



VAT ENERGY SAVINGS MATERIALS RELIEF – IMPROVING ENERGY EFFICIENCY AND REDUCING CARBON EMISSIONS

CALL FOR EVIDENCE RESPONSE

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INTRODUCTION

The British Property Federation (BPF) represents the UK real estate sector—an industry which contributes more than £107bn to the economy and supports 2.3 million jobs.

We promote the interests of those with a stake in the UK built environment and our members comprise a broad range of owners, managers and developers of property, as well as those who support them. Their investments help drive the UK's economic success, provide essential infrastructure and create great places where people can live, work and relax.

We welcome the opportunity to respond to HMRC's call for evidence on potential changes to the VAT energy saving materials (ESM) relief. Buildings account for around 25% of all UK greenhouse gas emissions and the property sector will have an essential role to play in helping the country achieve its target of a net zero economy by 2050.

The importance of tax policy in hitting net zero targets

As set out in our recent [Towards Net Zero](#) report, the existing net zero carbon policy landscape and guidance in the UK has set the property sector on a trajectory towards carbon reduction, but it is estimated that the pace of change and impact is not sufficient to achieve the 2050 goal. More targeted and relevant policy is needed to ensure the property sector, and the UK, can transition to net zero carbon within the planned timeline.

So far, the sector has largely taken the lead, stepping up and setting its own action plan for achieving net zero carbon. It is now time for Government to follow suit and drive the sector to accomplish its 2050 ambition. Part of this involves making sure that the tax system encourages and supports investment in energy efficient buildings. Given that 80% of the buildings that will exist in 2050 have already been built, we especially need to focus on retrofitting existing buildings and it's crucial that the tax system does not make this challenge even more difficult than it already will be.

In the context of VAT support for decarbonising residential buildings, we would make the following overarching comments:

The three key objectives

We understand that the Government will need to assess any proposals for policy reform against a set of criteria. However, we feel that in the case of ESM relief reform these criteria are overly strict and may undermine the potential for the relief to incentivise greater investment in more energy efficient residential buildings.

In particular:

1. We do not consider that “duality of purpose” (i.e. where a material or piece of kit has more than one purpose) should constitute an absolute bar to qualifying for ESM relief. Many roofing and cladding materials serve both functional and energy efficiency purposes and it feels inappropriate for the latter of these to be completely disregarded – especially given the urgency of decarbonizing the UK’s buildings.

We would therefore propose that where an item has a dual purpose that includes energy efficiency, zero-rating should be allowed, provided the effect of its installation is to improve energy efficiency to a specified standard. Manufacturer technical specifications could then be used to identify this, thus creating a clear objective test.

2. As detailed further in our response to question 18 below, it seems to us absurd that it should be so difficult to obtain VAT relief for ESM that is installed as part of a broader project. Given the pressing need to invest in domestic energy efficiency measures, it cannot be right that a VAT relief that exists to encourage such investment is so practically difficult to obtain.

We therefore disagree with the assertion in the call for evidence that *“it would not be appropriate to enable the ESMs element to be carved out of the wider single supply, as this would create uncertainty as to the broader VAT treatment of supplies involving multiple components”*. While we appreciate Government’s desire for any changes to ESM relief to not undermine broader VAT principles, it should be perfectly possible to carve out the ESM element of a wider single supply in a way that makes it clear that such carving out or apportionment is only intended to apply in a particular set of defined circumstances.

Indeed, apportionment of a single supply is an established arrangement for building work, and is the norm for works involving residential and non-residential elements, as can be seen in Notes 10 and 11 to Group 5 of Schedule 8 and Notes 1-3 to Group 6 Schedule 7A of the VAT Act 1994.

Responses to consultation questions

Detailed responses to selected consultation questions are set out overleaf. We would be delighted to discuss any of these further over the coming weeks.

QUESTION 1 Do you think battery storage should be included in the relief when retrofitted to solar panels or other ESMs (please provide details)?

