly defines that governmental bodies will be considered taxable persons if they provide electricity and gas.

Regarding the definitions of **chargeable event** and **chargeability**, VAT law doesn't use the same definition but numbers various cases when chargeability arises.

When it comes to the place of transaction for the supply of goods, the VAT law has the same general rule, but it is numbered among other various cases. As for the place of transaction for the supply of services, **the place of supply will be considered to be the place where the service provider is established**¹¹. The VAT law does not regulate separately the supply of services to taxable and to non-taxable person. Also, the VAT law doesn't explicitly mention the place of transaction for electricity and gas.

Although the VAT Directive allows for **reduced VAT rate** for electricity and gas, this provision is not applied in legislation of Bosnia and Herzegovina.

As for the **exemptions on importation**, Bosnia and Herzegovina exempts from VAT import of some goods but there is no special mention of electricity and gas and, therefore, this rule is not in compliance with the Art. 143. of VAT Directive. The same situation is with the **export of electricity and gas**, where there are no exact rules related to exemption on exportation of electricity and gas (noncompliance with the Art. 146 of VAT Directive).

Regulations regarding **supply of electricity and gas to taxable dealers (B2B) and customer (B2C), reverse charge and fraudulent activities** are not incorporated in the VAT law.

Conclusion

The provisions of the VAT Directive are only partially transposed in the VAT law, mostly in the form of definitions. The basic rules related to electricity and gas are not transposed in the legislation. The place of supply of services does not differentiate the service provided to a taxable person and non-taxable person. The place of supply of services related to access and use of electricity and gas network are not defined either.

¹⁰ Zakon o porezu na dodatu vrijednost ("Službeni glasnik BiH", broj: 9/05 i 35/05), Zakona o sistemu indirektnog oporezivanja u Bosni i Hercegovini ("Službeni glasnik BiH", broj: 44/03 i 52/04), Pravilnik o porezu na dodanu vrijednost (Službeni glasnik BiH, broj 93/05,21/06,60/06,06/07,100/07, 35/08,65/10)

¹¹ Except in case of consultancy services, marketing services, transfer of rights and similar services which are taxable in the place where the service recipient is established.

There are no rules related to supply of goods to taxable dealer or to the final customer. In addition, the VAT Law does not envisage possible rate reductions for electricity and gas. Furthermore, there are no special exemptions for import and export of electricity and gas, and there is no mechanism as reverse charge or institutes of fraud prevention implemented in the Law. Therefore, we conclude that VAT legislation in Bosnia and Herzegovina is inadequately harmonized with the VAT Directive.

C.2.2 Obstacles identified by stakeholders

Electricity network

Allocation of annual, monthly and daily cross border capacity between BiH on one side and Croatia and Montenegro on the other side is performed by SEE CAO. Allocation of intraday capacity is free of charge, hence there is no VAT implications. Therefore, for allocation of interconnection capacity between BiH on one side, and Montenegro and Croatia on the other side, VAT is payable in the country where the company booking the interconnection capacity has its seat, based on the fact that SEE CAO issues an invoice which does not include VAT.

At the border with Serbia, annual and monthly auctions are performed by EMS while daily and intra-day auctions are performed by Independent System Operator in Bosnia and Herzegovina (NOS BiH). Therefore, for booking of annual and monthly capacity, VAT is charged according to the Serbian VAT law (see section C.8). For booking of daily capacity, VAT is charged according to BiH legislation. The legislation stipulates that supply of services to residents of BiH is subject to VAT charge.



Figure 2: Interconnection booking mechanism between BiH and neighboring systems

At the same time, firms who are not residents of BiH, are not subject to VAT when booking daily interconnection capacity¹². Consequently, firms which are not BiH residents, receive an invoice from NOS BIH which does not include VAT charge. At the same time, NOS BIH delivers the same invoice to Elektroprijenos BiH together with debit note which includes the VAT amount. Such an invoice, together with the debit note, represents a sales invoice for NOS BIH. Following, Elektroprijenos BiH issues an invoice to NOS BIH for the amount which has been invoiced to the customer, together with respective VAT, which is equal to the VAT amount in debit note. Such an invoice represents a purchase invoice for NOS BIH. Therefore, for each transaction related to allocation of daily interconnection capacity, sales invoice is offset by purchase invoice, resulting in no VAT obligation nor cost to NOS BIH. On the other hand, Elektroprijenos BiH is responsible for VAT payment, following the invoice it issued to NOS BIH. At the same time the purchase invoice it receives from NOS BIH it does not use in determination of its VAT obligations. Hence, the VAT is finally paid by Elektroprijenos BiH and in the country where foreign firm has its seat.

When it comes to NOS BIH participation in SEE CAO, VAT charges are calculated in a similar manner. Based on monthly report issued by SEE CAO of allocation of NOS BIH interconnection capacity, NOS BIH invoices SEE CAO for the respective amount, exclusive of VAT. The procedure between NOS BIH and Elektroprijenos BiH is identical to the situation described above.

Gas networks

BiH has only one interconnection point, one with Serbia at Zvornik.



Figure 3: Gas network in BiH

Source: ENTSOG

¹² There is no legal grounds for such an approach. In our opinion such an approach, where foreign based companies are not charged VAT in case of provision of access to transmission capacity, is discriminatory towards other firms in other sectors. Nevertheless, we have been informed that BiH Tax authority has audited this practice and filed no objections to such a practice. Such an approach is not unique: we were informed that similar approach has been adopted in Serbia prior to the last change in VAT related legislation.

BIH imports gas from Russia, on the basis of a contract that BH – Gas i.e. Energoinvest has concluded with Gazprom Export. Transport of gas is done via Hungary and Serbia where BH – Gas has transport contracts with FGSZ and Srbijagas. In terms of the VAT payment, BH – Gas is exempted from VAT payment for transport services provided by FGSZ and Srbijagas.

C.3 Georgia

C.3.1 Overview of the VAT legislation

The Tax Code of Georgia (Tax Code) No 1886 of 26 December 2013 defines the rules on Value Added Tax. The Tax Code provides no definition of **chargeable** event as defined in the VAT Directive.

Regarding **export**, the Tax Code defines the place of supply to be Georgia but it exempts export.

The Tax Code does not differentiate **B2B** from **B2C** transactions, what means the same rules apply whether the recipient is a taxable person or not.

The Tax Code does not provide for any regulation regarding the avoidance of **double taxation** of VAT.

The Tax Code does not provide specific rules on the **place of supply of services** related to or connected with electricity or gas. Therefore, general rules on supply of services described in the Tax Code apply. The general rule is that services are supplied in the place where provider's business is located.

The Tax Code defines the **place of supply of electricity or gas** as the place of receipt of such goods. In the event of export from Georgia, the place of supply of such goods is Georgia. No difference is made between consumer and taxable dealer.

The Tax Code does not allow for **reduced VAT** rates for gas or electricity. The Tax Code states that the supply or importation of natural gas for generation of electricity is exempted. This is not in line with the VAT Directive because the exemption is only valid for gas and for a specific purpose.

The VAT Law makes no mention of **reverse charge** or **fraudulent activities** as mentioned in the VAT Directive. The reverse-charge mechanism is defined differently compared to VAT Directive. Under the reverse-charge mechanism, resident taxpayers and permanent establishments of foreign entities are responsible for the calculation and payment of VAT.

The VAT refund mentioned in article 171/2 of the VAT Directive is mentioned in article 181 of the Tax Code but only regarding goods: there is no provision for refund of VAT for services.

The Tax Code describes the persons liable for payment of VAT to tax authority in a similar but not completely identical manner as VAT Directive.

Conclusion

The Tax Code differs quite a bit from the VAT Directive. Differences are related to general descriptions and definitions, as well as specific regulations for electricity and gas. The lack of a rule for business to business and business to customer transactions related to supply of electricity and gas could provide an obstacle to trade.

C.3.2 Obstacles identified by stakeholders

No VAT obstacles have been identified by the stakeholders.



Figure 4. Interconnection booking mechanism between Georgia and neighboring systems

C.4 Kosovo*

C.4.1 Overview of the VAT legislation

In Kosovo*, the Law on Value Added Tax, No. 03/L-146 (VAT Law) defines the rules on Value Added Tax.

Conclusion

The VAT Law is in line with the VAT Directive: major definitions and regulations stated in the VAT Directive are incorporated in the VAT Law.

C.4.2 Obstacles identified by stakeholders

Given that Kosovo* does not have a gas network, stakeholder responses refer to electricity network only.

Kosovo* is not a control area, and as such does not allocate interconnection capacity. Interconnection capacity between Kosovo* on one side and Montenegro, Albania and FYR of Macedonia on the other side are allocated by EMS [Serbia]. As regards the interconnection between Serbia and Kosovo*, there is no allocation as both are considered a single control area. The stakeholders have not identified any VAT related obstacles.



Figure 5. Interconnection booking mechanism between Kosovo* and neighboring systems

C.5 Former Yugoslav Republic of Macedonia

C.5.1 Overview of the VAT legislation

Former Yugoslav Republic of Macedonia's VAT regime is regulated by Law on Value added tax with the last amendments dating from October 2016 (hereinafter: the VAT law).

Concerning the definition of **chargeable** event and **chargeability**, the definitions don't actually match. VAT law describes specific events when the tax debt will occur while the VAT Directive uses more general rule.

The definition of the **supply of goods** and **supply of services** is completely in line with the VAT Directive, but the VAT Law contains the third category of mixed supplies.

The last amendments of the VAT Law introduced the new regulation regarding allocation of interconnection capacities. According to the new amendment, providing access to the electricity network in case of congestion is taxable at the place where the recipient of services is established or has his permanent address.

Reverse-charge applies to amounts charged for goods or services supplied by foreign legal entities to Macedonian legal entities. However, under the reverse-charge mechanism, the recipient of the goods or services bears the responsibility for the calculation of VAT, the submission of a VAT return, the payment of tax and the payment of interest in the event of a late payment. Foreign traders may not have a VAT registration number.

Conclusion

The VAT law hasn't transposed rules regarding supply of electricity and gas to taxable dealers (B2B) and customers (B2C), reverse charge mechanism and fraudulent activities. Reviewing the situation it is safe to say that FYR of Macedonia did partially implemented the VAT Directive into its legislation.

C.5.2 Obstacles identified by stakeholders

Electricity network

In May 2016 Electricity Transmission System Operator of Macedonia (AD MEPSO) joined SEE CAO. According to the accession treaty signed between AD MEPSO and SEE CAO, auctions for allocation of capacity between FYR of Macedonia and Greece will be organized on yearly, monthly and daily basis, and the first auction to be realized is the annual auction for 2017. These auctions will be organized according to "*Auction Rules for allocation of transmission capacities in the SEE CAO*".



Figure 6. Interconnection booking mechanism between FYR of Macedonia and neighboring systems

In order for a foreign company to participate in the electricity market in FYR of Macedonia, it has to be registered as a company in FYR of Macedonia.

Gas network

FYR of Macedonia is interconnected with Bulgaria at the interconnection point Kyustendil (BG) / Zidilovo (MK). According to the information provided by FYR Macedonia TSO, GA-MA, currently there is no possibility for foreign based companies, not registered in Macedonia, to book interconnection capacity. The only option for a foreign company to participate in the FYR Macedonian gas market is to be registered as a company in Macedonia.



Figure 7. Interconnection point

Source: *ENTSOG*

In conclusion, the stakeholder analysis has not identified VAT as an obstacle to cross border trade.

C.6 Moldova

C.6.1 Overview of the VAT legislation

The VAT regime in Moldova is regulated by Fiscal code No. 1163 –XIII from 1997, last amended 23 September 2016 (No. 230) (hereinafter: the Code). Regarding the definition of **taxable person**, the definition does not completely match the definition of VAT Directive: the Code gives a list of taxable persons, which can be considered to match definition of taxable persons introduced in Article 9 of VAT Directive. However, the Code does not explicitly mention governmental bodies as being exempted from VAT, but envisages VAT exemption for some activities performed by central and local authorities.

Concerning the **supply of goods**, the Code is partially in line with the VAT Directive, stating that the supply of goods is, among others, transfer of the right to dispose of tangible property as owner. **Supply of services** is described, as opposed to the VAT Directive where it is defined as any transaction that is not a supply of goods, as a list of actions.

General rule for the place of transaction for the supply of goods is completely in line with the VAT Directive, but it differs from the Directive in regards to the supply of services.

The Code introduces a reduced VAT rate of 8% for natural and liquefied gases, but does not mention electricity. However, the Tax Code also envisages 0% VAT rate for electricity for residential consumers that contradicts the requirement of the Directive of fixing the **reduced rate** to no less than 5%. At the same time the prices for the same goods and services for commercial consumers include 20% VAT. There is no such provision for gas supplied to residential consumers.

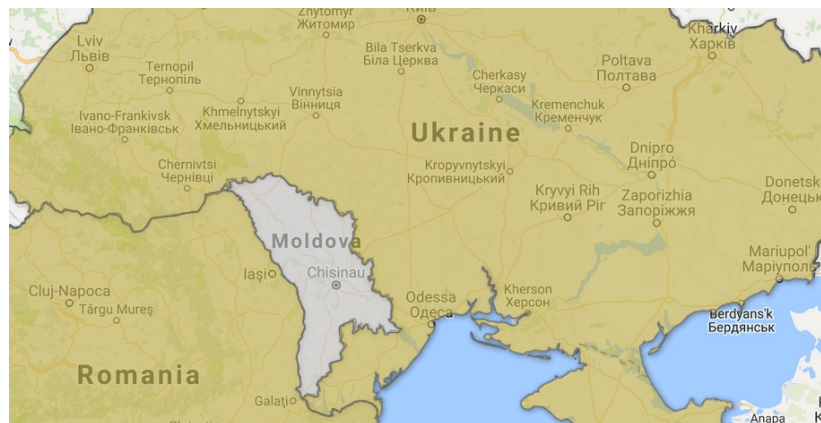
The Code doesn't mention **avoidance of double taxation, reverse charge and fraudulent activities**. The Tax Code envisages the place of supply of exported gas and electricity as the place of their receipt.

Conclusion

The VAT Directive is only partially transposed in the Fiscal code of Moldova, regulating only a small portion of institutes established by the Directive.

C.6.2 Obstacles identified by stakeholders

Despite the fact that Moldova does not export energy at the moment, there are currently no problems with the reimbursement of VAT while exporting other goods from Moldova.



Bilateral

Figure 8. Interconnection booking mechanism between Moldova and neighboring systems

Due to the absence of a competitive electricity and natural gas market in Moldova, there are no independent energy traders in Moldova, except for an independent supplier that buys electricity at MoldovaGRES (the TPP located at Pridnestrovian Moldavian Republic).

There is no rule for the allocation of cross-border capacities: they should be established within two years after the new Laws on electricity and natural gas markets come into force.

In conclusion, stakeholders have not identified VAT as an important obstacle to cross border trade.

C.7 Montenegro

C.7.1 Overview of the VAT legislation

VAT regime of Montenegro is regulated by the Law on Value Added Tax (hereinafter: the VAT law), last amended in January, 2017¹³.

Governmental bodies are not considered as taxable persons but can become one if they conduct a supply of goods or services and thus disrupt the competition. However, no special regulations are provided for the electricity and gas in relation to governmental bodies.

The definition of the **chargeable event** and **chargeability** is not identically described as in the VAT Directive.

As for the place of the transaction for the **supply of goods**, there are certain differences between the VAT law and VAT Directive. Although VAT law also separates cases when goods are transported and when they are not in transport, it sets a rule that if the dispatch starts outside of Montenegro it will be considered to be in Montenegro. For the place of supply of electricity and gas it is deemed to be the place where the customer is located. Rules for the place of **supply of services** are similar in the way that the word "transaction" in the VAT Directive is replaced with the words "performance, omission and toleration".

There are also no rules regarding the supply of electricity and gas to taxable dealers (B2B) and customers (B2C).

Related to **supply of services**, the place where the supply of services is performed is considered to be the place where the taxpayer who provides the service has established his business. **As an exemption on this rule is that the place of supply of the provision of access to a natural gas or electricity system is the place of the recipient of the services. If recipient of the services has his permanent address or usually resides outside Montenegro, the service shall be taxable where this person usually resides.**

Although VAT law allows **reduced rate** for some goods, electricity and gas are not explicitly mentioned. Furthermore, there are no exemptions on importation of electricity and gas. For the export of goods 0 VAT rate is applied, but also no special mention of the electricity and gas.

VAT law doesn't contain regulations regarding reverse charge mechanism nor reporting on fraudulent activities.

Conclusion

¹³ Zakon o porezu na dodanu vrednost"Službeni list Republike Crne Gore", br. 065/01 od 31.12.2001, 012/02 od 15.03.2002, 038/02 od 26.07.2002, 072/02 od 31.12.2002, 021/03 od 31.03.2003, 076/05 od 16.12.2005, 004/06 od 27.01.2006, Službeni list Crne Gore", br. 016/07 od 27.12.2007, 073/10 od 10.12.2010, 040/11 od 08.08.2011, 029/13 od 22.06.2013, 009/15 od 05.03.2015, 053/16 od 11.08.2016, 001/17 od 09.01.2017.

VAT law contains certain amount of rules that match the VAT Directive but there is still place for improvement of the legislation regarding certain institutes and mechanisms.

C.7.2 Obstacles identified by stakeholders

Montenegro does not have a gas network, hence all the analysis relates to transmission of electricity. Booking of interconnection capacity between Montenegro on one side and Bosnia and Herzegovina and Albania on the other side is performed by SEE CAO.

With Serbia, split auctions are organized. When booking interconnection capacity with Montenegrin Electric Transmission System (CGES), market participant is not charged VAT, following changes to VAT Law introduced in August 2016 (Art.17.3.9.a. of VAT Law). Regarding the interconnection capacity with Kosovo*, the allocation is done jointly with EMS.

Therefore, following the amendments of the Tax Law, stakeholder analysis has not identified VAT related issues as obstacles to cross border trade.

