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TAXATION AND CUSTOMS UNION
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Value added tax

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**VALUE ADDED TAX COMMITTEE
(ARTICLE 398 OF DIRECTIVE 2006/112/EC)
WORKING PAPER NO 937**

**QUESTION
CONCERNING THE APPLICATION OF EU VAT PROVISIONS**

ORIGIN:	Commission
REFERENCE:	Article 102
SUBJECT:	Application by Romania of a reduced VAT rate on the supply of district heating to households

1. INTRODUCTION

On 31 May 2017 Romania submitted a consultation to the VAT Committee in accordance with Article 102 of the VAT Directive¹, in view of applying the existing reduced VAT rate of 5% to *"the supply of thermal energy to the population"*², currently taxed at the standard VAT rate of 19%.

The Commission services requested further clarifications from Romania. In their reply, the Romanian authorities firstly specified the scope of the supply of thermal energy, confirming that the reduced rate concerns the supply of district heating. In this regard, it was noted that there is a public service for a centralised district heating system in the country. Secondly, they noted that the entry into force of the measure is scheduled for the 1st of January 2018. Finally, the objective of the measure was clarified. The Romanian authorities stressed that the application of a reduced rate only to the supply of district heating aims to dissuade consumers from disconnecting from the centralised heating system. The measure comes following complaints from local suppliers that there is a growing tendency of consumers to voluntarily disconnect from the centralised heating system.

Given that Romania intends to introduce the application of the reduced rate as from 1 January 2018, a written procedure was considered as the most appropriate procedure³. To launch the written procedure, the Commission services drafted Working Paper No 927 dated 10 August 2017 in which two main issues of concern were raised, on which Romania's response was requested.

As Romania's response to the questions raised was inconclusive as to the issues raised in relation to the intended application of the reduced VAT rate on district heating, it was decided to terminate the written procedure and put the matter on the agenda of the 109th meeting of the VAT Committee for an oral exchange.

2. SUBJECT MATTER

The intention of Romania is to subject the supply of district heating, currently taxed at the standard VAT rate of 19%, to the existing reduced rate of 5% as of 1 January 2018. The Romanian submission stresses that the application of the reduced VAT rate to supplies of district heating is intended only for households, whereas supplies to other types of consumers will be taxed at the standard VAT rate of 19%, as is currently the case.

Romanian law⁴ defines a district heating consumer as a natural or legal person using thermal energy on the basis of a contract in its facilities that are directly linked to the facilities of a supplier. The law provides for four categories of district heating consumers:

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).

² The term 'population' used in the Romanian consultation is understood to indicate household consumers.

³ Article 8 in the VAT Committee's Rules of Procedure.

⁴ Regulation on the supply and use of thermal energy, approved by Government Decision 425/1994, as amended.

- (a) agricultural consumers: consumers who use thermal energy for the cultivation of vegetables and flowers; to raise birds and animals; for premixture factories; for green fodder drying and granulating stations, stations for sorting eggs, fruit and vegetables, as well as stations for drying cereals and treating seed, including other similar consumers;
- (b) industrial consumers: consumers, other than agricultural consumers, who as a rule use thermal energy for technological purposes;
- (c) commercial consumers: consumers who use thermal energy to heat commercial spaces and to prepare hot tap water; and
- (d) urban consumers: consumers who use thermal energy to heat a home, the offices of institutions or socio-cultural buildings and to prepare hot tap water.

It is noted that consumption for the population falls under urban consumption. Therefore only consumers of this category will benefit from supplies of thermal energy at the reduced rate of 5%.

Moreover, Romania clarifies that consumers with both technological consumption and consumption for heating and/or hot tap water belong in the category of industrial, agricultural or commercial consumers. It follows that those consumers cannot benefit from the reduced rate of 5%.

As regards situations in which houses are also used for business purposes, Romania considers that it will not be possible to draw a strict line between the categories of beneficiary taxable persons and beneficiary non-taxable persons.

Romania expects that the reduced rate would contribute to the decrease of the share of heating expenses in the family budget as well as to a reduction in the difference between the centralised system heating costs and the cost of heat production in individual systems. It therefore assumes that this would discourage consumers from disconnecting from the centralised district heating system.

