

## **Current provisions for VAT treatment of CO2 transfers in the EU**

Author: Michał Glowacki attorney at law

What is current situation in the European Union as regards VAT taxation of transfers of CO2 allowances? The answer is complex.

It should be noted, that four different approaches are being taken across European Union in that matter now.

In the most of EU countries nothing have changed up to now, in some (like United Kingdom, France and Netherlands) in June and July this year were introduced (unilaterally and fiercely) new measures (different in each of them) and the European Commission also proposes something new – temporary measure in the VAT Directive.

There is of course also a differentiation in VAT treatment of domestic and cross-border transactions.

### ***Intra – Community transactions and local trades***

From a VAT perspective, transfers of CO2 allowances between taxable persons are considered as a supply of service and are taxable at the place where the recipient is established.

The system still in existence in relation to intra-community transactions consist in a rule, that transactions are taxed in the country of destination (they are zero-rated for the supplier and are taxed at the point of destination via the reverse-charge mechanism). At the same time tax neutrality is guaranteed by continuing to grant the supplier the right to deduct input VAT.

Such a solution is for the purpose to avoid distorting competition and relocation - due to the absence of harmonisation of VAT tax rates in different EU countries (International VAT Association, Combating VAT fraud in the EU, [www.iva-online.org](http://www.iva-online.org), page 13).

At an another level should be considered allowances transactions traded domestically – common approach so far was, that member states charged in that regard a standard rate of VAT.

### ***“Carousel fraud” in trading allowances as a direct cause for changes***

The European Commission in MEMO dated September 29 , 2009 (Commission proposal on temporary measures for a consistent response to carousel fraud in certain sectors- Frequently Asked Questions) said:

*“On internal supplies, a supplier charges VAT to his customer. His supplier pays this VAT to the Treasury. The customer, where it is a business, can reclaim this VAT from the Treasury. It is the final consumer who bears the VAT charge since he can not reclaim the VAT from the Treasury.*

*However, the rules are different for supplies to business clients in other Member States. The supplier does not charge VAT and the goods circulate VAT free.*

*The fraud mechanism works as follows. A company (B) acquires goods in another Member State without having to pay VAT to his supplier (A) . Subsequently it makes a domestic supply for which it charges VAT to his customer (C) . However, the company (B) does not pay the VAT to the Treasury and disappears. The customer (C) claims a refund of the VAT paid to the company (B). Consequently, the financial loss is for the Treasury which has to refund VAT to the customer (C) which it never collected from the supplier (B) .*

*Subsequently, Company C may declare an exempt intra-community supply to Company (A) and, in its turn, (A) may make an exempt intra-community supply to (B) and the fraud pattern resumes, thus explaining the term “carousel fraud”.*

*The main elements are the fact that there has been an intra-Community transaction and a trader charging VAT to his customer but not paying it to the Treasury and "going missing".*

*This is a very simplistic description of the fraud, which in reality is much more complex, involving a series of transactions with intermediary companies (D) in order to hide the fraudulent character of it.”*

Furthermore, the above described carousel fraud phenomenon isn't limited only to goods. According to the Commission several Member States have been confronted with carousel fraud related to greenhouse gas emission allowances, which – as was mentioned - are considered as supplies of services within the EU.

#### **Four different approaches**

Unilateral moves in the summer this year by the French, Dutch and British governments – and the speed with which the changes came into effect once announced, surprised many observers of the market.

It should be noted, that as a consequence four different approaches and four different VAT treatments are being taken now across European Union in that matter:

- 1) France on 8 June 2009 had exempted the allowances from VAT (treating them as transactions involving shares),
- 2) on 14 July 2009 the Netherlands had opted for a “reverse charge”, requiring all traders (including local transactions) to account for VAT at the time of purchase,
- 3) Britain introduced legislation to zero rate the supply of emissions allowances within the UK with effect from 31 July 2009,
- 4) other member states charged a standard rate of VAT and the absence of exemption is the position adopted by the majority of Member States.