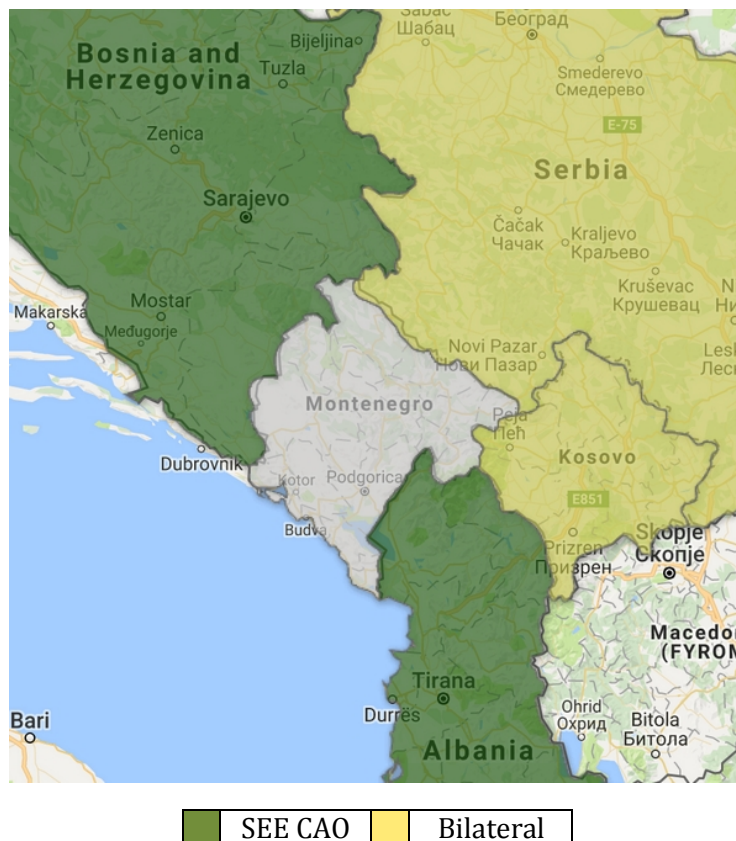


Figure 9. Interconnection booking mechanism between Montenegro and neighboring systems

C.8 Serbia

C.8.1 Overview of the VAT legislation

Serbia's VAT regime is regulated by the Law on value-added tax amended in 2016¹⁴ (hereinafter: VAT law). Regarding the definition of the **chargeable event** and **chargeability**, VAT law doesn't have a general rule such as the VAT Directive, but rather enlists numerous cases for which the chargeable event occurs.

Rules about place of transaction for the **supply of goods** and the **supply of services** are not completely in line with the VAT Directive. Namely, VAT law doesn't differentiate taxable and non - taxable person while defining a place of supply of services.

The VAT law introduces a reduced special rate of 10% for natural gas, without mentioning electricity. There are no special rules related to reporting on fraudulent activities.

Conclusion

Republic of Serbia has somewhat implemented the VAT Directive into its legislation but still needs to regulate the system of avoidance of double taxation. It should also regulate the reporting on the fraudulent activities.

C.8.2 Obstacles identified by stakeholders



Figure 10. Interconnection booking mechanism between Serbia and neighboring systems

Bilateral

¹⁴ Zakon o porezu na dodatu vrednost (Službeni glasnik RS", br. 84/04, 86/04 - ispravka, 61/05, 61/07, 93/12, 108/13, 68/14 - dr. zakon, 142/14, 83/15, 108/16)

The Serbian Energy Law (Sl. glasnik RS", br. 145/2014) enables non-resident firms to participate in the Serbian wholesale electricity market by means of obtaining a license for wholesale supply (article 19). The license entitles the license holder to trade electricity in Serbia but does not allow the license holder to supply electricity to end consumers (in order to participate in the retail market, a foreign based firm which is not registered in Serbia has to establish a branch or company in Serbia).

In order to avoid charging VAT to foreign companies not registered in Serbia, the amendment of VAT law introduced "reverse charge mechanism", compliant with EU acquis, as defined in article 11.4 of the VAT law. The article differentiates electricity sold at the wholesale market and electricity intended for end use. Electricity intended for wholesale is not subject to VAT.

In auctions organized by EMS, foreign firms are invoiced an amount for booking the interconnection capacity **which does not include VAT**, following the provision that place of taxation is determined by the place where service user has its seat (in this case foreign country). In case when the firm has its seat in Serbia and participates in cross border interconnection auctions, EMS invoices the amount which includes VAT.

Regarding negative prices, SEPEX a.d. Beograd (SEPEX) does not allow for negative prices nor does the energy legislation of Serbia allow for negative imbalance settlement prices.

Regarding the obstacles related to access to gas network, the Consultant has contacted market participants to obtain their views on the current status of access to gas network in Serbia and any possible outstanding issues. None of the market participants that were contacted participates in Serbian gas market (e.g. neither buys nor sells gas), reason being unclear rules of market access to gas infrastructure.

Consequently, the stakeholder analysis has indicated that VAT related issues do not represent an obstacle to cross border trade.

C.9 Ukraine

C.9.1 Overview of the VAT legislation

The Tax Code of Ukraine of December 2, 2010 No. 2755-VI and The Law No. 909-VIII “On Amendments to the Tax Code of Ukraine and Some Other Legislative Acts of Ukraine on Provision of Balance of Budget Revenues in 2016 (Tax Code)¹⁵ defines the rules on Value Added Tax.

The definition of a **taxable person** is similar but the definition is described in a lot more detail in the Tax Code than in the VAT Directive: the Tax Code contains an extensive list of legal and natural persons that are regarded as taxable persons. The Tax code does not **exempt** from VAT **state and governmental** bodies, but contains an exhaustive list of VAT exempted services provided by state, regional and local government bodies.

The definition of a **chargeable event** is defined according to the date of occurrence of a payment or according to the date of shipment, related to the tax period within which any of the events that have occurred before takes place. Although the definition is based according to the date of shipment or the payment, it still entails the economic activities similar to the VAT Directive.

The **place of transaction** according to the Tax Code differs from the definition of the VAT Directive. In the Tax code, the place of **supply of goods** to the customer is not defined in accordance with the seat or type of the customer (B2B or B2C). Definition of supply of goods is determined in accordance with the place of actual location of the goods or according to the location at the beginning of transportation.

The place of **supply of services** is determined according to the actual location where services related to moveable property are provided¹⁶.

The definition of a **taxable amount** is similar to the VAT Directive although no mention is made of subsidies that are included in the definition of the taxable amount of the VAT Directive.

The Tax Code makes no mention of supply of gas or electricity to a taxable dealer as stated in article 38 of the VAT Directive, nor does it mention the supply of gas or electricity to an end customer as stated in article 39 of the VAT Directive.

Although the Tax Code provides three VAT rates, there is no mention of reduced rates for gas or electricity.

The Tax Code specifically exempts the JSC “National Joint Stock Company” Naftogaz from taxation for transactions of natural gas that is imported into the Ukraine.

¹⁵ In 2017 a set of changes and amendments have been introduced into the Tax Code of Ukraine based on the adoption of the two draft laws: Draft law No.5368 on improvement of the investment climate in Ukraine and Draft law No.5132 on ensuring of the balanced budget receipts in 2017.

¹⁶ Except for consulting, engineering, legal, accounting, audit, , advertising, forwarding, information technology, data processing, telecommunication, broadcasting and certain other services, taxable where the service recipient is incorporated.

The export of goods outside the customs territory of Ukraine is zero-rated. Tax-exempt are transactions for supply of services for transit passenger and cargo carriage (transfer) through the customs territory of Ukraine and for transactions for supply of services related to such carriage (transfer). The exemption does not apply to transactions for supply of services performed (provided) for transit (transportation) of natural gas using cross-border pipelines (transportation of natural gas through Ukraine in customs transit regime).

The Tax Code makes no mention of reverse charge or fraudulent activities as mentioned in the VAT Directive.

VAT refund is mentioned in the Tax Code under certain conditions, although not as clear and unconditionally as in the VAT Directive.

Conclusion

The VAT provisions as stipulated in the Tax Code differ from those stipulated in the VAT Directive. The Tax Code does not distinguish supply to a taxable dealer from the supply to a final customer. Also, it does not mention that the place of supply of goods can be in certain circumstances the place of consumption or the place of residence of the taxable dealer. The place of supply of services and goods are in general determined by the location of the provision of the goods and/or services. Also, no mention is made of reverse charge nor are there any regulations regarding the avoidance of fraudulent activities.

C.9.2 Obstacles identified by stakeholders

Electricity

According to the informal feedback provided by electricity traders, the key problem is the practical procedures on the reimbursement of VAT for export operations. The VAT reimbursement for electricity traders is usually delayed by 3-4 months. It is also subject of a thorough inspection and the whole procedure is rather cumbersome, e.g. the documents are sent from a local tax office to the Department of Treasury via the central tax office. There have been cases when the VAT was not refunded at all, either because of the results of the inspection, because the documents were lost on the way to the Department of Treasury or due to the lack of financial resources on Treasury's accounts.

Regarding auxiliary services, there is no such market in Ukraine. Auxiliary services are provided by Ukrhidroenergo to TSO and only energy is charged. Energy provided is taxed at 20% VAT.



Figure 11. Interconnection booking mechanism between Ukraine and neighboring systems

Bilateral

Gas

The taxation of natural gas import is regulated by the Tax Code only. Art. 197.22 envisages that only the National Joint Stock Company "Naftogaz Ukraine" is exempt from the VAT tax on importing natural gas into the custom territory of Ukraine. Thus, all other traders (except JSC "Naftogaz") importing natural gas at the custom territory of Ukraine have to pay 20% VAT rate (article 180.1, article 193.1). Nevertheless, the new law "On Natural Gas Market" (№ 329-VIII dated 09.04.2015) envisages equal rights for all importers and exporters of natural gas into the custom territory of Ukraine. The Law came into force on October 1, 2015. The Government of Ukraine should have removed preferences for JSC "Naftogaz" in order to make the Tax Code compliant with the new Law.

According to article 14.1.191 of the Tax code, natural gas and electricity should be considered as goods. Article 195.1.1 envisages that the export of goods outside the customs territory of Ukraine should be taxed according to the "0 percent VAT tax rate"¹⁷.

¹⁷ The main difference between 0 percent VAT tax rate and Exemption of VAT is that suppliers of zero-rated goods/services can still reclaim all their input VAT (the VAT on their own purchases) and Suppliers of Exempt goods cannot reclaim the input VAT (the VAT on their own purchases) relating to Exempt Supplies. They can reclaim the input VAT only if prescribed by the Law as exemption.

Thus, theoretically, according to the Tax code a trader exporting natural gas outside the custom territory of Ukraine has to use “0 percent VAT tax rate” (get reimbursed the amount of the VAT paid using the same scheme as for the export of electricity – see above).

The export of gas is also regulated by Orders of the Ministry of Energy and Coal Industry and the new law “On Natural Gas Market” (№ 329-VIII dated 09.04.2015). According to the “Procedure on natural gas export” approved by the Order of the Ministry of Energy and Coal Industry № 1019 dated 17.12.2012, the export of natural gas is allowed only if a legal entity has as license on natural gas export within the limits defined in a forecast annual balance of natural gas supply and distribution in Ukraine. The forecast annual balance should be approved on the annual basis by the Cabinet of Minister of Ukraine. As for 2016, the export of natural gas is additionally regulated by the Cabinet of Ministers Decree “The list of goods, export and import of which is subject to licensing and quotas for 2016 (approved by № 1176 dated 30/12/2015). According to the list, the limits of the export of the natural gas extracted on the territory of Ukraine should be defined in a forecast annual balance of natural gas supply and distribution in Ukraine for 2016”. However, there is a discrepancy in the above legislation acts:

- Procedure on natural gas export (approved by the Order of the Ministry of Energy and Coal Industry № 1019 dated 17.12.2012) regulates export of all natural gas
- The list of goods, export and import of which is subject to licensing and quotas for 2016 (approved by the Cabinet of Ministers Decree № 1176 dated 30/12/2015) regulates export of natural gas extracted on the territory of Ukraine only.

As of September 2016, there is no approved forecast annual balance of natural gas for 2016 in Ukraine. Thus, in the absence of the forecast annual balance of natural gas for 2016 approved by the CoM, no trader can export natural gas from Ukraine.

Ukraine gas transmission system is operated by Ukrtransgaz (TSO) which is entirely owned by Naftogaz, a vertically integrated oil and gas company. Ukrtransgaz determines technical capacity for services related to transit, storage and maintenance of gas network. Currently, Ukraine is interconnected to neighboring countries via 19 interconnection points.

All financial issues related to import-export operations are performed by Naftogaz. Nevertheless, when invoicing, Ukrtransgaz applies 20% VAT rate to all tariffs and fees related to the services it provides.

Regarding backhaul capacity, Ukrtransgaz does not provide the service as the current contract with Gazprom forbids such operations. Thus, the company physically transfers the gas in the reverse direction.

Regarding balancing services, 20% VAT rate is applied to all payments related to the balancing of natural gas.

Also, given that Ukrtransgaz determines only technical possibility for import, export and transit of natural gas, it is not in charge of operational balancing: this issue falls within the domain of Naftogaz.

Unbundling, which is unambiguously envisaged by the current legislation framework and should establish certain responsibilities on Ukrtransgaz as TSO, has not been fully implemented in Ukraine. This results in Naftogaz's control over financial operations of Ukrtransgaz in many areas, including the management and taxation of balancing account.

As for Russian gas, there is no operational balancing account between Gazprom and Naftogaz as such. Any steering differences are covered by the adjustment of the amount of service gas provided by Gazprom (and not through financial payments) according to the current contract.

In conclusion, stakeholder analysis has identified VAT related issues as obstacle to cross border trade.

D. ELABORATION OF APPLICABLE RULES ON NETWORK ENERGY RELATED TRANSACTIONS TO BE APPLIED BETWEEN ECONOMIC OPERATORS FROM THE ENERGY COMMUNITY AND ECONOMIC OPERATORS FROM THE EUROPEAN UNION

In this section we elaborate on rules to be applied to transactions between economic operators in the Contracting Parties to the Energy Community and EU. In analysing the transactions we focus on provision of energy as good (trade in electricity and gas) and provision of interconnection capacity. In the first step we summarize the current regulation in the EU, followed by the analysis of the situation in each CP. In subsequent sections we elaborate on necessary changes to national legislation in order to harmonize national legislations with EU VAT Directive.

D.1 Situation in the EU

D.1.1 Trade in gas and electricity

The trade in gas and electricity between MS is considered supply of goods, not import or export.

In the case of the supply of gas or electricity to a **taxable dealer**¹⁸ (**B2B**), the place of supply is the place where that taxable dealer has established his business or has a fixed establishment **for which the goods are supplied**.

In the case of the supply of gas and electricity through the natural gas system to the **customer** (not to taxable dealer, i.e. **B2C**) the place of supply is the place where the customer effectively uses and consumes the goods.

D.1.2 Provision of access to gas and electricity network

The place of supply of services related to the access to transport and transmission networks to **customers established outside the European Union** or to **taxable persons established in the EU but not in the same country as the supplier**, is the place where the customer has established his business or has a fixed establishment for which the service is supplied.

Provision of access to the natural gas or electricity distributions system to a **non-taxable person outside the European Union** is the place where that person is established, has his permanent address or usually reside.

¹⁸Taxable dealer is a taxable person whose principal activity in respect of purchases of gas, electricity, heat or cooling energy is reselling those products and whose own consumption of those products is negligible.

For provision of access to the natural gas or electricity distributions system supplied to a **non-taxable** person **within Community**, the place of supply shall be deemed the place where service provider is established.

D.2 Summary of the above legislative provisions in the EU and CPs

The following table summarizes the current situation in the Contracting Parties in relation to trade in gas and electricity and access to interconnection capacity. For convenience and ease of comparison, summary of EU provisions is given first.

Country	Description
EU Member States	<p>1. Export of gas and electricity to non-EU countries¹⁹ VAT rate: VAT exempted Taxable person: foreign recipient- taxable and non-taxable person Place of taxable transaction: outside EU</p> <p>2. Import of gas and electricity from non-EU countries (Art.143 of VAT Directive) <u>B2B (Art. 38)</u> Taxable person: taxable dealer Place of taxable transaction: place where that taxable dealer has established his business or has a fixed establishment for which the goods are supplied.²⁰ <u>B2C (Art. 39)</u> Taxable person: customer Place of taxable transaction: place where the customer effectively uses and consumes the goods.²¹</p> <p>3. Access to natural gas or to electricity network and the provision of other services directly linked thereto²² (Art.59h of VAT Directive) <u>To taxable person</u> Taxable person: taxable person established outside the EU or taxable persons established in the EU but not in the same country as the supplier. Place of taxable transaction: the place where the customer has established his business or has a fixed establishment for which the service is supplied. <u>To non-taxable person</u> Taxable person: customer in EU Place of taxable transaction: place where the customer has established his business or has a permanent establishment for which the service is supplied Taxable person: customer/non-taxable person within EU²³ Place of taxable transaction: the place of supply is the place where service provider is established. If the EU provider supplies goods to the customer in EU, but in other country (intra-community supply), he will register the VAT number in that country and</p>

¹⁹The trade in gas and electricity between MS is considered as supply of goods, not as import or export.

²⁰ Art.38 VAT Directive

²¹ Art.39 VAT Directive

²² Customers established outside the European Union or taxable persons established in the EU but not in the same country as the supplier have the same treatment in terms of VAT rules in relation to access to interconnection capacity.

