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DIRECTORATE-GENERAL
TAXATION AND CUSTOMS UNION
Indirect Taxation and Tax administration
Value added tax

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**VALUE ADDED TAX COMMITTEE
(ARTICLE 398 OF DIRECTIVE 2006/112/EC)
WORKING PAPER NO 966**

**CONSULTATION
PROVIDED FOR UNDER DIRECTIVE 2006/112/EC**

ORIGIN: Portugal
REFERENCE: Article 102
SUBJECT: Application of a reduced VAT rate on the supply of electricity and natural gas

1. INTRODUCTION

In accordance with Article 102 of the VAT Directive¹, Portugal has submitted a consultation to the VAT Committee in view of applying a reduced VAT rate (6%) to the supply of electricity and natural gas (Annex I).

Article 102 of the VAT Directive provides that Member States may apply a reduced rate to the supply of natural gas, electricity or district heating after consulting the VAT Committee.

The intention of Portugal is to apply the reduced VAT rate of 6% to the fixed component of the supply of electricity whose subscribed power does not exceed 3.45 kVA and the fixed component of supplies of natural gas for low pressure consumption not exceeding 10 000 m³ per year. The fixed components of electricity supplies for which the contracted power exceeds 3.45 kVA as well as the supplies of low pressure gas exceeding 10 000 m³ per year will continue to be taxed at the standard VAT rate of 23%.

Portugal intends to implement the measure as soon as the consultation procedure with the VAT Committee is completed.

2. SUBJECT MATTER

Portugal states that the proposed measure is part of a set of measures aiming at reducing the costs associated with energy consumption and protecting final consumption, without significantly eroding the VAT revenue. It is estimated that the revenue losses resulting from the measure would amount to approximately EUR 37 million.

It is noted that, according to the Portuguese legislation, the compensation to be paid in respect of the supply of electricity and natural gas forms part of a fixed component and an amount varying according to the consumption. This aims at differentiating the price of energy consumed by reference to the volume and modes of consumption.

As regards electricity, the fixed components are determined according to the power contracted by the customer, whereas in the case of natural gas they are determined according to the actual consumption band. The consumption band is determined by the operator of the natural gas distribution system based on the annual consumption of the previous year or, in the case of the first year of contract, on the estimated annual consumption. These components are ring-fenced in the invoices relating to the supply of electricity and natural gas respectively.

The Portuguese authorities estimate that the proposed measure would benefit 3 163 270 customers out of a total of 6 049 819 customers (contracts) in the case of electricity and 1 477 560 customers out of a total of 1 482 642 customers (contracts) in the case of natural gas, whereby customers are domestic consumers or businesses.

¹ Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax (OJ L 347, 11.12.2006, p. 1).

It is underlined that the measure will have some redistributive effects, as it will benefit more those who consume less electricity and natural gas. In addition, it is considered as a positive environmental measure, because by focusing the reduction of the VAT rate on the fixed component rather than on the variable consumption, it does not encourage an increase in energy consumption or excessive consumption.

The Commission services requested from Portugal to clarify the following points:

- a. Whether there has been a specific reason for setting the limits to 3.45 kVA and 10 000 m³;
- b. Whether it would be possible to specify what percentage of the contracts relating to the supply of natural gas corresponds to businesses (taxable persons) and what percentage corresponds to domestic users, given that the measure will benefit the vast majority of the customers (1 477 560 contracts out of a total of 1 482 642);
- c. Similarly, as regards the supply of electricity, what is the percentage of taxable persons (businesses) and what is the percentage of domestic users to whom electricity of maximum 3.45 kVA is provided;
- d. The meaning of the ‘fixed component’ (whether this amounts to a standing charge or otherwise).

The Portuguese authorities responded as follows:

