

INITIAL WRITTEN ASSESSMENT for Modification Proposal P170 Amendments to the Balancing and Settlement Code (Code), and to the systems and processes that support it, to allow compliance with the changed application of VAT to Trading Charges

Prepared by: ELEXON¹ Limited

Date of issue:	27/08/2004	Document reference:	P170IR
Reason for issue:	Review	Issue/Version number:	Final/1.0

This document has been distributed in accordance with Section F2.1.10² of the Balancing and Settlement Code.

RECOMMENDATIONS

On the basis of the initial assessment BSCCo recommends that the Panel:

- **DETERMINE that Modification Proposal P170 should be submitted to the Assessment Procedure;**
- **AGREE the Assessment Procedure timetable such that a Assessment Report should be completed and submitted to the Panel for consideration at their meeting of 14 October 2004;**
- **DETERMINE that the Assessment Procedure should be undertaken by the P170 Modification Group; and**
- **AGREE any refinement to the Modification Group Terms of Reference.**

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¹ ELEXON Ltd currently fulfils the role of the Balancing and Settlement Code Company ('BSCCo'), pursuant to Annex X-1 of the Balancing and Settlement Code (the 'Code').

² The current version of the Code can be found at www.elexon.co.uk/ta/bscrel_docs/bsc_code.html

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SUMMARY OF IMPACTED PARTIES AND DOCUMENTS

As far as BSCCo has been able to assess the following parties/documents have been initially identified as being potentially impacted by Modification Proposal P170.

Parties	Sections of the BSC	Code Subsidiary Documents
Suppliers <input checked="" type="checkbox"/>	A <input checked="" type="checkbox"/>	BSC Procedures <input type="checkbox"/>
Generators <input checked="" type="checkbox"/>	B <input type="checkbox"/>	Codes of Practice <input type="checkbox"/>
Licence Exemptable Generators <input checked="" type="checkbox"/>	C <input type="checkbox"/>	BSC Service Descriptions <input type="checkbox"/>
Transmission Company <input type="checkbox"/>	D <input checked="" type="checkbox"/>	Service Lines <input type="checkbox"/>
Interconnector <input checked="" type="checkbox"/>	E <input type="checkbox"/>	Data Catalogues <input type="checkbox"/>
Distribution System Operators <input type="checkbox"/>	F <input type="checkbox"/>	Communication Requirements Documents <input type="checkbox"/>
Party Agents		
Data Aggregators <input type="checkbox"/>	G <input type="checkbox"/>	Reporting Catalogue <input type="checkbox"/>
Data Collectors <input type="checkbox"/>	H <input type="checkbox"/>	MIDS <input type="checkbox"/>
Meter Operator Agents <input type="checkbox"/>	J <input type="checkbox"/>	Core Industry Documents
ECVNA <input type="checkbox"/>	K <input type="checkbox"/>	Grid Code <input type="checkbox"/>
MVRNA <input type="checkbox"/>	L <input type="checkbox"/>	Supplemental Agreements <input type="checkbox"/>
BSC Agents		
SAA <input type="checkbox"/>	M <input type="checkbox"/>	Ancillary Services Agreements <input type="checkbox"/>
FAA <input type="checkbox"/>	N <input checked="" type="checkbox"/>	Master Registration Agreement <input type="checkbox"/>
BMRA <input type="checkbox"/>	O <input type="checkbox"/>	Data Transfer Services Agreement <input type="checkbox"/>
ECVAA <input type="checkbox"/>	P <input type="checkbox"/>	British Grid Systems Agreement <input type="checkbox"/>
CDCA <input type="checkbox"/>	Q <input type="checkbox"/>	Use of Interconnector Agreement <input type="checkbox"/>
TAA <input type="checkbox"/>	R <input type="checkbox"/>	Settlement Agreement for Scotland <input type="checkbox"/>
CRA <input type="checkbox"/>	S <input checked="" type="checkbox"/>	Distribution Codes <input type="checkbox"/>
Teleswitch Agent <input type="checkbox"/>	T <input type="checkbox"/>	Distribution Use of System Agreements <input type="checkbox"/>
SVAA <input type="checkbox"/>	U <input type="checkbox"/>	Distribution Connection Agreements <input type="checkbox"/>
BSC Auditor <input type="checkbox"/>	V <input type="checkbox"/>	BSCCo
Profile Administrator <input type="checkbox"/>	W <input type="checkbox"/>	Internal Working Procedures <input checked="" type="checkbox"/>
Certification Agent <input type="checkbox"/>	X <input checked="" type="checkbox"/>	Other Documents
MIDP <input type="checkbox"/>		Transmission Licence <input type="checkbox"/>
Other Agents		
SMRA <input type="checkbox"/>		
Data Transmission Provider <input type="checkbox"/>		

1 DESCRIPTION OF PROPOSED MODIFICATION

1.1 Modification Proposal

1.1.1 Overview

The Council of the European Union has directed an amendment to the rules on the place of supply of gas and electricity, for the purposes of turnover taxes³. This amendment takes effect from 1 January 2005 and directly affects the manner in which VAT is applied to the supply of electricity.

Currently, all BSC cost recovery and participation charges (hereafter referred to as 'Section D Charges') and Trading Charges are always subject to UK VAT at the prevalent rate.

The new rules will mean that this is not always the case. A taxable entity that is based outside the UK may qualify for Section D and Trading Charges being charged at 0% VAT within the UK.

