

Electricity Market

This document should be read in conjunction with section 31 of the VAT Consolidation Act 2010 (VATCA 2010)

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Background

A Single Electricity Market (SEM) for the entire island of Ireland has been introduced with effect from 1 November 2007. The SEM is a pool-based mechanism for the sale and purchase of wholesale electricity across the island of Ireland. Entities that generate electricity for sale (generators) sell their electricity through the pool, and entities that sell electricity direct to the final consumer (suppliers) buy their electricity from the pool, at the prevailing pool price for any given half-hour trading period. The pool price is determined based on the prices at which generators are prepared to sell their electricity in any given trading period and looking at the predicted demand for that trading period. Financial settlement of the trades in the pool will take place in accordance with the rules set out in the Trading and Settlement Code for the SEM.

The SEM is jointly regulated by the Commission for Energy Regulation (in the Republic of Ireland) and The Northern Ireland Authority for Utility Regulation (in Northern Ireland). To operate the market, a Single Electricity Market Operator (SEMO) has been established. The SEMO is a joint venture between EirGrid who is licensed as market operator in the Republic of Ireland and SONI Ltd who is licensed as market operator in Northern Ireland. The SEMO will:

- administer the mandatory pooling arrangements created by the SEM Trading and Settlement Code
- manage market operations in both jurisdictions
- have a physical presence in both the Republic of Ireland and Northern Ireland
- be responsible for calculating the price of electricity and recording all transactions within the SEM between generators and suppliers of electricity.

The introduction of the SEM necessitated joint approval by the Revenue Commissioners in the Republic of Ireland and Her Majesty's Revenue & Customs (HMRC) in the UK on how VAT is to be operated in relation to generation and supply of electricity on the island of Ireland. Following discussions between the Revenue Commissioners and HMRC and consultation with relevant stakeholders, agreement has now been reached on the operation of VAT in the SEM. This Information Leaflet sets out the agreed VAT treatment.

VAT registration - participants

Participants (generators and suppliers) in the SEM will be registered for VAT on the basis of their place of establishment in either the Republic of Ireland or Northern Ireland.

VAT registration - SEMO

The role of the SEMO results in it supplying services to SEM participants that are subject to VAT. The SEMO is registered for VAT as a joint venture, in both the Republic of Ireland and the UK, in respect of these services. The normal VAT rules relating to the supply of services apply to the services supplied by the SEMO and those services are subject to the rates of VAT applicable in Ireland and the UK, as appropriate.

In the context of its operation of the SEM pool, the SEMO receives supplies of goods and services. These supplies are subject to the normal VAT legislation in force in the Republic of Ireland or the UK, as appropriate.

Supplies of electricity through the Pool

4.1 General

The role of the SEMO is restricted to the operation of the pool and it does not take ownership of any of the electricity supplied between participants. As part of that role, the SEMO is responsible for calculating the price of the electricity supplied between the participants.

At the end of each settlement period the SEMO will provide each participant with a settlement document, which will include the VAT amount that is due to be paid by that participant to the Revenue Commissioners or to HMRC depending on the jurisdiction in which the participant is established. The settlement document will be acceptable to both the Revenue Commissioners and HMRC as the equivalent of a VAT invoice, and there will be no further requirement on participants to issue VAT invoices regarding the supply of electricity through the pool.

Participants operating within the pool will use these SEMO settlement documents as the basis for accounting for the output tax due on their supplies or recovering the input tax on purchases, as appropriate.

Information held by the SEMO will be available to the Revenue Commissioners and HMRC on request.

Cross-border supplies

Operation of the SEM will involve cross-border supplies of electricity. In the case of the cross-border supply of electricity from a generator to a supplier, the obligation to account for VAT rests with the recipient who is obliged to self account, on a reverse charge basis, for the VAT due on the supply at the appropriate rate (reduced rate of VAT where the recipient is established in the Republic of Ireland; standard rate of VAT where the recipient is established in the UK). However, the nature of the pooling arrangements in the SEM means that both generators and suppliers will be unable to positively identify the cross-border element of their respective sales and

purchases. Of necessity, therefore, the liability of recipient companies to account for VAT on the reverse charge basis in relation to cross-border supplies will be estimated by the SEMO. The production of electricity on the island of Ireland at present is such that, in overall terms, the cross-border element will be from Northern Ireland to the Republic of Ireland.