- a. The reason for setting the limits to 3.45 kVA and 10 000 m³ was to reduce the costs associated to the consumption of energy to a significant part of the consumers without having a significant impact on the VAT revenues. Moreover, Portugal understands that setting those limits will have a positive impact on the protection of the environment since this measure will benefit mostly those who consume less electricity and natural gas, promoting energy efficiency. Additionally, Portugal considers that this measure will not compromise the principle of neutrality nor increase the risk of distortion of competition since the VAT reduced rate will apply to contracts concluded by the suppliers with both non-taxable persons and taxable persons. Finally, Portugal has proposed these limits based on the fact that there is a similar VAT rate structure in France, which was considered in accordance with the VAT principles by the Court of Justice of the European Union (CJEU)²;
- b. The VAT reduced rate on the fixed component will apply to contracts concluded both with non-taxable persons and with taxable persons, notwithstanding the fact that the electricity and natural gas consumption structure of the acquirer should not exceed 3.45k A of contracted power, in case of electricity supplies, and 10 000 m³ of annual consumption, in case of natural gas supplies. With respect to the percentage of natural gas contracts concerning low pressure consumption that does not exceed annually 10 000 m³, it is estimated that 92% regards domestic users (normally non-taxable persons) and 8% businesses (taxable persons). These percentages are based on the statistics of the Portuguese energy market regulator (ERSE);

² Judgment of 8 May 2003, case C-384/01, *Commission v France*, EU:C:2003:264.

- c. Regarding the percentage of electricity contracts whose contracted power does not exceed 3.45 kVA, and assuming that those contracts represent 45% of the low tension contracts (≤ 20.7 kVA), it is estimated that 87% concern domestic users (normally non-taxable persons) and 13% businesses (taxable persons). These percentages are based on the statistics of the Portuguese energy market regulator (ERSE) and Directorate General for Energy and Geology (DGEG);
- d. The fixed component of the supplies of electricity and natural gas is a standing charge determined annually by the Portuguese energy market regulator that is reflected on the supplies of electricity and natural gas made both in the regulated market and in the liberalised market.

3. THE COMMISSION SERVICES' OPINION

The Commission services take note of the intention of Portugal to apply a reduced VAT rate of 6% to the supply of electricity and natural gas as soon as the consultation procedure with the VAT Committee is completed.

The reduced VAT rate of 6% will be applied to the fixed component of the supply of electricity whose subscribed power does not exceed 3.45 kVA and the fixed component of supplies of natural gas for low pressure consumption not exceeding 10 000 m³ per year. The fixed components of electricity supplies for which the contracted power exceeds 3.45 kVA as well as the supplies of low pressure gas exceeding 10 000 m³ per year will continue to be taxed at the standard VAT rate of 23%.

It is understood that the specific limits of 3.45 kVA as regards the supply of electricity and 10 000 m³ as regards the supply of natural gas have been chosen with a view to reducing the costs associated with the consumption of energy to a significant part of the consumers, while minimising the impact on the VAT revenues. Based on the statistics of the Portuguese energy market regulator (ERSE), it is estimated that 92% of natural gas contracts relating to low pressure consumption that does not exceed annually 10 000 m³ concern domestic users (normally non-taxable persons) and 8% concern businesses (taxable persons). The respective rates for electricity contracts whose contracted power does not exceed 3.45 kVA – assuming that those contracts represent 45% of the low tension contracts (≤ 20.7 kVA) – are 87% and 13%.

It follows that, although the reduced VAT rate on the fixed component will apply to contracts concluded with both non-taxable persons and taxable persons, the proposed measure will mostly benefit domestic users. Portugal underlines the redistributive effects that the proposed measure is likely to have. It also stresses that by focusing the rate reduction on the fixed component rather than on the variable consumption, the proposed measure ensures that energy consumption or excessive consumption is not encouraged. Moreover, given that domestic users in principle consume less electricity and natural gas, Portugal expects the specific limits to promote energy efficiency and thus have a positive impact on the protection of the environment. The Portuguese authorities estimate that the measure would result in a negative budgetary impact of EUR 37 million.

Additionally, Portugal considers that the proposed measure will not compromise the principle of neutrality nor increase the risk of distortion of competition, since the reduced VAT rate will apply to contracts concluded with both non-taxable persons and taxable persons.

As to the nature of the ‘fixed component’ of supplies of electricity and natural gas, the Portuguese authorities confirm that it amounts to a standing charge determined annually by the Portuguese energy market regulator. This charge is reflected on the supplies of electricity and natural gas both in the regulated market and in the liberalised market.

