

CIBSE RESPONSE TO DG TAX CONSULTATION PAPER

“REVIEW OF EXISTING LEGISLATION ON REDUCED VAT RATES”

ABOUT CIBSE

The **Chartered Institution of Building Services Engineers** (CIBSE) is the primary **UK professional body** for the engineers who design, install and operate the energy using systems, both mechanical and electrical, which are used in buildings. CIBSE is also a leading global professional organisation for building performance related knowledge and pioneer in responding to the threat of climate change.

The Institution is the principal UK source of professional guidance for the building services sector on the design and installation of energy efficient building services systems to deliver healthy and effective building performance. It publishes numerous Professional Guides and other titles setting out best practice in support of the industry. CIBSE is therefore very deeply involved in the practical efforts to improve existing buildings in the UK and more widely in Europe, and our members are acutely aware of the implications of VAT policy on client purchasing decisions in relation to the refurbishment of buildings. We are also very well aware of the interaction between EU VAT policy and other policy measures intended to contribute to EU energy and environmental goals.

CIBSE broadly supports these goals and is at the forefront of efforts to advance them in the UK. The EU faces a significant challenge to ensure that it maintains a secure and stable energy supply system, and to achieve significant cuts in energy demand, which also contribute to delivering those secure and stable supplies as well as meeting carbon abatement targets for the Union. Whilst we understand the philosophical and logical grounds for reviewing reduced rates of VAT, CIBSE strongly believes that progress on the EU energy and environmental policy goals must take immediate precedence over amendments to the VAT regime.

CIBSE is pleased to respond to DG Tax’s invitation to respond to the consultation on reduced rates of VAT. We have addressed the specific consultation questions below. Whilst CIBSE is domiciled in the UK, many of our members are based, or work for, companies outside the UK, including a number of manufacturing companies based elsewhere in Europe. We have therefore sought to address the questions from a wider EU perspective, to reflect the views of this wider membership base.

If you have any questions about our response please do not hesitate to contact me. CIBSE believes in open and transparent public consultation and therefore agrees to the publication of this response in full, including contact details.

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This response will also be published on the CIBSE website at
<http://www.cibse.org/index.cfm?go=page.view&item=2592>

RESPONSES TO QUESTIONS

Q2) Which arguments (social, economic, legal, etc) do you wish to put forward in the context of the assessment of the reduced VAT rate for water?

Section 6.1 notes the conflict between seeking to reduce the cost of a vital resource to vulnerable social groups through the VAT system, and at the same time effectively appearing to encourage sub optimal resource use. For water, as with energy, CIBSE believes that incentives should be applied to resource efficiency measures, and not to basic consumption.

Q3) Which arguments (social, economic, legal, etc) do you wish to put forward in the context of the assessment of the reduced VAT rate for certain energy products?

Section 6.2 of the consultation document correctly identifies that the application of reduced rates might distort decisions on the optimal energy mix, as well as the optimal level of consumption. It also frames the debate on reduced rates and energy in the context of EU-wide policy progress towards greater energy security and climate change mitigation.

A number of Member States currently apply reduced rates to end-user consumption and some apply them to measures aimed at reducing end-user consumption. For energy, as with water, CIBSE believes that incentives should apply to resource efficiency measures, and not to basic consumption.

We agree with the Commission paper that there is a need to address the social impact of higher VAT on the fuel poor and socially vulnerable, but we believe that the VAT rate for energy consumption should not be kept low solely to protect these groups, and alternative support mechanisms should be employed. On economic grounds consumption should be taxed more highly than energy efficiency measures in order to incentivise investment in energy saving measures. We believe that this approach is also consistent with the proposals for reform of the energy taxation directive.

The Communication from the Commission to the European Parliament and the Council on “Strategy for the sustainable competitiveness of the construction sector and its enterprises”, COM(2012) 433 final, issued on 31 July 2012 identifies a number of measures to stimulate the construction sector, and in particular invites Member States “to develop or strengthen appropriate programmes for repair, maintenance and renovation projects with ambitious sustainability targets, including examining the scope for relevant fiscal and financial instruments (**reduced VAT rate**, targeted subsidies, etc.) and for credit mechanisms for renovation projects with ambitious sustainability targets (emphasis added).”