²³ Art.59h of VAT Directive

	<p>charge the VAT of the customer country at the invoice. If the EU provider would supply goods to the non-taxable person outside EU, the exemption of VAT should be shown at the invoice.</p> <p>4. Transit of gas and electricity²⁴ (Art.146 of VAT Directive) Taxable person: exempted</p>
Albania	<p>1. Export of gas and electricity to other countries VAT rate: 0% Taxable person: customer outside Albania Place of taxable transaction: outside Albania</p> <p>2. Import of gas and electricity from other countries Taxable person: taxable dealer (B2B) Place of taxable transaction: the place of supply, where the taxable dealer has established his business or has a fixed establishment for which the goods are supplied. Taxable person: customer(B2C) Place of taxable transaction: Republic of Albania, where the customer effectively uses and consumes these goods.</p> <p>3. Access to natural gas or to electricity network and the provision of other services directly linked thereto Taxable person (B2B): service recipient Place of taxable transaction: the place where the service recipient is established. Taxable person (B2C): customer Place of taxable transaction: place where the customer has established his business or has a permanent establishment for which the service is supplied²⁵</p> <p>4. Transit of electricity Taxable person: exempted</p>
BiH	<p>1. Export of gas and electricity to other countries VAT rate: exempted Taxable person: foreign recipient Place of taxable transaction: outside Bosnia and Herzegovina</p> <p>2. Import of gas and electricity from other countries Taxable person: taxable dealer (B2B) Place of taxable transaction: the place of supply, where the taxable dealer has established his business or has a fixed establishment for which the goods are supplied.</p>

²⁴ Transit refers to transit of electricity as goods through the customs territory of a country, and does not refer to booking of interconnection capacity. The question that is addressed is whether businesses that are booking interconnection capacity

²⁵ As a consequence, a foreign foreign service supplier providing services to a non-taxable (B2C) person in Albania **should register for VAT purposes in Albania** by **appointing a fiscal representative** in the country to account for and pay the VAT liability.

	<p>3. Access to natural gas or to electricity network and the provision of other services directly linked thereto Taxable person: the recipient of the service²⁶ Place of taxable transaction: BiH</p> <p>4. Transit of electricity Taxable person: exempted</p>
Georgia	<p>1. Export of gas and electricity to other countries VAT rate: exempted with the right to deduct Taxable person: foreign recipient Place of taxable transaction: outside Georgia</p> <p>2. Import of gas and electricity from other countries (exempted for natural gas to thermal power stations) Taxable person: the place of receipt of such goods.</p> <p>3. Access to natural gas or to electricity network and the provision of other services directly linked thereto Taxable person: the person receiving the services</p> <p>Place of taxable transaction: the place of registration or place of management of the person receiving the services (if the persons delivering and receiving services are in different countries). When the non-resident has PE in Georgia, the place of transaction is place of supply of services.</p> <p>4. Transit of electricity Taxable person: exempted</p>
Kosovo*	<p>1. Export of gas and electricity to other countries VAT rate: exempted Taxable person: foreign recipient Place of taxable transaction: outside Kosovo</p> <p>2. Import of gas and electricity from other countries (exempted) Taxable person: taxable dealer (B2B) Place of taxable transaction: the place of supply, where the taxable dealer has established his business or has a fixed establishment for which the goods are supplied Taxable person: customer (B2C) Place of taxable transaction: the place where the customer effectively uses and consumes the goods</p> <p>3. Access to natural gas or to electricity network and the provision of other services directly linked thereto Taxable person: the service recipient Place of taxable transaction: the place where the taxable person who receives such services has his/her permanent address or usually resides</p> <p>4. Transit of electricity</p>

²⁶ The supply of services to foreign based firms booking daily interconnection capacity, are not charged with the VAT, although this is not prescribed by the VAT regulation.

	<p>Taxable person: exempted</p>
FYR of Macedonia	<p>1. Export of gas and electricity to other countries VAT rate: exempted Taxable person: foreign recipient Place of taxable transaction: outside FYR of Macedonia</p> <p>2. Import of gas and electricity from other countries Taxable person: taxable dealer (B2B) Place of taxable transaction: the place of supply, where the taxable dealer has established his business or has a fixed establishment for which the goods are supplied</p> <p>3. Access to natural gas or to electricity network and the provision of other services directly linked thereto Taxable person: service recipient Place of taxable transaction: place where the recipient of services is established or has his permanent address</p> <p>4. Transit of gas and electricity Taxable person: exempted Place of taxable transaction: destination country</p>
Moldova	<p>1. Export of gas and electricity to other countries VAT rate: 0% Taxable person: foreign recipient/exporter Place of taxable transaction: outside Moldova</p> <p>2. Import of gas and electricity from other countries Exempted for B2B for electricity and 8% rate for gas Taxable person: taxable dealer (B2B) Place of taxable transaction: the place of their receipt Taxable person: Only commercial consumers for electricity (0 rate for residential consumers). All customers for gas (B2C) Place of taxable transaction: the place of their receipt</p> <p>3. Access to natural gas or to electricity network and the provision of other services directly linked thereto Taxable person: service recipient Place of taxable transaction: Moldova</p> <p>4. Transit of electricity Taxable person: exempted Place of taxable transaction: destination country</p>
Montenegro	<p>1. Export of gas and electricity to other countries VAT rate: 0% Taxable person: foreign recipient Place of taxable transaction: outside Montenegro</p> <p>2. Import of gas and electricity from other countries Taxable person: taxable dealer Place of taxable transaction: place where the goods enter Montenegro.</p> <p>3. Access to natural gas or to electricity network and the provision of</p>

	<p>other services directly linked thereto Taxable person: service recipient Place of taxable transaction: place where the recipient of services is established or has his permanent address</p> <p>4. Transit of electricity Taxable person: exempted Place of taxable transaction: destination country</p>
Serbia	<p>1. Export of gas and electricity to other countries VAT rate: Exempted Taxable person: foreign recipient Place of taxable transaction: outside Serbia</p> <p>2. Import of gas and electricity from other countries <u>B2B</u> Taxable person: taxable dealer to whom supplies of gas and electricity are provided Place of taxable transaction: place where taxable dealer has established his business <u>B2C</u> Taxable person: customer Place of taxable transaction: the place of receiving water, electricity, natural gas and energy for heating or cooling, for final consumption</p> <p>3. Access to natural gas or to electricity network and the provision of other services directly linked thereto Taxable person: service recipient Place of taxable transaction: place where service user has its seat</p> <p>4. Transit of electricity Taxable person: exempted Place of taxable transaction: place of destination</p>
Ukraine	<p>1. Export of gas and electricity to other countries VAT rate: 0% Taxable person; foreign recipient Place of taxable transaction: outside Ukraine</p> <p>2. Import of gas and electricity from other countries 20% rate, except JSC "National Joint Stock Company Naftogaz" that has VAT exemption on gas import operations Taxable person: taxable dealer Place of taxable transaction: Ukraine</p> <p>3. 3. Access to natural gas or to electricity network and the provision of other services directly linked thereto ²⁷ Taxable person: service recipient</p>

²⁷There are some limitations for the allocation of electricity cross-border capacities in Ukraine. As of now, the Ukrainian legislation framework regulates the allocation of cross-border capacities for the local electricity market players only. Currently, there is a gap in the legislation framework regarding the allocation of cross-border capacities for transit of electricity by foreign firms. The latter issue is regulated by the Ministry of Energy and Coal Industry case-by case.

	Place of taxable transaction: place of registration of the supplier 4. Transit of electricity Taxable person: the transit is exempted, but without the right to deduction of paid VAT on related transit cost Place of taxable transaction: destination country
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D.3 Recommendation

As the above analysis has shown, CPs apply different approaches in relation to export and import of energy, access to network and transit of energy over their territory. In order to create a well-functioning market, CPs will have to harmonize their respective legislation with EU acquis as to allow for uninterrupted flow of energy and access to their market. The principle that should govern harmonization is that energy related goods and services provided in Energy Community are taxed using the same principles as energy related goods and services in intra Community transactions.

E. INSTANCES LEADING TO DOUBLE TAXATION

E.1 General remarks²⁸

The Value Added Tax system is based on the principle that VAT tax is collected at each stage of value chain, where the value of VAT payable for a company is determined by offsetting input VAT (VAT paid on the inputs used in production) from the output VAT (VAT paid on the final sales of goods). The VAT Directive 2006/112/EC and its amendments defines the main principle of VAT taxation which states that the obligation for VAT payment lays with the company providing goods and services.

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
- Double taxation
- Tax fraud

No taxation implies when the taxpayer does not pay the VAT he owes, or claims a debt to the administration that is actually not due.

Double taxation is an issue that might occur 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. Such a situation is rare, as countries generally have VAT refund policies in place. Nevertheless, stakeholders in Ukraine have identified difficulties in obtaining VAT refund.

An arrangement where VAT is paid at each stage of value chain by a supplier of goods and services gives rise to a possible **tax fraud**, called carousel or “missing trader” fraud. Carousel fraud occurs when supplier fails to pay output VAT whilst the buyer claims back the input VAT. The simplified version of carousel trade can be explained by the following figure.

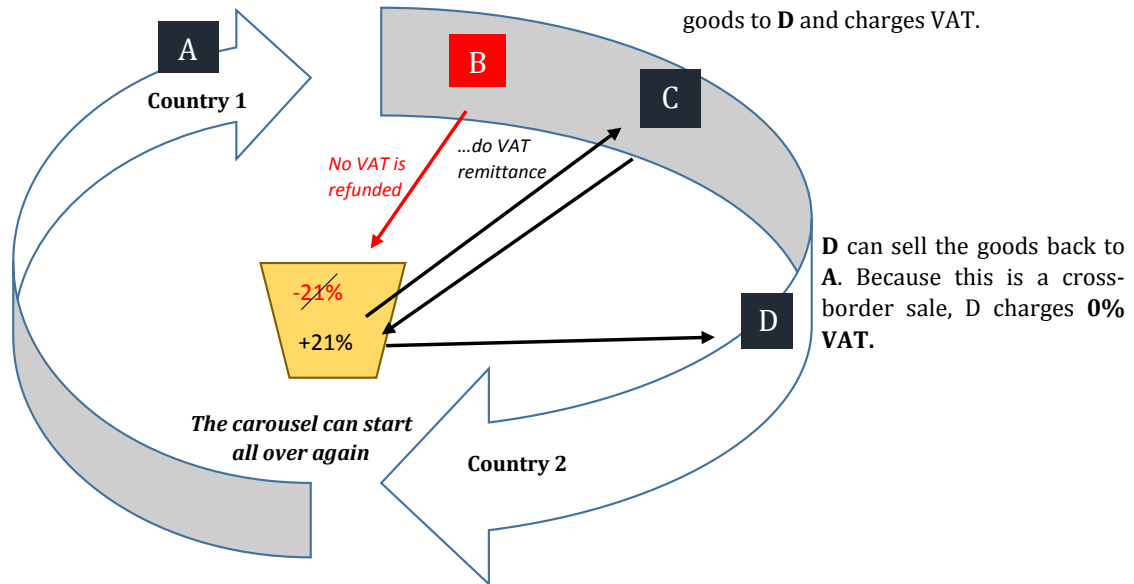
²⁸ Analysis is confined to the issues of cross border VAT taxation.

Figure 12: Simplified carousel fraud scheme

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.

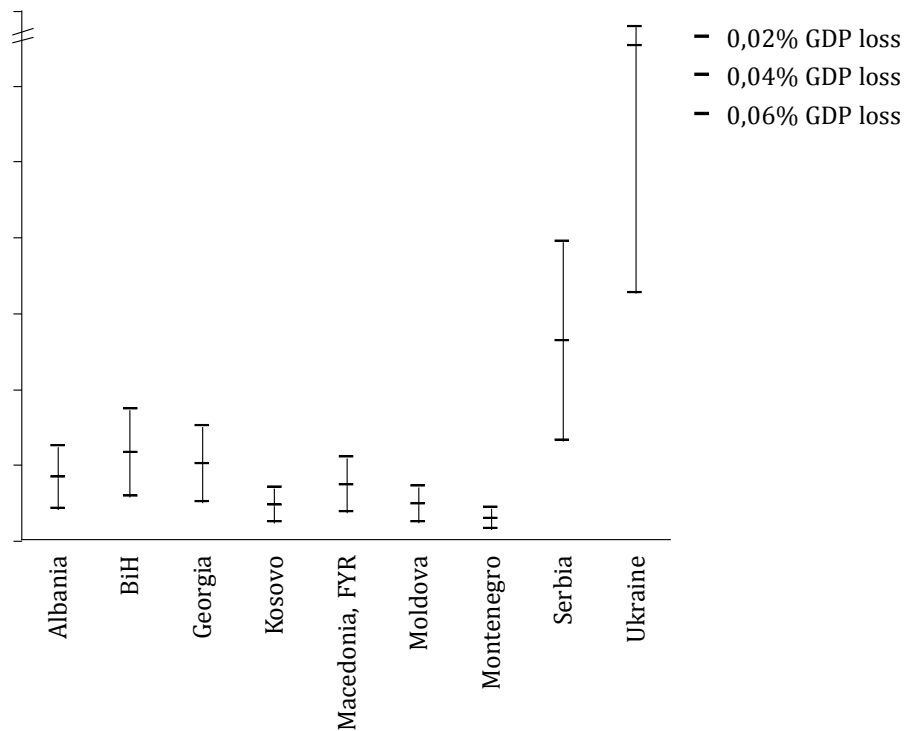


There are no reliable estimates of possible tax fraud in Energy Community CPs, but relevant sources state that the value of cross border VAT related fraud in the EU stands at €50 billion annually ([link](#)), which is roughly 0.4% of GDP²⁹. Assuming the same share of VAT fraud in Contracting Parties and assuming the value of GDP at current prices for all CPs of 176.3 billion EUR, this would imply a loss of 633 million EUR in total for all CPs³⁰. The following figure depicts the magnitude of potential loss of GDP in each CP, assuming 0.2%, 0.4% and 0.6% loss in the value of GDP due to tax fraud.

²⁹ This value is obtained assuming the value of tax fraud equivalent to €50 billion in 2013 and dividing it with the value of EU GDP in 2013 of €13,920 billion ([link](#))

³⁰ Values of nominal GDP are taken from the World Bank database and converted from US Dollars to EUR using an average annual exchange rate of 0.9013 EUR/US\$.

Figure 13: Estimate of potential loss of GDP due to tax fraud



As a possible method to be used to address the issue of VAT fraud is to apply a **reverse charge mechanism** (RCM). When the final buyer applies reverse charge mechanism, he or she credits both input and output VAT accounts, hence eliminating actual cash risk (EY, 2014). Therefore, application of reverse charge mechanism is a tool to combat VAT related tax fraud as the process of VAT payment rests at the ultimate stage of the value chain. Given that under RCM VAT is paid only once, RCM also allows for elimination of double taxation³¹.

Therefore, we conclude that introduction of reverse charge mechanism allows for elimination of instances of double or no taxation at all. As the following table shows, five CPs have implemented reverse charge mechanism in relation to provision of access to network infrastructure, with the exception of Bosnia and Herzegovina, Georgia, Moldova and, Ukraine. To assess the possible instances leading to double or no taxation, we investigate VAT mechanism payment in countries that have not implemented RCM.

³¹ Double taxation occurs when a business pay VAT twice: once in a foreign country where it purchases goods where it is not allowed to claim back the VAT, and second time in a home country.

Table 1: Contracting Parties that implemented reverse charge mechanism related to provision of access to gas and electricity networks

Country	Reverse charge mechanism
Albania	Yes
BiH	No
Georgia	No
Kosovo*	Yes
FYRM	Yes
Moldova	No
Montenegro	Yes
Serbia	Yes
Ukraine	No

E.2 Analysis of situation in Contracting Parties

Instances of double taxation are defined as a situation where VAT tax is paid twice on the provision of goods and services. By definition, instances of double taxation cannot occur in jurisdictions which apply RCM. Reverse charge mechanism implies that the provider of goods and services invoices an economic agent an amount that does not include VAT. Given that RCM implies that VAT is paid where the economic agent has its seat, economic agent claims input and output VAT simultaneously resulting in VAT being charged only once. Therefore, as the previous table shows, double taxation is theoretically possible in Bosnia and Herzegovina, Georgia, Moldova and Ukraine. Each of these CPs is investigated further to assess whether double taxation might be an issue.

E.2.1 Bosnia and Herzegovina

Allocation of cross border capacity

In Bosnia and Herzegovina the Consultant identified the issue of double taxation in cases when NOS BIH is a provider of interconnection capacity and when NOS BIH issues the invoices. The description of the situation is as follows.

Firms which are not BIH residents, receive an invoice from NOS BIH that does not include VAT amount. At the same time, NOS BIH delivers the same invoice in the same amount to Elektroprijenos BiH together with debit note which includes the VAT amount. Such an invoice, together with the debit note, represents a sales invoice for NOS BIH. Following, Elektroprijenos BiH issues an invoice to NOS BIH for the amount which has been invoiced to the customer, together with respective VAT, which is equal to the VAT amount in debit note. Such an invoice represents a purchase invoice for NOS BIH. Therefore, for each transaction related to allocation of interconnection capacity, sales invoice is offset by purchase invoice, resulting in no VAT obligation nor cost to NOS BIH. On the other hand, Elektroprijenos BiH is responsible for VAT payment, following the invoice it issued to NOS BIH. At the same time the purchase invoice it receives from NOS BIH it does not use in determination of its VAT obligations. Hence, the VAT is finally paid by Elektroprijenos BiH.

Consequently, the foreign firm pays VAT in the country where it has its seat, resulting in VAT being paid twice. This arrangement results in undue costs for Elektroprijenos BiH which are reflected in the form of higher tariffs which are consequently borne by all BIH electricity customers.

Trade in energy

When foreign based firms export gas and electricity from Bosnia and Herzegovina whose price already includes VAT, they have to request a VAT refund. This occurs in cases a foreign based firm buys gas or electricity in Bosnia, it has the right to request a VAT refund in case the bought gas or electricity is exported outside Bosnia and Hercegovina.

Conclusion

In case of export of goods, VAT Law envisages a refund in line with EU Directive: hence, no issue of double taxation has been identified. In case of network services, we have identified an issue of double taxation which does not per se distort competition but rather imposes unnecessary financial burden on Elektroprijenos BiH.

E.2.2 Georgia

Allocation of cross border capacity

When a foreign company books interconnection capacity in Georgia, it needs to pay corresponding VAT. Nevertheless, according to Article 181, it is not possible to obtain a refund related to provision of interconnection capacity as refund to foreign entities is possible only in case of goods. Consequently, a foreign based company is subject to double taxation on interconnected capacity: once in Georgia and then in home country (in case the foreign company is established in a Member State or Contracting Party where VAT on access to network is paid in the place of the recipient of the services).

Trade in energy

When gas is imported for the purposes of electricity generation and to thermal power stations, the import is exempted from VAT without the right to deduct³², VAT does not have to be paid at all.

