VAT on historic building repairs

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Building repairs have been taxed at the standard rate of VAT since VAT was introduced in 1973 – although alteration work to listed buildings is zero-rated. In recent years there has been an unsuccessful campaign to extend zero-rating to repair work for both historic buildings and churches. In 2001 the Labour Government introduced the 'Listed Places of Worship Grant Scheme' to meet part of the VAT cost for repairs to listed church buildings – equivalent to cutting the VAT rate to 5%.[1] However, the scheme does *not* extend to historic building repairs.

In Budget 2012 the Coalition Government proposed a number of changes to the scope of VAT from 1 October 2012, including the withdrawal of zero-rating for alterations to listed buildings.[2] The Government has said it will provide an extra £30m a year for the Listed Places of Worship Grant scheme to compensate churches fully for the impact of this change, but has not proposed any change in the scope of the scheme with regard to other listed buildings.[3]

This note sets out the VAT treatment of construction work and the UK's discretion in setting VAT rates with respect to European VAT law, before looking at the debate there has been on cutting VAT on historic building repair and the proposals made in Budget 2012.

Contents

1 Details of the scope of the scheme are given on its website: www.lpwscheme.org.uk.
2 HMRC, *VAT: Addressing borderline anomalies*, March 2012. The deadline for responses was 18 May.
3 HC Deb 17 May 2012 c731; HMRC, *VAT: Addressing borderline anomalies – summary of responses*, 28 June 2012 pp22-27

A. VAT on construction work

The construction of new buildings is charged a zero rate of VAT, provided the supply in question is for a social purpose: in effect, this means that only the construction of new houses, dwellings and buildings with a charitable purpose is zero-rated. Generally VAT is charged at the standard rate - currently 20% - on all repair, renovation and maintenance work whatever the status of the building concerned, although a reduced rate of 5% is charged on the conversion or renovation of some types of residential building. In addition, approved alteration work of certain types of protected buildings may be zero-rated.[4]

Schedule 8 to the *Value Added Tax Act (VATA) 1994* sets out those goods and services which are zero-rated; group 5 to this schedule covers new construction. Item 2 to group 5 specifies that the construction of "a building designed as a dwelling or a number of dwellings or intended for use solely for a relevant residential purpose or a relevant charitable purpose" may be zero-rated. Group 6 to schedule 8 covers construction work carried out on "protected buildings": broadly speaking, dwellings or buildings with a charitable purpose that are either listed buildings or scheduled monuments – though for these purposes, a 'protected building' may extend to a garage that forms part of a listed dwelling.

Zero-rating only applies to work that is an 'alteration' of a protected building; any works of "repair or maintenance" is specifically excluded (under note 6 to group 6). In most cases this will mean work for which listed building consent is needed, because the work will affect the building's character as a building of special architectural or historic interest. The department's guidance explains that "works of repair or maintenance are those tasks designed to minimise, for as long as possible, the need for, and future scale and cost of, further attention to the fabric of the building":

> Changes to the physical features of the building are not zero-rated alterations if, in the exercise of proper repair and maintenance of the building, they are either:
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> - trifling or insignificant, or
> - dictated by the nature and use of modern building materials.
>
> Similarly, if the amount of work or cost is significant, that does not make the work a zero-rated alteration if the inherent character of the work is repair and maintenance.[5]

Zero-rating extends to alteration work to a garage if it forms part of a listed dwelling (under note 2 to group 6). As the department's guidance notes, "buildings within the curtilage of a listed building such as outhouses or garages which, although not fixed to the building, form part of the land and have done so since before 1 July 1948 (for example, an outhouse) are treated for planning purposes as part of the listed building."[6] However, buildings that are separate to the dwelling do not qualify for relief: note 10 to group 6 states, "the construction of a building separate from, but in the curtilage of, a protected building does not constitute an alteration of the protected building". The department's manual on this aspect of VAT law quotes some case law which illustrates the difficulties to ascertaining exactly when zero-rate relief applies:

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4 Detailed guidance on the VAT treatment of construction work is given in, HM Revenue & Customs, *VAT Notice 708: Buildings and construction*, November 2011.

5 *VAT Notice 708*, para 9.3.1

6 *VAT Notice 708*, para 9.2.2

In **Martyn Arbib ([1995] STC 490)**, an owner of a listed dwelling demolished an outbuilding replacing it with a building to house a swimming pool. Although not structurally attached to the house, it was connected to the house by a covered way and a brick wall running between the side of the house and the swimming pool building.

In finding that the works were not the construction of a building separate from a 'protected building', the Tribunal relied on the dictionary meaning of 'separate', 'disconnected, detached, set or kept apart'.

The High Court said:

…the [Tribunal] decision continued as follows:

'The fact that the Commissioners would accept the building as an extension of the existing building if the walk-way were enclosed on both sides is an indication of how narrow the dividing line is between those cases they consider come within the provision and those that fall outside.'