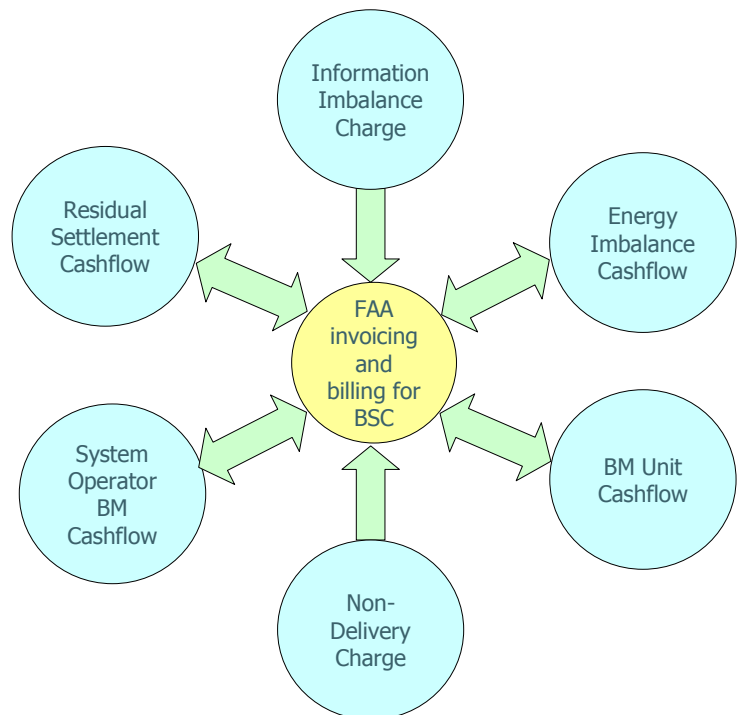
This has significant implications on ELEXON Clear as it means that its incoming and outgoing VAT will no longer balance. The reason for this is perhaps best explained in the context of an overview of Trading Charges.

Section T of the Code defines six major classes of payments and charges in respect of different activities covered under the Code. These six cashflows, and the directions in which each may flow, are shown in Figure 1.

Five of these are from or to Trading Parties whilst a further cashflow is from or to the Transmission Company. In all cases, the counterparty is a subsidiary of ELEXON – 'ELEXON Clear' – managed by the Funds Administration Agent (FAA) and set up specifically for the purpose of clearing the cashflows. The payments and charges are as follows:

- Account Energy Imbalance Cashflow (CAEI_{ij}):** payments by Trading Parties at System Buy Price (SBP_j) for negative energy imbalance volumes, i.e. top-up, and payments to Trading Parties at System Sell Price (SSP_j) for positive energy imbalance volumes, i.e. spill;
- Information Imbalance Charge (CII_{ij}):** payments by Trading Parties at the Information Imbalance Price (IIP_j) on the magnitude of any deviations of BM Unit Metered Volumes from Final Physical Notification (FPN) (as modified by any accepted Balancing Mechanism Offers or Bids). The Information Imbalance Price has always been set to zero;
- Period BM Unit Cashflow (CBM_{ij}):** payments to Trading Parties at Offer Price for accepted Offers, and payments by Trading Parties at Bid Price for accepted Bids;

Figure 1: Flow of Trading Charges under the Code



³ The amendment is contained within Council Directive 2003/92/EC, which amends Directive 77/388/EEC as regards the rules on the place of supply of gas and electricity.
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- **BM Unit Period Non-Delivery Charge (CND_{ij}):** payments by Trading Parties either: for non-delivered Offers, in the event that a payment at an Offer Price to a Trading Party exceeds the imbalance price paid on the shortfall resulting from any non-delivery; or for non-delivered Bids in the event that the imbalance price paid to a Trading Party for the spill caused by any non-delivery exceeds the price paid by the Trading Party for the Bid.

- **Residual Cashflow Reallocation Cashflow (RCRC_{aj}):** typically a payment to Trading Parties, being the aggregate of all Account Energy Imbalance Cashflows and Information Imbalance Charges pro-rated over a Trading Party's Credited Energy Volumes. Specifically, payments are pro-rated according to the Credited Energy Volumes for BM Units that are in delivering Trading Units, and the Credited Energy Volumes times minus one for BM Units that are in offtaking Trading Units;

- **System Operator BM Cashflow (CSOBM_j):** typically a payment by the Transmission Company to cover the net cost of Offer and Bid Acceptances.

Currently, all Trading Charges are subject to VAT at the prevalent UK VAT rate. This is important, as this allows ELEXON Clear to realise a position of zero VAT liability resulting from the calculation of Daily Party Residual Settlement Cashflow. The Total System Residual Cashflow (ie aggregated Daily Party Residual Settlement Cashflow) is defined as:

$$TRC_j = TCII_j + CSOBM_j + TCND_j - TCBM_j + TCEI_j$$

Where this means:

Total System Residual Cashflow =	Total System Information Imbalance Charge + System Operator BM Unit Cashflow + Total System Non-Delivery Charge - Total System BM Cashflow + Total System Energy Imbalance Cashflow
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VAT is not a Code defined component of any of these cashflows.

Therefore, **excluding the effects of the application of VAT**, the Total System Residual Cashflow will always balance out the other five cashflows such that the Trading Charges payable, and the Trading Charges receivable, balance to zero.

Currently all Trading Charges are liable to UK VAT. The uniform application of VAT to Trading Charges that are intended to balance to zero therefore results in the VAT payable, and the VAT receivable, also balancing to zero.

Because VAT is applied uniformly to all the Trading Charges, its application therefore also results in ELEXON Clear seeing a net nil position for VAT.

