



VAT: Changes to the reduced rate of VAT for Energy Saving Materials

Consultation document

Publication date: 9 December 2015

Closing date for comments: 3 February 2016

Subject of this consultation:	The UK was infringed by the European Commission ('EC') on its application of the reduced rate of VAT on energy saving materials ('ESMs') and subsequently lost its case in the Court of Justice of the European Union ('CJEU'). The UK is required to comply with the CJEU's judgment and amend the UK legislation that makes provision for the reduced rate for ESMs.
Scope of this consultation:	The purpose of this consultation is to receive comments as to whether or not the proposed legislation achieves its objective and whether the proposed implementation date is likely to cause any problems.
Who should read this:	Those who supply and/or install ESMs in residential accommodation.
Duration:	The consultation will start on 9 December 2015 and end on 3 February 2016.
Lead official:	For enquiries about the content of the consultation or requests for hard copies please contact: HMRC, VAT Liability Policy Team Room 3/34 100 Parliament Street London SW1A 2BQ Email: esms.consultation@hmrc.gsi.gov.uk Telephone enquiries: 03000 585639 (Michael McRae) or 03000 585703 (John Egerton) (from a text phone prefix this number 18001).
How to respond or enquire about this consultation:	Postal address and email address to which written responses can be submitted are as above.
Additional ways to be involved:	As the Government has decided to retain as much of the existing relief as is possible under EU law, this is primarily a technical consultation on the draft legislation and we would expect most contributions to be received by e mail or in writing. HMRC is also happy to meet with interested parties during the consultation period but any such meetings will be limited to the subject of the consultation and will not address any wider issues affecting ESMs.
After the consultation:	All the responses will be reviewed and will assist HMRC in deciding whether or not the draft legislation will achieve its objective and whether the implementation date is likely to cause any problems to business.
Getting to this stage:	The UK is required to make these amendments following the judgment of the CJEU.

**Previous
engagement:**

HMRC has met informally with interested representative bodies following the decision of the CJEU but there has been no discussion on the proposed changes.

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1. Introduction

Background

Under European legislation, the UK is permitted to have up to two different reduced rates of VAT. Currently, the UK has just one reduced rate at 5%, this being the lowest rate permissible.

Category 10 of Annex III of the European VAT Directive (Dir 2006/112) ('Annex III') namely "*provision, construction, renovation and alteration of housing, as part of a social policy*" is the European vire that the UK relies upon for its current reduced rate for ESMs (in Group 2 of Schedule 7A to the VAT Act 1994 ('VATA')).

The UK currently applies the reduced rate to the installation of ESMs in residential accommodation (dwellings and buildings used solely for a relevant residential purpose - such as care homes, children's homes etc.).

ESMs for the purpose of the reduced rate in the UK are:

1. insulation for walls, floors, ceilings, roofs or lofts or for water tanks, pipes or other plumbing fittings;
2. draught stripping for windows and doors;
3. central heating system controls (including thermostatic radiator valves);
4. hot water system controls;
5. solar panels;
6. wind turbines;
7. water turbines;
8. ground source heat pumps;
9. air source heat pumps;
10. micro combined heat and power units; and
11. boilers designed to be fuelled solely by wood, straw, or similar vegetal matter.

Consequently, when any of the ESMs above are installed in a residential property and are not part of, or ancillary to, a wider supply of building services, the supply is charged at the reduced rate of VAT (5%).

The EC implemented infraction proceedings against the UK as it considered that the UK's legislation was not consistent with EU law. The UK defended its legislation but, ultimately, the matter was referred to the CJEU.

The Judgement of the European Court

The CJEU found that the UK had failed to correctly apply the relief. In relying on the vire in Category 10 of Annex III ('Category 10'), the UK had:

- applied the relief too widely by failing to restrict the benefit to certain social groups or those with certain social needs;

- included in the list of ESMS items the installation of which did not amount to installations that constitute the 'provision, construction, renovation or alteration' of residential property.

