HMRC - VATSC64240 - VAT Treatment Of Trading Activities

Introduction

The important distinction, for VAT purposes, between compliance market credits (see VATSC64220) and non-compliance market credits (VERs) (see VATSC64230) is that the former are capable of consumption of the type envisaged by the VAT system, whereas the latter are not. As VAT is a tax on consumption, the sale of compliance market credits is a supply of services which is subject to VAT (currently at the standard rate), whilst VERs are outside the scope of VAT.

Compliance Market Credits

Compliance market credits are recognised under the statutory Kyoto and EU Emissions Trading System (EUETS) ‘cap and trade’ regimes (see VATSC64220). These regimes provide for exacting verification and regulatory processes, which allow parties to a compliance market transaction to attribute a subjective value to the credit units. The credits are widely traded on national and international markets.

Polluting businesses which are subject to the EUETS must hold, or obtain on the open market, and then ‘retire’ sufficient emissions credits to cover their emissions. If they do not, then they will suffer financial penalties. The businesses ‘consume’, in a VAT sense, the compliance credits so that they can engage in economic activity without penalty and meet their regulatory commitments.

From a VAT perspective, the motive of an individual paying for a credit does not matter, nor does it matter what is done with it. Thus if a private individual buys a compliance market credit, the supply of the credit to that person is still taxable (even though they are not subject to any regime) because the credit is capable of consumption.

The sale of compliance market credits was standard rated up until 30 July 2009, when Revenue & Customs Brief 46/09 announced the introduction of a new zero rate to prevent the escalating use of compliance market credits in Missing Trader Intra-Community (MTIC) VAT fraud. From 31 July 2009 until 31 October 2010, the VAT (Emissions Allowances) Order 2009 (SI 2009/2093) added a new Group 17 to Schedule 8 of VATA 1994 which zero rated the sale of the following compliance market credits

community tradeable emissions allowances (of the type covered by the EUETS)

units issued pursuant to the Kyoto Protocol, and

options relating to any such allowance or unit.

The zero rate was introduced as an interim measure, pending agreement on a common EU-wide approach for dealing with emissions trading fraud. In March 2010, the EU adopted an amendment to the Principal VAT Directive which offered Member States the option of introducing a reverse charge on emissions trading.

From 1 November 2010 the UK introduced a new reverse charge mechanism for some compliance market credit transfers, the previous zero rate provision was withdrawn, and the VAT liability of sales of compliance market credits therefore reverted to the standard rate.

Revenue & Customs Brief 35/10 sets out the scope of the new reverse charge provision, and Notice 735 (VAT reverse charge for mobile phones and computer chips) provides detailed guidance on operation of the reverse charge mechanism.

Only those compliance market credits which can be used to meet obligations under the EUETS are subject to the new reverse charge mechanism. These currently comprise EU Allowances, some Certified Emission Reductions (CER) and some Emission Reduction Units (ERU), as defined in Directive 2003/87/EC (as amended).

Suppliers must account for output tax on supplies of any non-EUETS compliance market credits, for example Assigned Amount Units (AAUs) and Removal Units (RMUs), in the usual way.

Non-compliance market credits

A Verified Emission Reduction (VER) (see VATSC64230) is essentially a promise that carbon has been or may be reduced somewhere in the world. There may be a general benefit to the reputation of a business (good PR, marketing and corporate responsibility) in paying for a VER, but no particular service is rendered which can be identified as a cost component of the business. There is therefore no consumption. No service is being provided to an identifiable consumer and no benefit is being provided which is capable of forming a cost component of the activity of another person in the commercial chain.

Payment for a VER might produce a general social benefit, it might produce a specified result, or it might give rise to a legal relationship with reciprocal obligations. However, a taxable person’s income is relevant for VAT purposes only if it constitutes the consideration for a supply of goods or services to a consumer. The mere fact that something is or may be done in exchange for a payment is insufficient to bring such a transaction within the VAT system. The public at large cannot constitute a specific recipient of the kind which must exist in order to give rise to a transaction chargeable to VAT. Further, and in marked contrast to the situation with compliance market credits, we have seen no evidence of the existence of a genuine secondary trading market in VERs.

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