ELEXON has been advised by its auditors, Deloitte and Touche LLP, that from 1 January 2005, it is no longer the case that all Trading Charges will be liable to UK VAT. Under the new rules, VAT will be chargeable according to where the recipient of the electricity is established and not where the electricity is at the time of sale. These changes are being introduced in the hope of simplifying the VAT compliance requirements for businesses in the electricity and gas industry.

A guidance note, prepared by Deloitte and Touche LLP, giving a plain English overview of the changes is contained in this document as Annex 4.

In order to comply with this taxation legislation BSCCo have obtained agreement from Customs and Excise for the proposed way forward. This involves BSCCo's VAT return being used for settling VAT relating to Trading Charges and there may be a requirement to carry out daily VAT balancing via ELEXON Ltd accounts.

In addition due to the fact that ELEXON Clear produce invoices both for Parties owing Trading Charges and Parties that are owed Trading Charges, ELEXON Clear will be required to know the VAT status of each Party (whether VAT should be charged at the UK rate or zero) and other VAT information that must be included in invoicing.

The Code, and the systems and processes that support it, require appropriate amendment to cater for this.

It should be noted that subsequent to P170 being raised ELEXON has been advised by its auditors, Deloitte and Touche LLP, that the application of VAT is changed for all BSC Charges to Parties, not simply those relating to Trading Charges. There will therefore be an impact upon the application of VAT to Section D Charges. It is not believed that this will result in any additional Code obligations under P170 that would not have already been required to cater for the changed application of VAT to Trading Charges.

P170 was raised by the BSC Panel on 12 August 2004 on the recommendation of ELEXON. The Panel further agreed that the BSC Panel Chairman should consult with the Authority as to whether it should be treated as an Urgent Modification Proposal and, if so, on the procedure and timetable that should apply.

The Authority notified the BSC Panel Chairman on 13 August 2004 that it did not consent to P170 being treated as an Urgent Modification Proposal. The Authority stated that it considers that the timescales along which P170 might be progressed are such that the Modification Proposal could be appropriately treated as non-urgent. The Authority considers that if a Modification Report were presented to the Authority by mid to late November the timescales are such to allow the modification to be implemented prior to 1 January 2005, in the event that it is approved by the Authority.

1.1.2 Alignment of P170 and CP1078

ELEXON raised Change Proposal 1078, 'System and process changes to allow compliance with the changed application of VAT to Trading Charges' ('CP1078') on 19 August 2004. CP1078 seeks to put in place those software, system and process changes required to allow compliance with the change in VAT law that are not dependent on Code changes. The decision to raise a separate Change Proposal was taken because ELEXON and the BSC Agent must commence implementation work on systems and process changes during September 2004 in order to comply with the change in VAT law by its effective from date. ELEXON will be seeking the permission of the Imbalance Settlement Group (ISG) to approve CP1078 by 8 September 2004.

It should be stressed that CP1078 is not an alternative or substitute to P170. P170 would put in place obligations on Parties (further detailed in Section 1.2 of this document) that cannot be achieved through a Change Proposal. The simplest way to explain the dichotomy of P170 and CP1078 is that P170 would deliver the obligations to comply with the changed application of VAT, whilst CP1078 would deliver the mechanisms to allow these obligations to be met.

P170 will continue to be required in order to ensure that there are appropriate obligations on Parties to provide relevant VAT information and to indemnify ELEXON, and by extension other BSC Parties, against the consequences of erroneous VAT declarations by Parties.

1.1.3 Overview of CP1078

CP1078 will put in place the system and process changes required to allow compliance with the changed application of VAT to BSC charges from 1 January 2005. These are principally focussed on systems and processes related to Trading Charges.

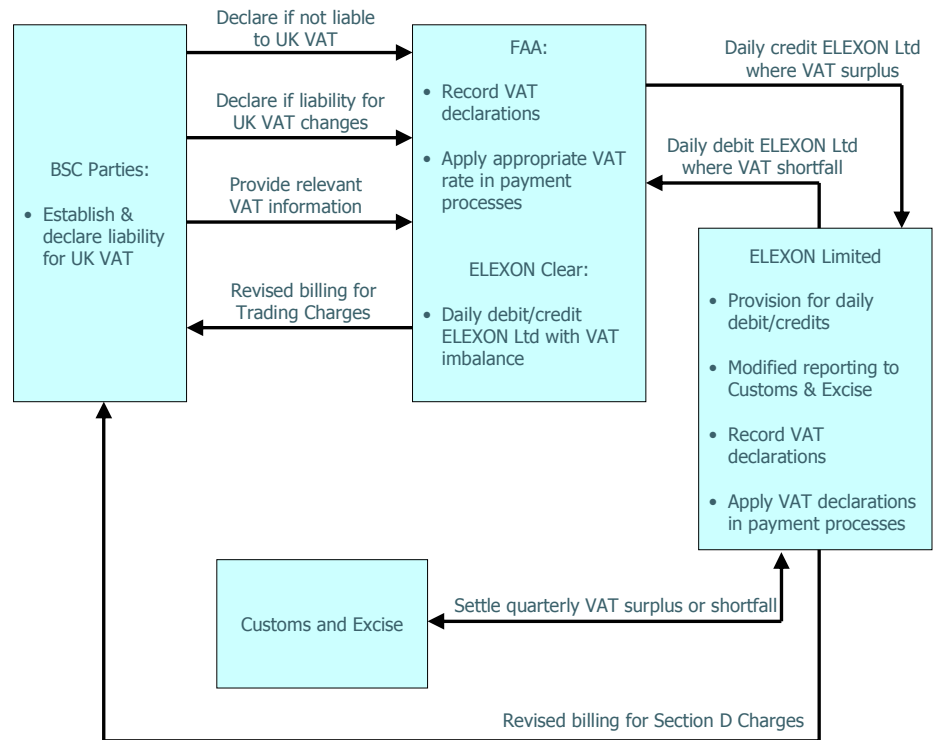
Because VAT will no longer be applied uniformly to Trading Charges, it will no longer be the case that the VAT payable, and the VAT receivable will balance to zero. Instead, on a daily basis, there will be a surplus or deficit of VAT that will need to be settled.