According to Council Directive 2009/162/EC⁵, the rules for determining the place of taxation of gas, electricity and heating and cooling energy determine that the VAT is levied at the place where the gas, electricity and heating and cooling energy is actually consumed. They thus ensure that there is no distortion of competition between Member States.

3. THE COMMISSION SERVICES' OPINION

The Commission services understand that the decline of district heating use in the residential sector has led Romania to adopt measures intended to discourage consumers from disconnecting from the centralised district heating system. One of these measures is the envisaged application of a reduced rate to supplies of district heating to household customers. Romania expects the measure to result in *"a reduction in the difference*

⁵ 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).

between the centralised system heating costs and the cost of heat production in individual systems".

According to the Romanian authorities, the proposed measure would result in an estimated negative budgetary impact of RON 282.3 million (0.04% of GDP) for 2017.

The rules for determining the place of taxation of the district heating supplies ensure that the VAT is levied at the place where the electricity is actually consumed. This precludes the distortion of competition between Member States.

Nevertheless, the Commission services identified two main issues that may cause concern.

A first issue of concern relates to the use of a reduced VAT rate as a means to subsidise the residential district heating prices, accentuated by the fact that the reduced rate would not apply to the supply of natural gas and electricity.

The application of a reduced VAT rate to supplies of district heating to household customers might provide a competitive advantage (lower cost which may result in cheaper prices) to the supply of residential heating at the expense of different sources of household heating, which may be considered as substitutes for residential heating purposes. This may cause distortion of competition and potentially raise State aid concerns.

For this reason, the Romanian authorities were invited to contact the Commission Directorate-General for Competition prior to the introduction of the measure in order to enquire whether the measure could amount to State aids affecting trade between Member States. In their response to Working Paper No 927, the authorities informed the Commission services that they had initiated the necessary procedures for consulting the Directorate-General for Competition.

Another point of concern relates to cases of mixed use (private and professional) of district heating. Romania intends to apply the reduced VAT rate of 5% only to the supply of district heating to households, whereas for supplies of district heating to other types of consumers, the standard VAT rate of 19% will continue to apply. Since there are situations in which houses are also used for business purposes, Romania admits that "*there will be cases in which it is not going to be possible to draw a strict line between the categories of beneficiary taxable persons and beneficiary non-taxable persons*".

The Commission services do not argue against the principle of restricting the reduced rate to private households⁶. However, Romania has to establish clear criteria to achieve this aim.

The Commission services remind that, in cases where a consumer has mixed activities (business/private) at the same address⁷, providing them with the choice between a residential or a professional contract with the district heating provider has not been considered as an adequate criterion⁸, because:

⁶ See the case of Latvia in Commission Decision of 18 December 2006 ([2007/68/EC](#)).

⁷ In principle, taxable persons working at home such as hairdressers, translators, etc. as well as liberal professions.

⁸ See the Commission services' opinion in Working paper No 807: *Application by Belgium of a reduced VAT rate on certain supplies of electricity*.

1. If he/she chooses a residential contract, they will receive an invoice charging 5% VAT but they will not be able to deduct this VAT, as they will be considered as a final consumer and not a taxable person, even though part of the district heating consumption would be used in the context of their taxable activity;
2. If he/she chooses a professional contract, they will receive an invoice charging 19% VAT and will be able to deduct the amount of VAT used for their taxable activity, but they will not benefit from a lower 5% VAT rate on their private consumption.

In the case of Belgium, the Commission services took the view that such an approach would fail to tax all private consumption at the reduced VAT rate and all professional consumption at the standard rate and would deprive the professional consumers from their right to deduct VAT.

The Commission services consider that Romania should put in place an appropriate mechanism to ensure that district heating, used for private consumption, can be taxed at a reduced rate in all cases, and equally that district heating used in the context of a professional activity is taxed at the standard rate.

Romania has thus been invited to indicate how it intends to distinguish between private and professional consumption in the case of mixed use of district heating. In its response to Working Paper No 927, the Romanian authorities reiterated that they have not identified criteria permitting delimitation between beneficiary taxable persons and beneficiary non-taxable persons. They noted that, as a result, the application of a the reduced VAT in all situations where thermal energy is destined for private consumption and the application of the standard VAT rate in all situations where thermal energy is destined for professional consumers could not be ensured.

4. DELEGATIONS' OPINION

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

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