

1. Agreements with Tax Authorities

Under paragraph 2.4.1 of Section D of the Balancing and Settlement Code (“the Code”), each Party agrees (subject to paragraph 2.4.3 of Section D) that it will be bound by any agreement made (whether before or after the entry into force of the Code) between BSCCo (or any of its Subsidiaries) and any tax authority as to the treatment for taxation purposes of any transactions envisaged by the Code between BSCCo (or any of its Subsidiaries) and any other Party.

In addition, under paragraph 5.1.1 of section N of the Code, each Payment Party agrees (subject to paragraph 5.1.3 of section N) that it will be bound by any agreement made (whether before or after the entry into force of the Code) between the BSC Clearer (or BSCCo on its behalf) and any tax authority as to the treatment for taxation purposes of obligations to pay amounts (pursuant to the Code) in respect of Trading Charges between the BSC Clearer and any Payment Party.

Agreements reached to date with the Inland Revenue and HM Customs and Excise in relation to transactions arising under the Balancing and Settlement Code (“the Code”) are set out below.

2. Corporation Tax and Income Tax

At this stage we are able to provide the following guidance to potential and acceded Parties under the Balancing and Settlement Code (“the Code”) on corporation tax and income tax issues. This guidance has been seen and approved by the Inland Revenue. Please note that the guidance set out below is relevant only to Parties who are or will be carrying on a trade which will be subject to United Kingdom corporation tax under Schedule D Case I pursuant to the Income and Corporation Taxes Act 1988. Any person contemplating becoming a Party under the Code who considers that they may not be carrying on such a trade should seek their own specialist taxation advice.

Depending upon the other activities of the Party concerned, the relevant Schedule D Case I trade might consist in the generation or supply of electricity, or for non physical participants may be a trade of another character, such as dealing in commodities or carrying on a financial services trade.

2.1. BSCCo Charges

1. Any amounts payable by a Party by way of BSCCo Charges under Section D of the Code will constitute normal revenue expenditure for the Trading Party concerned.
2. Accordingly such amounts should normally be deductible for United Kingdom corporation tax purposes in calculating the profits of the Party’s Schedule D Case I trade in the usual way. This, of course, assumes that such charges have been incurred wholly and exclusively for the purposes of the Party’s trade.

2.2. Trading Charges

1. Any net amount payable by BSC Clearer to a Payment Party in respect of a Trading Charge under Section N of the Code (including a Reconciliation Amount) will be treated as revenue for the purposes of United Kingdom corporation tax and accordingly would normally be subject to tax as income of the Payment Party’s Schedule D Case I trade.

2. Similarly any net amount payable by a Payment Party to BSC Clearer in respect of Trading Charges will be treated as revenue expenditure to be deducted in calculating the profits of the relevant Schedule D Case I trade in the usual way. This assumes that the Trading Charges have been incurred “wholly and exclusively” for the purposes of the Payment Party’s trade.

2.3. Interest and Amounts in Lieu of Interest

There is no obligation on any Payment Party to withhold any amount in respect of income tax from any amount in lieu of interest included in Reconciliation Charges under paragraph 6.4.2 of Section N of the Code or from any amounts of interest payable under Section N of the Code. All such payments should therefore be made gross. Similarly, neither BSCCo nor BSC Clearer is under any obligation to withhold income tax from amounts in lieu of interest included in Reconciliation Charges under paragraph 6.4.2 of Section N of the Code or amounts of interest arising under Section N of the Code. Accordingly such payments will be made gross.

The Inland Revenue have indicated that they will wish to review the guidance on interest if at any time there are Payment Parties other than:

- a) Payment Parties who are carrying on a trade in the UK and who treat the amounts described above as receipts of the trade and
- b) Payment Parties who are not resident in the UK but who have received clearance from the Inland Revenue under a double taxation agreement to have the amounts described above paid to them gross.

3. Value Added Tax

We are able to provide the following guidance to potential and acceded Parties under the Balancing and Settlement Code (“the Code”) on Value Added Tax (“VAT”) issues. This guidance has been approved by HM Customs and Excise. Any future changes in the Code may result in revised VAT treatment.

This has been produced in view of the fact that on 1 January 2005, new European VAT rules will come into effect. Under these new rules, VAT will be chargeable according to where the recipient of the electricity is established at the time of supply.

It should be noted that HM Customs and Excise have indicated that they reserve the right to review the VAT treatment of all transactions under the Code or arising under the Code from time to time.

3.1. Notified contracts

All contracts for the supply of electricity which are nominated into imbalance settlement pursuant to Section T of the Code, regardless of the identity or other business activities of the counterparties, will be treated as contracts for the wholesale supply of physical electricity.

This statement should not be interpreted as making any comment on the VAT treatment of any contracts not nominated into imbalance settlement.

3.2. BSCCo Charges

For United Kingdom VAT purposes BSCCo will be treated as carrying on a business consisting in the discharge of its various functions under the Code in return for charges levied on a Trading Party to cover its costs. BSCCo will maintain a UK VAT registration,

and the charges it makes to participants under Section D of the Code will be the consideration for supplies for VAT purposes.

3.3. Trading Charges

HM Customs & Excise have agreed that BSCCo may as agent in accounting for VAT on trading charges.

Invoices will be issued and VAT thereon will be accounted for by BSCCo. All elements in Trading Charges (except for Information Imbalance Charges and the amount in lieu of interest included in Reconciliation Amounts) arising for Payment Parties, namely BM Unit Cashflow, Non-delivery Charges, Energy Imbalance Cashflow and Residual Settlement Cashflow, are considered to be consideration for supplies of electricity. The System Operator BM Cashflows payable to or by the System Operator are also considered to be consideration for supplies of electricity.

3.4. BSC Clearer

BSC Clearer will not be treated as making any supplies for VAT purposes, and accordingly BSC Clearer will not maintain a United Kingdom VAT registration. As a result BSC Clearer is not capable of issuing VAT invoices, nor can it enter into a conventional self billing arrangement.