Agreement has been reached with Customs and Excise that this VAT imbalance should be settled by ELEXON Limited acting as an agent for ELEXON Clear. This will ensure that ELEXON Clear continues to provide limited liability to debt to the BSC community by remaining uncapitalised.

The model to facilitate this agreement is shown in Figure 2. Key features of this model are that:

Figure 2: Overview of expected system & process changes for CP1078

- BSC Parties will need to establish their liability to UK VAT and declare whether they are or not, plus relevant VAT information, to the FAA. The mechanism for making these declarations is likely to be via BSCP301, 'Clearing, Invoicing and Payment'.
- The FAA will need to apply these declarations in its payment processes to ensure VAT is applied at the correct rate by ELEXON Clear. ELEXON Clear will need to settle any daily VAT imbalance with ELEXON Limited.
- ELEXON Limited will need to debit or credit ELEXON Clear on a daily basis to ensure the latter does not accrue or incur an imbalanced VAT position. ELEXON will need to account for this VAT position on a quarterly basis with Customs and Excise. In addition, ELEXON Limited will need to modify its billing of Section D Charges.



1.2 Issues raised by the Modification Proposal

The Modification Proposal needs to address the following issues. It is recommended that they be included as additions to any Modification Group’s Terms of Reference.

1.2.1 Obligations for a Party to declare its VAT status

In order to correctly apply VAT to a Party’s Trading Charges, it will be necessary to establish whether the 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 responsibility for declaring whether or not UK VAT should be applied to Trading Charges, and the provision of relevant VAT details required for invoicing, will need to rest with each Party. As a default, it is anticipated that VAT would be applied at the UK prevalent rate.

The assessment of P170 will therefore need to consider how Parties should be obliged to ensure the correct VAT rate is applied to their Trading Charges.

1.2.2 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 to Trading Charges or Section D Charges that 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 rather than just by the Party at fault.

1.2.3 Definition of VAT within the Code

VAT is currently defined within the Code as 'United Kingdom Value Added Tax'. This definition may require changes. The Code contains references to VAT in numerous sections. 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.

1.2.4 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.

1.2.5 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.

1.2.6 Section D Charges

The assessment of P170 should consider whether obligations for applying VAT to Section D Charges need to be altered.

2 COSTS⁴

PROGRESSING MODIFICATION PROPOSAL

Meeting Cost	£ 1,000
Legal/expert Cost	£ 33,750
Impact Assessment Cost	£ 0 ⁵

⁴ Clarification of the meanings of the cost terms in this section can be found in annex 3 of this report.
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ELEXON Resource	39 Man days £ 6,930
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3 INITIAL ASSESSMENT OF IMPACTS OF MODIFICATION PROPOSAL

The following sections of this IWA set out the expected impacts of P170.

3.1 Impact on BSC Systems and processes

An initial assessment has been undertaken in respect of all BSC Systems and processes and no impact upon BSC Systems and Processes have been identified as potentially being impacted by the Modification Proposal. All system and process changes associated with the changed application of VAT will be catered for under CP1078.

3.2 Impact on other systems and processes used by Parties

An initial assessment has been undertaken in respect of systems and processes used by Parties and it is believed they will be impacted by the requirement to provide relevant VAT information to allow ELEXON Clear and ELEXON Limited to apply correct VAT rates in payment processes.

3.3 Impact on documentation

3.3.1 Impact on Balancing and Settlement Code

An initial assessment has been undertaken in respect of all Sections of the Code and the following Sections have been identified as potentially being impacted by the Modification Proposal.

Item	Potential Impact of Proposed Modification
Section A	Section A may be impacted to reflect the additional VAT information that a Party shall provide to BSCCo.
Section D	Section D may be impacted by the insertion of any appropriate cost recovery mechanisms to cater for the changes to BSC systems and processes and the changed application of VAT to Section D Charges.
Section N	Section N may be impacted to cater for the daily clearing of VAT imbalance between ELEXON Limited and ELEXON Clear. It may further require the insertions of appropriate obligations on each Party to declare whether they are liable to UK VAT; to provide relevant overseas VAT details; and to indemnify ELEXON from any costs or penalties arising from erroneous declarations.
General	There are frequent references to VAT throughout the Code, including references in sections: A, D, N, S-1, X and X-1. VAT is defined as 'United Kingdom Value Added Tax' in X-1. This definition may require changes. In addition, it would appear prudent to ensure that the contextual consistency of other VAT references is checked, which may necessitate changes to other areas of the Code.

⁵ Please note that there will be impact assessment costs associated with implementing the system and process changes required to comply with the changed application of VAT, however these will be accrued under CP1078.
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3.3.2 Impact on Code Subsidiary Documents

An initial assessment has been undertaken in respect of all Code Subsidiary Documents and none have been identified as potentially being impacted by the Modification Proposal. All changes to Code Subsidiary Documents will be catered for under CP1078.