This indicates to me that the Chairman was directing herself sensibly to the resolution of a very fine distinction. Whether every Tribunal would have come to the same conclusion is another matter. But I cannot say that the Tribunal was unreasonable in approaching it the way that this Chairman did, nor can I say that she reached a perverse conclusion.

Comment: The decision of the High Court was that the Tribunal had come to a reasonable decision based on the facts it found. However, an alternative decision could have been possible. Appellants seeking to rely on this case need to show that, as a matter of fact, the works are alterations to the existing 'protected building'.

A different conclusion was reached in **Collins & Beckett Ltd (VTD 19212)**. This case concerned the replacement of a swimming pool enclosure by one which included extensive leisure facilities and a glazed corridor link back to the listed house. The Tribunal found that the new enclosure was a separate building. The Tribunal said:

Note 10 envisages that an alteration falling within Item 2 might involve the construction of a separate building. 'Separate' in this context means separate from the protected building. We can see that in one sense the pool complex can be described as not separate because it is joined to the passage which in turn is joined to the house but the pool complex may also be described as separate from the house although linked to it by the passage. Visually we prefer the second interpretation. Our conclusion is that, having formed that conclusion the Commissioners' argument that a building which is essentially separate from the protected building cannot be taken outside Note 10 by some link back to the protected building is persuasive. And we have so concluded that the pool complex is a separate building albeit one which is physically linked to the house by the passage

In the matter of a building within the curtilage of a 'protected building' and linked to it by a covered walkway or some other tenuous means, we take the view that its construction is prevented by Note 10 from amounting to an alteration to the 'protected building'.

The decision in Martyn Arbib does not undermine this position. It does not contain an endorsement that all linked buildings fall outside the scope of Note 10. It accepted

> that the Tribunal had not acted unreasonably in reaching its conclusion, but that not every Tribunal would necessarily come to the same conclusion.[7]

In 2001 the Labour Government introduced some changes to the VAT treatment of construction work to encourage urban regeneration. First, a new reduced rate of 5% was introduced for conversion or renovation work on some types of residential building from 12 May 2001.[8] Second, the coverage of the existing zero rate on the construction of new buildings was extended to the sale of a renovated house empty for 10 years or more from 1 August 2001.[9] Notably these changes fell short of a new single VAT rate on all new build, repair and renovation work; some commentators have argued that equalising the VAT rate on these types of work could be an effective tool to encourage urban regeneration as it would remove an important disincentive for developers to refurbish empty properties.[10]

B. The implications of European VAT law

Any question of VAT liability has a European dimension, as VAT law in this country, as in all other Member States, is based on European VAT law. As a consequence all Member States have limited discretion in amending their national VAT structure and rates. In brief, under the current agreement on harmonising the rates of VAT, which was reached in October 1992, no Member State can introduce any *new* zero rates of VAT, though they may continue charging any lower rates, including zero rates, that were in place on 1 January 1991.[11] In addition Member States have the discretion to charge a reduced rate of VAT - between 5% and 15% - on a specified list of goods and services. One of the items of this list is the "provision, construction, renovation and alteration of housing, as part of a social policy."[12] As a consequence, Member States may charge a reduced rate of VAT on repair work for *social housing*, though not to historic buildings or churches.

The European Council is required to regularly review the list of permitted reduced VAT rates, based on a report by the Commission. In November 1997 the Commission found that the current VAT structure posed no serious problems for the satisfactory operation of the single market, and as a consequence there was no justification for introducing major modifications in these rules. In addition, the Commission argued that reduced VAT rates should be used only for particular social reasons.[13] In explanatory memorandum on the report, the then Financial Secretary, Dawn Primarolo, stated that, "in general, the UK believes that the widespread use of reduced VAT rates is likely to result in unnecessary complication of the tax, to the detriment of both business and the integrity of the tax itself. The UK does, however, accept that there are some circumstances where a reduced VAT rate may be a useful tool to address specific

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7 HM Revenue & Customs, *VAT on Construction Manual (VCONST)* "Zero-rating the 'approved alteration' of a 'protected building'" (para VCONST08600)

8 The range of eligible conversions and renovations was extended from 1 June 2002.

9 For details see sections 5-8 of *VAT Notice 708*.

10 The issue is discussed in more detail in, *VAT on construction*, Library standard note SN00587, 18 April 2012.

11 Directive 92/77/EEC of 19 October 1992 The directive came into effect on 1 January 1993. It is incorporated in the Council Directive 2006/112/EEC.

12 Item 10 to Annex III of Council Directive 2006/112/EEC. Since 1 January 2000 Member States have had the option to charge a reduced VAT rate on repair and renovation of private dwellings. This is examined in more detail below.