For the initial 14 months of operation of the Pool, the SEMO will provide both Revenue authorities with the estimated data to be used for this purpose. This will be based on the projections (used in setting up the SEM) of electricity:

- generated and supplied in Northern Ireland;
- generated and supplied in the Republic of Ireland;
- generated in Northern Ireland and supplied to the Republic of Ireland
- generated in the Republic of Ireland and supplied in Northern Ireland.

For each subsequent year estimates will be based on the actual trading for the previous year. At year-end the estimates may be compared against the actual energy flows and the rate of VAT applied to settlement documents for that year adjusted as appropriate. Ad hoc year-end settlement documents may be issued to participants reflecting any adjustments in the amount of VAT.

Settlement documents

All SEM transactions will be considered part of the supply of electricity and subject to VAT at the rate in force in either the Republic of Ireland or UK, as appropriate. A “blended” calculation (being VAT at the Irish reduced rate of VAT / UK standard rate of VAT as appropriate on the domestic element of the supply with no VAT due on the balance as this will be subject to a reverse charge by the relevant participants) will be applied by the SEMO based on the estimated cross border flows and applied to relevant supplies in accordance with the Trading and Settlement Code. An example of a blended computation is contained in Appendix 1 of this Information Leaflet. The settlement document will show the VAT due to be paid to the relevant jurisdiction. The example at Appendix 2 of this Leaflet outlines the entries that are required on the VAT returns of relevant participants.

The SEMO will also, as a temporary measure, issue an additional summary document (bi-monthly to relevant participants in the Republic of Ireland and monthly to participants in Northern Ireland) identifying the total value of cross-border supplies during the period in question. This information will enable participants to meet their intra-EU VAT accounting obligations, including application of the reverse charge by those receiving cross-border supplies. With the system now live since 1 November 2007, the SEMO will, as a priority, work towards including this information as part of the normal settlement document.

Supplies of electricity outside the Pool

Any trading of electricity outside of the Pool, in which the SEMO is not involved in any part of the transaction, will be subject to the VAT legislation in force in the Republic of Ireland or the UK, as appropriate.

SEMO supplies to participants

Invoices issued by the SEMO for its own services, as distinct from settlement documents issued in respect of the sale and purchase of electricity, will be subject to the VAT legislation in the Republic of Ireland or the UK, dependant on the VAT registration (Irish or UK, as appropriate) under which it is issued. Generally, these services will be supplied by the SEMO within the relevant jurisdiction – it is not anticipated that a cross border supply of such services will arise. Thus, supplies to a Northern Ireland participant will be supplied under the SEMO's UK VAT registration, while supplies to a Republic of Ireland participant will be supplied under the SEMO's Irish VAT registration. In the unlikely event that cross-border supplies of the SEMO's services arise, the VAT position will depend on the nature of the supplies and the VAT treatment will follow the normal place of supply rules.

Retention of Records

The time limit for retention of records will be six years for both the SEMO and the SEM participants.

Contracts for Differences

A feature of the SEM is that it is anticipated that Contracts for Differences (CFDs) may arise.

A Contract for Difference is an agreement through which parties can effectively fix the price of a price-volatile commodity, by reference to the difference between the fixed contract price and the market price. That difference is paid after the trading period. In this way the parties can hedge their exposure to price fluctuations.

In the context of the SEM, generators and suppliers may enter into CFDs, which will specify a fixed or indexed price for electricity (strike price) at which the parties have agreed to sell and buy electricity. Where in any trading period the pool price exceeds the strike price the generator pays the supplier the difference between the two. Similarly, where the strike price exceeds the pool price in any trading period the supplier will pay any difference to the generator.