3.4 Impact on Core Industry Documents

An initial assessment has been undertaken in respect of Core Industry Documents and no areas have been identified as potentially being impacted by the Modification Proposal.

3.5 Impact on other configurable items

An initial assessment has been undertaken in respect of other configurable items and none have been identified as potentially being impacted by the Modification Proposal. All changes to other configurable items will be catered for under CP1078.

4 IMPACT ON BSCCO

An initial assessment has been undertaken in respect of BSCCo and has identified that BSCCo will be impacted by the introduction of obligations on Parties to provide relevant VAT information to allow ELEXON Limited to apply correct VAT rates in payment processes.

5 IMPACT ON BSC AGENT CONTRACTUAL ARRANGEMENTS

An initial assessment has been undertaken in respect of BSC Agent contractual arrangements and no areas have been identified as potentially being impacted by the Modification Proposal. All changes to BSC Agent contractual arrangements will be catered for under CP1078.

6 RATIONALE FOR BSCCO'S RECOMMENDATIONS TO THE PANEL

BSCCo believes that further assessment of P170 by a Modification Group is required in order to address, and consult upon, the issues raised by this Initial Written Assessment.

BSCCo believes that the Modification Group members will require expertise in how BSC Parties account for VAT in their accounting procedures, as well as an overview of the Code and its Modification Procedures. This requirement for broad expertise does not suggest a Modification Group solely comprising members of one existing Standing Modification Group would be appropriate. In view of this, BSCCo recommends that a new Modification Group be formed to consider P170. The P170 Modification Group should be comprised from members of any of the existing Standing Modification Groups, plus any other such industry representatives, that may be identified as having suitable expertise. BSCCo believes that this will ensure that the issues raised by P170 are appropriately addressed.

7 PROCESS, TIMETABLE AND COST FOR PROGRESSING THE MODIFICATION PROPOSAL

BSCCo recommends that this Modification Proposal P170 be submitted to the P170 Modification Group for further assessment. The P170 Modification Group should be actioned to provide its report to the Panel by 14 October 2004.

It is estimated that progression of P170 will require:

- Two Modification Group meetings;
- One industry consultation including impact assessment;
- One ELEXON internal impact assessment; and
- One request for Transmission Company analysis.

The proposed timetable for the progression of P170 is shown in Annex 2 of this report.

BSCCo is recommending that the Assessment Procedure be limited to one month in order to minimise the time before the Authority is asked to make a determination on P170. This would allow the Code obligations by P170 to be introduced as soon as possible, thereby reducing market uncertainty and increasing the timescales within which Party's need to meet these obligations prior to the effective from date of the VAT law change.

8 DOCUMENT CONTROL

8.1 Authorities

Version	Date	Author	Reviewer	Reason for Review
0.1	16/08/04	Change Delivery	Sarah Parsons	Technical Review
0.2	25/08/04	Change Delivery	Sarah Parsons	Technical Review
0.3	26/08/04	Change Delivery	Sarah Parsons	Technical Review
0.4	27/08/04	Change Delivery	Alex Grieve	QA Review
0.4	27/08/04	Change Delivery	John Lucas	QA Review
1.0	27/08/04	Change Delivery	BSC Panel	Panel Decision

8.2 References

Ref No.	Document Title	Owner	Issue Date	Version
1	COUNCIL DIRECTIVE 2003/92/EC of 7 October 2003 amending Directive 77/388/EEC as regards the rules on the place of supply of gas and electricity. Http link: http://europa.eu.int/eur-lex/pri/en/oj/dat/2003/l_260/l_26020031011en00080009.pdf	The Council of the European Union	11 October 2003	N/A

ANNEX 1 MODIFICATION PROPOSAL

Modification Proposal	MP No: 170 <i>(mandatory by BSCCo)</i>
Title of Modification Proposal <i>(mandatory by originator):</i>	
Amendments to the Balancing and Settlement Code (Code), and to the systems and processes that support it, to allow compliance with the changed application of VAT to Trading Charges.	
Submission Date <i>(mandatory by originator):</i>	
12 August 2004.	
Description of Proposed Modification <i>(mandatory by originator)</i>	
<p>The Council of the European Union has directed an amendment to the rules on the place of supply of gas and electricity, for the purposes of turnover taxes⁶. This amendment takes effect from 1 January 2005 and directly affects the manner in which VAT is applied to Trading Charges.</p> <p>Currently, Trading Charges are always subject to UK VAT at the prevalent rate.</p> <p>The new rules will mean that this is not always the case. A taxable entity that is based outside the UK may qualify for Trading Charges being charged at 0% VAT within the UK.</p> <p>In order to comply with this taxation legislation BSCCo have obtained agreement from Customs and Excise for the proposed way forward. This involves BSCCo's VAT return being used for settling VAT relating to Trading Charges and there may be a requirement to carry out daily VAT balancing via ELEXON Ltd accounts.</p> <p>In addition due to the fact that ELEXON Clear produce invoices both for Parties owing Trading Charges and Parties that are owed Trading Charges, ELEXON Clear will be required to know the VAT status of each Party (whether VAT should be charged at the UK rate or zero) and other VAT information that must be provided to EU Parties on a monthly basis.</p> <p>The Code, and the systems and processes that support it, require appropriate amendment to cater for this.</p>	
Description of Issue or Defect that Modification Proposal Seeks to Address <i>(mandatory by originator)</i>	
<p>Processes and obligations to allow the identification of Parties who are not liable to UK VAT upon their Trading Charges currently do not exist. Neither does a safeguard to mitigate the risk to the BSCCo (and by extension, the BSC community) from an incorrect application of VAT resulting from the lack of such mechanisms.</p> <p>The BSCCo is obligated to comply with all applicable taxation legislation and needs to be appropriately empowered to ensure that this happens. The Proposed Modification will give the BSCCo the tools to do this in an effective manner that mitigates risks and costs to Parties.</p>	