When goods are exported by a foreign based company, a VAT amount shall be refunded on the basis of the special receipt made out by an authorized seller of goods.

Transit of gas and electricity is exempted form VAT.

Conclusion

³² We believes there is a terminological inconsistency between definitions used in Georgian Tax Code and Tax Codes of other countries and the EU VAT Directive in particular. We believe the Georgian Tax Code uses the term „*exempted without the right to deduct*“ to mean exempted but „*exempted with the right to deduct*“ to mean not exempted (in essence an economic agent pays the VAT but has an option to obtain a VAT refund).

We have identified a possible instance of double taxation in case of allocation of interconnection capacity.

In case of trade of goods and services, there is no outright instance of double taxation. Nevertheless, obtaining a tax refund for foreign firms can be time consuming (PwC, 2011). While home based companies frequently use overpaid VAT to meet other tax obligations, such option is not available to foreign based firms.

E.2.3 Moldova

Allocation of cross border capacity

Currently, there is no legislative framework defining the prices for access to cross border capacity in Moldova. Such methodology should be developed by July 2018.

Nevertheless, the current Tax Code treats services related to the transportation and distribution of electricity as subject to VAT, i.e. the place of transaction is the place where the service is provided. Therefore, foreign based economic operator being allocated transmission capacity would be charged VAT that could be later refunded (the Tax Code in sub-item 8 of item (8) of Art. 102 envisages VAT reimbursement for services related to the international transportation through electricity networks and gas pipelines).

Trade in energy

When an economic operator imports electricity into Moldova, it is VAT exempted, i.e. no VAT is applied (Art. 103, item 18). When electricity is exported from Moldova, the Tax code envisages VAT reimbursement on electricity that is exported (sub-item 7 of item (8) of Art. 102). When energy is in transit, there is not VAT to be reimbursed.

When gas is imported into Moldavia, VAT of 8% is applied (Art. 96). When gas is exported from Moldova, VAT paid on exported gas is reimbursed (sub-item 7 of item (8) of Art. 102)

Conclusion

Current VAT Tax code envisages the possibility of VAT refund for energy exported abroad as well as for use of electricity transmission and gas transport networks for international transport of gas and transmission of electricity. Therefore, there seems to be no issue of outright double taxation.

E.2.4 Ukraine

Allocation of cross border capacity

When cross border capacity is allocated (both gas and electricity), the price includes Ukraine VAT. Therefore, the economic operator has to file a request for VAT refund.

Trade in energy

When electricity is imported to Ukraine it is subject to 20% VAT. When natural gas is imported by the National Joint-Stock Company “Naftogaz” (Art 197.22), it is VAT exempt. However, when natural gas is imported into Ukraine by another economic operator, it is subject to 20% VAT. Needless to say, Naftogaz is placed in an obvious privileged position that is contrary to the common rules of a competitive market.

Even though Ukraine VAT mentions the possibility of VAT refund under certain conditions, it is not as clear and unconditional as in the VAT Directive. Interviews carried out with the stakeholders indicated that VAT might not be refunded due to numerous reasons such as results of the inspection, because the documents were lost on the way to the Department of Treasury or due to the lack of financial resources on Treasury’s accounts. Therefore, even though the issue of double taxation does not seem to be systematic, based on the stakeholder interviews, it still seems to be possible.

Conclusion

Even though Ukraine VAT legislation mentions the possibility of VAT refund under certain conditions, it is not as clear and unconditional as in the VAT Directive. Even though there should be no instances of double taxation in Ukraine, stakeholders have indicated that VAT refund is not performed in systematic manner. Therefore, there might be occurrence of double taxation as foreign economic operators have to pay VAT in their home country, whilst they are not reimbursed VAT paid in Ukraine.

F. POSSIBLE SCENARIOS FOR THE HARMONIZATION OF VAT RULES ON NETWORK ENERGY RELATED TRANSACTIONS WITHIN THE ENERGY COMMUNITY

We define three possible scenarios regarding the implementation of elements of the VAT Directive into national legislation of the Contracting Parties.

The **first scenario** implies there is no change of national legislation, or rather that none of the provisions of the VAT Directive are implemented into national legislation. In such a scenario business entities in different Contracting Parties would have considerable difficulties engaging with each other in commercial relationships regarding trade in gas and electricity as well as access to gas and electricity interconnection capacity. This would in particular be the case in relation to business entities registered in European Union Member States because of the provisions regarding the place of supply of goods and services. To put it differently, the risk of double taxation would be increased because of the lack of harmonisation and the probable protectionism that is result of refusal of harmonisation. Any market functioning would be greatly hampered in this scenario.

The **second scenario** would imply that the CPs implement the minimum requirements in order to enable better functioning of the gas and electricity markets. These core provisions would have to be transposed and implemented in order to reach the goal of a better functioning gas and electricity markets. The minimum requirements would include:

- Uniform treatment of electricity and gas as goods in VAT Law (tangible asset);
- Recognizing the subject of a taxable dealer in VAT Law provisions on supply of gas and electricity;
- Definition of the place of supply (B2B) of gas through the natural gas distribution system, or of electricity, to a taxable dealer, as the place where that taxable dealer has established his business³³;
- Definition that the supply of electricity at the final stage from traders and distributors to the final consumers should be taxed at the place where the customer actually uses and consumes the goods (B2C);
- Definition of supply of services to non-taxable persons outside the CP as the place of supply of the provision of access to a natural gas or to the electricity system situated within the territory of the CP, or the transmission or distribution through these systems or networks, and the provision of other services directly linked thereto to a non-taxable person who is established or has his permanent

³³ 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

address or usually resides outside the CP, shall be taxable at the place where that person is established, has his permanent address or usually resides.

- VAT shall be refunded to taxable persons who are not established within the territory of the CP. VAT Law shall define requirements for VAT refund - the institute of the Fiscal Representative or direct Tax Registration.
- VAT exemption of exportation 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 with the right to VAT deduction.

The **third scenario** would be that the Contracting Parties implement the VAT Directive in full. This scenario, although tempting because of full harmonisation with EU Member States, is not realistic. The principles and definitions of the VAT Directive can be implemented in the legislation of the Contracting Parties, but the various reporting mechanisms and reporting institutions are exclusively meant for EU Member States. These mechanisms and institutions derive their rights on monitoring and reporting on EU Member States from other legal foundations. In the case of the VAT Directive the Commission has a significant role on monitoring and gathering information. This role of an executive power is, however described in the VAT Directive, based on the Treaty on European Union and on the Treaty on the Functioning of the European Union. For this reason implementation of the VAT Directive into the legislation of Contracting Parties is not realistic before full membership to the European Union.

In what follows we elaborate on second (minimum) and third (maximum) harmonization scenario

F.1 Minimum requirements for harmonization of VAT rules on network energy related transactions

In order to achieve a minimum level of harmonization of VAT rules on network transactions within the Energy Community, CPs are to implement a number of rules and definitions regarding VAT legislation. Those rules that are to be implemented by the CPs are derived from Directive 2006/112/EC (VAT Directive).

Taxable person

First of all, the definition of taxable person should be uniformly adopted and/or amended in all the CPs. Although almost all the CPs have a definition similar or largely similar with the definition from the VAT Directive: *‘Any person who, independently, carries out in any place any economic activity, whatever the purpose or results of that activity.’*, some CPs have instead of a general definition an extensive list of all kinds of subjects that are taxable in that CP. In order to avoid doubt and ensure a uniform approach, it is recommended that all CPs adopt a uniform definition of a taxable person.

Supply of goods and services

With the definitions of supply of goods and services the same remarks apply as with the definition of taxable person in the CPs. In this case the CPs have different wording regarding the definition of supply of goods or services, however, some CPs lack the finite wording in their definitions of supply of goods and services as mentioned in the VAT Directive.

Therefore, the CPs should adopt the definition of supply of goods as stated in the VAT Directive: *'Supply of goods shall mean the transfer of the right to dispose of tangible property as owner'*, and more important, they should adopt the definition of supply of services: *'Supply of services' shall mean any transaction which does not constitute a supply of goods.'*

Treatment of electricity and gas as goods

It is of the most importance that the treatment of electricity and gas is uniformly defined in the Energy Community by the CPs. Without a uniform treatment of electricity and gas as goods, a harmonized market for energy transactions is not possible.

For that reason, it is recommended that the CPs implement in their legislation that electricity and gas shall be treated as tangible property (goods).

Double taxation

Goods

In case of application of the reverse charge mechanism in B2B transactions, between all parties in a transaction of supply of electricity or gas as tangible goods, we see decreased risk or even no risk for double taxations.

The risk of double transaction could arise from different reasons. First of all, not all businesses can fully recover input VAT. In most states, for instance, input VAT of a supply cannot be recovered if it is related to an exempt output supply. Further, even if a business is theoretically entitled to refunds, it may often encounter problems obtaining such a refund in cross-border situations. According to the OECD survey, 80% of businesses cannot recover fully their foreign VAT. Third, even if businesses can fully recover input VAT, there may be compliance costs involved with the additional need for (in many cases cross-border) input VAT recovery. The reverse charge mechanism significantly reduce the necessity for cross-border refunds and thus alleviates these problems.

In cases of B2C transactions, we acknowledge the possible double taxation risk, because VAT regimes follow the territoriality principle and the relevant connecting criterion is consumption. It may, therefore, be that more than one state levies tax because they all consider a certain supply to be consumed in their jurisdiction ("consumption vs consumption").

The most common reasons for VAT double taxation (and in the inverse case double non-taxation) are:

- the use of different rules to determine the place of taxation;
- different interpretation of (otherwise similar) place of taxation rules,
- different characterization of a supply (even if similar rules are in place to determine the place of taxation) due to different interpretation of the underlying facts.

VAT double taxation may also occur if taxation in the jurisdiction where property is situated collides with the jurisdiction where the recipient is established. **Therefore, it is important that CP's introduce the same definition of the place of consumption as the place where that person is established, has his permanent address or usually reside**³⁴.

Services

In a competitive market, avoidance of double taxation is as important as avoidance of tax fraud in order to stimulate market functioning fully. The harmonization of VAT legislation is important condition for avoidance of double taxation but also for a prevention and avoidance of tax fraud.

The VAT Directive gives for that reason the possibility to consider the place of supply of any or all services, if situated within the territory of a Member State, as being situated outside the European Community if the effective use and enjoyment of the services takes place outside the Community. Another option that the VAT Directive gives is that it can also be considered that the place of supply of any or all services, if situated outside the Community, is within the territory of a Member State if the effective use and enjoyment of the services takes place within that Member State.

In case of network energy related transactions within the Energy Community, same sort of provision should be implemented in the CPs.

Use of interconnection capacity and related charges are subject to VAT in case of congestion. In jurisdiction where in case of congestion, place of taxable transaction is determined in the place where service provider has its seat, it may pose obstacle to trade because VAT may also be due in the place where customer has its seat.

For service of providing access to interconnection capacity, the place of taxable transaction 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.

³⁴ The concepts of permanent address and usual residence which are relevant in many instances when determining the place of supply are defined in the Regulation 282/2011/EU

Supply to a taxable dealer and to a customer (B2B/B2C)

B2B

The VAT Directive recognizes the subject of a taxable dealer in its provisions on supply of gas and electricity.

The VAT Directive states that in case of 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.

The VAT Directive defines a taxable dealer as a taxable person whose principal activity in respect of purchases of gas or electricity is reselling those products and whose own consumption of those products is negligible.

In order for the network energy market within the Energy Community to function, it is highly recommended that the CPs implement the definition of *a taxable dealer* in the above mentioned wording.

Finally, in the legislation of CPs, the place of supply, before the goods reach the final stage of consumption, should be the place where the customer has established his business.

B2C

In case of supply of gas or electricity to a customer that is not a taxable dealer the VAT Directive states: *'...the customer shall be deemed to have used and consumed the goods at the place where he has his permanent address or usually resides.'*

This definition should be transposed to the legislation of the CPs in order to comply with the EU rules and further harmonization of the energy market in the Energy Community. The supply of electricity at the final stage from traders and distributors to the final consumers should be taxed at the place where the customer actually uses and consumes the goods.

Import and export of electricity and gas

On 25 June 2009, the Council adopted Directive 2009/69/EC amending the VAT Directive as regards tax evasion linked to imports (the joint liability being postponed to a later date). The Directive tightens the conditions under which the importer can benefit from the exemption: at the time of importation, he must clearly indicate to the Member State of import his VAT identification number, the VAT identification number of his customer and he must prove that the imported goods will be transported to another Member State.

Import and export are to be treated the same by the CPs in order to guarantee a well-functioning network energy market in the Energy Community. The VAT Directive states that importation of gas or electricity shall be exempted from VAT. It is recommended

that the same definition be adopted in the CPs not only because of the functioning of the network energy market in the Energy Community, but also for the functioning of that market between the EU and the CPs.

For export the same applies as for import, in the EU the VAT Directives exempts export for transactions of the supply of goods dispatched or transported to a destination outside the Community by or on behalf of the vendor, and export for transactions of the supply of goods dispatched or transported to a destination outside the Community by or on behalf of a customer not established within their respective territory. This definition should be adopted by the CPs for a good functioning of the market in the Energy Community as well as for the functioning of trade between the EU and CPs.

Reporting on the fraudulent activities

Although VAT Directive introduced rules about reporting on the fraudulent activities, only a few countries, if any, have actually implemented the subject of the article 199/4 of VAT Directive into their legal system. VAT Directive had set the deadline for reporting on the fraudulent activities for June 2017 but so far not one country had set the same deadline. However, we believe it is important that the above mentioned article is implemented into the legal systems of CPs.

Possibility of deduction

As far as for possibility of deduction (refund) to persons not established in the Member state, the majority of countries have rules regarding such deductions but they are to be further harmonized with the VAT Directive. For example, the VAT directive allows deductions for the taxable persons who are not established in the Member State in which they purchase goods and services if they are established in another Member state. Such deductions are also possible for taxable persons not established in the territory of the Community in compliance with the Directive 86/560/EEC. However, certain countries impose further rules and conditions (such as maximum amount) that are to be met in order to receive refund which is not in line with the VAT Directive.

Supplier established and registered outside the CP's should be authorized to supply domestic customers, as long as these customers may be considered as taxable persons, i.e. holding relevant VAT identification. This issue can be solved with the introduction of the Institute of tax representative and reciprocity principle.

Liability for payment of VAT

Further harmonization is needed also for defining the rules for persons liable for payment of VAT to authorities in relation with the supply of energy and gas. The VAT Directive sets up the principle where *the VAT is payable by any person identified for VAT purposes in the Member state in which the tax is due...., if the supplies are carried out by a taxable person not established within the Member state.* The majority of countries do not specify the person who is liable for VAT payment and this is especially important when it comes to the supply of energy and gas. Harmonizing VAT laws to comply with the said rule is advised.

F.2 Optimum requirements for harmonization of VAT rules on network energy related transactions

It is our opinion that the best choice would be to implement a number of particulate provisions of the VAT Directive into the legislation of the Contracting Parties in order to facilitate a gas and electricity market functioning among Contracting Parties and between the EU Member States and Contracting Parties that is based on the same VAT principles. These optimum implementations are elaborated in the following table.

<p>The definition of art. 9 VAT Directive regarding taxable persons states that any person who, independently, carries out in any place any economic activity, whatever the purpose or results of that activity.</p> <p>Art. 13 and Annex 1 VAT Directive regarding states, regional and local government authorities and other bodies governed by public law.</p>	<p>Although most of the Contracting Parties have a similar or even the same definition, it would be good to introduce this unified definition in order to remove any doubt on this subject, especially between states (Contracting Parties and EU Member States).</p> <p>It would be beneficial to include the exemption related to the State and governmental bodies regarding taxable persons of art. 13 of the VAT Directive in this definition. Mostly because of the fact that certain state owned companies and/or bodies in the Contracting Parties quite actively participate in the gas and/or electricity market. This definition would clarify their rights and obligations in relation to VAT.</p>
<p>Art. 31-36 VAT Directive determines the place of supply of goods.</p> <p>Art. 44 VAT Directive defines the place of supply of services to a taxable person.</p>	<p>The place of supply of goods and services that is defined in the VAT Directive should be implemented in the Contracting Parties in order to unify the place of taxation of VAT. Without a uniform definition of place of supply it would be impossible to harmonise the place of taxation.</p>
<p>Treatment of electricity and gas as goods as stated in Art. 15 VAT Directive.</p>	<p>Electricity and gas shall be treated as tangible property in all Contracting Parties.</p>
<p>The provision of access to a natural gas or to the electricity distribution system of Art. 59h of the VAT Directive: supply of services to non-taxable persons outside the Community.</p>	<p>In order to facilitate the services regarding the provision of access to a natural gas or to the electricity system situated within the territory of a Contracting Party, or the transmission or distribution through these systems or networks, 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 Contracting Party, shall be taxable at the place where that person is established, has his permanent address or usually resides. This provision serves to enhance the market functioning between the EU and Contracting Parties.</p>

<p>Supply of goods (gas and electricity) to a taxable dealer (Business to Business) of Art. 38 VAT Directive determines that in 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.</p> <p>Taxable dealer shall mean a taxable person whose principal activity in respect of purchases of gas or electricity is reselling those products and whose own consumption of those products is negligible.</p> <p>Supply of goods (gas and electricity) to the customer (Business to Customer) of Art. 39 of the VAT Directive states that in 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, and the place of supply shall be deemed to be the place where the customer effectively uses and consumes the goods.</p>	<p>These provisions (article 38 and 39 of the VAT Directive) are the most clear example of definitions that facilitate proper market functioning.</p>
<p>Member States may apply a reduced rate to the supply of natural gas, electricity or district heating in accordance with art. 102 and 99 of the VAT Directive.</p>	<p>The consultant is of the opinion that this provision should be implemented in the Contracting Parties as a way to keep some control over the final price paid by the consumers.</p>
<p>Art. 143 of the VAT Directive obliges Member States to exempt the 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, of electricity or of heat or cooling energy through heating or cooling networks.</p>	<p>The same argument of market functioning applies here for the implementation of this provision in Contracting Parties. In order to have fair and non-discriminatory trade between Contracting Parties and EU Member States, the provisions on import and export have to be implemented.</p>
<p>Art. 146 of the VAT Directive determines that Member States exempt the supply of goods dispatched or transported to a destination outside the Community by or on behalf of the vendor, and the supply of goods dispatched or transported to a destination outside the Community by or on behalf of a customer not established within their respective territory, with the exception of goods transported by the customer himself for the equipping,</p>	

