



BRIEFING PAPER

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VAT on solar panels

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1. Summary

VAT is charged at the reduced 5% rate on the installation of energy saving materials, including solar panels, in residential accommodation.¹ The Government has introduced secondary legislation to amend the scope of the 5% rate to comply with European VAT rules.² This is to take effect from 1 October 2019, although the Government has stated that it expects the majority of solar panel installations to be unaffected.³

2. Background

VAT is charged on the supply of all goods and services, unless specifically exempt, either at the standard rate - currently 20% - or the zero rate. In September 1997 a reduced VAT rate of 5% was introduced on the supply of domestic fuel and power.⁴ Since then the coverage of the reduced rate has been extended to a small number of other supplies including, the installation of energy saving materials (from 1 July 1998),⁵ children's car seats (from 12 May 2001), and sanitary protection (from 1 January 2001).

VAT law is consolidated in the *VAT Act 1994*; [schedule 7A](#) to the Act sets out those goods and services liable to the 5% rate. Group 2 to this schedule covers the installation of energy saving materials (ESMs). In addition to this, group 3 to this schedule provides for a 5% rate on the grant-funded installation of heating equipment or security goods or connection of gas supply. HM Revenue & Customs publish detailed guidance on the scope of the 5% rate to both these supplies.⁶ It is estimated that the annual cost of the 5% VAT rate is about £75 million.⁷

The 5% rate applies to the *installation* of these items – as HMRC's guidance makes clear, "installation, in this context, means putting in place energy-saving materials" adding "if

¹ Provision to this effect is made by [Schedule 7A to the VAT Act 1994](#) (specifically group 2 to this schedule).

² [The Value Added Tax \(Reduced Rate\) \(Energy-Saving Materials\) Order SI 2019/958](#). The Order was debated and agreed, on division, in the Delegated Legislation Committee [on 24 June 2019](#).

³ [PQ265551, 20 June 2019](#)

⁴ Initially zero-rated, this supply had been charged an 8% rate from 1 April 1994.

⁵ For more background see HMRC's online [VAT Energy-Saving Materials and Grant-Funded Heating Supplies Manual](#); specifically para [VENS AV2000 \(History of the reduced rate\)](#).

⁶ [Energy-saving materials and heating equipment \(VAT Notice 708/6\)](#), 17 July 2014.

⁷ HMRC, [Principal Tax Reliefs](#), May 2019. The figure is for 2018/19. By contrast the annual cost of the 5% VAT rate on domestic supplies of fuel and power is put at around £4.85 billion.

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you supply energy-saving materials without installing them, your supply is standard-rated.”⁸ A standard guide to VAT law notes that in this context, “the reduced rate only applies to supplies made by installers or energy-saving materials and does not apply to purchases of energy-saving materials by businesses or to purchases for DIY use.”⁹

The legislation lists those items to be considered “energy-saving materials” for these purposes, in note 1 to group 2 of schedule 7A. This includes solar panels, although, it is worth noting, not storage batteries; the full list is reproduced below:

- (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.
- (k) boilers designed to be fuelled solely by wood, straw or similar vegetal matter

In this context, HMRC’s guidance on the coverage of the 5% rate comments:

Solar panels include all systems that are installed in, or on the site of, a building and that are:

- solar collectors such as evacuated tube or flat plate systems, together with associated pipework and equipment, such as circulation systems, pump, storage cylinder, control panel and heat exchanger
- photovoltaic (PV) panels with cabling, control panel and AC/DC inverter.¹⁰

There are EU-wide rules limiting Member States’ discretion in setting VAT rates on individual goods and services. In brief, Member States must apply a standard VAT rate of 15% or more, and have the option of applying one or two reduced rates, no lower than 5% to certain specified supplies (this list is now consolidated in Annex III to [VAT Directive 2006/112/EC](#)). Member States may continue to charge any lower rates, including zero rates, that were in place on 1 January 1991, though they cannot introduce any new rate under 5%.¹¹ One item on this list is the “provision, construction, renovation and alteration of housing, as part of a social policy” (category 10 to Annex III), and it was under this provision that the UK introduced the 5% rate on energy saving materials.¹²

In June 2015 the European Court of Justice ruled that the current scope of the UK’s 5% VAT rate on ESMs infringed these EU-wide rules.¹³ Later that year HMRC published a consultation on how the law might be amended to retain as much of the relief as possible whilst ensuring that UK law was fully compliant with EU law. As this noted, the Court had found that “in relying on the vires 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

⁸ HMRC, *VAT Notice 708/6*, July 2014 para 2.2, para 2.1

⁹ *Tolley’s VAT 2019/20 ed.* para 59.2

¹⁰ HMRC, *VAT Notice 708/6*, July 2014 [para 2.9](#)

¹¹ For details see, [VAT: European law on VAT rates, Commons Briefing paper CBP2683](#), 17 January 2019

¹² Provision was made by s135 & schedule 35 of the *Finance Act 2000*. As Treasury Minister, Dawn Primarolo explained in Committee, this was the lowest rate allowed under EU law ([Standing Committee H, 23rd sitting, 27 June 2000](#)).