Portugal refers to a similar VAT rate structure in France, which was considered in accordance with the VAT principles by the CJEU³. The case concerned the application of a reduced VAT rate only to the fixed component of the prices for gas and electricity supplied by the public networks⁴. The CJEU ruled that the fiscal neutrality principle, which precludes treating similar goods, which are thus in competition with each other, differently for VAT purposes was not infringed by the selective application of the reduced VAT rate to one part only of the supply of gas and electricity, provided that no risk of distortion of competition existed. The CJEU further clarified that, since the reduced VAT rate is an exception, the restriction of its application to concrete and specific aspects, such as a standing charge, is consistent with the principle of strict interpretation of the exemptions or derogations⁵. The Commission services note further that the division of the consideration for the supply of natural gas and electricity into a fixed and a variable part was deemed as “*constitut[ing] the exercise of the distribution undertakings’ freedom to fix prices for an integrated supply*”⁶.

The Commission services agree with the above considerations. In this regard, they point out that, according to Council Directive 2009/162/EC⁷, the rules for determining the place of taxation of natural gas and electricity determine that VAT is levied at the place where the gas and electricity is actually consumed. They thus ensure that there is no distortion of competition between Member States.

Furthermore, Portugal affirms that the simultaneous application of the reduced VAT rate to fixed components of the supply of electricity and natural gas should not lead to distortions of competition in the national energy market in those areas where these two products can be interchangeable. The Commission services note that the determination of whether the proposed measure is likely to cause competition concerns in the domestic market shall be left to the competent national authorities.

The text of the consultation as well as the response from the Portuguese authorities to the Commission services' request for clarification are annexed to this document.

³ Ibid.

⁴ The French government charged a reduced rate on standing charges for the public networks for the supply of gas and electricity and a standard rate on the consumption of these two products.

⁵ See paragraphs 25-28 of the judgment.

⁶ See Advocate General’s opinion, ECLI:EU:C:2002:574.

⁷ Council Directive 2009/162/EU of 22 December 2009 amending various provisions of Directive 2006/112/EC on the common system of value added tax (OJ L 10, 15.1.2010, p. 14).

3. DELEGATIONS' OPINION

Delegations, in particular Portugal, are invited to express their views on the matters raised and the observations made by the Commission services.

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Consultation request by Portugal (English translation):

Consultation of the Portuguese Republic to the VAT Committee under Article 102 of Directive 2006/112/EC

Legal framework

Council Directive 2006/112/EC of 28 November 2006 on the common system of VAT allows the Member States in their Article 98 to apply one or two reduced rates to the supply of goods or services in the categories set out in Annex III to that Directive.

Article 102 of Directive 2006/112/EC allows Member States, after consulting the VAT Committee, to apply a reduced rate to the supply of natural gas, electricity or district heating.

Scope of the measure and the reasoning

The Portuguese State wishes to make use of the option provided for in Article 102 of Directive 2006/112/EC to tax the reduced VAT rate of 6% on the fixed component of the supply of electricity whose subscribed power does not exceed 3,45 kVA and the fixed component of supplies of natural gas for low pressure consumption not exceeding 10.000 m³ per year.

The measure should be implemented as soon as the consultation procedure with the VAT Committee is completed.

The variable amounts payable according to consumption and fixed components of electricity supplies for which the contracted power exceeds 3,45 kVA and when supplies of low pressure natural gas exceeding 10.000 m³ per year continue to be taxed at the standard VAT rate of 23%.

Under the terms of the legislation applicable to the supply of electricity and natural gas, the compensation to be paid in respect of those supplies forms part of a fixed component and amounts which vary according to the consumption observed, with the aim of differentiating the price of the energy consumed by reference to the volume and modes of consumption.

The fixed components are determined in the case of electricity according to the power contracted by the customer and in the case of natural gas depending on the actual consumption band, and these components are ring-fenced in the invoices relating to the supply of electricity and natural gas. It should be noted that, in the case of supplies of natural gas, the consumption band is defined by the natural gas distribution system operator on the basis of the annual consumption of the previous year, or in the case of the first year of contract, in the estimated annual consumption.

According to the estimates made by the Portuguese State, the measure to reduce the VAT rate in the fixed component of the supplies of electricity and natural gas benefits 3.163.270 customers (contracts) out of a total of 6.049.819 customers in the case of electricity and 1.477.560 customers (contracts) out of a total of 1.482.642 customers

(contracts) in the supply of natural gas, whereby customers are final consumers or subject to VAT.

