VAT reform would promote CO2 emissions reductions, more sustainable building & cost nothing – so why the delay?
A Project Compass response to the Climate and Biodiversity Emergency objectives defined in [ARCHITECTS DECLARE](https://projectcompass.co.uk/index.php/2019/07/26/vat-reform-would-promote-co2-emissions-reductions-so-why-the-delay/)


Government for too long has been missing an enormous opportunity to incentivise investment in sustainable construction: **VAT reform**. This means redressing the long-standing skew in favour of new build over refurbishment. **Current VAT rates** – 5% for new construction and 20% for refurbishment – distort the market in favour of new build. VAT is a powerful tool which must now be used here and abroad to help accelerate low-carbon sustainable construction.

The majority of CO2 emissions in the built environment emanate from existing buildings. Yet because they exist, they have the lowest embodied energy. Rather than demolishing and rebuilding whenever the most sustainable solution is upgrading an existing building evidentially this should be done. Because there is not a level playing field, the current disparity between VAT rates results in a significant financial penalty for refurbishment.

A policy paper on UK architectural VAT was produced by the RIBA’s Procurement Reform Group in 2013 ([LINK AVAILABLE HERE](https://projectcompass.co.uk/index.php/2019/07/26/vat-reform-would-promote-co2-emissions-reductions-so-why-the-delay/)) This recommended reforming VAT with a new ‘payment by results’ quality-based approach which was evaluated to have minimal impact on HRMC tax revenues. This relies on an incentive structure where specifically sustainable construction is met or exceeded delivering VAT benefits. This creates an incentive for greener construction and better performance.

**THE PROPOSAL IS TWOFO LD**

1. First, the current 20 per cent VAT rate on repair and improvement work to existing buildings should be reduced to 5%, when the works deliver sustainability benefits that are certifiable above the minimum level of the current Building Regulations. This would encourage investment on improving performance across the existing stock.

As an essential first step reduction of the VAT rates on refurbishment to create a level playing field with new build, as has long been called for, is now urgently required.
But VAT should also be a tool to further accelerate CO2 reductions, improvements and innovation.

2. Second, there should be a standard 5% VAT rate on new-build residential dwellings. This would be applied except where such works would deliver sustainability benefits that are certifiably above the minimum level of the Building Regulations, in which case the current zero per cent VAT rate would be applied.

In both cases, the certifiable sustainability level above the regulatory minimum would in quantum and detail be set by a reasonable margin. The margins could be introduced with suitable transitional arrangements progressively adjusted and modelled for neutral cost to the exchequer. This approach to VAT reform would encourage UK homeowners to undertake sustainable improvements, and incentivise developers and industry to drive CO2 emissions reductions and push qualitative improvements in new building performance. Circular economic principles, local sourcing, recycling, upcycling, and waste reduction along with social values are all standards which could also be applied upon certification. This would further stimulate quality and professionalism, across the sector and particularly on smaller developments, reduce the grey economy that is encouraged by current VAT differentials.

HOW MIGHT VAT REFORM WORK IN PRACTICE?

The following is recommended as a development model.

Prior to the start of construction anticipated performance targets relative to Building Regulations would be set. Certification of building performance at completion is currently available through a Building Regulations completion certificate. But in this case certification extends to cover measurable performance standards upon completion and/or POE (post occupancy evaluation, as opposed to simply the designed standards).

A ‘stick’ or a ‘carrot’ approach is proposed for implementing VAT reform.

In the ‘stick’ approach.

- A developer client would always have an incentive to achieve the lowest possible VAT rate.
- Developer clients with design teams and contractors electing to construct projects targeted at achieving the lowest possible VAT level, where the targeted outputs were not achieved on completion, would become liable to tax.
- For new build if a designed VAT rate of 0% was therefore targeted, and not achieved, a 5% VAT liability would arise. In refurbishment where a 5% VAT rate
was targeted and not achieved, a 20% VAT liability would arise.

In the ‘carrot’ approach.

- For developer clients with design teams and contractors working on projects targeting the higher levels of VAT, where the targeted performance outputs were exceeded sufficiently on completion, a tax could become recoverable.

What has been learnt from the Green Deal is the need to develop robust and simple solutions with the widest possible market penetration. Pragmatically and to reduce complexity therefore, it is probable that the easiest option would be to determine VAT rates at the commencement of construction for all at 5%, and then use the stick approach on refurbishment and the carrot approach for new build.

VAT reform is nothing new. In 1999, the Urban Task Force chaired by Richard Rogers included harmonisation of VAT rates as one of its recommendations. This proposition offers potential to rapidly incentivise change to more sustainable zero carbon construction, and at no cost to the exchequer, as part of the jigsaw needing implementation. It is also an international model transferable to other contexts.

If the government is to achieve significant UK carbon emissions reduction before 2050 construction VAT should be reformed now.

**We cannot afford to wait any longer!**


[ii] Menteth W., *Incentivising design quality and sustainability, VAT Policy paper. RIBA February 2013*. [NB. A paper which also also covers the differential VAT rates applied to professional fees when charged directly by a client (20%) and when charged through a works contract (recoverable) – which incentivises D&B contracting]
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