
Meeting name BSC Panel

Date of meeting 2 September 2004

Paper Title INITIAL WRITTEN ASSESSMENT FOR MODIFICATION PROPOSAL P170: AMENDMENTS TO THE BSC, AND TO THE SYSTEMS AND PROCESSES THAT SUPPORT IT, TO ALLOW COMPLIANCE WITH THE CHANGED APPLICATION OF VAT TO TRADING CHARGES

Purpose of Paper For Decision

Synopsis Modification Proposal P170 seeks to amend the Balancing and Settlement Code to allow compliance with the changed application of VAT to supplies of electricity. ELEXON recommend that Modification Proposal P170 is submitted to a 1-month Assessment Procedure and that an Assessment Report is submitted for consideration at the Panel meeting of 14 October 2004.

1. PROPOSED MODIFICATION

- 1.1. Modification Proposal P170 'Amendments to the BSC, and to the systems and processes that support it, to allow compliance with the changed application of VAT to Trading Charges' (P170) was submitted on 12 August 2004 by the BSC Panel. P170 proposes to introduce processes and obligations to allow ELEXON and BSC Parties to comply with a change to the application of VAT to Trading Charges that will take effect from 1 January 2005.
- 1.2. The Proposer believes that P170 would better facilitate achievement of Applicable BSC Objective(s):
 - d) Promoting efficiency in the implementation and administration of the balancing and settlement arrangements.
- 1.3. Obligations on Parties who will not be liable to UK VAT to declare this currently do not exist. The Code does not contain relevant safeguards to mitigate the risk to ELEXON (and by extension, the BSC community) from an incorrect application of VAT resulting from the lack of such obligations.
- 1.4. ELEXON and BSC Parties are obliged to comply with all applicable taxation legislation. It is contended that P170 will provide robust obligations, systems and processes to allow this to happen.

2. RESULTS OF INITIAL WRITTEN ASSESSMENT

- 2.1. ELEXON has prepared an Initial Written Assessment for P170, which is included as Attachment 1 to this paper. This identifies the following issues:
 - Issue 1 – Obligations for a Party to declare its VAT status. In order to correctly apply VAT it will be necessary to establish whether a Party is liable to UK VAT or not. It is not believed to be practical or prudent for either ELEXON or the FAA to make assumptions on behalf of Parties in this regard, given the large number of Parties who operate in multiple national markets and the complex nature of VAT law. The assessment of P170 will therefore need to consider how Parties should be obliged to ensure the correct VAT rate is applied.

- Issue 2 – Party responsibility for erroneous VAT declarations. The Assessment Procedure will need to consider the potential that a Party could erroneously declare its VAT status, resulting in 0% VAT being applied when it should have been liable at the UK prevalent rate – or vice versa. Such errors could result in ELEXON incurring financial costs or penalties to resolve the error. Consideration should be given to instituting Code obligations that indemnify ELEXON from costs resulting from an erroneous declaration, in order to avoid the potential that costs or penalties incurred as a result of one Party's error would need to be paid for by all other Parties through ELEXON's funding structure.
 - Issue 3 – Definition of VAT within the Code. VAT is currently defined within the Code as 'United Kingdom Value Added Tax'. This definition may require changes, and it would appear prudent for the context of all VAT references in the Code to be checked to ensure they remain accurate given the law change.
 - Issue 4 – Accounting for deficit or surplus of VAT between ELEXON Clear and ELEXON Limited. The remit of ELEXON Clear to make or receive payments is strictly defined in Section N of the Code. This includes provisions to limit Party liability for bad debts by limiting the ability of the BSC Clearer to paying out only those amounts that have been paid to or recovered by them in respect of a specific Business Day. Agreement has been reached with Customs and Excise that daily VAT imbalances seen by ELEXON Clear should be settled via ELEXON Limited. CP1078 will put these mechanisms in place, but the assessment of P170 should consider if these mechanisms should also be stipulated in the Code.
 - Issue 5 – Interrelation with CP1078. ELEXON has raised CP1078, 'System and process changes to allow compliance with the changed application of VAT to Trading Charges', as it must commence implementation work on BSC systems and process changes quickly if it is to comply with the change in taxation law by 1 January 2005. This will necessitate implementation work on system and process changes running concurrently with the assessment of P170. The Assessment of P170 should consider its inter-relation with CP1078.
 - Issue 6 – Section D Charges. The assessment of P170 should consider whether obligations for applying VAT to Section D Charges need to be altered.
- 2.2. The issues associated with P170 are sufficiently well defined, therefore ELEXON recommend submitting P170 to the Assessment Procedure, as set out in F2.6 of the Code, in order to determine whether P170 better facilitates the achievement of the Applicable BSC Objectives.
- 2.3. It is further proposed that a new Modification Group be formed to consider P170. Members of this Modification Group should have expertise in how BSC Parties account for VAT in their accounting procedures as well as an overview of the Code and its Modification Procedures.

3. PROCESS AND TIMETABLE FOR PROGRESSING THE MODIFICATION

- 3.1. In recognition of the above, it is recommended that the Panel endorse that the Modification Proposal be submitted to the Assessment Procedure with an Assessment Report being presented to the Panel at their meeting on 14 October 2004.

- 3.2. It is estimated that the progression of P170 through the Modification Process will incur third party costs of £33,750 funded from the demand led budget in addition to core team staff costs. This estimate is based on current information and may be subject to change.
- 3.3. An outline timetable for the assessment of P170 is attached to this report and will be discussed at the first meeting of the Modification Group (provisionally planned for 6 September 2004).

4. RECOMMENDATIONS

4.1 Having considered, and taken into due account, the contents of the P170 Initial Written Assessment, the Panel is invited to:

- a) NOTE the results of the Initial Written Assessment;**
- b) DETERMINE that Modification Proposal P170 should be submitted to the Assessment Procedure in accordance with section F2.6 of the Code;**
- c) AGREE the Assessment Procedure timetable such that an Assessment Report should be completed and submitted to the Panel for consideration at their meeting of 14 October 2004;**
- d) DETERMINE that the Assessment Procedure should be undertaken by the P170 Modification Group; and**
- e) AGREE any refinement to the Modification Group Terms of Reference.**

Chris Rowell
Modification Secretary

List of attachments:

Attachment A: Initial Written Assessment of Modification Proposal P170 - Amendments to the BSC, and to the systems and processes that support it, to allow compliance with the changed application of VAT to Trading Charges