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Zero-rating of Emissions Allowances

The UK Treasury has announced that all supplies of emissions allowances within the UK will be zero rated for Value Added Tax ("VAT") purposes from 31 July 2009.

As a result, for UK carbon credit transactions, no VAT will be charged on invoices for European Union Allowances and Certified Emissions Reduction certificates, and any VAT charged on invoices will not be recoverable by the purchaser. This will include over-the-counter spot trades, futures transactions and options.

These amendments do not affect cross-border transactions.

Background

This measure has been introduced in response to the threat of VAT fraud in connection with trading of emissions allowances, in particular in the spot market, which has seen a huge increase in trading volumes this year. These increased volumes of trade aroused a suspicion of VAT carousel fraud. The opportunity for such fraud arises where standard-rated goods or services can effectively be traded VAT-free between EU member states. This VAT-free supply provides the opportunity to perpetuate the VAT carousel fraud. The fraud occurs when a UK company

purchases the emissions allowances from an overseas trader; sells them to another UK company charging VAT on the supply and fails to pay it over to HM Revenue & Customs and disappears.

EU Legislation

There is currently no specific provision in EU law to introduce this measure, and the adoption by the UK of the zero rating is an interim measure pending implementation of an EU-wide solution. The UK Treasury believes it was in the public interest that this step was taken, to prevent substantial potential losses to the Exchequer and to ensure that the legitimate market is not undermined by fraudulent trading.

Certain VAT Risks Remain

The risk of fraud in UK trading has been minimised by these changes; however, the risk continues to remain for certain cross-border carbon transactions and transactions on non-UK exchanges such as the European Energy Exchange in Germany and SENDECO2 in Spain. Purchasers should continue to exercise caution and exercise appropriate due diligence of counterparties before undertaking transaction in overseas markets.

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