13 COM(97)559 Final 20 November 1997

problems - the recent announcement on the VAT treatment on energy-saving materials[14] is a case in point."[15]

In October 1999 the European Council agreed to an amendment to these rules to give Member States the *option*, should they wish, to apply a reduced VAT rate to certain 'labour-intensive services', as a means to reduce unemployment; this list of services included the "renovation and repairing of private dwellings, excluding materials which form a significant part of the value of the supply."[16] A number of countries took the opportunity to have a reduced VAT rate on this supply, though not the UK.[17] Notably repairs to historic and listed buildings could be covered by this provision, *provided* they were dwellings.[18]

In June 2003 the Commission published a report on the effectiveness of the scheme for reduced rates on 'labour-intensive' services, concluding that "it was not possible to find solid evidence of such reductions … boosting job creation."[19] The next month the Commission published a general review of reduced rates, arguing the range of reduced rates should be harmonised, and that the automatic right of Member States to maintain their transitional derogations should be withdrawn, so as to improve the functioning of the internal market.[20] In a memorandum on these proposals the Commission set out its position on the treatment of housing and construction work:

> **What changes are proposed in the housing sector?**
> In order to rationalise this complex and chaotic situation and improve the functioning of the internal market, it is proposed to … allow reduced rates to be applied to the following operations: the supply, construction, renovation, alteration, repair and maintenance of housing; the rental of housing where a Member State does not opt for exemption. These changes not only substantially rationalise the reduced rates on housing but are a significant extension of Member States' option to apply reduced rates in the housing sector.
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> Under various specific derogations, several Member States are currently exempt from the requirement to apply the reduced rate solely to housing under social policy and apply it to certain operations in the private housing sector as well. There is no definition of social housing at Community level and it has therefore been defined variously in the legislation of different Member States. At the present time, housing is subject to the reduced rate under various measures in ten Member States. The change will also incorporate two categories currently covered by the Directive authorising Member States to apply a reduced rate of VAT to certain labour-intensive services (renovation and repair of private dwellings, and window cleaning and cleaning in private households) …

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14 [The Government introduced a 5% VAT rate on energy-saving materials supplied under the Home Energy Efficiency Scheme from 1 July 1998.]

15 HM Customs & Excise explanatory memorandum, 17 December 1997

16 under Directive 1999/85/EC. This is now consolidated in Article III of Directive 2006/112/EEC (specifically item 10a with regard to the renovation and repairing of private dwellings).

17 Belgium, France, Italy, Netherlands, and Portugal (HM Customs & Excise explanatory memorandum, 25 January 2000).

18 HC Deb 8 March 2000 c 769W

19 COM (2003) 309 final, 2 June 2003 p 25

20 COM (2003) 397 final, 23 July 2003. See also, European Commission press notice IP/03/1024, 16 July 2003

Why isn't the Commission proposing to allow a reduced rate for renovation work on historical monuments?

Currently there is only provision for a reduced rate in relation to housing: nevertheless, one Member State (UK) applies a zero rate to certain types of work on historical buildings. However, the standard rate is applicable in the other Member States. It would therefore be appropriate to put an end to this derogation and make the standard rate the norm. There is in fact no need for a reduced rate of VAT in this area: Member States have much more appropriate means at their disposal to finance work on historical buildings (direct subsidies or full cover for work carried out, grants to owners of listed buildings not used as housing, etc.).[21]

From the UK's perspective the Commission's proposals were controversial as they did not allow for certain zero rates to be maintained, including the zero rate on children's clothing, something the Government regarded as unacceptable.[22] Other Member States expressed strong reservations and a final agreement was not reached until February 2006: a minimalist package that allowed for existing reduced and zero rates to continue, and a technical change to allow an existing provision for a reduced rate on domestic supplies of fuel and power to cover supplies of district heating.[23]

In July 2008 the Commission proposed some minor additions to the list of goods and services that could be charged a reduced rate. Notably the Commission suggested that States should be allowed to charge a reduced rate on the supply of all housing – not just housing linked with a social policy – and on the "renovation, repair, alteration, maintenance and cleaning of housing and of places of worship and of cultural heritage and historical monuments recognised by the Member State concerned."[24] Reaching agreement proved difficult once more. In March 2009 European Finance Ministers finally agreed to make two small additions to this list - restaurant services and books on all physical means of support - and to put the scheme for 'labour intensive services' on a permanent footing: it had been anticipated that it would end in 2010. However, *no change* was made to the scope of these provisions as they apply to VAT and construction – such as extending their scope to include the repair of all types of historic buildings.[25]

Recently there has been some discussion of the case of widening the VAT base and removing certain VAT reliefs and reduced rates, in the context of the Commission publishing an over-arching strategy on VAT in December 2011; however there are no proposals at present to make changes to these – and it is certain that negotiations on any reforms would be a protracted affair.[26]

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21 European Commission memorandum MEMO/03/149, 16 July 2003

22 HM Customs & Excise, *Explanatory memorandum on ... COM(2003) 397 final*, 29 August 2003 paras 16-17

23 Directive 2006/18/EC of 14 February 2006

24 COM(2008) 428 final & European Commission press notice IP/08/1109, 7 July 2008

25 As noted in answer to a PQ at the time: HC Deb 19 March 2009 c1048. These changes took effect from 1 June 2009, under Directive 2009/47/EC.