<p>fuelling and provisioning of pleasure boats and private aircraft or any other means of transport for private use.</p>	
<p>Reverse charge provision of Art. 199a Paragraph 1 of the VAT Directive allows Member States to, until 31 December 2018 and for a minimum period of two years, determine that the person liable for payment of VAT is the taxable person to whom the following supplies are made: (i) supplies of gas and electricity to a taxable dealer and (ii) supplies of gas and electricity certificates</p>	<p>The reverse charge mechanism for supplies of gas and electricity to a taxable dealer is obligatory (not optional) for all EU Member States in accordance with the Art.38.2. of VAT Directive.</p>
<p>The provisions on Reporting of fraudulent activities of Art. 199a Paragraph 4 of the VAT Directive oblige Member States to submit a report on fraudulent activities to the Commission.</p>	<p>The EU legislation in the field of administrative co-operation and mutual assistance between Member States' tax and customs authorities provides tools to share information in order to prevent tax fraud, tax evasion and tax avoidance. It allows, for example, exchanging tax information automatically, spontaneously or upon request.</p> <p>Some sort of central registration of fraudulent activities that are noticed by Contracting Parties would be desirable to have. This role might be taken up by the Energy Community Secretariat, they could also be a liaison to the Commission regarding fraudulent activities. In this way there would be some sort of monitoring system that is necessary to have, especially when the tax burden is laid upon a party that is not under control of the sending party.</p>
<p>Art. 171 of the VAT Directive states that VAT shall be refunded to taxable persons who are not established within the territory of the Community in accordance with the detailed implementing rules laid down in Directive 86/560/EEC.³⁵</p>	<p>Because of equal treatment, this provision on VAT refund will have to be implemented in all Contracting Parties as well.</p> <p>CPs shall determine the arrangements for submitting applications, including the time limits for doing so, the period which applications should cover, the authority</p>

³⁵ A taxable person not established in the territory of the Community' shall mean a taxable person as referred to in Article 4 (1) of Directive 77/388/EEC who, during the period referred to in Article 3 (1) of this Directive, has had in that territory neither his business nor a fixed establishment from which business transactions are effected, nor, if no such business or fixed establishment exists, his permanent address or usual place of residence, and who, during the same period, has supplied no goods or services deemed to have been supplied in the Member State referred to in Article 2, with the exception of:

(a) transport services and services ancillary thereto, exempted pursuant to Article 14 (1) (i), Article 15 or Article 16 (1), B, C and D of Directive 77/388/EEC;

(b) services provided in cases where tax is payable solely by the person to whom they are supplied, pursuant to Article 21 (1) (b) of Directive 77/388/EEC;

	<p>competent to receive them and the minimum amounts in respect of which applications may be submitted. They shall also determine the arrangements for making refunds, including the time limits for doing so. They shall impose on the applicant such obligations as are necessary to determine whether the application is justified and to prevent fraud, in particular the obligation to provide proof that he is engaged in an economic activity.</p>
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G. PROPOSAL OF NECESSARY CHANGES IN THE NATIONAL LEGISLATION, BOTH PRIMARY AND SECONDARY, FOR EACH CONTRACTING PARTY

G.1 Albania

Although Albania has aligned the largest part of its VAT legislation with the VAT Directive, some articles still remain to be aligned and /or amended in order to be compatible with the VAT Directive.

The Albanian legislation did not implement any rules as stated in art. 59a of the VAT Directive for the avoidance of double taxation, non-taxation or distortion of competition. It is, therefore, suggested to implement the following regulation in the Law on VAT in the Republic of Albania:

“ Art. 25/3 - For the purpose of avoiding double taxation, non-taxation or distortion of competition, the Minister of finance shall be authorized, as an exception to paragraphs 1 and 2 of Article 24 and to paragraph 1 of this Article, to determine the place of provision of certain services according to the place where the services actually have been used and consumed.”

Furthermore, article 57 of the Albanian Law on VAT sets a VAT rate of 0 for export transactions of supplies, whereas the VAT Directive exempts all supplies of goods outside the Community. Because of the fact that a general exemption lessens the burden it is suggested that the Albanian Law on VAT is amended in the following way, based on art. 147 of the VAT Directive:

“ Art. 57 - The following export transactions shall be exempt from VAT:

- a) the supply of goods dispatched or transported outside of the territory of Republic of Albania, by or on behalf of the vendor;*
- b) the supply of goods dispatched or transported to a destination outside Republic of Albania by or on behalf of a customer not established within the territory of Republic of Albania.*

This provision is not applied to goods transported by the customer himself for the equipping, fuelling and provisioning of pleasure boats and private aircraft or any other means of transport for private use.”

The reverse charge mechanism is recognized in Albanian VAT Law, but there is no mention of any reporting mechanism on fraudulent activities as stated in article 199a Paragraph 4. the VAT Directive. The suggestion is that the following article should be implemented in the Albanian Law on VAT:

“Art. 86a - The Minister of finance shall determine the conditions for producing a report on fraudulent activities in territory of Republic of Albania in relation to supplies of gas and electricity.”

Article 86 of the Albanian Law on VAT should be amended in order to include electricity and gas in the regulation:

“ Art. 86a - VAT shall be payable by any person who is identified for VAT purposes in the Republic of Albania in which the tax is due and to whom goods are supplied in the circumstances specified in Article 21, if the supplies are carried out by a taxable person not established in the Republic of Albania.”

G.2 Bosnia and Herzegovina

The Law on value added tax in Bosnia and Herzegovina has to be amended in quite a few parts. Certain basic principles of the VAT Directive should be implanted in order to align the legislation with the *European Acquis* in order to enhance trade with EU countries and other neighboring countries.

The Law on VAT should mention electricity and gas in the exception of VAT for state bodies, the suggested amendment as follows:

“Art. 12/7 - The bodies referred to paragraph 6 of this Article shall be regarded as taxable persons in respect of activities of supplying of water, gas, electricity and thermal energy, provided that those activities are not carried out on such a small scale as to be negligible.”

The Law on VAT makes no mention of services related to the provision of access to a natural gas or to the electricity system. Therefore it is necessary to implement article 59 of the VAT Directive as a whole:

For provision of access to the natural gas or electricity distributions system 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.

“The place of supply of the provision of access to a natural gas or to the electricity system situated within the territory of the Republic of Bosnia and Herzegovina, or the transmission or distribution through these systems or networks, 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 Republic of Bosnia and Herzegovina, shall be taxable at the place where that person is established, has his permanent address or usually resides.”

Furthermore, Articles 38 and 39 of the VAT Directive are not implemented in the legislation. The mentioned articles define the key principles of VAT regarding supply of gas and electricity to taxable dealers and customers, and should for that reason be implemented in the Law on VAT:

“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.

Taxable dealer shall mean a taxable person whose principal activity in respect of purchases of gas or electricity is reselling those products and whose own consumption of those products is negligible.”

and,

“In the case of the supply of gas through the natural gas distribution system, or of electricity, to a customer, 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.”

The Law on VAT does not recognize the possibility of different, lower VAT rates for electricity and gas. Thus, the following amendment should be made to the Law on VAT:

“The Ministry of Finance and Treasury may apply a reduced rate of not less than 5 % to the supply of natural gas, of electricity or of district heating.”

Regarding the importation of gas and energy recognized in Article 143 of the VAT Directive, the following amendment should be made to the Law on VAT:

“Art. 26/1/9 - The following shall be exempt from VAT:

1.- 8. (..)

9. the 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, of electricity or of heat or cooling energy through heating or cooling networks.”

Reverse charge as stated in the VAT Directive is not mentioned. A possible implantation of the reverse charge mechanism could be implemented as follows:

“The person liable for payment of VAT is the taxable person to whom supplies of gas and electricity to a taxable dealer and supplies of gas and electricity certificates are made.”

Also, an amendment regarding reporting on the reverse charge results should be included in the VAT Law:

“The Ministry of Finance and Treasury shall determine the conditions for producing a report on fraudulent activities in territory of the Republic of Bosnia and Herzegovina in relation to supplies of gas and electricity.”

Regarding Deductions (refunds to persons not established in Bosnia and Herzegovina) the following amendment should be made to Article 53 of the Law on VAT:

VAT shall be refunded to taxable persons who are not established in the Republic of Bosnia and Herzegovina in which they purchase goods and services or import goods subject to VAT, or they have only carried out the supply of goods or services to a person liable for payment of VAT.

It is also necessary to align the definitions of persons liable for payment of VAT with the VAT Directive: the following is suggested:

A taxable person who has a fixed establishment within the territory of the Republic of Bosnia and Herzegovina where the tax is due shall be regarded as a taxable person who is not established within the Republic of Bosnia and Herzegovina when the following conditions are met:

a.) he makes a taxable supply of goods or of services within the territory of the Republic of Bosnia and Herzegovina;

b.) an establishment which the supplier has within the territory of the Republic of Bosnia and Herzegovina does not intervene in that supply.

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

G.3 Former Yugoslav Republic of Macedonia

The Law on Value Added Tax of the Former Yugoslav Republic of Macedonia (FYROM) is partly in line with the VAT Directive. A few amendments should be made in order for the Law on VAT to be aligned with the EU Acquis.

The Law on VAT should contain the following article regarding the exemption of state bodies:

“The state bodies, the bodies of the local self-government units and the other public-legal bodies shall be regarded as taxable persons in respect of activities of supplying of water, gas, electricity and thermal energy.”

Articles 38 and 39 of the VAT Directive are to be implemented in full in the Law on Value Added Tax in the following manner:

“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.”

“Taxable dealer shall mean a taxable person whose principal activity in respect of purchases of gas or electricity is reselling those products and whose own consumption of those products is negligible.”

In the case of the supply of gas through the natural gas distribution system, or of electricity, to a customer, 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.”

It is also recommended that the Law on VAT offers the possibility to introduce reduced VAT rates for electricity and gas, thus the following Article should be included:

“The Minister of Finance may enact a reduced rate of not less than 5 % to the supply of natural gas, of electricity or of district heating.”

It is also necessary to exempt the import of gas and electricity from VAT by including the following in the VAT Law:

“The 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, of electricity or of heat or cooling energy through heating or cooling networks shall be exempted from VAT.”

Also, export of gas and electricity needs to be exempted from VAT by including the following:

“The following export transactions are exempted from VAT:

- a) the supply of goods dispatched or transported outside of the territory of the FYR of Macedonia, by or on behalf of the vendor;*
- b) the supply of goods dispatched or transported to a destination outside the FYR of Macedonia by or on behalf of a customer not established within the territory of the FYR of Macedonia.”*

In FYROM the reverse charge is not implemented. Therefore, in order to establish a fair trade relationship with the surrounding countries that do apply reverse charge FYROM should implement the same, as follows:

“The person liable for payment of VAT is the taxable person to whom the following supplies are made: supplies of gas and electricity to a taxable dealer and supplies of gas and electricity certificates.”

“The Minister of Finance shall determine the conditions for producing a report on fraudulent activities in territory of the FYR of Macedonia in relation to supplies of gas and electricity.”

To complete the definitions and regulations regarding VAT, FYROM should implement the following regulations regarding definitions of persons liable to pay VAT:

“A taxable person who has a fixed establishment within the territory of the FYR of Macedonia where the tax is due shall be regarded as a taxable person who is not established within the FYR of Macedonia when the following conditions are met:

- a.) he makes a taxable supply of goods or of services within the territory of the FYR of Macedonia;*
- b.) an establishment which the supplier has within the territory of the FYR of Macedonia does not intervene in that supply.*

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

G.4 Georgia

The Georgian Tax Code has to be amended in various parts in order for it to be compatible with legislation of the European Union with the aim to facilitate trade of supplies and services regarding gas and electricity.

First of all, the Tax Code will have to define the role of State Bodies regarding gas and electricity more clearly by including the following provisions:

“States, regional and local government authorities and other bodies governed by public law shall not be regarded as taxable persons in respect of the activities or transactions in which they engage as public authorities, even where they collect dues, fees, contributions or payments in connection with those activities or transactions.”

“The bodies referred to previous paragraph of this Article shall be regarded as taxable persons in respect of activities of supplying of water, gas, electricity and thermal energy, provided that those activities are not carried out on such a small scale as to be negligible.”

The Georgian tax Code will have to be amended regarding the definition of the place of supply, it should contain an article with the following content:

“The place of supply of services to a taxable person acting as such shall be the place where that person has established his business. If those services are provided to a fixed establishment of the taxable person located in a place other than the place where he has established his business, the place of supply of those services shall be the place where that fixed establishment is located. In the absence of such place of establishment or fixed establishment, the place of supply of services shall be the place where the taxable person who receives such services has his permanent address or usually resides. The place of supply of services to a non-taxable person shall be the place where the supplier has established his business.”

The second paragraph of Article 165 defining the place of supply as Georgia in case the supply takes place outside Georgia should be deleted, and it should be replaced by the following paragraph:

“For the purpose of avoiding double taxation, non-taxation or distortion of competition, the Minister of finance shall be authorized, to determine the place of provision of certain services according to where the services has actually been used and consumed.”

Regarding the place of supply of gas and electricity the following should be included in order to define the taxable dealer, a notion that currently does not exist in the Tax Code:

“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.”

Taxable dealer shall mean a taxable person whose principal activity in respect of purchases of gas or electricity is reselling those products and whose own consumption of those products is negligible.”

In order to differ the supply of gas and electricity to a customer from the supply to a taxable dealer, it is suggested to include the following in the Tax Code:

“In the case of the supply of gas through the natural gas distribution system, or of electricity, to a customer, 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.”

The Georgian Tax Code should foresee to have a reduced tariff for gas and electricity:

“The Minister of Finance may apply a reduced rate of not less than 5 % to the supply of natural gas, of electricity or of district heating.”

Import 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, or of electricity should be exempted from VAT, therefore an amendment should be implemented:

“The following shall be exempt from VAT:

- the 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, of electricity or of heat or cooling energy through heating or cooling networks.”

Reverse charge related to gas and electricity does not currently exist in the Georgian Tax Code, the following should be implemented:

“The person liable for payment of VAT is the taxable person to whom the following supplies are made: supplies of gas and electricity to a taxable dealer and supplies of gas and electricity certificates.”

and

“The Minister of Finance shall determine the conditions for producing a report on fraudulent activities in territory of the Republic of Georgia in relation to supplies of gas and electricity.”

In order to completely align the rules for deductions with the VAT Directive the following should be implanted in the Tax Code:

“VAT shall be refunded to taxable persons who are not established in the Republic of Georgia in which they purchase goods and services or import goods subject to VAT, or they have only carried out the supply of goods or services to a person liable for payment of VAT.”

Finally, the Tax Code should contain a definition of the persons liable to pay VAT:

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

G.5 Kosovo*

The Law on Value Added Tax of Kosovo* is mostly in line with the VAT directive. Only a few amendments will have to be made in order for the Law on VAT to be completely aligned with the EU Acquis.

There should also be a possibility for a reduced VAT rate for electricity and gas:

“The Minister of Economy and Finance shall enact a reduced rate of not less than 5 % to the supply of natural gas, of electricity or of district heating.”

Because there is no mention of fraudulent activities in the Law on VAT of Kosovo*, the following should be implemented:

“The Minister of Economy and Finance shall determine the conditions for producing a report on fraudulent activities in the territory of Kosovo in relation to supplies of gas and electricity.”*

G.6 Moldova

The Fiscal Code of Moldavia is largely in line with the VAT Directive. A few amendments will have to be made in order for the Fiscal Code to be aligned with the EU Acquis.

In order for the Fiscal Code to be compatible with the VAT Directive, the following article should be implemented regarding the place of supply of services:

“For the purpose of avoiding double taxation, non-taxation or distortion of competition, the Minister of finance shall be authorized, to determine the place of provision of certain services according to where the services has actually been used and consumed.”

In line with the above stated, the following article regarding the provision of access to natural gas or electricity system should be included in the Fiscal Code:

“The place of supply of the provision of access to a natural gas or to the electricity system situated within the territory of the Republic of Moldova, or the transmission or distribution through these systems or networks, 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 territory of the Republic of Moldova, shall be taxable at the place where that person is established, has his permanent address or usually resides.”

The Fiscal Code does differ supply to a customer from supply to a taxable dealer, therefore, the following should be adapted:

“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.”

“Taxable dealer shall mean a taxable person whose principal activity in respect of purchases of gas or electricity is reselling those products and whose own consumption of those products is negligible.”

For the same reason as mentioned above, the Fiscal Code should contain:

“In the case of the supply of gas through the natural gas distribution system, or of electricity, to a customer, 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.”

Since no provisions on reverse charge are mentioned in the Fiscal Code, the following should be implemented:

“The person liable for payment of VAT is the taxable dealer to whom supplies of gas and electricity and supplies of gas and electricity certificates are made.”

With the reverse charge provision, a provision on reporting the reverse charge implementation should be incorporated in the Fiscal Code:

“The Minister of Finance shall determine the conditions for producing a report on fraudulent activities in territory of the Republic of Moldova in relation to supplies of gas and electricity.”

G.7 Montenegro

The Law on Value Added Tax of Montenegro is partly in line with the VAT directive. Some amendments will have to be made in order for the Law on VAT to be aligned with the EU Acquis.

The Law on VAT should contain the following article regarding the exemption of state bodies:

“The state bodies, the bodies of the local self-government units and the other public-legal bodies shall be regarded as taxable persons in respect of activities of supplying of water, gas, electricity and thermal energy.”

Article 38 and 39 of the VAT Directive are to be implemented in full in the Law on Value Added Tax in the following manner:

“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.”

“Taxable dealer shall mean a taxable person whose principal activity in respect of purchases of gas or electricity is reselling those products and whose own consumption of those products is negligible.”

In the case of the supply of gas through the natural gas distribution system, or of electricity, to a customer, 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.”