In line with the CJEU's judgment, the Government intends to amend the relevant legislation in Finance Bill 2016. The Government's decision is to retain as much of the relief as possible whilst ensuring that UK law is fully compliant with EU law.

2. Changes to the reduced rate for energy saving materials

The proposed changes to implement the CJEU's decision fall into three parts which can be summarised as follows:-

- A. installations complying with the 'social policy' requirement in Category 10;
- B. other installations in residential buildings;
- C. changes to the list of installed goods included within the reduced rate.

A. Installations complying with a social policy

Subject to the changes to the list of installed goods included within the relief (see 2C below), the reduced rate will continue to apply as it does now to supplies made to people living in dwellings who have a social need ('**qualifying persons**'), to supplies made to '**relevant housing associations**' and to installations in all buildings **used solely for a relevant residential purpose**.

For '**qualifying person**', we have cross referred to the definition in Note 6 of Group 3 of Schedule 7A VATA (reduced rate for grant funded installations of certain goods) which relies on the same EU vires.

This defines a qualifying person as someone who:-

- a) is aged 60 or over; or
- b) is in receipt of one or more of the following benefits-
 - i. council tax benefit;
 - ii. disability living allowance;
 - iii. any element of child tax credit except the family element, working tax credit, housing benefit or income support;
 - iv. income based job-seekers allowance;
 - v. disablement pension;
 - vi. war disablement pension;
 - vii. personal independence payment;
 - viii. armed forces independence payment;
 - ix. universal credit.

For '**relevant housing association**', we have cross referred to Note 21 of Group 5 of Schedule 8 VATA.

This defines a relevant housing association as-

- a private provider of social housing;
- a registered social landlord within the meaning of Part I of the Housing Act 1996 (Welsh social landlords);
- a registered social landlord within the Housing (Scottish) Act 2010 (asp 17) which is either-
 - a society registered under the Co-operative and Community Benefit Societies and Credit Unions Act 1965 (c.12), or
 - a company within the meaning of the Companies Act 2006 (c.46); or
- a registered housing association within the meaning of Part II of the Housing (Northern Ireland) Order 1992 (Northern Irish registered housing associations).

In addition, installations in buildings used solely for a relevant residential purpose will also remain eligible for the reduced rate and **'use for a relevant residential purpose'** will be defined as it is now in Note 2(2) to Group 2 of Schedule 7A VATA ('Group 2').

These changes are designed to ensure that UK legislation is fully compliant with EU legislation – specifically the vires in Category 10, namely the *'provision, construction, renovation and alteration of housing, as part of a social policy'*.

B. Other installations in residential buildings

Again subject to the changes to the list of installed goods included within the relief (see 2C below), the reduced rate will also apply to supplies made to persons living in dwellings who are not qualifying persons but, where the cost of the materials element of the installation exceeds the cost of installing the goods (the labour element), the reduced rate will be restricted to the labour element of the supply. For example, if the installation of a new Micro CHP (Combined Heat and Power) boiler costs £6,000 (ex VAT) made up of £4,000 for the boiler and £2,000 installation costs, as the cost of the materials is greater than the labour cost, the £4,000 materials cost will be subject to VAT at the standard rate (20%) with only the £2,000 installation cost being subject to VAT at the reduced rate (5%).

This relies on the vires in Category 10a of Annex III ('Category 10a') - *'renovation and repairing of private dwellings, excluding materials which account for a significant part of the value of the service supplied'*.

In the vast majority of cases, we would expect the reduced rate to still apply to the whole supply as the cost to the customer of the materials installed will be lower than the cost of the labour element of the supply. However, this will not always be the case.

These changes are designed to ensure that UK legislation is fully compliant with EU law.