26 More detail on this issue is given in, *VAT : European law on VAT rates*, Library standard note SN02683, 13 February 2012

C. The campaign to cut VAT on historic buildings

There has been a long-running campaign for a cut in the VAT rate on repair work for historic houses and churches.[27] In December 2000 English Heritage published a report on the historic environment in which it proposed a harmonised 5% VAT rate on all building work.[28] This proposal was noted by Lord Montagu of Beaulieu in a Lords debate on the report just after its publication:

> The single most frequently raised issue during consultations for the report was the situation of VAT. Although the Chancellor said as late as last month that he was keen to preserve Britain's rich built heritage for both current and future generations, one wonders how he proposes to do this, as repair work is still subject to full VAT while, ironically, new build is VAT free. One wonders how any government's policy for the heritage can be taken seriously while such a regime exists. Indeed, owners face a penalty on the cost of repairs to their houses when it is well known that a stitch in time saves nine and an annual programme of maintenance not only creates employment and new skills, but also ensures the future of the house, at a more affordable cost.
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> Sensibly, the report advocates a single harmonised rate of 5 per cent VAT for all building work and those concerned were encouraged by the Chancellor's recent announcement of his intention to reduce VAT to 5 per cent on the cost of converting empty residential buildings and, in particular, on the maintenance of 11,000 listed places of worship. However, there are some 350,000 other listed buildings, so VAT rules will continue to discourage other listed building repairs and, further, will discourage regular maintenance, thus promoting new build at the expense of re-use. This makes no economic or environmental sense and it is interesting to note that Britain is the only country in western Europe which does not give fiscal relief for the maintenance of historic properties. The sooner that VAT is equalised on all building work, the fewer historic buildings will be lost.[29]

In its response to the report, published in December 2001, the Labour Government simply noted that it would "take this recommendation into account carefully when considering the future VAT treatment of building work."[30]

In the 2002-03 session Lindsay Hoyle put down an Early Day Motion calling on the Government to "reduce VAT on restoration work [for homes and historic buildings] to its lowest possible level."[31] In the 2005-06 session, Gordon Marsden put down an EDM supporting a single rate of VAT below 10% for all building work, applied to "for all conversions, refurbishment and repairs to historic buildings and places of worship as well as existing domestic properties, thus protecting the countryside and built heritage, encouraging the supply of new housing and encouraging urban regeneration."[32] Despite this the Labour

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27 for example, "Tax the old to give to the new", *Times*, 30 October 1999; "Making sure our heritage has proper protection", *Financial Times*, 29 January 2000.

28 English Heritage, *Power of place: the future of the historic environment*, December 2000 p 11

29 HL Deb 20 December 2000 c 743

30 DCMS, *The Historic Environment: A Force for our Future*, 2001 [Dep 01/1805] para 4.20

31 EDM 547 of 2002-03 "VAT on building restoration", 21 January 2003. The motion received 71 signatures.

32 EDM 879 of 2005-06 "Regeneration and VAT on repairs", 26 October 2005. The motion received 86 signatures.

Government's position on this issue remained unchanged, as indicated in a written answer in June 2006:

> **Mr. Austin Mitchell:** To ask the Chancellor of the Exchequer what the reasons are for the differing VAT treatment of repairs to listed buildings and alterations to listed buildings made with listed building consent.
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> **Dawn Primarolo:** When VAT was introduced in 1973, zero-rating applied to the construction and alteration of all buildings. The repair and maintenance of buildings has, however, always been standard-rated. Due to difficulties in administering the borderline between 'repairs' and 'alterations', the zero rate for alterations was largely withdrawn in 1984 by the then Government, although the zero rate for work carried out in the course of an approved alteration to a listed building was retained.
>
> Under agreements with our European partners we can keep our existing zero rates of VAT but we are not able to extend them or introduce any new ones. The VAT treatment of repairs and approved alterations to listed buildings could therefore only be levelled if the Government were to withdraw the existing zero rate for approved alterations. The Government have no plans to do so.[33]

In July 2006 the Culture, Media & Sport Committee published a report on protecting and preserving the country's historic environment, in which it argued that the current VAT regime "distorts priorities, rewards neglect and works against conscientious maintenance of historic assets"; a long extract from the report is reproduced below:

> 169. VAT, as a tax chargeable on business transactions, goods and some services, applies in the heritage field to materials for repair, the labour cost of repair when undertaken by firms registered for VAT, and professional services required in preparation for repair work, such as surveyors' and architectural consultants' fees. Whereas the construction of new buildings has attracted a zero-rate of VAT since its introduction in 1973, the repair and maintenance of buildings has always been standard-rated. Until 1984, all alterations were zero-rated; the zero-rate was then generally withdrawn for work on alterations except for work carried out in the course of an approved alteration to a listed building [HC Deb 8 June 2006, col.859W].
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> 170. The harmonisation of tax policy at an EU level normally prevents the Government from applying zero-rating (or a reduced rating) of VAT to new fields (or extending existing zero-rating). Agreement was however reached among EU Finance Ministers during the UK EU Presidency in 2005 which afforded a window of opportunity to apply to exercise an option to introduce a reduced rate of VAT on the labour input of renovation and repair work to private dwellings [Ev 161]. The window closed on 31 March 2006 without the UK Government having made an application, despite encouragement from English Heritage and others [Q 343].
>
> 171. The issue of VAT-rating for repairs to listed buildings united the sector perhaps more than any other in evidence. We were told that the differential between rates applicable to new build construction costs and repair costs penalised maintenance and created perverse incentives [Mr Babb Q 142; Mr Spooner Q 170]. It encouraged alterations to listed buildings (at zero-rate); and it encouraged owners to leave

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[33] HC Deb 8 June 2006 c859W. see also, HC Deb 1 June 2009 c54W; HC Deb 22 June 2009 c671W; HC Deb 26 June 2009 c1151W

buildings to rot to such a state that demolition was justified [Ev 74; SAVE Britain's Heritage Ev 318]. The Campaign to Protect Rural England argued that the favouring of new-build encouraged greenfield development but stagnation of previously developed land, which contributed to a cycle of decline and a trend towards rundown areas which were less attractive to investors [Ev 74]. The Architectural Heritage Fund drew our attention to the gains for sustainable development arising from re-use and retention [Ev 16].

172. We note that the former ODPM itself recognised the cost-effectiveness of repair and refurbishment, citing evidence from Heritage Counts 2003 demonstrating that older housing "costs less to maintain and occupy over the long-term life of the dwelling than more modern housing". ODPM found that when the energy costs of demolition, site remediation and new construction were taken into account, there was "an even stronger argument for promoting the re-use of the historic built stock".[34]

173. Heritage Link wrote to the Chancellor of the Exchequer in March 2006 listing the various reasons why reduced or zero rating should be introduced for repairs to listed buildings, and urging him to take advantage of the window of opportunity secured by EU Finance Ministers. The Treasury made no such move.

174. The Government has cited two reasons for resisting calls to reduce or zero-rate VAT for repairs to listed buildings. The first, in response to the report by the former ODPM Select Committee on The Role of Historic Buildings in Urban Regeneration, was that the Government "had seen no compelling evidence that the absence of a reduced VAT rate on repairs significantly hinders the maintenance of historic buildings, and no evidence that most of the benefit of a blanket relief for repair and maintenance work would not just go to middle and higher income households making improvements to houses already in a good state of repair".[35] The second reason given, this time in response to a Parliamentary Question tabled by the Committee Chairman asking whether the Government would take up the opportunity afforded by the European Commission, was that a reduced rate for the renovation and repair of private dwellings was "one of a number of reduced rates introduced into EU legislation on an experimental basis whose objective is to create employment opportunities by stimulating demand through lower prices" and that the Government had always chosen not to participate, as it believed that its employment objectives were "better targeted through measures such as the welfare to work strategy and the New Deal" [HC Deb 13 March 2006, col. 1983W].

175. In the past, the Minister of Culture (Mr Lammy) has described the case for change to the existing regime applicable to repair costs as "unproven" [HC Deb 27 October 2005, col. 527W]. When the question was raised with him in oral evidence, he said that the he was "in constant dialogue" with Treasury colleagues on the issue but that "gains specific to the heritage sector might mean losses in other areas like new construction and other things" [Q 388] He did not however offer a specific rationale for favouring new build; nor was any given in the Government response to the ODPM Committee in 2005.