¹³ [Case C-161/14, 4 June 2015](#)

those with certain social needs, [and] 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."¹⁴

The consultation closed in February 2016. Since then the Treasury has been considering how it should comply with the judgement.¹⁵ Initially the Government had planned on including provision to this effect in the Finance Bill 2016,¹⁶ although on 21 March 2016, just prior to the Bill being published, Treasury Minister David Gauke confirmed that, "the decision was taken some weeks ago not to proceed with any changes to VAT on energy-saving materials in this Finance Bill because new evidence had emerged and we no longer believed that we needed to go ahead with what was previously suggested."¹⁷

Of course more recently there has been speculation that Brexit would mean the UK leaving the ambit of the EU entirely, and be free to set VAT rates entirely as it wishes. Clearly at the current time one cannot be definitive as to how Brexit may be implemented. That said, under the terms of the draft Withdrawal Agreement, it is envisaged that the UK would *remain compliant* with EU VAT law during the 'transition period', and so, in the past, the Government ruled out any immediate changes to VAT rates, on the assumption that the Prime Minister's deal would be agreed (as opposed to leaving with 'no deal').¹⁸

In April 2019 HMRC published draft secondary legislation that would amend the wording of group 2 to schedule 7A.¹⁹ As HMRC explain, the legislation would:

- maintain the reduced rate on installations of ESMs in residential accommodation for recipients who are aged 60 or over or receiving certain benefits, and for housing associations
- remove the reduced rate for the installation of wind and water turbines
- maintain the reduced rate for all other installations in residential accommodation where the cost of the materials does not exceed 60% of the total cost of installation.

HMRC has stated that this change "is expected to have a negligible impact on the Exchequer" although "the final costing will be subject to OBR scrutiny."²⁰ In turn the [Value Added Tax \(Reduced Rate\) \(Energy-Saving Materials\) Order SI 2019/95](#) was laid on 21 May; it is due to take effect from 1 October 2019.

The Order was debated and agreed, on division, in the Delegated Legislation Committee [on 24 June 2019](#). On this occasion the Financial Secretary, Jesse Norman, introduced the Order, saying the following:

The instrument amends the Value Added Tax Act 1994 to alter the scope of the reduced rate of VAT for the installation of energy-saving materials. That ensures consistency with the 2015 judgment of the Court of Justice of the European Union ...

The negotiations [with the Commission] have taken place over the last three years, and the Government felt that, all things considered, it was appropriate not to delay further but to continue with the process of seeking to comply. We could be placed under infraction proceedings if we delayed on this matter, so it is important not to be

¹⁴ HM Revenue & Customs, [VAT - Changes to the reduced rate of VAT for the installation of Energy Saving Materials](#), December 2015 pp5-6

¹⁵ [PQ201711, 17 December 2018](#)

¹⁶ HMRC, [VAT: changes to the reduced rate for energy saving materials – tax information & impact notes](#), December 2015. See also, [PQ26298, 12 February 2016](#); [PQ25267, 8 February 2016](#)

¹⁷ [HC Deb 21 March 2016 c1233](#)

¹⁸ see for example [PQ193456, 23 November 2018](#)

¹⁹ HMRC, [Draft legislation: VAT \(Reduced Rate\) \(Energy-Saving Materials\) Order 2019](#), 8 April 2019

²⁰ HMRC, [VAT: changes to the reduced rate for ESMs: tax information & impact note \(draft\)](#), April 2019

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delayed ... It will be perfectly possible and not difficult for a future Government to reverse the change by statutory instrument, in the usual way, after we leave the EU ...

HMRC does not expect the changes to have a significant impact on the industry. Around 1,500 future installations of solar panels, energy-saving boilers and wind turbines, plus some other smaller-scale items, are expected to be affected annually. That represents less than 5% of the value of all installations currently eligible for the reduced rate. Overall, the changes are expected to have a negligible impact on Exchequer revenue.²¹

Speaking for the Opposition Peter Dowd was strongly critical of the Government's decision to introduce the Order, given the proposals to amend the EU rules on VAT rates, as well as the likelihood of the UK leaving the EU:

Colleagues will remember that, following the 2016 Budget debates, the Labour party forced a Government U-turn on their proposals to implement the decision, so why is it being introduced now ... The timing is particularly unfortunate and incongruous because ... the European Commission continues to consider its action plan on VAT and has proposed, "regular review(s) of the list of goods and services eligible for reduced rates", and/or abolishing the list altogether ... [In addition] if we are to be out of the European Union by 31 October—apparently—why not kick the can down the road a little bit further? ... Given both the current ambiguity as a result of ongoing legislative reform in Europe, as well as the UK's planned imminent departure from the EU, it does not seem appropriate for the UK to use the 2015 ECJ judgment in this way.²²