C. Changes to the list of installed goods included within the reduced rate

Category 10 is limited to supplies that amount to the 'provision, construction, renovation or alteration' of housing and Category 10a is limited to supplies that amount to 'renovation or repairing' of private dwellings. The installation of ESMs can be seen as the "renovation" of a property but, in order to ensure that UK law is fully EU law compliant following the decision of the CJEU, we need to exclude certain items from the reduced rate in future on the basis that their installation cannot properly be said to 'renovate' a property (rather, they simply serve to generate electricity). These are:

- solar panels;
- water turbines;
- wind turbines.

These items will therefore be excluded from the reduced rate by amending the list of ESMs in Note 1 to Group 2.

3. Practicalities

The revised legislation as drafted will mean that there could be a different VAT treatment depending upon the status of the customer (for example, whether or not the customer is a 'qualifying person'). However, the different treatment will only arise in cases where the supply includes installed materials and the cost of the materials element of the supply is greater than the labour installation cost. All other supplies will be unaffected.

Following the change in legislation, where the cost of the materials element is greater than the labour element of a supply of installing ESMs, an installer will need to account for VAT at the standard rate (20%) on the material element (the labour element remains entitled to the reduced rate). However, if the supplier can demonstrate that its customer is a 'qualifying person', a relevant housing association or a building used solely for a relevant residential purpose (see 2A above) the whole supply will be entitled to the reduced rate (including the materials element).

In most cases, it will be evident from the customer's details whether it is a housing association or the building is used solely for a relevant residential purpose. However, it may not be clear whether the customer is a 'qualifying person'. HMRC do not propose to prescribe the type of evidence that an installer needs to obtain in such a case as customers may provide different types of evidence. The requirement will be that the installer is able to demonstrate that the customer is a 'qualifying person'. However, we would normally expect evidence to take the form of one of the following: a current copy of the customer's pension or benefit statement, a copy birth certificate, a copy passport or anything else that clearly demonstrates the customer is a 'qualifying person'.

4. Date of implementation

As the UK is required to implement judgments of the CJEU without any undue delay, these changes will be included in the Finance Act 2016 and the current intention is that they will come into effect on 1 August 2016. This will give those affected sufficient notice of the changes and time to make any necessary adjustments to their work and accounting practices. For all payments made prior to this date or for any signed contracts for installations of ESMS that take place after this date, the current reduced rate will still apply.

5. Tax Lock

As outlined in the Finance (No. 2) Act 2015, the Government's policy on tax lock will not prevent changes being made to a VAT reduced or zero rate if that change is necessary following a decision of a binding court. In this case, following infringement by the EC, the CJEU has determined that the UK's reduced rate applies too widely and so these changes are necessary and, as such, comply with the Government's policy on tax lock.

6. Tax Impact Assessment

HMRC considers that the impact is likely to most affect those businesses that install solar panels and members of the public who wish to have them installed.

Summary of Impacts

Exchequer impact (£m)	2016-17	2017-18	2018-19	2019-20	2021-22
	+45	+65	+65	+65	+70
	The Office for Budget Responsibility has included these numbers in its forecast.				
Economic impact	This measure is not expected to have any significant economic impact.				
Impact on individuals and households	<p>The measure is likely to affect fewer than 500,000 individuals (and households) and the impact on affected individuals (and households) is anticipated to be negligible.</p> <p>The measure is not expected to impact on family formation, stability or breakdown</p>				
Equalities impacts	The measure does not have any impact on equalities Impact on business including civil society organisations.				