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[34] Government response to the Eleventh Report of the ODPM Select Committee, on The Role of Historic Buildings in Urban Regeneration, Session 2003-04, HC 47-I, response to recommendation 4

[35] The Role of Historic Buildings in Urban Regeneration, 11th Report of the Select Committee on the Office of the Deputy Prime Minister, Session 2003-04, HC 47-I

> 176. Mr Lammy told us that it would "be unusual to restrict that kind of VAT relief [i.e. zero-rated] to one sector" [Q 393]. This is not a convincing argument, given that the Treasury has agreed to refund VAT payments for repairs to listed places of worship and memorials. The Chancellor announced in the 2006 Budget that the refund scheme would continue until 2010-11 and that it would be extended to cover professional fees and repairs to fixtures and fittings [Financial and Budget Statement Report 2006 para 5.75].
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> 177. The present VAT regime for repairs distorts priorities, rewards neglect and works against conscientious maintenance of historic assets. The result can be either a slide towards demolition or a call on public funds for grant aid. We find it extraordinary that the Government did not take up the opportunity afforded by the EU earlier in the year to seek a carefully targeted relief when urged to do so by Heritage Link, on behalf of the sector. Opting in would have cost the Government nothing. The chance to secure such a relief has passed for now, but the Government should instead take a policy decision to return as grants some or all of the VAT paid on repair work to listed buildings. At the very least, building preservation trusts and other charitable institutions should be beneficiaries of such a scheme. In addition, proper consideration should be given to including heritage properties in private ownership where a clear public benefit can be demonstrated. The Treasury should recognise that the majority of potential private owner beneficiaries would not be high income earners; and many of the buildings at risk that would stand to benefit are not residential properties.[36]

The Labour Government published its response to the Committee's report in December 2006; in this, it argued that special VAT reliefs should only be introduced where "they provide the most direct, cost effective and best targeted method of delivering the available resources to achieve Government objectives and priorities"; the then Government's full response on the VAT question is reproduced below:

> The VAT treatment of construction work is partly the product of historical development. When VAT was introduced in 1973, zero rating applied to the construction, extension and alteration of all buildings. The current position is that zero rating applies to the construction and sale of new dwellings and communal residential and charitable buildings. In contrast, the repair or maintenance of existing buildings was and has always remained standard-rated. As a result of campaigning by heritage bodies, the zero rate was also retained for approved alterations to listed buildings which are also dwellings or communal residential or charitable buildings. Long-standing formal agreements with our European partners allow us to keep these zero rates, but do not allow us to extend them or introduce new ones.
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> The reduced rates of VAT which cover certain Labour Intensive Services (LIS) were introduced into EU legislation on an experimental basis for a fixed period. One such rate covers the renovation and repairing of private dwellings, and as such it does not provide the opportunity to introduce a reduced rate for all historic buildings. The objective of the experiment is to create employment opportunities by stimulating demand through lower prices. The UK has always chosen not to participate as the Government believes that employment objectives are better targeted through other measures, such as training and skills development through the welfare to work strategy and New Deal. The Government continues to take this view. Indeed, the EU

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[36] *Third report: Protecting and Preserving our Heritage*, 20 July 2006 HC 912 2005-06 pp60-62

> Commission's evaluation report on the experiment concluded that a VAT reduction measure is not effective in stimulating employment and that its financial cost is disproportionate to its economic effects.
>
> Special VAT refund arrangements remain limited exceptions to the general rule that Government funding and support for heritage should take into account irrecoverable VAT costs. They have only been applied where they provide the most direct, cost effective and best targeted method of delivering the available resources to achieve Government objectives and priorities. That was the case for the refund scheme for Listed Places of Worship where the Government has a long-term commitment to lower the VAT rate on such repairs and maintenance and is committed to negotiate at EU level for a permanent reduced rate of VAT in this area.
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> To date, where the Government has introduced VAT measures for housing, these have been targeted on its objective of making more affordable housing available. For example, since 1997 the Government has introduced targeted reduced rates of VAT on areas of specific need such as residential conversions (creating new homes through better use of the existing housing stock), and the renovation of housing that has been empty for more than three years (helping to bring vacant homes back into use). The Government continues to keep under review the use of VAT reliefs for construction work where these could help to support regeneration and renewal. We acknowledge the committee's recommendation that we should encourage the Treasury to assess the cost of a limited relief set against income for private owners and have passed the proposal to the Treasury for their consideration.[37]

D. Budget 2012 : VAT on approved alteration work

In the Budget the Coalition Government announced proposals to extend the scope of VAT to deal with a series of "loopholes and anomalies", including the application of VAT to approved alterations of listed buildings from 1 October 2012. Taken together it was estimated these changes to VAT liability would raise £270m by 2013/14, of which the change to approved alteration work would contribute £85m.[38] More details of the change and its anticipated impact were given in a Budget note from which the following is taken:

> The repair and maintenance of a protected building is standard-rated, but the approved alteration of a protected building is zero-rated. Some alterations restore or enhance the unique character of a building or prolong its active life, but most work covered by the relief is extension work which is unnecessary for heritage purposes. Alteration work on other types of building is standard-rated so owners of listed buildings receive a tax advantage over owners of other types of building …
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> The measure will result in i) all building materials and construction services supplied in the course of an approved alteration to a protected becoming subject to VAT at the standard rate and ii) a narrowing of the circumstances in which the first sale or long lease by a developer of a substantially reconstructed protected building can be zero-rated, so that only buildings reconstructed from a shell continue to benefit from the zero rate …

