

VAT reform would promote sustainable building and cost nothing – so why the delay? asks *Walter Menteth*

The so-called ‘greenest government ever’ has missed 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 per cent for new construction and 20 per cent for refurbishment – distort the market in favour of new build. VAT is a powerful tool; it should be used to help progress the government’s low-carbon agenda.

The majority of CO₂ emissions in the built environment emanate from existing buildings, yet because they exist, they have the lowest embodied energy. Whenever the most sustainable solution is upgrading an existing building, we should be doing this rather than demolishing and rebuilding. The current disparity between VAT rates results in a financial penalty for refurbishment.

The RIBA Procurement Reform Group undertook a detailed analysis of VAT in the construction sector. We recommended a new ‘payment by results’ quality-based approach. This relies on an incentive structure, whereby a provider receives VAT dispensation once prescribed sustainable construction outcomes have been met. This creates an incentive for greener construction and mitigates against poor performance.

Our proposal is twofold. First, the current 20 per cent VAT rate on repair and improvement work to existing buildings should be reduced to 5 per cent, when the works deliver sustainability benefits that are certifiable above the minimum level of the Building Regulations (or other agreed measure). Second, there should be a standard 5 per cent VAT rate on new-build residential dwellings, except where such works would deliver sustainability benefits certifiable above the minimum level of the Building Regulations, in which case the current zero per cent VAT rate would be maintained.

In both cases, the certifiable sustainability level above the regulatory minimum should be set at a reasonable margin (to be determined) and should be modelled to deliver at no cost to the exchequer. This approach to VAT reform would encourage

UK homeowners to undertake energy-efficient improvements. This would in turn stimulate the construction industry and employment growth. It would also improve the quality and professionalism of this sector, and reduce the grey economy that is encouraged by the current VAT differentials.

How might VAT reform work in practice? Anticipated performance targets relative to Building Regulations or other standards would be set prior to the start of construction. Certification of building performance at completion is currently available through a Building Regulations completion certificate. The remit of the certificate could be extended to cover certification of the performance standard.

VAT reform could be implemented via a ‘stick’ or a ‘carrot’ approach. In the stick approach, if clients, design teams or contractors elected to construct projects targeted at achieving the lowest possible VAT level, and the targeted outputs were not achieved on completion, a tax would become liable. In the carrot approach, if these parties elected to construct projects targeted at achieving the higher levels of VAT, and the targeted outputs were exceeded on completion, a tax would become recoverable. Pragmatically, the easiest option would be to fix VAT rates at construction commencement for all at 5 per cent, using the stick approach on refurbishment and the carrot approach on new build. What has been learnt from the Green Deal is the need to develop robust and simple solutions with the widest possible market penetration.

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. But we cannot afford to wait any longer if the government is to achieve its target of a 60 per cent reduction in UK carbon emissions by 2050. As with the move to lead-free petrol, this proposition offers the potential to incentivise rapid change, and to do so at no cost to the exchequer.

Walter Menteth of Walter Menteth Architects was chair of the RIBA’s Procurement Reform Group from 2011–13