In CIBSE’s view it therefore follows that where a Member State continues to apply a reduced rate to end-user consumption, then not to do so for energy efficiency and self-production of renewable energy constitutes not only a significant distortion in the market (favouring consumption of energy over capital measures to reduce consumption), but also leads to a sub-optimal level of consumption.

Such a policy also runs counter to the EU 20:20:20 policy aims of improving energy security and delivering climate change mitigation. CIBSE understands the Commission view that reduced VAT rates undermine the objectives of the Energy Taxation Directive. But we believe that disallowing reduced rates for energy efficiency and self-production measures in any Member State that applies reduced rates to energy consumption undermines the 20:20:20 policy, as well as being in direct conflict with the Strategy for the construction sector. It creates an economic distortion that runs counter to EU energy security and climate change mitigation policies, as well as being a significant social dis-benefit, particularly for those in socially vulnerable groups in fuel poverty.

Given the importance of renewable energy objectives, climate change policy and the need to stimulate the construction sector we believe that any rationalisation of VAT rates in these areas must be a secondary priority and should not be pursued at this current time.

Q5) In your view, how can the reduced VAT rate for housing be best applied in order to take the resource efficiency element into account, and how should/can this be achieved with a minimum of increase in the administrative burden for businesses, in particular SME’s, providing supplies of goods and services in the housing sector?

Q5a) How should the rate be best applied?

Energy is a key resource and therefore cost in the EU's economy. The consultation spells out the scale of the opportunity:

'Better construction and use of buildings in the EU would influence 42% of final energy consumption, 35% of greenhouse gas emissions and more than 50% of all extracted materials'.

It therefore follows that reducing energy use should be a key component in progress towards a more resource efficient Europe. Measures to reduce energy use, such as energy efficiency and end-user self-production of energy represent significant opportunities to make the energy system more resource efficient, and it is universally accepted that energy efficiency is the cheapest and most resource efficient way of meeting a number of EU policy goals:

- 1) Social Policy – Capital measures for energy efficiency and self-production reduce a building's energy bills over the whole life cycle.
- 2) Energy Security – the less energy the EU uses the less exposed it is to economic shocks in volatile energy prices, now commoditised on a worldwide basis, and to supply shocks.
- 3) Climate Change mitigation – Reduction in energy use leads to substantial and cost-effective reductions in CO₂ emissions.

A number of Member States currently apply reduced rates to final end-user consumption of energy, thereby effectively subsidising energy consumption. Whilst in the short-term this may be socially beneficial as it has the effect of lowering energy prices (particularly for the fuel poor), it clearly runs counter to any objective to improve resource efficiency. In fact it encourages more use of energy, and therefore leads to greater levels of resource *inefficiency*. We believe that this is addressed by the proposed amendments to the energy taxation directive (See also our answer to question 2 above).

In view of these goals and of the Strategy for the construction sector CIBSE therefore considers that:

- any Member State applying reduced rates to energy consumption should be required (so as to avoid market distortions and lower levels of resource efficiency) to also apply reduced rates to measures that seek to reduce energy consumption (particularly capital measures that improve energy efficiency or self-production of energy from low carbon sources). If the reduced rate for energy efficiency measures is to genuinely incentivise reduced energy consumption then it should be set at a lower level than the energy consumption rate.
- the VAT Directive should be amended to explicitly state that installed energy efficiency and self-production measures are eligible for reduced VAT rates even where a Member State also applies reduced rates to consumption. Because resource efficiency and market justifications alone justify this approach, this should be made explicit in the Directive with a separate Annex III category so that it does not need to be connected to renovation or solely a social policy justification. This also decouples consumption and conservation for VAT purposes.

As well as being consistent with the Action Plan for Construction, this is also consistent with the Commission's roadmap on resource efficiency:

'Existing policies for promoting energy efficiency and renewable energy use in buildings therefore need to be further strengthened and complemented with policies for resource efficiency, which look at a wider range of environmental impacts across the life-cycle of buildings and infrastructure'

..and with the Commission's statement that

'existing policies for promoting energy efficiency and renewable energy use in buildings therefore need to be further strengthened'

Q5b) How can this be applied and achieved with minimum increase in administration for businesses?

The VAT system is simple to administer, and businesses across the EU are quite used to completing VAT returns with differential rates of VAT where these apply. Moreover, companies installing energy efficiency or end-user self-production measures are normally specialist in doing so and properly resourced to handle the back-office systems needed to apply reduced rates. There is therefore unlikely to be any material impact on administrative burdens for these businesses.