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[37] Dept for Culture, Media and Sport, *Government Response to the Committee's Third Report*, Cm 6947 October 2006 pp 16-17

[38] HC 1853 March 2012 para 2.179, p50 (Table 2.1 – items 27 & 28)

> Removing the zero rate removes a perverse incentive to change listed buildings rather than repair them and ensures that all alteration works receive the same tax treatment. The change makes the VAT rules simpler for businesses to understand and for HM Revenue & Customs (HMRC) to administer and reduces the scope for error and non-compliance ...
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> There are an estimated 350,000 listed dwellings in the UK. It is estimated that around 10,000 individuals and households may be affected each year by the measure, with the additional costs from the VAT change varying according to the extent of work undertaken … There are an estimated 35,000 to 50,000 listed buildings owned by businesses or charities used for a residential or charitable purpose. It is estimated that around 1,000 businesses and charities may be affected each year …
>
> Listed places of worship will … be affected by the change, although our evidence suggests that places of worship form only a small minority of the total number of listed properties in the UK. These will be predominantly used by Christian denominations. In order to mitigate the impacts on these groups the DCMS is expanding the existing Listed Places of Worship Grant Scheme which refunds the VAT on repairs and maintenance work, so that this includes approved alterations to listed buildings.[39]

The Government proposed that approved alterations which had already been contracted for or under way will be entitled to transitional relief. Anti-avoidance legislation is included in the *Finance Bill* to prevent developers obtaining zero-rating for work contracted on or after Budget day, but performed on or after 1 October.[40] Full details were given in a consultation document the department published alongside the Budget, which asked for views of businesses and individuals affected by the changes, so as to identify any unintended consequences or unidentified impacts. In this case the department asked for views on both the impact of removing the zero-rate, and on its proposals for transitional relief.[41] The deadline for responses was 18 May 2012.[42]

These proposals proved very controversial, though commentators focused on the potential impact for listed churches – and not other categories of listed building.[43] As the *Financial Times* reported, in announcing the change the Chancellor "was aiming at work on private homes with historic value – such as millionaires installing swimming pools – but 45 per cent of the buildings with a grade 1 listing are churches."[44] Indeed, when this issue was raised at Prime Ministers Questions on 18 April, the Prime Minister cited this particular problem in setting out the Government's rationale for amending the rules:

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39 VAT: approved alterations to listed buildings, TIIN4806, March 2012

40 HC Deb 21 March 2012 c57WS; the provision are clause 195 & schedule 26 of *Finance (No.4) Bill 2010-12*.

41 HMRC, *VAT: Addressing borderline anomalies*, March 2012 pp 23-28

42 Initially this deadline was 4 May, but was extended to 18 May "in recognition of the wide interest in these proposals" (HC Deb 30 April 2012 c1212W). The Exchequer Secretary, David Gauke, announced this change to the House on 18 April (HC Deb cc441-2).

43 For some comment on the impact on historic homes and other listed buildings see, Historic Houses Association press notice, *Budget Effects for Historic Houses and Gardens*, 23 March 2012; Society for the Protection of Ancient Buildings press notice, *VAT and listed buildings – the SPAB view*, April 2012; "Approved alterations", *Taxation*, 7 June 2012.

44 "Ditty by dean's wife joins chorus of disapproval over VAT charge", *Financial Times*, 17 April 2012. For more details see, *VAT on churches*, Library standard note SN01051, 18 May 2012

> **Mr Gordon Marsden (Blackpool South) (Lab):** Churches and places of worship, including many in Blackpool, do immensely valuable work in adapting their buildings for community and voluntary sector use. Why, then, is the Prime Minister backing a 20% VAT raid in the Budget on alterations to listed buildings, which will cost many of those churches and places of worship millions of pounds—in the case of the Church of England, an estimated £10 million—thereby infuriating them and the charities concerned and shooting his own big society in the foot?
>
> **The Prime Minister:** Let me try to explain to the hon. Gentleman the basic unfairness in the current system. Repairs to churches are already subject to VAT, whereas alterations to listed buildings are not subject to VAT. That means that if you repair a church, you do pay VAT, but if you put a great big swimming pool in a listed Tudor house, you do not pay VAT, so it makes sense to redraw the boundaries. But this is the crucial point: we will be putting money aside to make sure that churches that are undertaking repairs and alterations get the moneys that they need.[45]