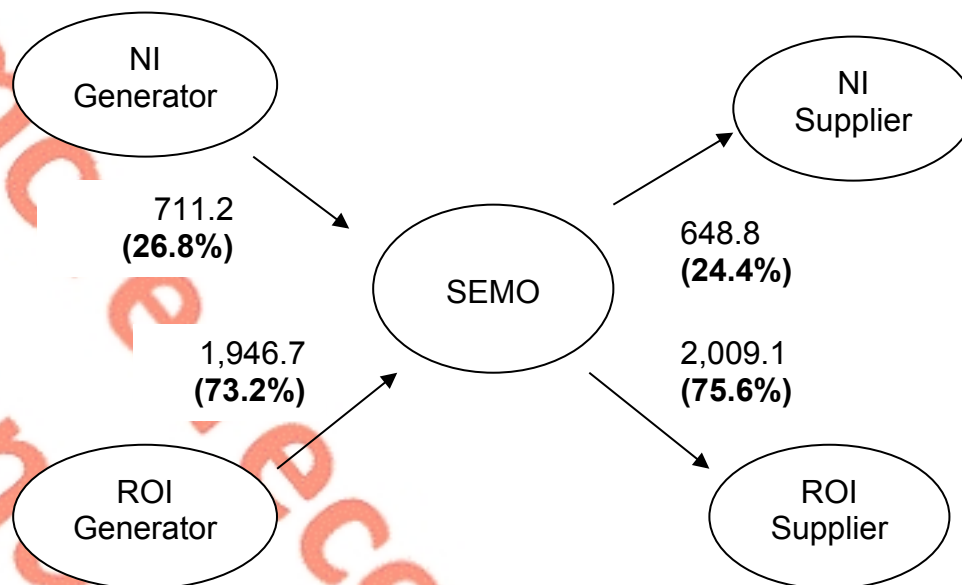
CFDs are completely outside the pool trading and settlement arrangements, under which the sale of the electricity itself takes place. CFDs are exempt from VAT on the basis that they are considered to be a financial transaction and are not connected with the supply of electricity. Thus, it will be necessary for participants who trade in

CFDs to apportion the VAT input credit to take account of their exempt income. The apportionment should be agreed with the participant's local Revenue District.

A more recent version of this manual is available.

Appendix 1 - Computation of blended calculation

The diagram below illustrates the flow of electricity, (expressed in € millions), in and out of the SEMO pool. The figures in brackets shows the electricity expressed as a percentage of total generation and total supply.



Total Generated = 2657.9m

NI Generator

Assuming that all electricity generated in NI goes first to NI suppliers, the NI generators' position is as follows:

Generates: 711.2

To NI: 648.8

To ROI: 62.4

The amount of cross border supply (to ROI) represents 8.77% of the total amount generated in NI. Therefore 91.23% generated represents local supply. Effectively this means that 91.23% is taxed at 17.5% (local UK rate) and 8.77% is zero-rated as an intra-Community supply. In order to tax the whole amount generated as one, a blended calculation is carried out as follows:

Percentage supplied to NI * Local UK Rate

$$91.23\% \quad * \quad 17.5 = 15.97\%$$

Therefore, the total amount generated by a NI generator is liable to VAT at the blended calculation of 15.97%.

ROI Supplier

Following the same logic as above, an ROI supplier receives 96.9% (1946.7/2009.1) of its electricity from ROI generators and 3.1% from NI generators. Effectively, this means 96.9% of electricity is taxed at 13.5% and 3.1% zero-rated under the reverse charge mechanism. See below for the blended calculation:

Percentage received from ROI * Local ROI rate

$$96.9\% \quad * \quad 13.5 \quad = \quad 13.08\%$$

Appendix 2 - Completion of VAT Return

Below is an example of the VAT treatment and appropriate entries in an ROI VAT return in respect of these transactions.

ROI Generator

- Supplies electricity to the pool.
- SEMO provides document recording sale of €50,000, plus VAT of €6,750 (at local rate of 13.5%; no cross border element).
- SEMO pays the Generator €56,750. Generator declares €6,750 VAT to Revenue Commissioners and retains €50,000.

VAT Return

Box T1: €6,750
Net VAT Payable: €6,750

- Return of Trading Details required annually.*

ROI Supplier

- Purchases electricity from the pool.
- Invoiced by the SEMO for purchase of €40,000 plus VAT of €5,232 (at blended calculation of 13.08%, shown in Appendix 1).
- SEMO also provides a document showing the total value of energy supplied, split between local and cross border acquisitions according to the estimated percentage split; 96.9% local and 3.1% cross-border.
- Supplier pays the SEMO €45,232.
- Supplier calculates VAT on reverse charge element, [$€40,000 * 3.1\% = €1,240$ @13.5% = €167.4]. This amount is declared as output tax in Box T1 and is also added to the actual VAT amount incurred.

VAT Return

Box T1: €167.40
Box T2: €5,399.40
Box E2: €1,240 [$€40,000 * 3.1\%$]
Net VAT Deducted: €5,232

- Return of Trading Details required annually.*

* ROI participants will be required to submit a return of trading details annually on form VAT 3G(A). Details of the VAT-exclusive values for sales, purchases, importations and intra-Community acquisitions and intra-Community supplies made by participant in the period covered by the return must be included. This is an existing requirement for all taxable persons and there is no additional burden for participants in the SEM.

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