It is also recommended that the Law on VAT offers the possibility to introduce reduced VAT rates for electricity and gas:

“The Minister of Finance may enact a reduced rate of not less than 5 % to the supply of natural gas, of electricity or of district heating.”

It is also necessary to exempt the import of gas and electricity from VAT:

“The 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, of electricity or of heat or cooling energy through heating or cooling networks shall be exempted from VAT.”

Montenegro did not implement reverse charge. In order to establish a fair trade relationship with the surrounding countries that do apply reverse charge, reverse charge should be implemented:

“The person liable for payment of VAT is the taxable person to whom supplies of gas and electricity, and supplies of gas and electricity certificates are made.”

“The Minister of Finance shall determine the conditions for producing a report on fraudulent activities in territory of Montenegro in relation to supplies of gas and electricity.”

To complete the definitions and regulations regarding VAT, The Law on VAT should contain the following regulations regarding definitions of persons liable to pay VAT:

“A taxable person who has a fixed establishment within the territory of Montenegro where the tax is due shall be regarded as a taxable person who is not established within Montenegro when the following conditions are met:

- a.) he makes a taxable supply of goods or of services within the territory of Montenegro;*
- b.) an establishment which the supplier has within the territory of Montenegro does not intervene in that supply.*

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

G.8 Republic of Serbia

The Law on Value Added Tax of the Republic of Serbia is partly in line with the VAT Directive. Some amendments will have to be made in order for the Law on VAT to be aligned with the EU Acquis.

A suggestion for an amendment of Article 9 of the Law on VAT is:

“Art. 9 - The Republic and its authorities, the territorial autonomy and local self-government authorities, as well as legal entities established under law or other act of the Republic, territorial autonomy, or local government authority, for the purpose of execution of activities of the State administration or local government (hereinafter: the Republic, authorities and legal entities), shall not be the tax payers in terms of the present Law if they are engaged in the trade of goods and services within the scope of their responsibility, or for the purpose of execution of activities of the State administration or local government.”

The Republic, authorities and legal entities shall be the tax payers in trade of goods and services referred to in paragraph 1 of this Article if the tax exemption pursuant to paragraph 1 of this Article could lead to distortion of competition, as well as in the trade of goods and services outside of the scope of their responsibility, or outside the scope of activities of the State administration or local government, when such trade is taxable in accordance with the present Law. It shall be considered that exemption referred to in paragraph 1 of this Article could lead to distortion of competition, pursuant to the present Law, if the trade of goods and services referred to in paragraph 1 of this Article, apart from the Republic, authorities and legal entities, is also conducted by some other entity.

The Republic, authorities and legal entities shall be regarded as taxable persons in respect of activities of supplying of water, gas, electricity and thermal energy, provided that those activities are not carried out on such a small scale as to be negligible.”

It is suggested that the Law on VAT adopts a more general definition of a chargeable event instead of listing various events that are chargeable events:

“A ‘chargeable event’ shall mean the occurrence by virtue of which the legal conditions necessary for VAT to become chargeable are fulfilled. VAT shall become ‘chargeable’ when the tax authority becomes entitled under the law, at a given moment, to claim the tax from the person liable to pay, even though the time of payment may be deferred.”

The VAT Directive differs the place of transaction regarding whether the person is taxable or non-taxable, Serbian legislation does not. Therefore a distinction should be made in the Serbian Law on VAT:

“The place of supply of services to a taxable person acting as such shall be the place where that person has established his business. If those services are provided to a fixed establishment of the taxable person located in a place other than the place where he has established his business, the place of supply of those services shall be the place where that fixed establishment is located. In the absence of such place of establishment or fixed

establishment, the place of supply of services shall be the place where the taxable person who receives such services has his permanent address or usually resides.

The place of supply of services to a non-taxable person shall be the place where the supplier has established his business. However, if those services are provided from a fixed establishment of the supplier located in a place other than the place where he has established his business, the place of supply of those services shall be the place where that fixed establishment is located. In the absence of such place of establishment or fixed establishment, the place of supply of services shall be the place where the supplier has his permanent address or usually resides.”

Because of the lack of provisions on double taxation the following should be implemented in the Law on VAT:

“For the purpose of avoiding double taxation, non-taxation or distortion of competition, the Minister of finance shall be authorized to determine the place of provision of certain services according to where the services has actually been used and consumed.”

The VAT Directive contains a provision on the place of supply of the provision of access to a natural gas or to the electricity system, the Serbian Law on VAT does not. A possible amendment might be:

“The place of supply of the provision of access to a natural gas or to the electricity system situated within the territory of the Republic of Serbia, or the transmission or distribution through these systems or networks, 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 Republic of Serbia, shall be taxable at the place where that person is established, has his permanent address or usually resides.”

It is also recommended that the Law on VAT offers the possibility to introduce reduced VAT rates for electricity and gas:

“The Minister of Finance may enact a reduced rate of not less than 5 % to the supply of natural gas, of electricity or of district heating.”

Serbia did implement reverse charge, but there is no obligation under the Law on VAT on reporting or monitoring the implementation of that provision. It is therefore recommended to add:

“The Minister of Finance shall determine the conditions for producing a report on fraudulent activities in territory of Serbia in relation to supplies of gas and electricity.”

To complete the definitions and regulations regarding VAT, The Law on VAT should contain the following regulations regarding definitions of persons liable to pay VAT:

“A taxable person who has a fixed establishment within the territory of Serbia where the tax is due shall be regarded as a taxable person who is not established within Serbia when the following conditions are met:

a.) he makes a taxable supply of goods or of services within the territory of Serbia;

b.) an establishment which the supplier has within the territory of Serbia does not intervene in that supply.

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

G.9 Ukraine

The Tax Code of Ukraine is not quite in line with the VAT directive. Some amendments will have to be made in order for the Law on VAT to be aligned with the EU Acquis.

In order to exempt state bodies from VAT a suggestion for an amendment is:

“The Republic, regional and local government authorities and other bodies governed by public law shall be regarded as taxable persons in respect of activities of supplying of water, gas, electricity and thermal energy, provided that those activities are not carried out on such a small scale as to be negligible.”

Because of the lack of provisions on double taxation the following should be implemented in the Tax Code:

“For the purpose of avoiding double taxation, non-taxation or distortion of competition, the Minister of finance shall be authorized, to determine the place of provision of certain services according to where the services has actually been used and consumed.”

The VAT Directive contains a provision on the place of supply of the provision of access to a natural gas or to the electricity system, the Tax Code does not. A possible amendment might be:

“The place of supply of the provision of access to a natural gas or to the electricity system situated within the territory of the Republic of Ukraine, or the transmission or distribution through these systems or networks, 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 Republic of Ukraine, shall be taxable at the place where that person is established, has his permanent address or usually resides.”

Article 38 and 39 of the VAT Directive are to be implemented in full in the Tax Code in the following manner:

“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.”

“Taxable dealer shall mean a taxable person whose principal activity in respect of purchases of gas or electricity is reselling those products and whose own consumption of those products is negligible.

In the case of the supply of gas through the natural gas distribution system, or of electricity, to a customer, 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.”

It is also recommended that the Tax Code offers the possibility to introduce reduced VAT rates for electricity and gas:

“The Minister of Finance may enact a reduced rate of not less than 5 % to the supply of natural gas, of electricity or of district heating.”

The provision that only JSC "National Joint Stock Company" Naftogaz Ukraine is exempt from taxation on import is not in line with the VAT Directive. An amendment is to be made as follows:

“The 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, of electricity or of heat or cooling energy through heating or cooling networks shall be exempt from VAT.”

Export of gas and electricity should also be exempted from VAT, the following is suggested to implement in the Tax Code:

“The following export transactions shall be exempt from VAT:

a) the supply of goods dispatched or transported outside of the territory of the Republic of Ukraine, by or on behalf of the vendor;

b) the supply of goods dispatched or transported to a destination outside the Republic of Ukraine by or on behalf of a customer not established within the territory of the Republic of Ukraine.

This provision is not applied to goods transported by the customer himself for the equipping, fuelling and provisioning of pleasure boats and private aircraft or any other means of transport for private use.”

The Ukraine did not implement reverse charge, It is therefore recommended to add:

“The person liable for payment of VAT is the taxable person to whom the following supplies are made: supplies of gas and electricity to a taxable dealer and supplies of gas and electricity certificates.”

and:

“The Minister of Finance shall determine the conditions for producing a report on fraudulent activities in territory of Serbia in relation to supplies of gas and electricity.”

H. VAT TREATMENT OF SPECIFIC ENERGY RELATED ISSUES

H.1 Supply of electricity and gas by non-resident suppliers

Directive 2009/72/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in electricity and repealing Directive 2003/54/EC (Text with EEA relevance) OJ L 211, 14.8.2009, p. 55–93 (Electricity Directive) in Article 3(4) and Directive 2009/72/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in electricity and repealing Directive 2003/54/EC (Text with EEA relevance) OJ L 211, 14.8.2009, p. 55–93 (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. In this regard, Member States shall take all measures necessary to ensure that administrative procedures do not discriminate against supply undertakings already registered in another Member State.

In what follows we analyze the implications of this requirement in the context of VAT and energy legislation. First we evaluate these two articles in the context of VAT Directive and then propose possible options for CPs.

H.1.1 EU VAT compliance

For businesses with an EU VAT registration, and providing taxable supplies of goods or services, there are a number of requirements to follow to ensure they are fully compliant with European VAT regulations (detailed in VAT Directive).

H.1.1.1 VAT registration (VAT number)

For companies operating across the European Union (EU), there may be a requirement to register their business with a VAT number in another EU country. The requirements for this vary from country to country, but are based on the EU's VAT Directive. A company will be required to complete and submit a local VAT registration form, where each Member State has different requirements in terms of required documentation that needs to be submitted.

When selling goods to another business (B2B) established in another EU country, the supplier does not charge VAT - if the customer has a valid VAT number. The supplier may deduct the VAT which he has paid on related expenses (goods/services bought in specifically to make those sales).

If the goods are supplied to end customers (B2C) in another EU country, supplier needs to register there and charge VAT at the rate applicable in that country - unless the total value of the sales to that country in the year falls below the limit set by the country (EUR 35 000 or EUR 100 000).

The supply of natural gas and electricity is exempted from this rule (EU Directive Art 17.2), which means that the supplier needs to register in another country at the moment of first supply to the customer (B2C).

H.1.2 Tax Agent or Fiscal Representative

H.1.2.1 The Role and Liability of the Fiscal Representative

The tax authorities regard a fiscal representative as the local agent of the foreign based trader. In many cases, the Fiscal Representative is still held jointly and severally liable for the taxes of the trader. As a result, it is an industry practice to require a full bank guarantee in favor of the Fiscal Representative to protect it from losses.

In most countries, the Fiscal Representative is required by the local tax code to ensure that:

- The foreign based trader is properly registered with the local tax office.
- The trader is fully compliant with rules on invoicing, VAT treatment, exchange rates etc.
- Accounting records are maintained to local standards, and that they are readily available for inspection by the tax authorities.
- All VAT and associated filings are correctly prepared and submitted.
- Enquiries and tax inspections from the VAT office are professionally handled.

H.1.2.2 EU companies

Until 2003 all companies trading across European Union borders were required to appoint a local Fiscal Representative in each country where they were providing a taxable supply. This requirement was simplified by EU VAT Directive 2006/65/EC, which required EU member states to instead allow companies to directly register with the relevant tax authorities.

There still remain barriers to direct VAT registration in several countries. These range from tax offices being reluctant to provide simple explanations of the compliance requirements and reporting procedures in anything but the local language, e.g. France and Spain; through to still requiring the formal appointment of a local tax agent, e.g. Poland and Bulgaria.

H.1.2.3 Non-EU Companies

More than half of the 28 EU member states oblige non-EU business to appoint a Fiscal Representative if they are providing taxable services within their state borders. Since the duty to appoint a Fiscal Representative and potentially provide bank guarantees can be extremely onerous, many non-EU companies chose to form a company in one EU country which can then be used as a platform to obtain simplified direct registrations in the rest of the European Union.

Case Study: Croatia

In accordance with the EU VAT Directives, a local Croatian fiscal representative or agent is not required by a company resident in another EU member state. EU residents may register directly with the Croatian Tax Administration. However, a fiscal representative, who is jointly liable for the Croatian VAT, is required for non-EU companies. There is a special scheme for non-EU companies providing electronically supplied services which allows them, under certain circumstances, to register directly with the Croatian VAT authorities.

H.1.3 Impact on EU suppliers supplying natural gas or electricity

The following tables illustrates the impact of the VAT rules on EU suppliers. Table 2 covers supplies made to wholesale customers (buying for resale) and Table 3 to supplies made to end customers. All suppliers have to comply with the EU VAT rules:

1. (VAT Directive, Art 38.) The EU Country (French) supplier supplying natural gas (located in a natural gas system within or linked to EU) or electricity to a customer buying for resale who are established in:

In France	In another EU Member State	Outside EU
The place of supply is France where customer is established. The French VAT will be charged on this supply.	<p>The place of supply is the EU Member State where the customer has established their business. (B2B)</p> <p>The French supplier does not need to charge or account for French VAT on the supply if the customer is VAT registered. The customer accounts for the VAT on a basis of reverse-charge.</p>	The place of supply is outside EU (the place where customer is established). The French VAT will be not charged on this supply, as it is outside the scope of EU VAT.

Table 2: impact of VAT rules on supply of electricity or gas to wholesale customers in another country

2. (VAT Directive Art. 39) If The EU Country (French) supplier supplying natural gas (located in a natural gas system within or linked to EU) or electricity to end customer and consumption takes place:

In France	In another Member State	Outside EU
<p>The place of supply is France, where consumption takes the place. The French VAT will be charged on this supply.</p>	<p>The place of supply is the EU Member State where consumption takes place (B2C).</p> <p>If the customer is not VAT registered, the French supplier need to register for VAT in the Member state where consumption takes place and account for VAT on this supply in another Member State.</p>	<p>The place of supply is outside the EU (the place where the consumption takes place).</p> <p>The VAT will be not charged on this supply, as it is outside the scope of EU VAT.</p> <p>If the EU supplier wants to charge the VAT to the non-registered customers outside EU, he will have to comply with the VAT rules of the non-EU country. Most of non-EU countries requires establishment of the Company or a Branch office or at least VAT registration and Fiscal Representative.</p>

Table 3: impact of VAT rules on supply of electricity or gas to end customers in another country

H.2 Application to Energy Community CPs

Each CP has its own rules for VAT registration and a mechanism related to tax refunds, tax representatives and other requirements related to non-established businesses in each country.

In some CPs, there is no possibility to do business or obtain a VAT refund without establishing a company or a branch office. In other countries, the VAT registration is not obligatory if the foreign supplier supplies goods only B2B, since reverse charge mechanism is applied. In those countries, only B2C transactions require VAT registration, as is the case in EU countries. In most of the countries, the institute of the fiscal representative is obligatory.

In what follows we analyze the legal requirements in each CP in relation to supply of gas and electricity by non-resident firms.

H.2.1 Albania

H.2.1.1 Non-established businesses

A non-established business³⁶ is not required to register for VAT if all its taxable supplies in Albania fall under the reverse-charge mechanism.

H.2.1.2 Fiscal representative

A non-established business must appoint a resident VAT representative to register for VAT purposes unless the reverse-charge mechanism (RCM) applies. The VAT representative may act on behalf of the taxable person for all purposes related to VAT and is jointly liable for compliance with all VAT obligations of the non-established business.

H.2.1.3 Conclusion

A foreign supplier providing supply of goods and services to a non-taxable (B2C) person in Albania **should register for VAT purposes** by **appointing a fiscal representative** in Albania to account for and pay the VAT liability. A non-established business is not required to register for VAT if all its taxable supplies in Albania fall under the reverse-charge mechanism.

H.2.2 Bosnia and Herzegovina

H.2.2.1 Non-established businesses

Any taxpayer who does not have an established business in Bosnia and Herzegovina have the right to a refund of input tax which was charged to that person on the basis of the supply of goods and services performed by taxpayers in Bosnia and Herzegovina, or which was charged on goods imported into Bosnia and Herzegovina. On the condition of reciprocity, Bosnia and Herzegovina refunds VAT incurred by businesses that do not have a headquarters or a branch office in the country and that satisfy the following additional conditions:

- They do not make any supplies in the country
- They do not owe any outstanding VAT.

H.2.2.2 Fiscal representative

A taxpayer not based in Bosnia and Herzegovina shall, if the taxpayer supplies goods or services in Bosnia and Herzegovina, be registered with a tax representative based in Bosnia and Herzegovina. The taxpayer and the representative shall be jointly and severally liable for the tax that is chargeable under this Law.

³⁶ A “non-established business” is a business that does not have a fixed establishment in Albania.

H.2.2.3 Conclusion

A non-established business providing the supply of goods and services **should register for VAT purposes** by **appointing a fiscal representative** in Bosnia and Herzegovina to account for and pay the VAT liability.

H.2.3 Georgia

H.2.3.1 Non-established businesses

A “non-established business” is a business that does not have a permanent establishment in Georgia. If a business does not have a permanent establishment in Georgia, it may not register for VAT even if it makes taxable supplies of goods or services there. Reverse-charge VAT generally applies to the supply of services made by non-established businesses in Georgia.

H.2.3.2 Fiscal representative

Non-established businesses cannot recover VAT, because only entities registered for VAT in Georgia may claim recovery of input tax. There is no legal possibility of appointment of fiscal representative.

H.2.3.3 Conclusion

A foreign service supplier providing supply of goods and services in Georgia has to register a permanent establishment in Georgia (the Company or a Branch).

H.2.4 Kosovo*

H.2.4.1 Non-established businesses

A “non-established business” is a business that does not have a fixed establishment in Kosovo*. No VAT registration threshold applies to taxable supplies made in Kosovo by a non-established business

H.2.4.2 Fiscal representative

A non-established business must appoint a resident VAT representative to register for VAT purposes in Kosovo* regardless of the amount of turnover, unless the reverse charge mechanism applies. The VAT representative may act on behalf of the taxable person for all purposes related to VAT and is jointly and severally liable for compliance with all VAT obligations of the non-established business. The reverse-charge mechanism applies to supplies of services made by non-established business to taxable persons in Kosovo. A non-established business is not required to register for VAT if all its supplies in Kosovo fall under the reverse-charge mechanism.