Prior to the Government publishing its formal response to this consultation exercise, Ministers confirmed three changes in its proposals. First, on 17 May the Chancellor, George Osborne, announced that the Government would provide an extra £30m a year for the Listed Places of Worship scheme, though the scope of the scheme would remain confined to listed churches.[46] Second, on 28 May the Exchequer Secretary, David Gauke, announced new plans to deal with VAT anomalies affecting hot takeaway food and holiday caravans.[47] However, the position on listed buildings was unchanged:

> **Zac Goldsmith:** To ask the Chancellor of the Exchequer if he will develop plans to provide support for (a) community organisations and (b) charities based in listed buildings which are not listed places of worship and who will be required to pay VAT on alterations to their buildings. [111507]
>
> **Mr Gauke:** Community organisations and charities based in listed buildings which are not listed places of worship are likely to be eligible for a range of financial support and reliefs. Charities benefit from a number of VAT zero rates and exemptions, worth around £200 million. Total reliefs for charities, including Gift Aid, are worth more than £3 billion a year. Listed buildings are potentially eligible for a number of sources of financial support, including Heritage Lottery Fund and English Heritage grants.[48]

On 28 June the Exchequer Secretary announced the publication of the department's response to the consultation, and that provision would be made in the *Finance Bill* to implement these changes to the VAT rules.[49] The removal of zero-rating on approved alterations gathered more responses than any of the other measures to tackle VAT anomalies: 818 out of a total of 1,493 – though the nature of some of these responses was notable:

> A large number of the responses (135) were in fact enquiries, either about the VAT treatment of works under the current VAT rules, or about how specific projects would

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45 HC Deb 18 April 2012 c319
46 HC Deb 17 May 2012 c731
47 *Letter from the Exchequer Secretary to the Treasury, David Gauke MP to the Chairman of the Treasury Select Committee, Andrew Tyrie MP*, 28 May 2012
48 HC Deb 18 June 2012 c728W
49 HC Deb 28 June 2012 c21WS

> be affected by the changes. Most of these were from private individuals either altering or repairing domestic properties. In some cases the enquiries demonstrated a poor understanding of the current rules and suggested that some repair work is incorrectly being treated as zero-rated. [50]

Many respondents commented on the proposals for a transitional period to allow zero-rating to extend until 20 March 2013 for certain types of project:

> The draft legislation as proposed in the consultation document included transitional relief for i) works of approved alterations where a written contract was in place before Budget day and ii) the first grant of a substantially reconstructed protected building where three fifths of the reconstruction is an approved alteration and where, before Budget day, either 10% of the reconstruction had been completed or a written contract had been put in place. The proposed transitional period in all cases would last until 20 March 2013.
>
> A large number of respondents commented on the transitional arrangements. Almost all of these argued that the transitional arrangements were insufficient to provide relief for all projects already underway at the time of the Budget announcement. Some responses indicated that certain projects had been temporarily halted and others may not be completed due to the unanticipated funding shortfall caused by the VAT increase. Many responses felt that the requirement to have a written contract for approved alterations work in place before Budget day was too restrictive as the construction work is the final phase in a project which can also include lengthy planning and in some cases fundraising phases, both of which involve the owner or developer incurring costs. [51]

Given these views, the Government now propose that these arrangements should be more generous, but have not changed their position on removing this zero-rate:

> Having specifically invited comments on the point, the Government will amend the transitional arrangements to make them more generous and provide relief to more projects already underway at Budget by specifying an earlier trigger point for projects to benefit from transitional relief and by extending the length of the transitional period. We have considered a number of options and concluded that in order to be fair, the trigger point should apply equally to all types of project.
>
> Projects will therefore now also continue to benefit from zero-rating if listed building consent (or the equivalent approval for listed places of worship) had been applied for before 21 March 2012 (Budget day). This is in addition to the works which qualify because there was a written contract in place before Budget day or because it was a substantial reconstruction project meeting the 10% test. The Government will also extend the end of the transitional period to 30 September 2015, allowing qualifying projects to continue to benefit from zero-rating for 3 ½ years, or 4 summers. This should ensure that the majority of qualifying projects underway at Budget should qualify for transitional relief …
>
> HMRC are of the view that there remains a strong case for removing a relief that is illogical and poorly targeted. The VAT system is not the most effective vehicle for

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50 *VAT: Addressing borderline anomalies – summary of responses*, 28 June 2012 para 2.6.2

51 *op.cit.* para 2.6.8-9

> achieving targeted policy objectives, such as bringing listed buildings back into use. Removing the zero rate for approved alterations work reflects the Government's view that support for the heritage, and public money for such objectives, is better channelled through expenditure rather than poorly targeted tax reliefs, especially when public finances are tight.[52]

It is estimated that the new transitional arrangements will cost around £5m in 2012/13 and 2013/14; total receipts from this measure are now estimated to be £85m, rising to £95m, over those two years.[53]

[52] *op.cit.* para 2.6.14-5, para 2.6.24
[53] *op.cit.* p55