⁶ The amendment is contained within Council Directive 2003/92/EC, which amends Directive 77/388/EEC as regards the rules on the place of supply of gas and electricity.
Issue/Version number: Final/1.0

Modification Proposal	MP No: 170 <i>(mandatory by BSCCo)</i>
Impact on Code <i>(optional by Originator)</i>	
<p>New obligations that may need to be inserted into the Code are expected to include, but may not be restricted to:</p> <ul style="list-style-type: none"> • obliging Parties to inform BSCCo / the Funds Administration Agent (FAA) of their VAT status in relation to Trading Charges, and to update this information if circumstances change; • ensuring appropriate indemnification is in place to protect BSCCo from any consequential costs resulting from incorrect VAT information; • obliging Parties to provide relevant overseas VAT information to allow FAA billing and invoicing; and • allowing any consequential interest resulting from the differential VAT rates that may be applicable to Trading Charges to be appropriately recharged to Parties 	
Impact on Core Industry Documents <i>(optional by Originator)</i>	
No impact upon other Core Industry Documents has been identified.	
Impact on BSC Systems and Other Relevant Systems and Processes Used by Parties <i>(optional by originator)</i>	
<p>FAA systems and processes will need to be modified to allow for the differential applicability of VAT rates, VAT reporting and fund transferral between ELEXON Clear and ELEXON.</p> <p>BSCCo systems and processes will need to be modified to allow for the centralised reporting and settlement of VAT relating to Trading Charges to the relevant UK tax authorities.</p>	
Impact on other Configurable Items <i>(optional by originator)</i>	

Modification Proposal	MP No: 170 <i>(mandatory by BSCCo)</i>
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Justification for Proposed Modification with Reference to Applicable BSC Objectives *(mandatory by originator)*

Section F2.1.1(d)(i) of the BSC gives the Panel the authority to propose a modification in accordance with Section C3.8.8.

Section C3.8.8 states that the BSCCo shall keep under review whether any possible modification of the Code from time to time would better facilitate the objective in Condition C3(3)(d) of the Transmission Licence, and shall recommend to the Panel any particular such modification which in BSCCo’s opinion would do so.

Condition C3(3)(d) of the Transmission Licence relates to *‘promoting efficiency in the implementation and administration of the balancing and settlement arrangements’*.

In accordance with its obligations, ELEXON has recommended to the Panel that this Proposed Modification would better facilitate the promotion of efficiency in the implementation and administration of the balancing and settlement arrangements. This would be achieved by providing an operationally efficient and legally robust framework for ELEXON and Parties to meet the obligations of the new taxation legislation. The current absence of appropriate processes and obligations may prevent ELEXON and Parties from complying with this legislation and would therefore detrimentally impact upon the implementation and administration of the balancing and settlement arrangements. ELEXON cannot confirm that it can comply with the new taxation legislation without a Modification Proposal. ELEXON may be exposed to significant financial penalties if it fails to comply with taxation legislation and due to its funding structure the risk of exposure to these costs rests with Parties.

In addition to this, mandating appropriate procedures and obligations to allow smooth compliance should result in a reduction in ELEXON, BSC Agent and Party resource demands when compared with attempting to ensure compliance based upon voluntary procedures without the explicit authority of the Code. Clear mechanisms to allow compliance will promote efficiency in the implementation and administration of the balancing and settlement arrangements.

Details of Proposer:

Name.....

Organisation.....BSC Panel.....

Telephone Number.....

Email Address.....

Details of Proposer’s Representative:

Name.....Chris Rowell.....