H.2.4.3 Conclusion

A foreign service supplier providing services to a non-taxable (B2C) person should register for VAT purposes by appointing a fiscal representative in Kosovo to account for and pay the VAT liability.

H.2.5 Former Yugoslav Republic of Macedonia

H.2.5.1 Non-established businesses

Foreign traders may not need a VAT registration number. If a supply is made by a taxpayer that does not have headquarters or a branch office in FYR of Macedonia, the VAT reverse-charge mechanism applies.

In FYR of Macedonia, the reverse charge applies to supply of goods and services by foreign legal entities to Macedonian taxpayers. Under the reverse-charge mechanism, the recipient of the goods or services bears the responsibility for the calculation of VAT, the submission of a VAT tax return, the payment of tax and the payment of interest in the event of a late payment. On the condition of reciprocity, FRY of Macedonia refunds VAT incurred by businesses that do not have a headquarters or a branch office in the country and that satisfy the following additional conditions:

- They do not make any supplies in the country
- They do not owe any outstanding VAT.

H.2.5.2 Fiscal representatives

There is no legal possibility of appointment of fiscal representative.

H.2.5.3 Conclusion

A foreign service supplier providing services to a non-taxable (B2C) person has to register a permanent establishment in Macedonia (the Company or a Branch).

H.2.6 Moldova

H.2.6.1 Non-established businesses

Foreign traders are not allowed to have a VAT registration number. If a foreign entity develops entrepreneurial activity in Moldova that results in a permanent establishment, it must register for VAT locally. It is then treated in the same way as a resident entity.

H.2.6.2 Fiscal representatives

Moldova does not refund VAT incurred by businesses that are neither established nor registered for VAT.

There is no legal possibility of appointment of fiscal representative.

H.2.6.3 Conclusion

A foreign service supplier providing supply of any services or goods in Moldova has to register a permanent establishment in Moldova (the Company or a Branch).

H.2.7 Montenegro

H.2.7.1 Non-established business

Taxpayer who has not established their business in Montenegro shall have the right to refund input VAT which was charged to that person on the basis of the supply of goods or services performed by taxpayers in Montenegro, or which was charged upon the import of goods into Montenegro

H.2.7.2 Fiscal Representative

As per the VAT Law of Montenegro, the appointment of the fiscal representative is obligatory. The VAT taxpayer is defined as the tax representatives appointed by the taxpayer who does not have a registered office, business unit, which is regular residence in Montenegro if the taxpayer performs the supply of goods or services in Montenegro. If the taxpayer not based in Montenegro does not appoint a fiscal representative, the recipient of the goods or services shall pay the VAT.

H.2.7.3 Conclusion

A foreign service supplier providing supply of goods and services in Montenegro **should register for VAT purposes** by **appointing a fiscal representative** in Montenegro to account for and pay the VAT liability.

H.2.8 Serbia

H.2.8.1 Non-established businesses

A “non-established business” is a business that does not have a registered establishment in Serbia. In accordance with the amended VAT law from 15 October 2015, a foreign entity that supplies goods or services in Serbia is obliged to appoint a tax representative (only one tax representative can be appointed, either an individual or a legal entity), except for supplies of services provided electronically and for the transport of passengers by bus. The VAT representative must be resident in Serbia and must be registered for VAT at least 12 months before applying to be a tax representative. The tax representative should perform all activities related to VAT liabilities and VAT recovery on behalf of the foreign entity. A non-established business that does not make any supplies of goods or services in Serbia may claim a VAT refund, under prescribed conditions.

H.2.8.2 Fiscal representatives

According to Serbian tax regulations, a fiscal representative appointed in the Republic of Serbia by a foreign entity which does not have legal presence in the Republic of Serbia is considered to be a tax debtor for VAT purposes. The fiscal representative is solely liable

for all liabilities of the foreign entity. In case the foreign entity fails to appoint a fiscal representative, the recipient of the goods/services will be considered as a tax debtor for VAT purposes. According to Serbian tax legislation, the reverse charge mechanism is applied for services rendered by a foreign service provider for which the place of supply is Serbia, if the foreign service provider does not appoint a fiscal representative in Serbia.

H.2.8.3 Conclusion

A foreign service supplier providing services to a non-taxable (B2C) person should register for VAT purposes by appointing a fiscal representative in Serbia to account for and pay the VAT liability.

H.2.9 Ukraine

H.2.9.1 Non-established businesses

In general, VAT registration of the non-established business is not possible. If a nonresident falls under mandatory VAT registration requirements or wishes to opt for voluntary VAT registration, it must first establish business presence in Ukraine.

H.2.9.2 Fiscal representative

There is no legal possibility to appoint the fiscal representative. No VAT recovery mechanism is available for non-established businesses in Ukraine.

H.2.9.3 Conclusion

A foreign service supplier providing supply of goods and services in Ukraine has to register a permanent establishment in Ukraine. (the Company or a Branch).

H.3 Concluding remarks

The above analysis has shown significant differences among CPs regarding their requirements for compliance with the VAT Law of each country. Therefore, if a company intends to supply gas and electricity in different CPs, it will have to abide by different rules in each of those CPs which represents significant administrative and financial burden.

In addition, it should be noted that implementation of the above two articles from Electricity and Gas Directives is possible only if national legislation in CPs is amended in respect to energy legislation as well. Supply of domestic customers by foreign based suppliers implies that foreign based supplier needs to register with the national regulatory authority (NRA) for supply activity. At the same time, pursuant to market participation acts, foreign based supplier needs to register with domestic TSO as a market participating party (e.g. nominating power flows, participation in balancing, etc).

To implement the above two articles from Electricity and Gas Directives further harmonization among CPs would be required in the domain of energy legislation. Some of possible approaches to this issues are:

- **Mutual recognition of supply licenses.** In this scenario, an Energy Community level agreement between CPs would be reached where CPs would recognize each other retail licenses. At the same time, in a simplified, cost and time effective procedure, foreign based suppliers would be able to register with TSOs to become market participants.
- **Reciprocity principle.** Based on bilateral agreements, foreign based suppliers would not need to obtain a supply license in a country with which supplier's home country has concluded a reciprocity agreement. In addition, foreign based suppliers would be required to register as a market participant through time and cost effective procedure.
- **Conditioned licensing.** In this scenario, a supply license issued by a foreign authority (NRA) would be accepted as being valid, under pre-defined criteria. This scenario envisages the possibility that some CPs might have higher standards than other CPs which would be reflected in additional conditions. Registration as market participant should be made time and cost effective.
- **Streamlined procedure.** This scenario implies foreign based suppliers would be required to obtain a supply license in a procedure which would be time and cost effective. This scenario envisages reduction of various administrative procedures to the minimum. Such an approach could be devised at the Energy Community level as well.

H.4 Treatment of backhaul capacity

Backhaul, or 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).

For the purpose of this study, we have examined the VAT treatment of backhaul capacity service in number of EU MS, by contacting the following TSOs: Austria (Gas Connection Austria), Bulgaria (Bulgartransgaz), Belgium (Fluxys), Denmark (Energinet DK), Hungary (FGSZ), Romania (Transgaz), Slovakia (eustream), Poland (GAZ System), and The Netherland (Gasunie Transport Services B.V.) Except for the Eurostream who indicated they do not offer backhaul capacity, and for Bulgartransgaz and Transgaz who have not given a reply yet, all of the other contacted TSOs confirmed that **backhaul capacity is treated as a service, and thus apply the VAT legislation as for the standard services**, which is in line with the EU Directive.

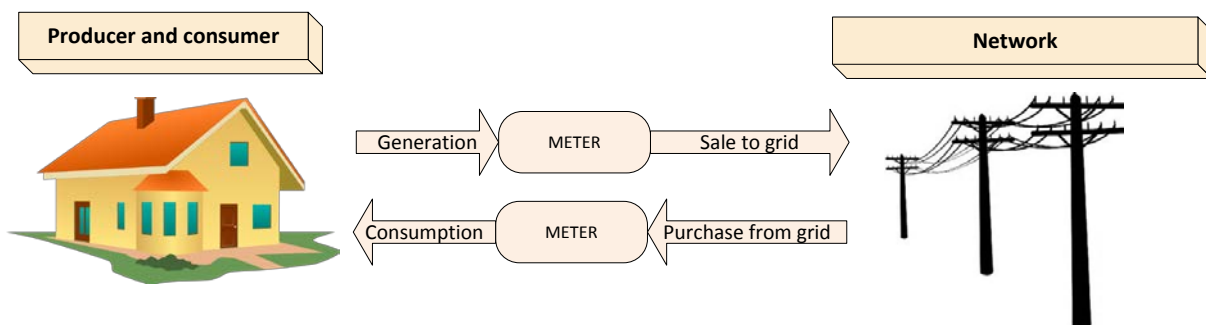
We suggest no special provisions should be made in VAT laws of CPs regarding backhaul capacity. Given that backhaul capacity is a service provided by gas TSOs, we suggest it should be treated as such by CPs.

H.5 Treatment of net metering for generation of electricity by end consumers

H.5.1 Description of the issue

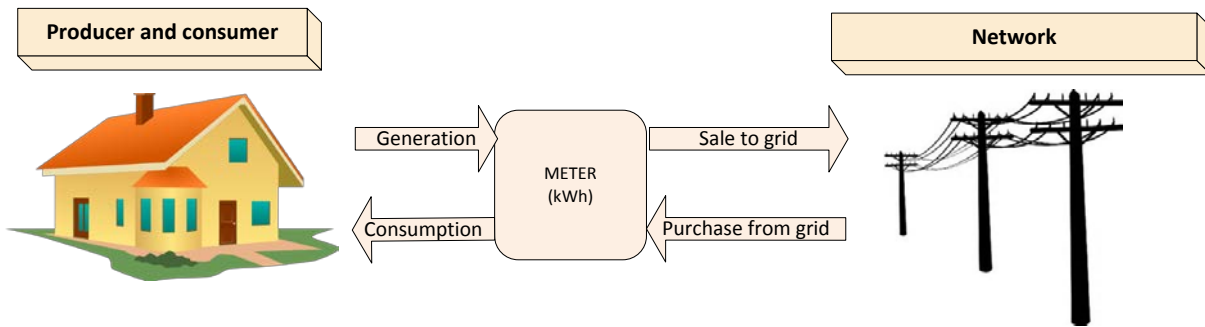
When a customer is an end customer and producer of energy at the same time, traditional approach to metering is to independently meter generation and consumption. To this end, a customer has two meters installed: one for metering electricity generated and one for metering electricity consumed.

Figure 14: independent metering of generation and consumption



In case of net metering, a bi-directional meter is installed. A bidirectional meter is able to independently meter electricity generated and consumed. In a net metering scheme, extra generated electricity (above consumption) is delivered into the grid. Figure 15 depicts the principles of net metering.

Figure 15: simplified net metering scheme



Ostensibly net metering is a simple scheme, but there are some important issues which need to be defined before the scheme can be put in practice. An important issue in relation to VAT legislation is treatment of electricity generated in excess of consumption over certain period of time. According to the European Commission document *Best practices on Renewable Energy Self-consumption* (EUROPEAN COMMISSION, 2015), net metering is defined as a regulatory framework under which the excess electricity injected into the grid can be used at a later time to offset consumption during times when their onsite renewable generation is absent or not sufficient. Under this model, end customers with self-generation are using the grid to artificially store electricity produced at one point of time to consume it at another point of time. Therefore, during certain period of time, a household or business entity, is a consumer of electricity, and in the following period it is a producer of electricity. Nevertheless, as has been observed in Republika Srpska, such an arrangement might not be approved by national Ministry of Finance.

The idea of using the grid to store the energy and to be able to withdraw it when needed is important for household consumers. In case grid cannot be used to store electricity, households would have to engage in commercial activity of selling electricity to the grid, which in some jurisdictions can impose significant costs to household consumers, making such arrangement financially not viable.

Case Study Slovenia

Slovenian government introduced a Regulation on self-supply of electricity from renewable sources in 2016 ([link](#)). The regulation introduces a possibility for small producers of electricity from renewable energy with installed capacity of up to 11 KW who are not beneficiaries of RE support schemes (such as feed in tariffs) to apply for net metering scheme.

Under the scheme, energy withdrawn from the grid and energy delivered to the grid are recorded. In case energy produced on site is lower than energy withdrawn from the grid, the user is invoiced difference between energy withdrawn and energy supplied to the grid. In case energy supplied to the grid exceeds energy withdrawn from the grid, excess energy supplied to the grid will become the property of energy suppliers, for which the user will not receive financial compensation.

Arguments for such an arrangement where small RE producer does not receive compensation for energy produced over its consumption are:

- Owner of RE facility does not sell electricity, hence it does not need to be registered as a business entity

- There is no cost of health and social security associated with running small business which would occur in case small producer (household) was selling electricity to the grid.

H.5.2 Situation in CPs

Bosnia and Herzegovina

Elektroprivreda Republike Srpske (ERS) attempted to implement net metering, as defined by Law on Renewable Energy Sources and Efficient Cogeneration (OG no. 39/13 and 108/13) (Law). The net metering scheme is available to end consumers who meet part of their consumption needs via own generation.

Article 35 of the Law establishes principles of net metering:

- values of net active energy recorded by bidirectional meter represent a basis for billing and payment of energy;
- in an event that a bidirectional meter indicates an end consumer has withdrawn more active energy than it has fed into the low voltage network in a metering period, the consumer pays the difference according to the prevailing retail price of electricity;
- in an event that a bidirectional meter indicates that an end consumer has fed more energy into the network than it has withdrawn in a metering period, the difference between active energy delivered into the grid and active energy withdrawn from the grid is carried over to the net metering period.

Tax authority of Bosnia and Herzegovina does not allow netting of VAT obligations. In the opinion issued to ERS, the tax authority specifies that ERS has to issue an invoice to end consumers for all energy withdrawn from the network. By the same token, electricity producers have to issue an invoice to ERS for all active energy fed into the grid, including the VAT. Such a requirement represents a serious obstacle to household consumers who would have to register for VAT purposes. Consequently, ERS decided not introduce net metering scheme.

Ukraine

Ukraine has a net metering scheme in place. When a household consumes more than it generates, it pays a regulated tariff, whilst when it generates more than it consumes it receives a feed in tariff. There are not obstacles to net metering scheme in Ukraine.

I. ASSESSMENT OF COST AND BENEFITS RESULTING FROM IMPLEMENTING THE OPTIMUM LEGISLATIVE CHANGES

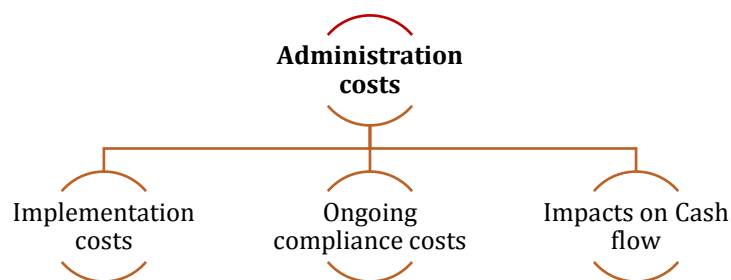
I.1 Cost and benefits to economic operators

I.1.1 Methodology

Changes of national legislation undertaken in order to harmonize national VAT legislation with *acquis communautaire* can result in certain administrative costs for businesses operating in those countries. The costs fall within three categories:

- Costs of implementing measures undertaken to harmonize national legislation, e.g. **onetime costs**.
- **Ongoing** compliance costs resulting from obligations imposed by new legislation.
- **Impact on cash flow** resulting from reverse charging the VAT in the form of changes in working capital.

Figure 16: General classification of administrative costs



Source: (EY, 2014)

From the policy standpoint, the new legislation generally imposes certain obligations on businesses in the form of information they have to provide to policy makers, known as **information obligations** (IOs).

The comprehensive framework that can be used to assess the administrative costs resulting from introduction of new legislation has been put forward by the European Commission in the form of "*Standard Cost Model*" (SCM) (EUROPEAN COMMISSION, 2015). The purpose of the Model is to determine whether new legislation imposes significant costs to businesses.

SCM involves applying activity based costing (ABC) in order to determine the additional costs incurred by "normally efficient businesses" as they fulfill IOs. The costs are then classified as time based costs and acquisition costs. Time based costs represent one-time or recurring costs that relate to the time spent by employees of the business in fulfilling

IOs. Time based costs are calculated taking into account time required to fulfill a particular activity and wage rate of employees performing the activity. Acquisition costs on the other hand are one-time or recurring external costs that are not related to time spent: this includes items such as postage costs, IT upgrade, etc.

Possible IOs include items such as (PricewaterhouseCoopers, 2007):

- Obligation to obtain a special reverse charge VAT number in order to apply the reverse charge;
- Obligation to book the invoices in a purchase ledger;
- Obligation to issue compliant invoices and obligation to book the invoices in a sales ledger;
- Obligation to file a general purchase and sales listing electronically;
- Obligation to file periodic VAT returns;
- Obligation to file quarterly intra-Community sales listing;
- Obligation to cooperate with periodic VAT inspections.

The above list of IOs shows the outcome or results that businesses have to meet when proposed legislation is applied. In order to meet the above IO, businesses have to undertake a set of activities, which fall within three broad categories of processes (PricewaterhouseCoopers, 2007): sales, purchasing and compliance with VAT obligations.

Particular activities related to each process might include the following:

- Sales: quotation, confirmation of orders, invoicing customers, processing account receivables and managing collections, manage and processes discounts;
- Purchasing: selecting suppliers and developing contracts, ordering and receiving goods and services, processing accounts payable;
- Compliance with VAT obligations: file purchase and sales listing, fill periodic VAT returns, communication with tax authorities;

Moreover, each of the above activities has a set of sub activities or tasks that businesses have to perform on recurring or one time basis. For example, in relation to sales, the firms have one time activity related to update of IT system to reflect computer or recurring activities related to handle customer requirements.