Let's look into particulars of some of the above changes.

#### **The approach taken by Netherlands**

The Netherlands decided to extend the reverse charge regime to apply to all transactions relating to emission allowance trading, including local transactions. As was mentioned above, under the reverse charge mechanism the purchaser becomes responsible for the VAT on the purchase. However, this extension in respect of local transactions remains optional for the contracting parties.

So, as announced the Dutch State Secretary of Finance de Jager, the VAT taxation on CO2 allowances in the Netherlands will move from the seller of allowances to the buyer.

According to information published at the Dutch Climex webpage:

*“For most Climex Members the application of the degree will not have a direct consequences, since the Dutch measure only applies to Dutch based entities trading on Climex. Starting today, Netherlands based members will receive an invoice without VAT and a reference to the Reversed Charge Mechanism.  
For organisations based outside of the Netherlands nothing will change, because this mechanism was already applicable to such transactions. For Companies based in the United Kingdom and clearing with APX Commodities Ltd in the UK, VAT will remain applicable.”*

### **United Kingdom – zero rate**

The United Kingdom decided to zero rate the transactions. This means, as it seems, that whilst VAT is no longer due on UK carbon credit transactions, businesses retain the right to recover VAT they incur on their associated costs.

According to Revenue & Customs Brief 46/09 the Government has introduced legislation to zero rate the supply of emissions allowances within the UK with effect from 31 July 2009.

Up to the said date, most emissions allowances have been standard-rated in UK to UK transactions and VAT free when purchased from outside the UK by a UK based company.

As the British government said, although a number of other options had been considered, zero rating had been the only option that could be introduced quickly enough in the UK and without any significant impact on legitimate trade in the markets concerned.

So, in the UK now the zero rate will apply to any transaction in EU emissions allowances and transferable units issued pursuant to the Kyoto Protocol. This will include over the counter spot trades, transactions for future delivery and options. Cross-border transactions are not affected.

The tax point for these supplies will be the earliest of either the transfer of title or payment. Therefore any amount purporting to be VAT on tax invoices dated from 31 July 2009 will not be recoverable as input tax.

### **Proposition of the European Commission**

The variety of adopted domestic measures has driven the Commission to propose once more solution. We have now in place the *“Proposal for a Council Directive amending Directive 2006/112/EC as regards an optional and temporary application of the reverse charge mechanism in relation to supplies of certain goods and services susceptible to fraud”*.

The essence of the proposal is providing the possibility for interested Member States to apply targeted reverse charge mechanism in relation to emission allowances and certain limited category of goods.

As was said above the reverse charge mechanism results in no VAT being charged by the supplier to taxable customers who, in turn, become liable for the payment of the VAT. In

practice, customers (insofar as they are normal taxable persons with a full right of deduction) would declare and deduct at the same time without effective payment to the treasury.

The proposition of the Commission amends the Directive 2006/112/EC by inserting Article 199a (1), according to which Member States may, until 31 December 2014 and for a minimum period of two years, introduce and apply a mechanism whereby the VAT due on supplies of the limited categories of goods and services is payable by the person to whom those goods and services are supplied.

So, the aim of the regulation - the elimination of theoretical possibility to commit fraud – would be attained.

New measures are intended to cover *inter alia* “allowances to emit greenhouse gases as defined in Article 3 of Directive 2003/87/EC(\*), transferable in accordance with Article 12 of that Directive, and other allowance units that may be used by operators for compliance with the same Directive.”

Consequently, the draft of new provisions relates not only to CO2 allowances (EUA) but also to ERU and CER.

### **What to do now**

Taking into account the situation in other countries, risk of VAT fraud continues to exist in relation to allowances transactions.

One of the possible precautionary measures is to undertake thorough Know Your Customer (KYC) procedures before cross-border transactions.