

Modification Proposal

MP No: 170

(mandatory by BSCCo)

Title of Modification Proposal *(mandatory by originator):*

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 *(mandatory by originator):*

12 August 2004.

Description of Proposed Modification *(mandatory by originator)*

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 taxes¹. This amendment takes effect from 1 January 2005 and directly affects the manner in which VAT is applied to Trading Charges.

Currently, 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 Trading Charges being charged at 0% VAT within the UK.

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 provided to EU Parties on a monthly basis.

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

¹ 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.

Modification Proposal

MP No: 170
(mandatory by BSCCo)

Description of Issue or Defect that Modification Proposal Seeks to Address *(mandatory by originator)*

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.

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.

Impact on Code *(optional by Originator)*

New obligations that may need to be inserted into the Code are expected to include, but may not be restricted to:

- 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 *(optional by Originator)*

No impact upon other Core Industry Documents has been identified.

Modification Proposal**MP No: 170***(mandatory by BSCCo)***Impact on BSC Systems and Other Relevant Systems and Processes Used by Parties** *(optional by originator)*

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.

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.

Impact on other Configurable Items *(optional by originator)*

Modification Proposal

MP No: 170
(mandatory by BSCCo)

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.....

Modification Proposal

MP No: 170
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Details of Proposer's Representative:

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

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

Telephone Number.....

Email address.....

Details of Representative's Alternate:

Name.....

Organisation.....

Telephone Number.....

Email address.....

Attachments: No *(mandatory by originator)*