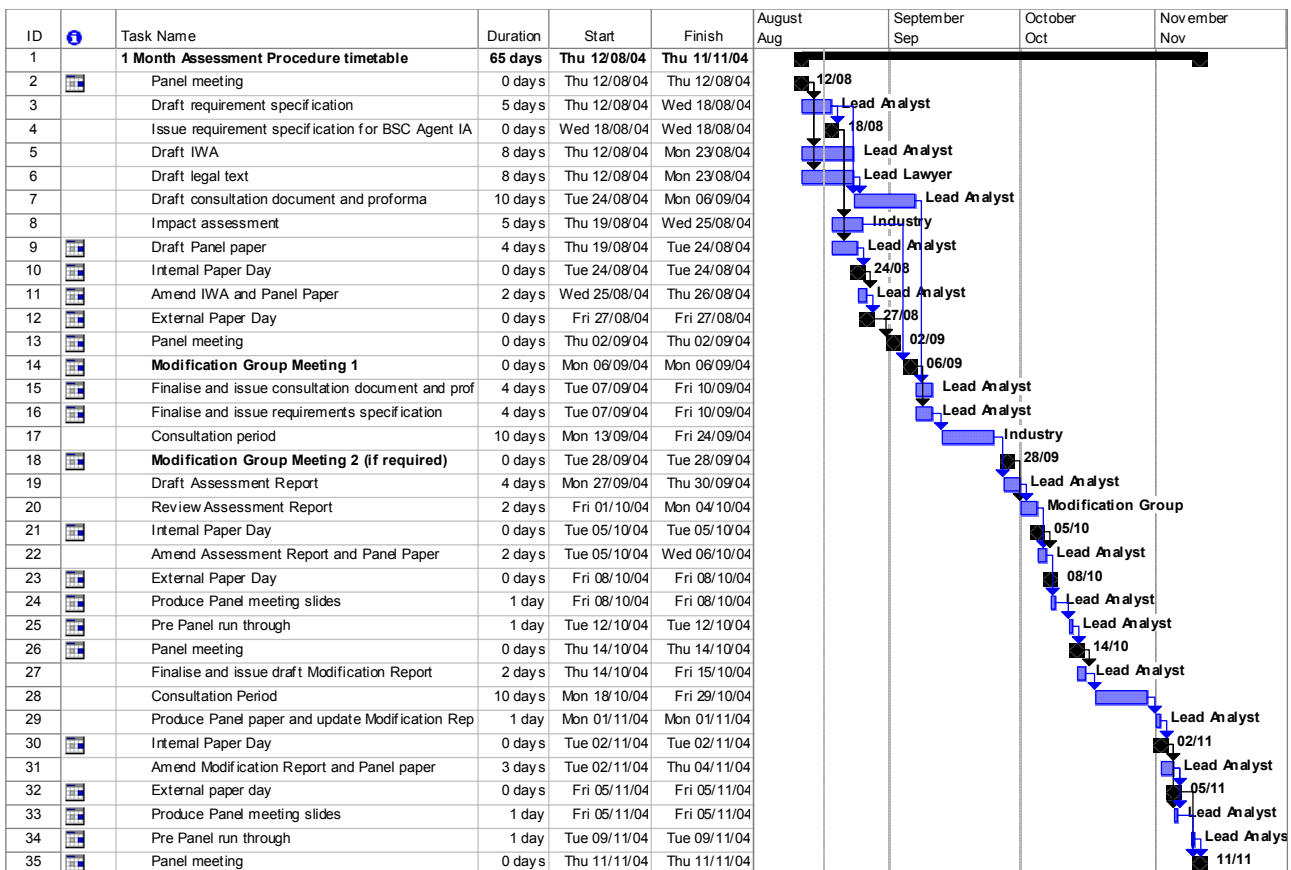
Organisation.....ELEXON Ltd.....

Telephone Number.....

Email address.....

<h2 style="margin: 0;">Modification Proposal</h2>	MP No: 170 <i>(mandatory by BSCCo)</i>
Details of Representative's Alternate:	
Name	
Organisation	
Telephone Number	
Email address	
Attachments: No <i>(mandatory by originator)</i>	

ANNEX 2 GANTT CHART



ANNEX 3 CLARIFICATION OF COSTS

PROGRESSING MODIFICATION PROPOSAL	
Meeting Cost	This is the cost associated with holding Modification Group meetings and is based on an estimate of the travel expenses claimed by Modification Group members.
Legal/expert Cost	This is the cost associated with obtaining external expert advice, usually legal advice.
Impact Assessment Cost	Service Provider Impact Assessments are covered by a pre-determined monthly contractual charge. Therefore the cost included in this report is an estimate based on the level of impact assessment that the modification is expected to require and may not reflect the actual cost attributed to the modification, which will be based on a percentage of the contractual impact assessment costs for each month that it is assessed.
ELEXON Resource	This is the ELEXON Resource requirement to progress the Modification Proposal through the Modification Procedures. This is estimated using a standard formula based on the length of the Modification Procedure.

ANNEX 4 GUIDANCE NOTE ON THE IMPACT OF THE GAS AND POWER DIRECTIVE PREPARED BY DELOITTE AND TOUCHE LLP⁷

Guidance Note on the Impact of the Gas and Power Directive

Background

Currently trading charges are treated for VAT purposes as being the consideration for a supply of electricity. Under the present VAT rules the electricity is treated as being supplied in the UK and each trading party is required to be registered for VAT in the UK. All changes are therefore subject to VAT. As the net amounts received and payable under the balancing mechanism are equal, the VAT amounts are also equal.

On 1 January 2005, new European rules will come into effect. Under these new rules, VAT will be chargeable according to where the recipient of the electricity is established and not where the electricity is at the time of sale. These changes are being introduced in the hope of simplifying the VAT compliance requirements for businesses in the electricity and gas industry.

Under the old rules, businesses were often required to maintain numerous VAT registrations across the various territories where they sold gas and electricity. In future it will be the customer's responsibility to account for VAT on supplies of wholesale gas and electricity when he is established in a different country to the supplier. The practical impact for Elexon is that payments made under the balancing mechanism to trading parties outside the UK will no longer be made

⁷ The content of this annex is a guidance note commissioned by ELEXON from its auditors, Deloitte and Touche LLP, intended to provide a 'plain English' overview of the impact of the EU Directive. It should be noted that this was commissioned to assist Parties in understanding how the issue prompting P170 has arisen, and the steps that ELEXON must take to address it. This annex does **not** constitute formal legal advice to Parties on how they should adhere to the changed VAT regime. As outlined in section xxxx of this IWA, it is intended that each Party should hold responsibility for declaring whether they are liable to UK VAT or not. It is therefore recommended that - if in any doubt - a Party should seek independent legal advice on whether its Trading Charges should be liable to UK VAT. ELEXON cannot, and will not, make this determination on its behalf.

with VAT added, and VAT will not be chargeable on payments made by these parties.

Although Elexon Clear is not registered for VAT, the confirmation notes issued served as sales and purchase invoices for trading parties. This has been allowed as the VAT totals are in balance; Under the new rules Elexon Clear would have either a surplus or a shortfall of VAT as the VAT amounts will no longer balance.