Yes

The UK has made good progress in transitioning away from fossil fuels for electricity generation and towards renewable sources. However, it is well known that generation of wind and solar power is intermittent and for them to become even more effective in powering our electricity grid there's a pressing need for energy storage mechanisms. It makes complete sense for the installation of such mechanisms to be considered ESM for the purposes of VAT.

QUESTION 2 Do you think battery storage should be included in the relief when as a standalone technology, not connected to another ESM?

Yes

See response to Question 1 above.

QUESTION 3 Can you explain how this type of battery storage would meet each of the 3 objectives set out in Chapter 2

Yes

Objective 1 – as noted above, battery storage allows for surplus wind and solar energy to be stored and used instead of fossil fuel-generated power even when those sources of renewable power are not sufficient to meet demand.

Objective 2 – at 20% of cost, VAT is an important element of the price consumers have to pay to access the clean energy benefits of consistently reliable renewable energy. Reducing its all-in cost will increase affordability and encourage uptake.

Objective 3 – we cannot see how including such technology within the ESM relief would undermine broader VAT principles in any way.

QUESTION 14 Do you think the relief for the installation of ESMs in a building intended for use solely for a relevant charitable purpose should be reinstated? And if so, why?

Yes

In order to hit net zero targets we need to be making it as economically viable as possible for property owners and occupiers of all types and descriptions to sustainably retrofit their buildings. The tax system recognises that charities merit differential treatment that reflects the valuable social role that they play and it feels appropriate that the ESM rules should support those charities looking to improve the energy efficiency of their premises.

As a large proportion of charities are unable to recover the majority, if not all, of their VAT, the addition of VAT to the cost of improving the energy efficiency of their building has a more significant impact on cost than it might, for example, the owner of a commercial property.

The call for evidence refers to buildings intended for use “solely” for a relevant charitable purpose (RCP). However, following our exit from the EU, there would not appear to be any technical VAT need for this “solely” restriction to apply. It would be more appropriate in our view to adopt the approach taken by the VAT reduced rate for fuel and power, where Note 3(b) to Group 1 of Schedule 7A refers to “*use by a charity otherwise than in the course or furtherance of a business*”. Indeed, it would seem odd in the context of meeting our net zero commitments for VAT policy to be more generous with the use of energy than with measures to limit its use.

QUESTION 18 Are there any other suggestions you have for making the relief more effective and efficient?

Application where ESM installed as part of a broader refurbishment project

Buildings can be very long lived assets. Indeed, many homes around the UK are well over one hundred years old and the country most likely has the oldest housing stock in the world. While it can make for picturesque neighbourhoods, it also means that UK residential property is among the least energy efficient and the country has a steeper hill to climb than others in terms of getting its homes to the point where they consume less energy.

Old buildings do not survive on their own – they need periodical maintenance and refurbishment to remain habitable and structurally sound. People carrying out such refurbishment works (be they individuals regarding their own homes or large-scale property owners regarding their portfolios) will often look to improve their property rather than simply restore it to its state of a few years prior. This increasingly includes taking the opportunity to install measures that improve the building's energy efficiency when a building is already being worked on.

It is generally commercially and time efficient for whichever contractor is carrying out the refurbishment works to also be the one who installs any energy efficiency or ESM measures. This is especially the case for property that is rented out (e.g. by a housing association) where the occupiers may need to be relocated for the duration of the works (or at least their most intrusive elements).

Property owners will want to minimise the time that occupiers can't be in their homes and having multiple contractors on site (e.g. one that installs the ESM and one that does the rest of the works) is usually more costly and complex (and raises the risk of tri-partite litigation where the contractors each dispute culpability for defects). Complexity during the refurbishment often results in it taking longer and, therefore, the building being empty and unable to generate an income for a longer period.

However, the way that the ESM relief rules work at the moment means that the relief is only available where separate contracts are procured for the ESM and non-ESM components, which means the relief works against the grain of commercial reality and is therefore not able to operate to its full potential.