Additional costs related to implementation of legislative changes relates to changes in **working capital**. Introduction of reverse charge mechanism affects the timing of payment of VAT. Since the buyer directly makes the payment to the tax authorities, the seller does not collect the VAT. This means the seller cannot benefit from holding cash from sales in advance of its next VAT payments to the tax authority. A buyer does not pay VAT when it makes a purchase, because they “reverse charge” this from its own VAT

return and claim the deduction on the same VAT return, making the reporting cash neutral.

To calculate the impact on working capital and cash flow, numerous assumptions need to be made regarding VAT policies on revenues (amount of revenue, percentage of revenue impacted by VAT, average VAT rate applicable to revenue impacted by VAT, average terms of payments of clients), costs (amount of costs, percentage of cost impacted by VAT, average VAT rate applicable to cost impacted by VAT, average terms of payments to suppliers), and VAT cycle (periodicity of VAT statements -i.e. monthly or quarterly, VAT payment terms - after end of VAT period, VAT recovery terms - after end of VAT period).

I.2 Results

To assess the actual administrative costs resulting from new legislation, we use the results of existing studies performed on the EU level. As the research shows, the administrative costs resulting from implementation of new legislation are extremely business specific. Cost are dependent on many factors such as number of IOs, number of activities affected by IOs, local labor cost, size of the business, etc. Nevertheless, some estimates can be made. As the table below shows, both one time and recurring costs can be estimated, on average, to be 0.05% and 0.0295% of turnover value respectively.

Table 4: Estimated costs of implementation of reverse charge mechanism

	One-time Cost in EUR	Recurring Cost in EUR	One-time Cost in % of Turnover	Recurring Cost in % of Turnover
Small and Medium Sized – 5 obs ³⁷ .				
Average	7,354	3,294	0.0220%	0.0175%
Large – 10 obs.				
Average	280,670	57,742	0.0085%	0.0055%
Outliers– 5 obs.				
Average	3,410,135	161,719	0.2075%	0.1225%
Total Sample – 20 obs.				
Average	994,707	70,124	0.0490%	0.0295%

Source: (PricewaterhouseCoopers, 2007)

In conclusion, it can be stated that expected costs to businesses of introducing legislative changes, and in particular introducing RCM mechanism can be considered rather low. The estimated costs should be weighed against some of the benefits that are difficult to monetize, which include:

- Simplification of VAT payment procedure: VAT paid only once, in the country where the buyer of goods or services has its seat:

³⁷ Obs. Stands for observations

- Reduction of administrative burden related to securing a VAT refund
- Reduction in uncertainty related to possible difficulties in obtaining VAT refund.

I.3 Impact on end consumers and national budgets

Harmonization of VAT legislation in CPs can have an impact on end consumer in the form of different prices resulting from changes of VAT rates applied to electricity and gas products. Furthermore, harmonization of VAT legislation can have a net impact on national budgets only in the context of VAT collected on energy sold to end consumers at domestic markets. Given that CPs currently either administer RCM or allow for VAT refund to foreign based firms, harmonization of VAT legislation in CPs would not result in loss of VAT revenue in cross border trade. Uniform introduction of RCM would eliminate administrative procedures involved in administering tax refunds, reducing administrative costs in countries already not having RCM in place.

Therefore, in this section we assess what are the VAT rates prescribed by the VAT Directive for energy products, we lay out the rates applied by CPs and for comparison purposes lay out the rates applied by EU Member States. Finally, we assess the potential impact on budgets of CPs resulting from VAT rate harmonization and impact on end prices to household consumers.

I.3.1 Application of VAT rates on electricity and gas in EU MS and CPs

In order to prevent possible divergences in the level of standard VAT rate applied in Member States that might lead to distortion of competition, the VAT Directive prescribes a minimum standard fixed rate of 15%. In addition, the Directive allows for application of two reduced rates of not less than 5% for goods and services listed in Annex III, none of which are related to electricity and gas markets. Nevertheless, in article 102 the Directive allows for application of reduced rate to *“the supply of natural gas, of electricity or of district heating, provided that no risk of distortion of competition thereby arises”*, subject to the prior approval of the Commission.

Current levels of VAT rates applied to electricity and gas in EU Member States are given in the following two figures. As the figures show, minimum level of applied VAT rate to gas and electricity is 5%, albeit with most of the countries having rates above the minimum 15% prescribed by the Directive.

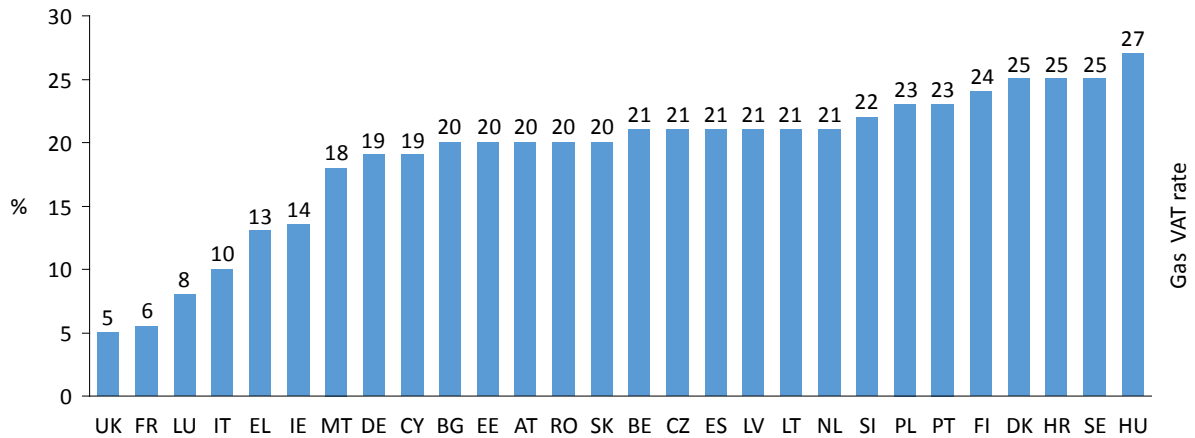


Figure 17: VAT rates on supply of gas in EU Member States

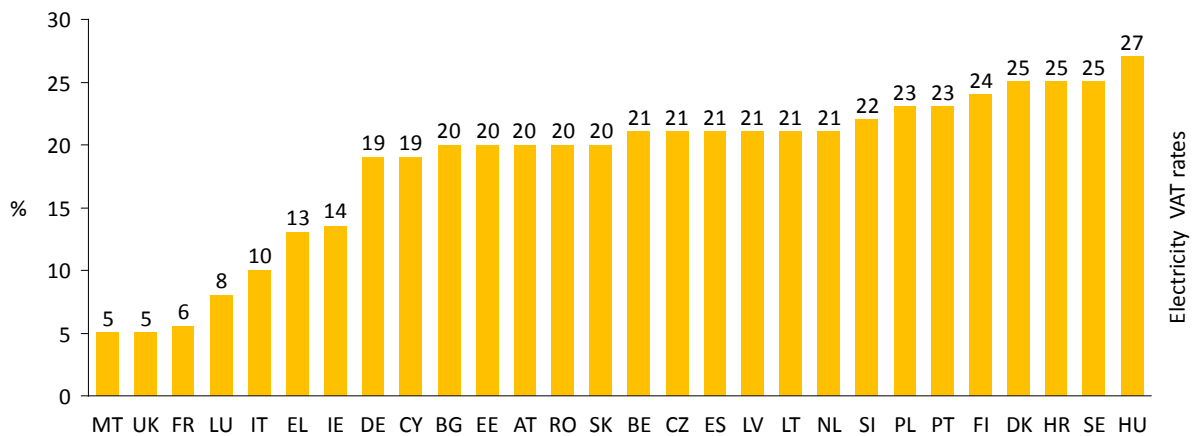


Figure 18: VAT rates on supply of electricity in EU Member States

The applied VAT rates in CPs to gas and electricity are shown in the following figure. Except for Moldova, all countries apply VAT rates which are above the standard 15% rate, and hence do not require any further harmonization.

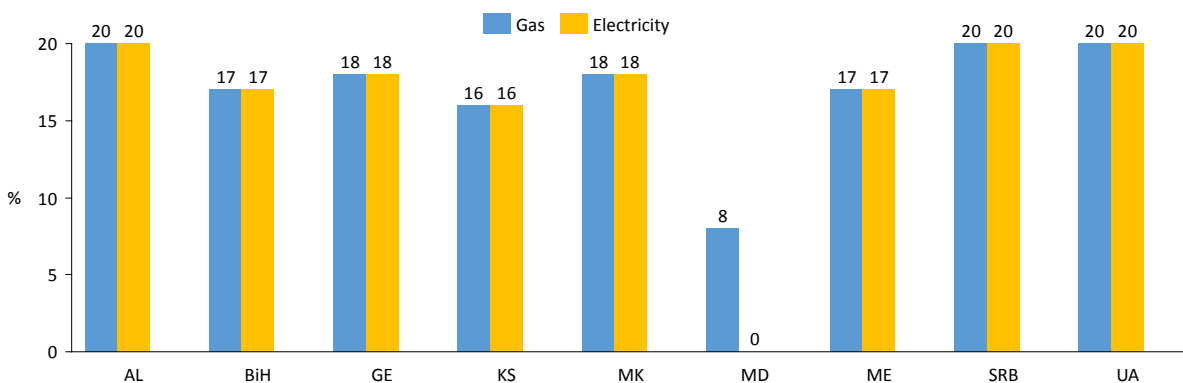


Figure 19: VAT rates on supply of electricity and gas in CPs

I.3.2 Assessment of impact of VAT legislation on national budget and end user prices

I.3.2.1 Harmonization of VAT rates

As the above figure shows, only Moldova is applying VAT rates on supply of gas and electricity to household consumers which are below the standard rate, as follows:

- Supply of gas is taxed at 8% for all customers.
- Supply of electricity to household is subject to 0% VAT rate (industrial consumers are taxed at 20%).

Therefore, proposed harmonization of VAT rates could only have a direct impact on energy prices to end consumers in Moldova. We assume VAT payments are neutral for businesses (input VAT is used to offset output VAT), therefore, we assess the impact of changes in VAT rates on household consumers only.

To determine the impact of changes in VAT rates applied to gas and electricity, we use the following data on average household consumption:

Table 5: Average household consumption of natural gas and electricity in Moldova

Item	Unit	Value
Natural gas		
Total	000 m3	279,216
Average	m3	566.9
	MJ ³⁸	19,274.6
# of consumers ³⁹		492,531
Electricity		
Total	000 kWh	1,668
Average	kWh	1,495
# of consumers		1,116,038

Source: (ENERGY CONSUMPTION IN HOUSEHOLDS: Results of the Survey on energy consumption, 2016)

Prices paid by household consumers for electricity and gas during first half of 2016 were as given by the following table:

Table 6: Residential natural gas and electricity prices in Moldova

Energy prices	Unit	2016 S1
Gas (D1)	EUR / GU	7.31
Electricity (DB)	EUR / MWh	94.90

Source: EUROSTAT

³⁸ Conversion is done using a conversion factor of 34 MJ/m3.

³⁹ Total number of consumers who actually use gas.

To estimate the impact of changing VAT rate on residential consumers we assume three scenarios:

- **Base case:** Current scenario where 0% VAT rate is applied to household electricity consumption and 8% VAT rate to household gas consumption.
- **15%:** Minimum standard rate of 15% is applied to both electricity and gas.
- **CP average:** average VAT rate of 18.25% applied among CPs is used as a VAT rate for both electricity and gas.

The impact of changing VAT rates is assessed as follows:

- Impact on unit energy prices;
- Impact on average household expenditure where we assume households will not reduce their electricity consumption (in effect assume demand to be perfectly price inelastic);
- Impact on national budget in the form of increased VAT revenues.

The following two figures show the impact of change on average household electricity and gas prices. As expected, VAT rate harmonization has greater impact on electricity prices as current rate applied is 0%, whilst for gas it is 8%.

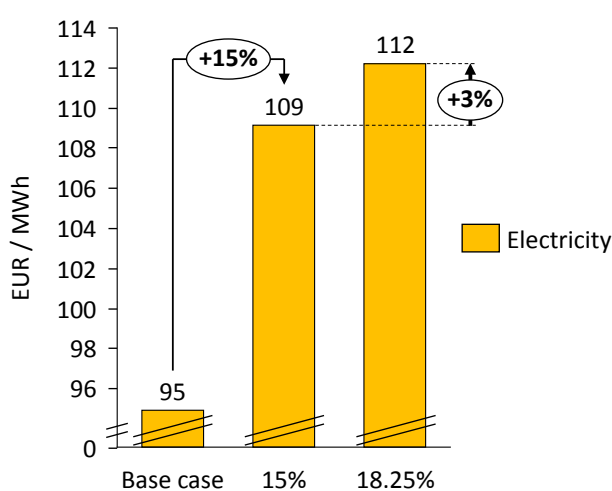


Figure 20: Impact of different VAT rates on electricity household prices

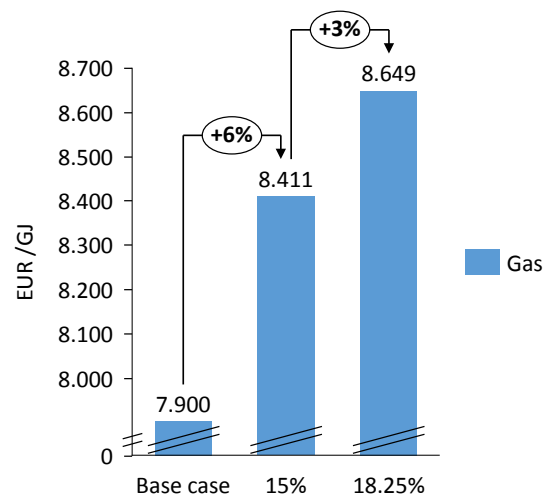


Figure 21: Impact of different VAT rates on gas household prices

Assuming average consumption levels as given in Table 5, the following two figures show the change in average annual expenditures for electricity and gas.

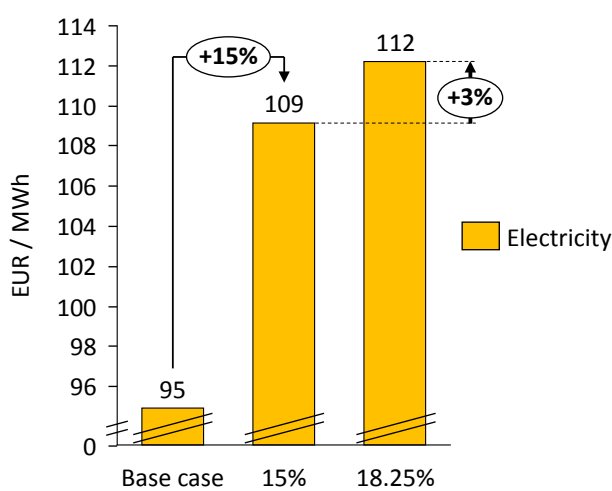


Figure 22: Impact of different VAT rates on household expenditures on electricity

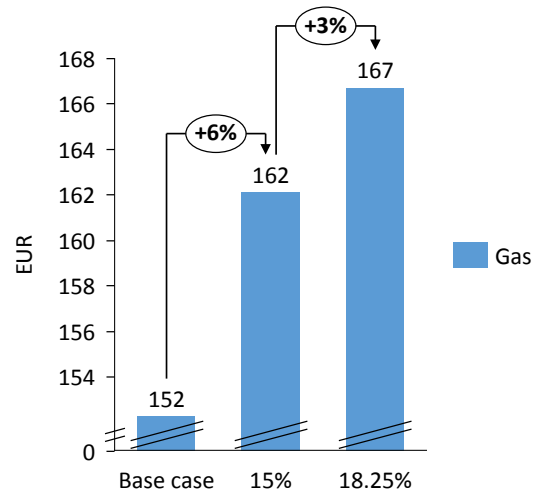


Figure 23: Impact of different VAT rates on household expenditures on gas

Finally, given the above changes in VAT rates and expenditures on gas and electricity of household consumers, the following figures show expected changes in VAT revenue collected by the government.

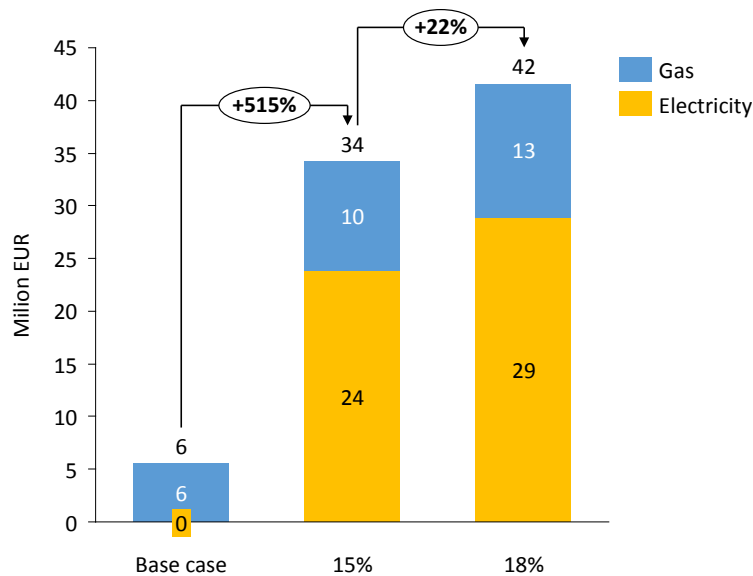


Figure 24: Impact of different VAT rates on VAT revenue to government

I.3.2.2 Impact of harmonization of VAT legislation in relation to place of taxation

PLACE OF TRANSACTION

J. ABBREVIATIONS

Abbreviation	Full name
CGES	Montenegrin Electric Transmission System
CPs	Contracting Parties
EMS	Elektromreža Srbije
EnC	Energy Community
EnCS	Energy Community Secretariat
EU	European Union
KOSTT	Kosovo Transmission System Operator
MEPSO	Electricity Transmission System Operator of Macedonia
NOS BiH	Independent System Operator in Bosnia and Herzegovina
OST sh.a	Albanian Transmission System Operator
RCM	Reverse Charge Mechanism
SEE CAO	Coordinated Auction Office in South East Europe
SEEPEX	SEEPEX a.d. Beograd
VAT	Value added tax

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