Impact on businesses and Civil Society Organisations	<p>This measure is expected to have a negligible impact on businesses and civil society organisations.</p> <p>We estimate that there are roughly 3,000 business who will incur small one-off costs updating their invoicing systems to account for the change in the tax rate on the installation of solar panels, wind turbines and water turbines. These costs are therefore expected to be negligible.</p> <p>Businesses installing Energy Saving Materials where the cost of the material outweighs the cost of installation will have to spend more time ensuring they are applying the correct tax rate. However, to date this has only been identified as an issue for the installation of Micro Combined Heat & Power boilers and we estimate that there are fewer than 30 businesses affected and note that there were fewer than 30 Micro-generation Certification Scheme certified installations in 2014-15.</p>
Impact on HMRC or other public sector delivery organisations	<p>It is not anticipated that implementing this change will incur any additional costs / savings for HMRC.</p>
Other impacts	<p>Other impacts have been considered and none have been identified.</p>

7. Consultation Questions

1. Does the legislation as drafted achieve the objectives as described in this document? If not, why not?
2. Do you have any other comments on the proposed implementation of these changes?

8. The Consultation Process

This consultation is being conducted in line with the Tax Consultation Framework. There are 5 stages to tax policy development:

- Stage 1 Setting out objectives and identifying options.
- Stage 2 Determining the best option and developing a framework for implementation including detailed policy design.

- Stage 3 Drafting legislation to effect the proposed change.
- Stage 4 Implementing and monitoring the change.
- Stage 5 Reviewing and evaluating the change.

This consultation is taking place during stages 2 and 3 of the process.

The purpose of the consultation is to seek views on:

- i) the detailed policy design and a framework for implementation of a specific proposal, rather than to seek views on alternative proposals;
- ii) draft legislation in order to confirm, as far as possible, that it will achieve the intended policy effect with no unintended effects.

How to respond

A summary of the questions in this consultation is included at chapter 5.

Responses should be sent by e-mail to esms.consultation@hmrc.gsi.gov.uk or by post to:

HMRC
VAT Liability Policy Team
Room 3/34
100 Parliament Street
London
SW1A 2BQ
Telephone enquiries: 03000 585639 (Michael McRae) or 03000 585703 (John Egerton) (from a text phone prefix this number with 18001)

Paper copies of this document or copies in Welsh and alternative formats (large print, audio and Braille) may be obtained free of charge from the above address. This document can also be accessed from the HMRC Internet site at <http://www.hmrc.gov.uk/consultations/index.htm>. All responses will be acknowledged, but it will not be possible to give substantive replies to individual representations.

When responding, please say whether you are a business, individual or representative body. In the case of representative bodies please provide information on the number and nature of people you represent.

Confidentiality

Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with the access to information regimes. These are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004.

If you want the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public

authorities must comply and which deals with, amongst other things, obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on HM Revenue and Customs (HMRC).

HMRC will process your personal data in accordance with the DPA and in the majority of circumstances this will mean that your personal data will not be disclosed to third parties.

Consultation Principles

This consultation is being run in accordance with the Government's Consultation Principles.

The Consultation Principles are available on the Cabinet Office website:

<http://www.cabinetoffice.gov.uk/resource-library/consultation-principles-guidance>

If you have any comments or complaints about the consultation process please contact:

Amy Burgess, Consultation Coordinator, Budget Team, HM Revenue & Customs, 100 Parliament Street, London, SW1A 2BQ.

Email: hmrc-consultation.co-ordinator@hmrc.gsi.gov.uk

Please do not send responses to the consultation to this address.

Annex A: Relevant (current) Legislation

VAT ACT 1994 - Group 2 of Schedule 7A

Item No.

1. Supplies of services of installing energy-saving materials in residential accommodation.
2. Supplies of energy-saving materials by a person who installs those materials in residential accommodation.

Notes:

1. For the purposes of this Group “**energy-saving materials**” means any of the following-
 - a) Insulation for walls, floors, ceilings, roofs or lofts or for water tanks, pipes or other plumbing fittings;
 - b) Draught stripping for windows and doors;
 - c) Central heating system controls (including thermostatic radiator valves);
 - d) Hot water system controls;
 - e) Solar panels;
 - f) Wind turbines;
 - g) Water turbines;
 - h) Ground source heat pumps;
 - i) Air source heat pumps;
 - j) Micro combined heat and power units; and
 - k) Boilers designed to be fuelled solely by wood, straw, or similar vegetal matter.

