EXPLANATORY MEMORANDUM TO

THE VALUE ADDED TAX (PLACE OF SUPPLY OF GOODS) ORDER 2004

2004 No.3148

1. This explanatory memorandum has been prepared by H.M. Customs and Excise and is laid before the House of Commons by Command of Her Majesty.

This memorandum contains information for the Select Committee on Statutory Instruments.

2. Description

2.1 This Order revokes and, in Part 2, re-enacts with minor amendments the Value Added Tax (Place of Supply of Goods) Order 1992 (S.I. 1992/3283).

2.2 Part 3 of the Order provides that wholesale supplies of gas through the natural gas distribution system or electricity, made on or after 1 January 2005, are to be treated for VAT purposes as taking place where the dealer's business is established and defines when this is to be regarded as outside the United Kingdom. Other supplies are to be treated as taking place where the gas or electricity is consumed.

3. Matters of special interest to the Select Committee on Statutory Instruments

None

4. Legislative Background

4.1 This instrument is one of a number of measures required to implement EC Directive 2003/92/EC (O.J. L260, 11.10.2003. p 0008-0009). They all take effect from 1 January 2005 and amend the VAT rules in relation to supplies of natural gas and electricity. They comprise:

- Section 9A of the Value Added Tax Act 1994 (c. 23) inserted by section 21 of the Finance Act 2004 (c. 12).
- The Value Added Tax (Imported Gas and Electricity) Relief Order 2004.
- The Value Added Tax (Removal of Gas and Electricity) Order 2004.
- The Value Added Tax (Reverse Charge) (Gas and Electricity) Order 2004.
- The Value Added Tax (Amendment) (No.4) Regulations 2004.

4.2 EC Directive 2003/92/EC amends Articles 8, 9, 14, 21 22 & 28 of Council Directive 77/388/EEC ("the Sixth VAT Directive") A Transposition Note is attached.

4.3 This Order implements the changes in relation to Article 8. Under Article 8, supplies of goods which are to be delivered are normally treated as taking place where the delivery commences. This, together with various other place of supply rules, serves to determine whether a supply takes place within the EC and, if so, the Member State in which it is taxable. Article 8 is implemented in UK legislation by section 7 of the Value Added Tax Act 1994.

4.4 The amendment to Article 8 of the Sixth VAT Directive introduces new place of supply rules for supplies of gas through the natural gas distribution network and for electricity. Under these changes, supplies to persons whom the Directive refers to as "taxable dealers" take place where the dealer's business is established. Other categories of supply are to take place where the gas or electricity is effectively used and consumed. The variation to the normal rules in section 7 of the Value Added Tax Act 1994 is made by Order under the powers provided by section 7(11) of that Act.

4.5 Article 14 of this Order, which article determines whether a person is outside the United Kingdom, is made under the powers given in the new section 9A(6) of the Value Added Tax Act 1994 and this is the first exercise of those powers.

4.4 The Draft Council Directive amending Directive 77/388 EEC is cited in the House of Commons, European Scrutiny – Sixth Report, printed on 8 January 2003, at paragraph 13 (reference (24085) 15369/02 COM (02) 688)) and considered not to raise questions of sufficient legal or political importance to warrant a substantive report to the House.

4.5 The proposal cleared scrutiny in the House of Lords and is cited in Part II i of the House of Lords, European Union – Progress of Scrutiny Report, printed on 19 February 2003 (reference 15369/02).

5. Extent

This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

Not applicable

7. Policy background

7.1 These changes to the EC VAT rules are intended to modernise and simplify the VAT system as it applies to supplies of natural gas and electricity. In particular they are aimed at standardising EC treatment and reducing the need for suppliers to register in other Member States. This is to be achieved through changes in the place of supply and by transferring responsibility to account for VAT in certain circumstances to the person receiving the supply. The changes reflect an increasing liberalisation of the gas and electricity markets through deregulation, and an increase in trade between Member States.

7.2 Gas and electricity is currently treated in the same way as any other supplies of goods. However, the normal VAT rules do not sit particularly well with such supplies

because they are not typical of goods requiring transportation. They are transmitted through networks or grids linked together by inter-connectors between Member States. Unlike other goods, the piped gas or electricity entered into the grid or network is unlikely to be the same piped gas or electricity that the customer actually receives. Instead, it is an equivalent amount to that originally added to the system by the supplier, or on his behalf.

7.3 In the past, these problems have had little impact since the gas and electricity industries were almost completely state-owned, and trade was limited to within the borders of each Member State. Since the establishment of the internal market and the increasing liberalisation of the gas and electricity market, these problems have become more evident

7.4 The changes have been welcomed by the UK gas and electricity industries.

8. Impact

8.1 A Regulatory Impact Assessment has been prepared for this Order.

8.2 The impact on the public sector is minimal.

9. Contact

Bob Gilligan at H.M. Customs & Excise Tel: 0208 929 4675 or e-mail: bob.gilligan@hmce.gsi.co.uk can answer any queries regarding the instrument.