The Portuguese State considers that the measure sought is equivalent to the measure validated by the Court in its judgment of 8 May 2003 in Case C-384/01, in which, even with regard to Article 12(3)(b) of the Sixth VAT Directive, it ruled that selective application of the reduced rate in the supply of natural gas and electricity cannot be ruled out, provided that there is no risk of distortion of competition and that the limitation of the application of the reduced rate to certain specific and specific aspects of supply is consistent with the principle that exemptions or derogations must be interpreted restrictively (see paragraphs 27 and 28 of that judgment).

Considering that the supply of electricity and natural gas concerned is subject to taxation at the place where the customer actually uses and consumes these goods, there are no distortions of competition with other Member States.

Similarly, the decision to apply the reduced rate simultaneously to fixed components of the supply of electricity and natural gas should not lead to distortions of competition in the national energy market in those areas where these two products can be interchangeable.

Objective

The reduction of the VAT rate in the fixed component of the supply of electricity and natural gas under the terms described above is part of a set of measures that the Portuguese State is taking to reduce the costs associated with energy consumption and to protect final consumption. This solution is intended to mitigate that the measure does not have a significant impact on VAT revenue.

The VAT revenue losses associated with this measure amount to approximately EUR 37 million.

In any event, it is recognised that this measure will have some redistributive effects, benefiting relatively more of those who consume less electricity and natural gas and, at the same time, is a positive environmental measure, because by focusing the reduction of the VAT rate on the fixed component, rather than on variable consumption, it does not encourage an increase in energy consumption or excessive consumption.

Request

Considering that the conditions laid down in Article 102 of Directive 2006/112/EC are met, Portugal shall ask the European Commission to submit this consultation to the VAT Committee.

Further information provided by Portugal:

On behalf of the Permanent Representation of Portugal, further to your email requesting the clarification of several issues regarding our request of 16 January 2019, received on 22 January, for a consultation of the VAT Committee on the basis of Article 102 of the VAT Directive, please find below the answer to your queries:

1. Is there a specific reason for setting the limits to 3,45 kVA and 10.000 m3?

As referred in our consultation, the reason for setting the limits to 3,45 kVA and 10.000 m3 is to reduce the costs associated to the consumption of energy to a significant part of the consumers without having a significant impact in the VAT revenues.

Moreover, Portugal understands that setting those limits will have a positive impact on the protection of the environment since this measure will benefit mostly those who consume less electricity and natural gas, promoting energy efficiency.

Additionally, Portugal considers that this measure will not compromise the principle of neutrality nor increase the risk of distortion of competition since the VAT reduced rate will apply to contracts concluded by the suppliers with non-taxable persons and taxable persons.

Finally, Portugal has proposed these limits based on the fact that there is a similar VAT rate structure in France which was considered in accordance with the VAT principles by the Court of Justice in the judgment of 8 May 2003, case C-384/01.

2. We understand that the measure will benefit the vast majority of the customers as regards the supply of natural gas (1.477.560 contracts out of a total of 1.482.642). Would it be possible to specify what percentage of these contracts corresponds to businesses (taxable persons) and what percentage corresponds to domestic users?

As mentioned above, the VAT reduced rate on the fixed component will apply both to contracts concluded with non-taxable persons and taxable persons, notwithstanding the fact that the electricity and natural gas consumption structure of the acquirer should not exceed 3,45kVA of contracted power, in case of electricity supplies, and 10.000 m3 of annual consumption, in case of natural gas supplies.

With respect to the percentage of natural gas contracts concerning low pressure consumptions that do not exceed annually 10.000 m3 we estimate that 92% regards to domestic users (normally non-taxable persons) and 8% to business (taxable persons). These percentages are based on the statistics of the Portuguese energy market regulator (ERSE).

3. Similarly, as regards the supply of electricity, what is the percentage of taxable persons (businesses) and what is the percentage of domestic users to whom electricity of maximum 3,45 kVA is provided?

Regarding the percentage of electricity contracts whose contracted power do not exceed 3,45kVA, and assuming that those contracts represent 45% of the low tension contracts ($\leq 20,7$ kVA) we estimate that 87% regards to domestic users (normally non-taxable persons) and 13% to business (taxable persons). These percentages are based on the statistics of the Portuguese energy market regulator (ERSE) and Directorate General for Energy and Geology (DGEG).

4. What is meant by ‘fixed component’? Would this be a standing charge or otherwise?

The fixed component of the supplies of electricity and natural gas is a standing charge determined annually by the Portuguese energy market regulator which is reflected on the supplies of electricity and natural gas made both in the regulated market and the liberalized market.