2(1) For the purposes of this Group “residential accommodation” means-

- (a) a building or part of a building, that consists of a dwelling or a number of dwellings;
- (b) a building, or part of a building, used for a relevant residential purpose;
- (c) a caravan used as a place of permanent habitation; or
- (d) a houseboat.

2(2) For the purposes of this Group “**use for a relevant residential purpose**” has the same meaning as it has for the purposes of Group 1 (see paragraph 7(1) of the Notes to that Group).

2(3) In sub-paragraph (1)(d) “houseboat” has the meaning given by paragraph 7(3) of the Notes to Group 1.

Note 7 to Group 1, Schedule 7A

7(1) For the purposes of this Group, “**use for a relevant residential purpose**” means use as-

- (a) a home or other institution providing residential accommodation for children,

- (b) a home or other institution providing residential accommodation with personal care for persons in need of personal care by reason of old age, disablement, past or present dependence on alcohol or drugs or past or present mental disorder,
- (c) a hospice,
- (d) residential accommodation for students or school pupils
- (e) residential accommodation for members of any of the armed forces
- (f) a monastery, nunnery or similar establishment, or
- (g) an institution which is the sole or main residence of at least 90 per cent. Of its residents, except use as a hospital, a prison or similar institution or a hotel or inn or similar establishment.

7(2) For the purposes of this Group “self-catering holiday accommodation” includes any accommodation advertised or held out as such.

7(3) In paragraph 6 “**houseboat**” means a boat or other floating decked structure designed or adapted for use solely as a place of permanent habitation and not having means of, or capable of being readily adapted for, self-propulsion.

Directive 2006/112 Annex III – List of supplies of goods and services to which the reduced rates referred to in Article 98 may be applied

(10) Provision, construction, renovation and alteration of housing, as part of a social policy.

(10a) Renovation and repairing of private dwellings, excluding materials which account for a significant part of the value of the services supplied.

Annex B: Draft proposed legislation

VAT: installation of energy-saving materials

(1) In Part 2 of Schedule 7A to VATA 1994, Group 2 (installation of energy-saving materials) is amended as follows.

(2) For items 1 and 2 substitute—

“1 The supply of services of installing energy-saving materials in residential accommodation, where the energy-saving materials are not supplied by the person supplying the services.

2 The supply of services of installing energy-saving materials in residential accommodation, including the energy-saving materials installed, where—

(a) the supply is made to a qualifying person,

(b) the supply is made to a relevant housing association, or

(c) the residential accommodation is a building, or part of a building, used solely for a relevant residential purpose.

3 The supply, in a case not falling within item 2, of services of installing energy-saving materials in residential accommodation, including the energy-saving materials installed (but see note A1).”

(3) After “NOTES:” (and before the italic heading “Meaning of “energy-saving Materials”) insert—

“Restriction on item 3

A1 (1) Item 3 does not apply to a supply so far as relating to the energy saving materials installed if the cost of those materials to the person to whom they are supplied exceeds the cost to that person of the service of installing them.

(2) In sub-paragraph (1), references to costs are to costs net of VAT.”

(4) In note 1 (meaning of “energy-saving materials”) omit paragraphs (e) to (g).

(5) After note 3 insert—

“Meaning of “qualifying person”

4 For the purposes of this Group “qualifying person” has the same meaning as it has for the purposes of Group 3 (see paragraph 6 of the Notes to that Group).

Meaning of “relevant housing association”

- 5 For the purposes of this Group “relevant housing association” has the meaning given by Note 21 of Group of Group 5 in Part 2 of Schedule 8.”
- (6) The amendments made by this section have effect in relation to supplies made on or after 1 August 2016, except for—
- (a) supplies paid for before that date, or
 - (b) supplies made pursuant to a contract entered into before that date.