Speaking for the SNP Kirsty Blackman raised concerns that HMRC's impact assessment "does not go into the impact on the industry, which is relatively small and will therefore be significantly affected by a change like this." Ms Blackman went on to ask about the Government's decision to set the 60% threshold for qualifying installations:

Choosing a threshold of 60% seems a very odd way to do it. I was looking at the consultation notes, and basically if a supplier pays £400 for the materials and then charges the customer £1,000, they will be eligible for the reduced rate of VAT. However, if they pay £650 for the material and charge the customer £1,000 before VAT, they will not be eligible for the reduced rate, and the customer will therefore be significantly worse off, purely because the labour costs are less in that particular area of the country ... It would be useful if the Minister explained the reasoning behind choosing this method for working out the costs, because I do not understand the logic behind it.²³

Richard Benyon asked the Minister if the Government would not consider a grant scheme, to mitigate the impact of this change; the Member also raised concerns about the VAT charged on solar batteries:

Some years ago, a similar situation arose regarding VAT on repairs to churches. The Government produced something called the listed places of worship grant scheme to offset that. Could the Minister suggest a grant scheme to offset the cost as part of a future Budget? ... Secondly, under current HMRC guidelines, battery installs can attract the reduced 5% rate only if they are installed at the same time as new solar, unlike all the other technologies defined as energy saving by HMRC, which can be installed separately. However, the proposed HMRC change means that any combined solar and storage system is likely to be over the 60% material/install threshold and, therefore, will attract the full 20% VAT rate. I would like to ask the Minister about the option for HMRC to allow stand-alone battery installs to attract the 5% rate, opening up the battery retrofit market to around 1 million homes that already have solar.²⁴

²¹ Delegated Legislation Committee, 24 June 2019 cc3-5

²² *op.cit.* cc6-7

²³ *op.cit.* cc8-9

²⁴ *op.cit.* c10. Details of the grant scheme mentioned by the Member are here: <http://www.lpwscheme.org.uk/>

In his response the Minister said that Mr Benyon's suggestions were "interesting ideas" but "tangential to the scope of this debate", though he promised to write to the Member "with proper advice about whether we could do something in both areas."²⁵ On Ms Blackman's concerns, Mr Norman said, "I assure the hon. Lady that officials meet the industry regularly and have shared aspects of the negotiation as they have gone forward, to bring that consent with them." He went on to address the decision to set a 60% threshold:

EU VAT law allows the reduced rate to apply to all installation costs except where the cost of the goods is significant. The question is: what does "significant" mean? The original suggestion was 50%; in negotiation, that was pushed up to 60%. That was a better outcome than was anticipated—certainly a better outcome than was anticipated by the other side. Our judgment has been that it strikes the right balance—certainly the right negotiable balance—between the twin concerns of complying with EU law and minimising any adverse impact on UK businesses ...

It is important to note ... that we are talking about a very small change in terms of impact. Some 95% of installations are projected to be unaffected by this change, and its overall effect on the Exchequer is negligible—less than £5 million. As we have spent £30 billion supporting renewable energy over the last few years, one can see the magnitude of the contrast.²⁶

Finally, in response to the comments made by Mr Dowd, the Minister noted "the original infraction case has dragged on for many years", and a consequence, "it is a problem that any Government would have faced. The hon. Gentleman is not prepared to say whether a Labour Government would accept the EU judgment or incur the infraction costs, which illustrates the hollowness and bombast of his position."²⁷ The Committee divided and agreed to the Order by 9 votes to 7.

In answer to PQs, Ministers have underlined that the limited impact of these changes on the installation of solar panels:

Asked by Dr David Drew : To ask the Chancellor of the Exchequer, for what reason the Government plans to increase VAT on domestic solar panels and batteries from 5 per cent to 20 per cent in Autumn 2019.

Answered by: Jesse Norman : The Government is currently amending VAT rules regarding the installation of certain energy saving materials in order to comply with a ruling of the Court of Justice of the European Union while maintaining as much of the relief as possible. The VAT treatment of the vast majority of solar panel installations is expected to be unaffected by the changes. Under UK law, battery storage systems have always been subject to VAT at the standard rate of 20%.²⁸

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Asked by Dr David Drew : To ask the Chancellor of the Exchequer, pursuant to the Answer of 11 June 2019 to Question 258958 on Solar Power: VAT, which energy saving products will be subject to the proposed rise in VAT.

Answered by: Jesse Norman : HMRC expect that the vast majority of energy saving materials will be unaffected by this change. This includes insulation, central heating or hot water system controls, solar panels, ground source heat pumps, air source heat pumps, micro combined heat and power units, and boilers designed to be fueled by vegetal matter.²⁹

²⁵ *op.cit.* c11

²⁶ *op.cit.* cc11-12

²⁷ *op.cit.* c12

²⁸ [PQ258958, 11 June 2019](#). See also, Chartered Institute of Taxation press notice, [Sign contract by the end of September to save VAT on solar panel installation](#), 17 June 2019

²⁹ [PQ266629, 28 June 2019](#)

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