It is also possible for a standalone ESM installation project – which a property owner would reasonably assume would qualify for the relief – to uncover wider issues with the building that also need to be rectified. If the ESM installer carries out these remedial works then ESM relief could be lost, which strikes us as a particularly perverse outcome. It is clear that this aspect of the ESM VAT relief rules needs to change.

Taking a different approach to the current restrictive list of energy saving materials

Currently, in order to qualify for zero-rating, the goods being installed must fall within the definition contained in Group 2, Schedule 7A, VAT Act 1994. Any expansion of this list, therefore, requires

changes to the primary legislation. This can be slow and cumbersome, which does not lend itself to adapting to the rapidly evolving technological changes in this area.

A more adaptable method of enabling zero-rating would be to set specified standards of energy efficiency – if a material met this standard it would then qualify as “energy saving materials”. The standard specified could be set to a sufficiently high bar such that it did not ‘open the floodgates’ and may promote innovation, to give one manufacturer a commercial advantage over another.

If the approach described above is not appealing, we would suggest expanding the list such that it includes an additional item: any materials recommended by an accredited assessor as set out in an Energy Performance Certificates (EPCs). It seems illogical that one government department (Department for Levelling Up, Housing and Communities) requires developers, landlords and home owners to purchase a Certificate which highlights a building’s energy inefficiencies and makes recommendations, while another government department’s policies disincentivise those recommendations from being implemented by the imposition of tax.

In summary

As mentioned earlier in our response, the challenge of decarbonising our buildings is considerable and the tax system should be supporting this endeavour by making energy efficient retrofit easy and more affordable.

Accordingly, we strongly feel that the ESM relief rules should be amended such that the benefit can more easily apply where ESMs are installed by the same supplier as part of a broader programme of works. In particular, we recommend that in such situations an apportionment is made between the ESM and non-ESM elements of the supply, as happens for supplies that fall within Item 1 of Group 6 Schedule 7A.

QUESTION 19 Are there any other issues that you would like to raise?**Yes***DIY ESM installation*

ESM relief does not currently apply where someone installs ESM themselves rather than commission someone else to carry out the installation works. We don't see why the tax system should discriminate in this way depending on how the ESMs are installed and would suggest that the Government explore the potential for extending zero-rating to purchases of relevant energy saving materials on a standalone basis, rather than only as part of a wider installation services. The quality / efficiency of the eligible materials could be required to meet a specified minimum standard if desired. This minimum standard could be increased as innovations improved the energy efficiencies of materials.

It seems unlikely that such materials would be purchased except with the aim of increasing the energy efficiency of a property and so the potential for misuse of this extended relief seems low. However, if misuse was a concern, an alternative option might be for individuals to make a claim to HM Revenue & Customs similar to that already in operation under the VAT DIY Housebuilders Scheme. Technology could be used to minimise the ongoing cost of administering such a scheme.

Legislative clarity

The ESM legislation currently refers to services of installing ESMs in residential accommodation. This is widely - and sensibly - interpreted as including ESM on the premises of but not physically inside a given residential property (e.g. heat pumps, solar panels, external insulation). However, for the sake of clarity we would recommend that if any legislative changes are to be made following this call for evidence, the Government uses the opportunity to make this "de facto" position (espoused by HMRC's in VENS AV3320, which says that "in" is interpreted as "serving") clear in law.

Community use

Similarly if ESM were installed for the benefit of the community or for a group of users, rather than an individual property (e.g. for the benefit of several houses in a village or neighbourhood) it seems to us that the objectives of the relief would still be served. Consideration should therefore be given to including a provision for ESM to be installed for the benefit of one or more dwellings (for example shared batteries)

Leased ESM

There is currently no provision for relief to be provided where ESMs are leased, other than on a hire-purchase contract, rather than purchased by the person who is commissioning the ESM works. We would suggest that the Government should consider remedying this.