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**European Energy Regulators' response to the European Commission's  
consultation "On the Future of VAT – Towards a simpler, more robust and  
efficient VAT system"  
4-May-2011**

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The Council of European Energy Regulators (CEER) welcomes the possibility to comment on the Green Paper on the future of VAT.

The aim of European Energy Regulators is to improve market functioning across Europe and ensure a fair and predictable regulatory framework for market participants. Thus, questions on taxation are generally not an issue for energy regulators. However, CEER is concerned about the threat of VAT fraud to market integrity in electricity and gas markets. We would like to draw attention to this issue which should be taken into account when revising the VAT regime.

Several National Energy Regulatory Authorities (NRAs) have been informed by energy exchanges, traders, transmission system operators or tax authorities that dubious companies have tried to find out how to enter the electricity and gas markets and set up trading relations.

VAT fraudsters take advantage of the different treatment of domestic and cross-border trades. To simplify, a fraudster located in one Member State imports goods VAT-free from a company in another Member State, and sells these goods domestically at VAT-inclusive prices without paying the VAT to the tax authorities. This becomes even more severe as the same product may be circulated several times between Member States, and thus the fraud represents a tax loss which is several times the amount of VAT levied upon it.

As the opportunities for VAT fraud have been eliminated in the emission trading sector (by extending the recently introduced "reverse-charge" procedure or by reducing VAT on emission allowances to zero), a high risk is perceived that VAT fraudsters will now attack electricity and gas wholesale trading as their next target market. Conspicuous companies from the emission trading market have already tried to register with power exchanges.

**We therefore welcome the Green Paper on the future of VAT – Towards a simpler, more robust and efficient VAT system in general. However, due to recent events, we would like to highlight the issue of VAT fraud which may lead to tremendous tax revenue losses. This is especially true for energy products as they can be resold before actual delivery. Nevertheless, CEER is not only concerned about losses in tax revenues, but about the detrimental effect that VAT fraud would have on competition and liquidity as recently demonstrated in the CO<sub>2</sub> market.**

It has been estimated that, in some markets, up to 90 percent of the entire CO<sub>2</sub> trading volume was actually a result of fraudulent activities. As a result, transaction volumes in these markets broke down once the fraud was detected and have not recovered since.

CEER is concerned that something similar may happen in electricity and gas markets. These markets are young and still in an early stage of development. The transaction volumes on energy exchanges and in the OTC market have been constantly increasing over the last years. In the course of the liberalisation of the energy sector, wholesale energy trading has become an important pillar of the energy business and plays a significant role in developing competition. Cases of VAT fraud in these markets could – as has happened in the emission certificate markets – corrupt the confidence of market participants in the market. This would have a detrimental effect on energy trading and could lead to a backlash on the path to the creation a Single European Energy Market.

It must be noted that such misgivings are fostered by the fact that, for several reasons, electricity and gas markets may be prone to VAT fraud:

- VAT liability does not depend on the actual point of delivery, but on the location of the company providing and receiving the goods. Therefore, no actual physical cross-border transfer of electricity and gas is required. A **domestic trade could thus qualify as a “cross-border” VAT-free trade** provided that one of the traders is from abroad.
- Trading chains with **huge turnovers** can be created.
- By involving electricity or gas exchanges, **supply chains become hardly traceable** due to the principle of anonymity which is applied on exchanges.
- In contrast to other physical goods, there is **no comprehensive register of cross-border trades**. This makes Europe-wide coordination or a control to detect fraud more difficult.
- **VAT fraud in electricity or gas markets does not necessarily become visible** in nomination or transaction, depending on national regulations. There is no **Europe-wide register for energy traders** and **no Europe-wide monitoring of transactions**. In Germany, for instance, it is possible to trade without being “visible” to transmission system operators and authorities if traders find a balancing responsible party that allows them to trade on their balancing account. This way it becomes more difficult to detect VAT fraudsters.

CEER is committed to contributing to the mitigation of fraud in energy trading. There are national initiatives as well as dialogue between European authorities and relevant stakeholders aimed at addressing the threat of VAT fraud. However, these can only be interim measures which are unlikely to banish fraudsters from the European energy market completely. Thus, the VAT regime will have to be designed in a way which eliminates the potential of VAT fraud in the energy sector, and all other sectors, in Europe. The European Commission should therefore consider extending the 'reverse-charge' mechanism at short notice to the goods at stake, wholesale electricity and gas products, as an immediate measure as has already been done for CO<sub>2</sub> trading.

From the European Energy Regulators' point of view, this would give the necessary time and opportunity for a thorough consideration of an overall change towards a simpler, more robust and efficient VAT system.

European Energy Regulators would be pleased to give further input on this issue in the course of the discussion process if this is considered helpful by the European Commission.