Proposed solutions

In the light of the concerns regarding the difficulties in dealing with the VAT accounting a number of different potential solutions were proposed to Customs:

1. Register all market participants for VAT
This was rejected as being incompatible with EU law.
2. Register Elexon Clear for VAT
Rejected as Elexon Clear is not a legal entity in its own right.
3. Average weighted VAT charge
This involves adjusting the rate of VAT charged to ensure that the amount is equal to that paid. A similar approach was used under the pool but this was rejected as being too complex.
4. Adjusting VAT via Elexon Limited
This involves either adjusting the VAT balance of Elexon Clear via Elexon Limited's VAT return, or treating Elexon Limited as an agent.

Outline of Customs' response to the proposals

In the light of the proposals, Customs have proposed that "Elexon Ltd be allowed to act as an agent in its own name to account for VAT incurred under the reverse charge using its current registration."

On a practical basis, this will mean the following in terms of Elexon's VAT accounting:

- By acting as agent, Elexon Limited would be treated as making sales and purchases of electricity that arise under the balancing mechanism. Since there will be a difference between the VAT incurred on the purchase of electricity and the VAT due on the sale of electricity, Elexon Limited will either recover VAT from Customs or make payment to Customs at the end of each VAT return period (whether this is a payment or refund would be subject to the location of the trading parties during the balancing period). This methodology involving Elexon Ltd acting as agent should solve the difficulty in dealing with the discrepancy between the level of VAT incurred and due under the balancing mechanism.
- We understand that this proposal would capture all supplies made under the balancing mechanism and not solely the difference between supplies made and received. In other words, Elexon Ltd will show all supplies under the balancing mechanism on its VAT return.
- This would mean that where a trading party is not established in the UK for VAT purposes and is treated as making a sale of electricity under the balancing mechanism, then Elexon Limited would self account for VAT under the reverse charge (i.e. as if it had made both the purchase and supply of the electricity). This procedure has no practical effect on Elexon Limited.

- Similarly where there are purchases of electricity under the balancing mechanism by trading parties that are not established in the UK, then Elexon Limited would treat this as a sale by Elexon Limited, which is outside the scope of UK VAT and accordingly no VAT would be accounted for on the sale.
- Under this proposal, we envisage that there should be almost no change in the way that the mechanism functions for the trading parties. That said, there will have to be some changes to the documentation requirements for overseas invoicing as invoices to parties established outside the UK but within the EU would need to comply with the requirements of the EU Invoicing Directive. We deal with this issue in further detail below.
- The proposal will be binding on all parties, including Customs, as the proposed changes will be subject to a new modification proposal as well as a revised agreement with the tax authorities.

Why this solution?

It is considered that this approach is the easiest to adopt. It falls within the principles of EU VAT law, and has minimal impact on trading parties. It is the easiest for Elexon to operate, and should be secure for the VAT authorities point of view. We anticipate that trading parties will welcome the proposal.

Practical Implications

However there are various practical implications:

1. **Time of supplies** – at present Elexon Clear calculates its balances on a half-hourly basis, meaning that there are 48 balancing periods in each daily period. Under the current time of supply rules for electricity the taxpoint is the earlier of payment or issue of an invoice. Since Elexon receives one daily payment and issues one daily document in relation to the 48 periods that arise each day under the balancing mechanism, there is at present one daily taxpoint for supplies under the balancing mechanism.

While the new legislation concerning the time of supply rules for electricity arising under the new place of supply rules has not been released, broadly, the tax point for electricity is likely to be the same as for services subject to the reverse charge (i.e. the tax point arises on the date of payment). On this basis, Elexon Ltd will be treated as making supplies on a daily basis arising from the daily payment made under the balancing mechanism.

2. **Confirmation of place of supply for trading parties** – it is our understanding that for the purposes of the new place of supply rules, the place where a business is established will depend on broadly the same criteria as those currently used for supplies to business established outside the UK and where the recipient must self-account for VAT. Clearly, Elexon would want to ensure the correct running of this system. On this basis, Elexon proposes to determine where a business is established for VAT purposes using the following approach:

(i) **Certification** – Elexon will require trading parties to provide details of where they are established for VAT purposes via a certificate or some other written documentation.

(ii) **Test of establishment** – In addition to certification, Elexon would make sure

that it has a record of the EU VAT registration number for the trading party to which it will be making supplies and this will be used on the VAT documentation, which we discuss further below. This test would not function when applied to non-EU established traders and Customs will provide guidance on this point shortly.

- 3. Documentation** – In the past, Elexon has had detailed discussions with Customs regarding the requirements for invoicing and in the light of these discussions has agreed with Customs that certain documents may qualify as VAT invoices. It is intended that Elexon Ltd would be permitted to carry on invoicing using the same documentation for domestic supplies of electricity. However, as outlined above, the new rules regarding the place of supply will have an effect on the format of all documents provided to trading parties established in the EU and outside the UK.

Elexon propose to continue to issue documentation to trading parties as it has done before. In addition, Elexon would also issue a monthly summary VAT invoice to overseas trading parties, which would adhere to the Invoicing Directive. This would include the VAT registration number of the overseas trading party.

Under UK legislation there is a requirement to issue a VAT invoice within 30 days of a supply. On this basis, we propose that Elexon will raise the monthly document to non-UK trading parties established in the EU, which will summarise the supplies for each monthly period. While this monthly document will be the evidence for VAT purposes of supplies made, on a day-to-day basis, the current documentation system will still be able to function.